

## **Sensex at 6233-to stay invested or to take profits?**

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A note analyzing the long- term direction of Indian Equities from the present lofty levels.

### **Background**

Right from Feb. 2003 onwards when Sensex was close to 3000, I have advised investors through my newspaper column, e-mails, seminars and direct communication to invest in Indian equity. I have communicated frequently and at various market levels. To NRI investors, I have promoted India as an attractive investment destination incessantly, since a TV interview to a Canadian channel in the year 2001. Two recent notes of July 17,2004 and August 3, 2004 are enclosed. ***We are happy to report that all our investors without a single exception are making healthy returns. Some who invested in early 2003 have more than doubled their money.***

### **Question**

Sensex is presently at an all time high. Return of our investors is even healthier. However, preservation of profits is extremely important. The markets are dynamic and it never lets you rest on your laurels. The question, which is important to answer, is 'what to do now'?

### **Confluence of factors leading to a sustained and major rally**

#### *India story*

This has been discussed in my previous notes including robust economic factors, political stability and good pace of reforms. The most important thing is that we are at an inflection point, where in the next 3-5 years, India will witness tremendous growth.

#### *Undervaluation*

Indian stocks on a comparative global basis are still undervalued. Price-earnings multiple based on one year forward earnings is only around 15.

### *Rising interest rate environment*

Globally, interest rates after remaining low for a significant period of time have started going up, this reduces the return on long-term debt funds. Since money competes for an asset class with the maximum return, at this stage of the business cycle, equities remain much more attractive.

### *Declining Dollar*

America's current-account deficit is in uncharted territory, both as a share of the economy and in terms of the share of foreign savings it soaks up. Most economists have argued that this imbalance must at some point be corrected. That could come through greater demand outside America, or slower demand within America (implying higher saving and/or lower investment); or a continued downward slide in the dollar.

The view of Bush administration is that a painless way for this adjustment will come through a weaker dollar.

This confluence of factors, for example dollar depreciation, forces the funds managers to invest in other markets, amongst which India happens to be at the moment the most attractive.

### ***Tremendous opportunity, but is it being noticed?***

Even when all factors point towards a rally, still money has to flow into the stocks for those to go up. This is being provided by:

#### *Foreign institutional investors (FII)*

FII investment this year has been over \$7 billion. It is imperative for foreign fund managers to invest more in countries whose currencies are likely to rise against USD as a declining dollar hedge. Moreover countries like Taiwan & Korea which were the favoured destinations are export dependent economies and will suffer because of declining USD. Indian growth is dependent more on domestic demand. It makes it even more attractive and allocation to India is expected to grow significantly.

#### *Retail Investor*

With alignment of Indian interest rates, pension reforms, changing social environment and increasing longevity, Indian retail investor is giving lot more attention to equities.

This will become a very significant source of capital. They are presently on the sidelines but increasingly being drawn in.

### **Sentiment/Anecdotal evidence**

- The present rise is against the backdrop of Reliance family controversy and consequent selling of Reliance shares. Considering that Reliance has about 11% weightage in Sensex, it is a remarkable showing and portends well for the future.
- It is a very broad rally with the involvement of multiple sectors.
- Even smaller stocks are doing well, investors are increasingly researching and finding value in numerous mid cap and smaller companies. Number of good quality stocks commensurate with size of Indian capital markets is increasing and that is a good sign.
- Amongst foreign investors it is not only risk takers like hedge funds investing in India but also risk-averse, serious and conservative players like pension funds and insurance players.
- Visits by numerous foreign delegations comprising of investment managers
- Registration of more foreign funds with SEBI
- Retail investors staying invested even when markets had fallen drastically to 4300 in May 2004 post election results
- Markets coming up fast and threatening the previous high of 6249 after falling only 7 months back to 4300.

### **Recommendation**

To stay invested and increase allocation in Indian equities, of course with following my 5 principles of investing in equities-diversification, long term horizon, appropriate asset allocation, alert monitoring and selection of best investment vehicles.

