ING INVESTMENT MANAGEMENT HOUSEVIEW

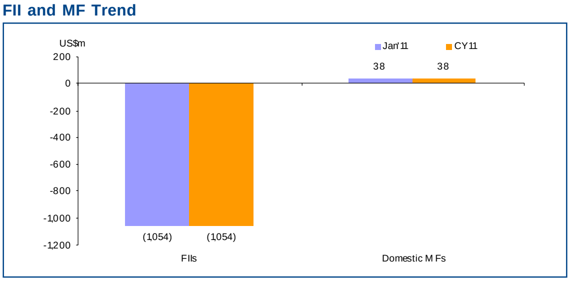
Indian Economic Outlook

- After a stable month, RBI's tone again turned hawkish and it increased policy rates in its quarter review of monetary policy. Both the repo and reverse repo rates were hiked by 25bps each to 6.50% and 5.50%, respectively.
- RBI decided to keep the Credit Reserve Ratio (CRR) unchanged at 6.0%. Containing inflation remains the dominant policy concern. WPI inflation target for March'11 end was revised sharply to 7.0% from 5.5%, earlier.
- Inflation spiked up again in December after witnessing a fall in November. Inflation stood at 8.43% yoy in December compared to 7.48% yoy in November. High food prices were the main reason behind the spike in inflation number. After easing to 13% in November, the primary article inflation surged to 16.5% in December.
- The index of industrial production (IIP) witnessed a sharp fall in growth and saw 2.7% yoy growth in Nov'10. Tepid growth in the Manufacturing sector (2.3%) pushed overall IIP growth down to its lowest in 20 months.
- Current Account Deficit (CAD) widened to US$15.8bn (4.4% of GDP) in 2QFY11, the highest quarterly deficit ever recorded by India.

Indian Equity Market Insights

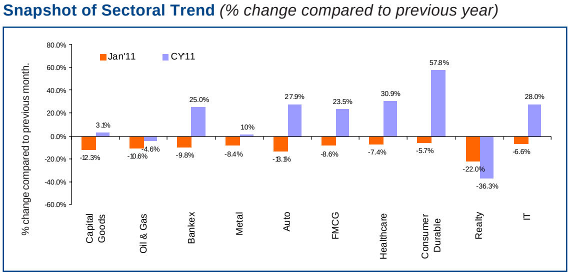
- Most developed markets were stable during last month and ended the month marginally positive. However, debt concerns in European markets and political situation in Egypt impacted the emerging markets which ended the month in red.
- Indian markets remained under immense pressure amidst global uncertainties. The large cap indices Sensex fell 10.6% during the month of January. Midcap and Small cap indices underperformed large caps and fell 12.0% and 12.3%, respectively.
- After a stupendous 2010 (FII flows of US$1054m), FII flows to Indian markets turned negative since beginning of 2011. FIIs sold US$924m worth of equities since start of this year. Domestic MFs on the other hand were net buyers and bought equities worth US$38m during the same period (Domestic MF data as on 28th January).
- All sector indices ended the month in red with Realty being the biggest loser (down 22% in January). IT and Consumer Durables were relative outperformers with fall of 6.6% and 5.7%, respectively.

FII and MF Trend



Source: SEBI

Snapshot of Sectoral Trend *(% change compared to previous year)*



Source: Bloomberg

ING OVERVIEW OF SECTORAL TREND

AUTO

While volume growth continues to be strong across cars and two wheelers, we expect some moderation in growth going forward. The auto industry faces multiple headwinds in the short-run due to increase in cost of ownership as selling prices have increased on the back of higher raw material costs and an increase in cost of operations as fuel prices have increased over the last 1 year. Further, rising competitive intensity in the auto industry has restricted the ability of companies to pass on full inflation in raw material costs to the consumer which will result in pressure on margins.

BANKING

Credit growth for the period ended January 14, 2011 fell to 23.6% from 24.4% in the earlier fortnight, whereas deposit growth fell marginally to 16.4% from 16.5%. RBI has clearly articulated that the liquidity deficit is more a structural issue emanating out of the wide gap between deposit growth and credit growth.The incremental non-food credit-deposit ratio rose to 102 % by end-December.In the corresponding period of the previous year, the ratio was 58 %. Hence, we expect banks to hike deposit rates further. Also, 4Q is seasonally a strong quarter for credit growth and a tight quarter in terms of liquidity resulting in high probability of deposit hikes. Though lending rates are also likely to go up we do expect near-term pressure on margins. Nevertheless, we believe select PSU and private banks with better funding franchise viz high Current Account & Savings Account (CASA) ratio, lower dependence on bulk deposits, and a well-managed ALM profile would be able to protect margins effectively.

METALS

Given the recent increase in imported steel prices, we expect Indian steel mills to increase prices in the month of February. However, Indian steel prices would continue to be at a discount to international prices which reflects the weak state of the domestic market with supply increasing and demand continuing to remain sluggish. With spot Iron Ore prices in excess of $190 and Coking Coal crossing $300, we prefer steel companies with a higher degree of integration, which would enable them to benefit from increasing steel prices. Margins for Copper smelters are expected to rise in the near term due to an easing in supply of concentrate, however the global shortage of Copper is expected to continue over the next couple of years as demand growth continues to outstrip supply. World Aluminum production was higher by 1.8% in the month of December on the back of an increase in Chinese Aluminum production as companies restarted smelters due to higher London Metal Exchange (LME) prices and a removal on the curb of power use.

IT

Good 3Q results for most IT companies indicates a strong recovery in demand. Most companies registered good volume growth with flat to marginally higher pricing. Due to better utilisation and better pricing, most companies were able to absorb the impact of rupee appreciation during the quarter. Employee attrition remains a concern and can impact utilisations and margins going forward. We remain positive on the sector

OIL & GAS

Crude prices continued to remain strong during January 2011. Brent crude is currently hovering at around US$98-99/bbl. During January 2011, crude prices averaged US$96/bbl compared to US$91/bbl in December 2010. Henry Hub natural gas price is currently at US$4.3/mmbtu from its high of US$4.7/mmbtu during the last week of January 2011. Average for the month stood at US$4.5/mmbtu as compared to US$4.2/mmbtu in December 2010. In January 2011, Global Refinering Markets (GRMs) averaged at US$6.8/bbl, showing an 8% increase over the previous month (December 2010 average stood at US$6.3/bbl)

CONSUMER STAPLES

Cost inflation pressures became evident in Q3FY11 results, with margins slipping and competitive scenario heating up. Hindustan Unilever experienced lowest margin of 7.5% in soaps and detergents space. Colgate upped its advertising spends on potential scaling up of competitive activity. Copra and Palm oil prices touched new highs, impacting hair oil and soap segment. New Copra crop expected in feb-april period hold the key for Coconut hair oil players. All this played out in the sector returns with most Staples stocks posting underperformance to benchmark.

CAPITAL GOODS

Erratic IIP data, high inflation and corresponding higher interest rates along with high commodity prices have stalled the nascent recovery in industrial capex. Government investments in Industrial capex have also slowed with greater political uncertainty due to various scams. We expect order inflows and revenues of capital goods companies to get impacted due to these factors and thus are cautious on the prospects of the sector.

HEALTHCARE

Para IV Developments - Glenmark received an unfavourable outcome in the Tarka (hypertension drug) patent litigation as the US jury rejected Glenmark's claim and awarded damages amounting to US$16mn to the innovator.The court's verdict is still awaited. Couple of deals during the month - 1) Lupin expanded its footprint into the Latin American market; signed strategic agreement with Brazil's largest healthcare PSU, Farmanguinhos. 2) Aurobindo Pharma divested the majority stake in its China subsidiary to Sinopharm Group. The deal is expected to lead to improvement in profitability for Aurobindo.