

Finance Doctor's CONCISE VIEW FOR 2009

Jan .27, 2009, Sensex at 8835

Context- beginning of a new era

2009 is an important year since it heralds a new beginning both politically and economically. The preceding year 2008 marked the end of an important phase lasting for 25 years. In 1983 world was taking its initial steps towards being unipolar with USSR moving gradually towards its disintegration. Economically also, USA was embarking on a favourable and dominant economic path, once it had mastered the high inflation of early eighties.

2008 saw a major global financial meltdown and the failure of the prevailing financial system. Moreover USA has had rather unproductive engagements in its foreign policy initiatives. Election of Barack Obama is based on 'Change'. 2009 is the starting point of a new era and the capital markets eventually will reflect the new reality.

For India, issue central to 2009 forecast is that whether global strategic shift strengthens in favour of major emerging economies like India, China and Brazil. My several previous notes have emphasized such a shift and 2008 global financial meltdown could accelerate it.

The beginning of a new world order-Henry Kissinger

In a recent article, Henry Kissinger wrote the following 'America will recognize the limits of hegemony and will move towards implementing consultation beyond largely American conceptions. Other countries, while asserting their growing roles, are likely to conclude that a less powerful America still remains indispensable. America will have to learn that world order depends on a structure that participants support because they helped bring it about. The G8 will need a new role to embrace China, India, Brazil and perhaps South Africa.'

Emerging markets as an asset class in 2009 & beyond-Mark Mobius

Today's emerging markets are quite different from when listing of first emerging funds started 20 years back. The perception of risk in emerging markets is now beginning to shift as investors realize that:

- 1 Emerging markets have become net creditors with vast holdings of foreign exchange reserves.
 - 2 Emerging countries continue to record much higher economic growth compared to developed countries
 - 3 The debt levels of many emerging countries is lower than that of developed countries
- Moreover, their contribution to world GDP growth is much more than that of developed world.

BRIC long term growth story remains intact

BRIC economies will continue to be a key driver of global economic growth. They are among the fastest growing economies in the world. The four markets together account for more than 40% of the world population. Domestic demand growth remains robust. India with its favourable demographics will continue to benefit from twin factors of globalization and technology.

India's favourable macroeconomic fundamentals

Although a slowdown is expected in 2009 to 6% and even slower in 2010, still Indian GDP growth remains one of the fastest in the world. Inflation has come down rapidly to below 6% levels since it was mainly commodity led. Paradoxically slowing down of USA and European economies, by bring down oil and commodity prices, has helped ease off the pressure on inflation in India. This has allowed RBI to be in a growth-supporting mode rather than in inflation fighting. 10-year bond yields have come close to 5.5% from a high of 9.5% and that will prove to be stimulative for long

term including infrastructure projects. With more room for stimulus packages, domestic demand will again start growing.

2009 view only a minor factor in determining Asset Allocation

Since we are in a major transition with 2009 just a starting point for a new era, allocation based on a macro long-term view is the most relevant. 2009 could be volatile from a market direction view but it remains a minor subset of a very significant long-term view. Importantly, our long-term asset allocation does not change even if we believe that 2009 will be a tough year.

Recommended Asset Allocation

As always, each portfolio is built on liquidity, safety and yield enhancement in that order. With 2009 expected to be volatile, a slightly higher allocation to liquid instruments is recommended.

With interest rates headed down, Indian long-term debt will provide good returns. Government bond yields have come down and the returns have been to the tune of 25% in the last 4 months. Now blue chip corporate bonds are trading at a high yield spread over Government bonds and therefore offer compelling opportunity.

For longer-term money, this is a great opportunity to get in Indian equity at attractive valuations. Money could also be invested in a systematic manner over a period of time. Over a period of next 3-4 years, Indian equity is likely to deliver significantly good returns.

NRIs/PIOs will be able to enhance their total portfolio returns by allocating a significant part of their portfolio to Indian equities and even more so as the long-term appreciation trend of Indian rupee remains intact and the current exchange levels are favourable.

Certain principles of allocating in volatile assets like equities remain sacrosanct. These are appropriate time horizon, diversification and valuation.

Best Wishes,
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