

## **Answer to Investor's question about probability of 25% return,**

**AUGUST 3, 2004**

As you very rightly say, it will be inappropriate to guarantee any returns. However, I will rate the probability of generating a return of 25 % on Indian investments as very high.

The reasons are:

### **Current Valuation of the Indian market**

Multiple parameters show that Indian market is presently undervalued. The Indian market like other global markets was overvalued in Feb. 2000 and it was undervalued in Dec. 2002. If we compare some of the parameters it will help us in evaluating the current stage of valuation.

Date	Sensex Level	Price/Earning	Price/Book	Dividend Yield	Verdict	Subsequent Move
Historical range		11-29	1.9-4.1	0.95-2.4		
Feb 2000	6200	28	3.98	1	overvalued	Big downward move for 3 years
Dec 2002	3400	14.37	2.24	2.18	undervalued	125 % returns in year 2003
August 2004	5200	15.38	2.88	2.24	undervalued	Expected to move up significantly

- Price Earnings multiple-This is just the price at which a company's share is trading divided by earnings of the company per share. For example, if a share is trading at USD 30 and its earnings are 1 USD per share, P/E multiple is 30. The current P/E at a Sensex level of 5200 is 15.38. Generally P/E in the Indian markets has fluctuated between 11 and 29.
- Price/Book value- this represents the price of a stock as a multiple of the stock's book value. The lower the ratio, the more undervalued the stock is. Currently it is at 2.88 that is also low by historical range. In the overvalued market of Feb. 2000 it was at 3.98.
- Dividend Yield-This represents the return that an investor would get from earning dividend on a stock purchased at the current market price. Higher the dividend yield, the more attractively priced a stock is. Currently it is 2.24 %. In the overvalued market of February 2000 it had fallen to 1 %, while in the severely undervalued market of Dec. 2002 it was 2.18.

### **Economic Fundamentals**

GDP growth continues to grow at a healthy clip, outpacing most of the other global economies.

### **Recent Price Action**

Market in 2003 showed a major spike from 3000 to above 6000. then it showed a correction to a level of 4300. So it has already gone through a major correction.

Anecdotal evidence shows that investors hung on when the correction was going on and fresh buying is emerging at these levels.

### **Market Sentiment**

Foreign Institutional Investors (FIIs) are investing more funds and recently more FIIs have registered themselves in India. Similarly, domestic participation in equity markets is rising.

### **Past returns**

Top equity funds delivered an annualized compounded return of 27% over last 11 years.

### **Conclusion**

*Current valuation at the Sensex level of 5200 is close to what it was in December 2002 when Sensex was trading at 3400. This is because while the numerator of Price has increased, so has the denominator of Earnings of Indian companies grown strongly .In 2003 we saw good Indian funds delivering strong returns of 125 %. Although we don't anticipate a move of that magnitude, 25 % up move is highly likely, even by very conservative standards.*