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Budget 2007- a concise analysis of impact on asset allocation

Verdict

My rather contrarian view is that it is a good budget-a budget of continuity and consolidation. It strives to build up on solid economic growth of the last 4 years by not tinkering with facilitators of corporate growth while providing a major thrust to the lagging areas of agriculture, rural development and infrastructure. Agriculture with which half of Indian population is directly connected, is growing only at 2.7% rate and a 4% growth will facilitate achieving the goal of 10% GDP growth. It will also help in moderating inflation pressures by easing supply side constraints though with a time lag.

Overall, it attempts to lay a good foundation for sustainable growth by not disturbing the present Indian virtuous spiral while at the same time trying to make it inclusive and curtailing factors that could disturb it. The only criticism is that allocation is for too many schemes instead of 2-3 major themes and therefore implementation and outcomes will remain suspect.

Backdrop

This budget was presented with the backdrop of impressive economic growth for the last four years but where the inflation has started picking up. While services and manufacturing are growing at a good rate, agriculture has lagged behind. Moreover, the asset prices are no longer undervalued. Additionally, now the elections are only two years away.

Major thrust areas

The budget focused on agriculture, rural development and infrastructure. It has also significantly increased allocation for the important areas of education and health. For the industry, the customs and excise duties were decreased. However, fringe benefit tax on ESOPs was introduced, MAT now applies to IT industry too and a new education cess of 1% is added.

Investment taxation

Favourable tax treatment continues. Long-term capital gains tax on stocks and equity funds remains at 0 while short term only at 10%. However, the dividend distribution tax (DDT) on debt funds has gone up to 25% while on stocks to 15%. DDT on equity mutual funds is 0. Tax saving on real estate transactions under section 54EC is now capped at 50 lakhs of capital gains.

Conclusion for asset allocation

The stock market will be driven by fundamentals and corporate earnings growth. For the next few years, stock market should continue to deliver good returns. Interest rates will continue to rise slowly, debt returns are now at a good level and short term or floating rate funds can give good safe returns. Growth schemes of debt funds held for more than 1 year will be advantageous rather than dividend schemes. ***Overall, still the business cycle stage is such that a heavier allocation to Indian equities is favourable and therefore the current drop (a lot of it from global cues rather than the budget) serves as a very good buying opportunity.***