

**OPTIMISTIC  
AT CURRENT  
LEVELS**



## RAMANATHAN K

Chief Investment Officer  
ING Mutual Fund

Ramanathan feels that the worst is behind us and that the market has already factored in inflation worries and interest rate hikes

Years of work experience

**16 years**

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### Theme identification strategy

- Identify a secular theme which implies potential growth over a longer period of time
- Theme is identified through a combination of issues such as company meetings, regulatory changes, government programmes, macro economic developments and trends in direct investments
- Research is focused on
  - i) Ascertaining the likelihood and speed at which a theme can develop
  - ii) The potential market size
  - iii) Which firms are best positioned to take advantage of the opportunity

### Stock picking strategy

Bottom up stock picking using

- Blend of 'value' and 'growth' at reasonable price for stock selection
  - In-depth company analysis with emphasis on company meetings
  - Valuation assessment using wide range of valuation techniques including growth and value elements
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## INTERVIEW

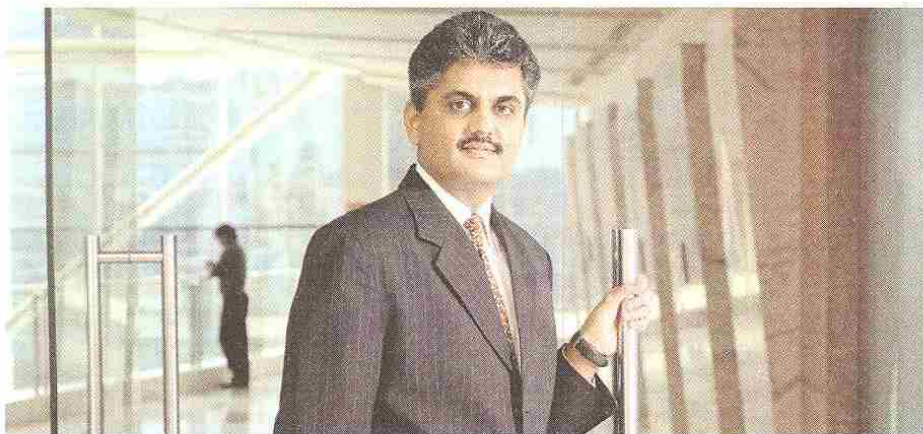
**Currently what is the stance of your AMC? Are you fully invested or have increased your cash holdings?**

Our primary focus is to beat the benchmark. To do this there are three alpha sources, alpha as you know is excess return over the benchmark.

The first is security selection, the second is sector overweights or underweights and the third is cash holdings.

At ING Mutual Fund, we try to generate alpha by using the first two sources rather than cash calls.

Our cash calls are limited to 10 per cent of the portfolio, irrespective of the state of the market. The problem with holding cash is that one can miss out on sudden reversals in market. Take a look at the period March - May 2009 when the market suddenly reversed the downward



trend after the election results were declared. Many portfolio managers missed out on the initial leg of the rally because of high cash holdings and this dented returns.

As of today we have cash holdings averaging 5-6 per cent of our portfolios. A part of it, around 2 -4 per cent, is kept for redemptions. The rest is to benefit from opportunities because if based on some news stocks get beaten down, there is cash to buy these stocks at attractive valuations. For instance, when the market crashed in the morning\* based on the news of changes in the Indo-Mauritius tax treaty it threw up some good buys.

\* June 20, 2011

**In ING Dividend Yield, the cash holding is around 8 per cent.**

Yes. The Dividend Yield fund does have a higher cash component right now than the rest of the equity funds; it is closer to 10 per cent. That is because we got a fair amount of inflows in May so we are still in the process of deploying that cash.

**If you had huge inflows today, what sort of stocks would you look at right now? For instance, would you look at low beta defensives, those with stable earnings growth or those with a higher possibility of re-rating of PE multiple?**

We would look at stable growth and re-rating stories. By nature, re-rating stories will be high beta stocks.

I am not too inclined to dramatically increase beta overnight. There are a lot of high beta stocks in the

industrial sector - Infrastructure, Capital Goods. Also in Banking one can find such stocks.

**How do you see the global headwinds affecting the Indian market?**

Look at the issues that troubled the market around six months ago. High commodity prices including crude oil. Money was also flowing into the developed markets due to better than expected recovery. All these led to the Indian market underperforming. Now, with troubles in Europe, slowdown in the US and measures undertaken by central banks in China and India to control inflation, demand for commodities is expected to come off. Given this

background, crude oil prices have dropped from \$110/barrel to \$92/barrel. Cooling commodity prices are positive for the Indian market. Most of the issues which resulted in underperformance of the Indian market - commodity price inflation, faster than expected pace of economic recovery in the US etc - are reversing now.

**You do not see inflation eating into the India growth story?**

Inflation has reached its peak. While the headline inflation number will continue to remain high for the next few months due to pass-on of oil prices, incremental inflation post this is expected to moderate. Softening of global commodity prices and base effect will also result in softening of inflationary trends. From current levels, I do not see inflation eating into the India growth story.

**What about higher interest rates?**

That has already been factored into the market levels. Earnings downgrades have already happened. At the start of the calendar year, analysts were talking of 20-22 per cent earnings growth. Now it is down to 16 per cent and could go down a bit further to 13 per cent - YoY.

**Looking at your optimism, do you foresee a rally?**

We expect market returns to be in line with earnings growth. Macro worries in terms of inflation and interest rates have already been factored into current levels. With US slowing down and commodity prices coming off we should see resurgence of flows into the Indian market. Also valuations at 14 times FY12 earnings are at reasonable levels. A couple of quarters down the line the market will start discounting FY13 earnings and that's when the market would start looking attractive.

**In the past six months how have you churned your portfolios?**

We have always been overweight on Consumption, which includes Auto and Consumer Discretionary, basically stocks which benefit from rising income levels in this country. However, currently in Autos we are neutral to underweight due to stock specific factors.

We have been overweight the IT sector, but have been slowly paring down our exposure to this sector.

There are various names in the Financials space which are at attractive valuations. With macro fundamentals improving, we would look to be overweight this sector. We have already started increasing our exposure to Banking.

In Infrastructure (industrials sector), there is less clarity on the growth in order book. But these companies will benefit if interest rates come down. We would look at being overweight on this sector once the visibility on order book improves.

#### **Why are you changing your stance on Infotech?**

We are overweight on the IT sector right now but are slowly reducing our exposure for two reasons. The first being high valuations, especially amongst large caps. Secondly, the fortunes of these companies are linked to the growth and recovery in the US and Europe, where growth is currently stuttering.

#### **When you talk of increasing exposure to Banking, are margins not going to be squeezed due to rate hikes?**

The market has already discounted that. The market typically discounts earnings a year ahead. If you look at estimates, all are assuming a 20 bps contraction in NIMs this year. The question is whether it will be more than that. That would depend on bank to bank and their ALM. As of now we are overweight on private sector banks. But if due to risk aversion public sector banks fall even more we would also consider buying this space.

#### **Which sectors do you see maintaining growth for the next few years?**

Consumer Discretionary, I am not referring to FMCG though. I am referring to items which are above the basic necessities. Individuals are now getting acquainted with brands and volume growth itself is around 20-25 per cent. I am not even talking about price growth.

#### **What are the upsides you see for India? Reforms being implemented? Policy announcements?**

The upside is fall in crude prices and commodity prices. Fundamentally macro headwinds are reducing. Announcements in insurance, retail FDI will all have a positive impact. Environmental issues are getting sorted out gradual-

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## **WE ARE A MULTINATIONAL INVESTMENT MANAGEMENT FIRM WITH STRONG FOCUS ON RISK CONTROL. FEW SUCH FIRMS IN INDIA HAVE TRACKING ERROR LIMITS, ACTIVE BET LIMITS & NON-BENCHMARK LIMITS**

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ly from earlier being a total stalemate. Policy inertia in some sectors is getting sorted out. And, of course, valuations continue to be attractive.

#### **Do you think a 4.6 per cent fiscal deficit in 2012 is a big gamble on growth? How worrisome is this deficit?**

That figure is very, very difficult to achieve. A more realistic figure would be 5.1 per cent. Coming to your next question, it is not too worrisome for the equity market. It is a big concern for the bond market because it would result in more auctions in the second half.

#### **Looking at the equity market and the debt market and the interest rate scenario, where would you advise investors to invest in right now?**

Current high interest rates offer attractive opportunities in fixed income. Given that the inflationary headwinds are receding, investors should lock on these high rates by investing in longer tenure FMPs. From a risk-reward perspective this is an attractive opportunity. Given reasonable valuations and softening commodity prices, current levels are also attractive to invest in equities. However returns will be only in line with earnings growth (12-15%).

#### **The equity offerings at ING Mutual Fund tend to be volatile - good performance then not so good. Do you agree that consistency is something that your fund house yet has to achieve? None of the equity schemes, barring Dividend Yield, are great performers in their category.**

If one looks at the performance over the past few years, I would say across the board we have had good performance in our schemes. Most of the funds including ING Dividend Yield, ING Core Equity, ING C.U.B., ING Midcap and ING Domestic Opportunities have done well. These funds are also in the top two quartiles in terms of peer comparison. These funds have beaten the benchmark with a good margin.

We pride ourselves as one of those few multinational investment management firms that have a strong focus on risk control. Very few investment management firms in India have tracking error limits, active bet limits and non-benchmark limits. The investment process is tuned to deliver consistent performance. ■

*AMC: Asset Management Company/ PE: Price Earnings ratio/ Infotech: Information Technology/ NIM: Net Interest Margin / ALM: Asset Liability Management/ bps: basis points where 100 bps = 1% / FDI: Foreign Direct Investment / YoY: Year on Year / FMCG: Fast Moving Consumer Goods / FMP: Fixed Maturity Plan*