Issue 10 – India is now cheaper than the 2008 high, Interview with Hindu Business Line, Sunday 19th Dec 2010.


Sanjay Sinha. CEO, L&T Mutual Fund

What's your outlook on market and valuations?

Eleven quarters have passed since the previous January 2008 high and over these quarters, corporates have only advanced. So on a like-to-like basis, today at the same absolute level of the index, we are relatively cheaper. India's valuation is also frequently compared with other emerging markets. When that is done, we need to keep a couple of things in mind. One, the composition of earnings in India is very different. The Indian indices are broad-based, with a diverse sectoral representation, while some of these markets have a much skewed tilt towards, say, commodities. Two, we need to look at the valuations in terms of India's outlook on the earnings growth. With a price-to-earnings multiple of 15 times and earnings outlook of 18-20 per cent growth for FY12, it is an open question if India should get the same valuations as some of its Asian peers.

What about sector-specific outlook? There's been a lot of divergence across sectors in terms of earnings performance.

In the last couple of quarters, there have been significant changes, with interest rates hardening and commodity prices moving up. These will obviously have a bearing on the earnings outlook. So while we may have the overall earnings remain in line, sectors that are vulnerable to interest rate hikes and commodity prices might see their margins under pressure. That said, we have also seen that the demand outlook for some of these sectors has been much higher than expectations. The first such confirmation will come in the third quarter results. It will reveal if demand growth can lead the economies of scale to absorb the increase in commodity prices and interest rates. But if it doesn't, then we'll have commodity-based sectors see an earnings upgrade while the sectors that are vulnerable to interest rates might suffer earnings downgrade.

What about infrastructure as an investment theme? Mutual funds investing on this theme haven't done as well in this market cycle.

There are a couple of prominent reasons for their underperformance. One, following the global financial crisis the capacity expansions were put on hold as the demand outlook wasn't clear. With the resumption of growth in most of the economies, the capacity expansion plans are back on track. This will have an immediate rub-off effect on infrastructure-related projects. Two, access to capital had become restricted earlier, but with the financial markets now pening up, the flow of capital is becoming freer. Three, in the Eleventh Five Year Plan, there was an ambitious target to spend Rs 20 lakh crore on the sector. However, the mid-term review showed that only Rs 8 lakh crore has so far been spent. While, it may not be practically possible to spend the balance in the remaining two years, one can expect to see some acceleration in the pace of infrastructure projects in the remaining two years.

With mid-caps suffering a crisis of confidence following allegations of insider trading, how should investors select mid- and small-cap stocks?

The key distinction between a good and bad company in the midcap segment is linked to two factors — one, the growth trajectory and two, the quality of corporate governance. It may, however, not always be possible for the lay investor to qualify the corporate. governance standards of mid and small-cap companies. While there definitely is an interest to directly invest in equities, given the complexity of decision making and the fact that business cycles are getting compressed in time and that global events increasingly have had a bearing on most companies, it would be better for lay investors to confine investments to a limited number of stocks that can be tracked closely.