Tailwinds to the fore

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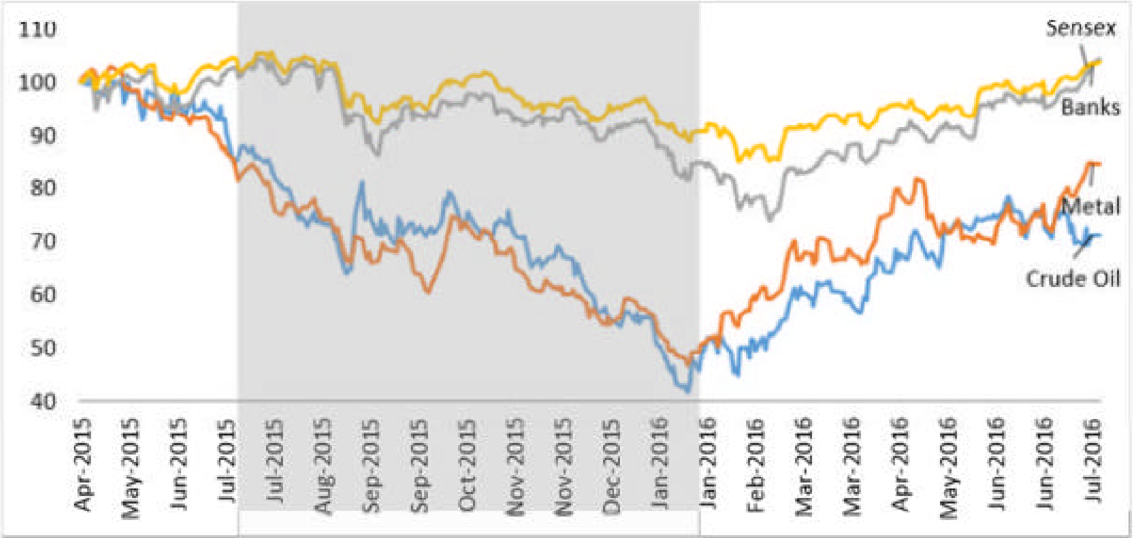
The global economy saw weak growth and dwindling inflation on the back of lower commodity markets and a strengthening dollar. Asset classes across the world witnessed volatile movements during the year driven by several event led losses coupled with uncertainty rising from the Chinese slowdown and US unwinding of quantitative measures.

Nothing recedes like success is probably an apt way of describing fiscal 2016 in India. Granted, there were a conflagration of issues like multi-year low commodity (metals and crude oil) prices; near scary levels of NPA provisioning for banks; abysmal monsoons impacting consumption sector growth for the second consecutive year and more importantly, an absolute lack of material transmission of rate-cuts to drive growth. But more importantly, there was a paralysis by analysis by the political class and understandably, the aura around the new government receded. The start of the new year however saw most of these headwinds turning into tailwinds.

Exhibit 1: Movement of Commodities, Metal, Sensex and Bank Index



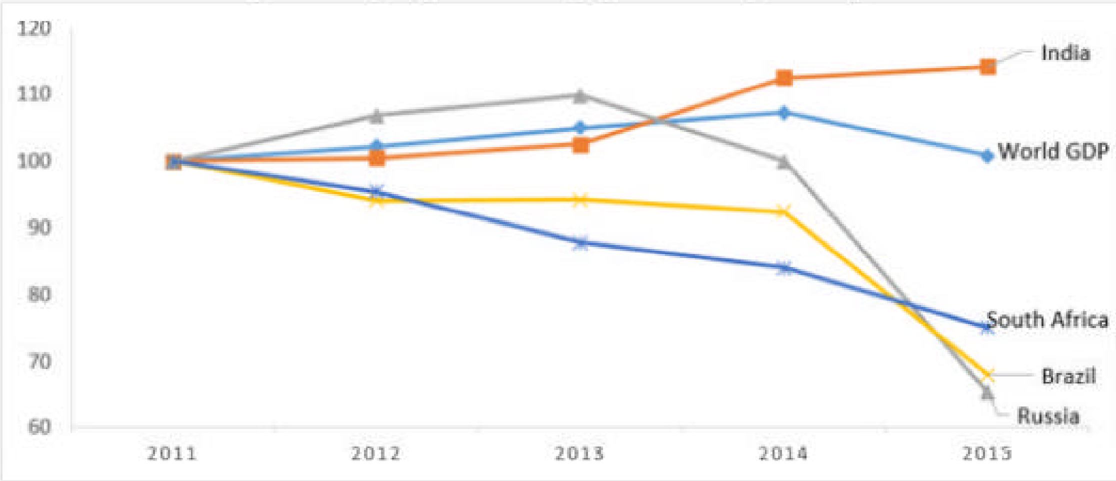
Source: Bloomberg; Values Indexed

There is no denying the fact that the ground reality for industrial production, factories, businesses in India is beginning to look up at this stage after a prolonged period of uncertainty. The markets too seem to be relatively less impacted by global events such as Britain exiting the European Union, perhaps signs that the participants are beginning to mature.

After pouring in equity dollars in 2014, flows from foreign investors into Indian equities had ebbed for the most of 2015. Concerns around global growth, especially in China, had triggered the exodus of foreign flows. The government will have its work cut out on the reform front and near-term expectations are muted given the turbulent sessions of Parliament that we have seen.

As I write this however, it seems we have been blessed with what can be considered a normal monsoon; consumption has been given a booster shot by the seventh pay commission; commodity prices seem to be improving and importantly credit growth is beginning to see first signs of growth. The rural economy, that was hitherto a mute spectator is expected to be an enthusiastic participant in the second quarter as farm output is set to rise.

Exhibit 2: India's GDP growth eclipsing other emerging economies (ex-China) as well as Global GDP



Source: Bloomberg, World Bank (GDP in Constant USD); Values indexed

Time to go long

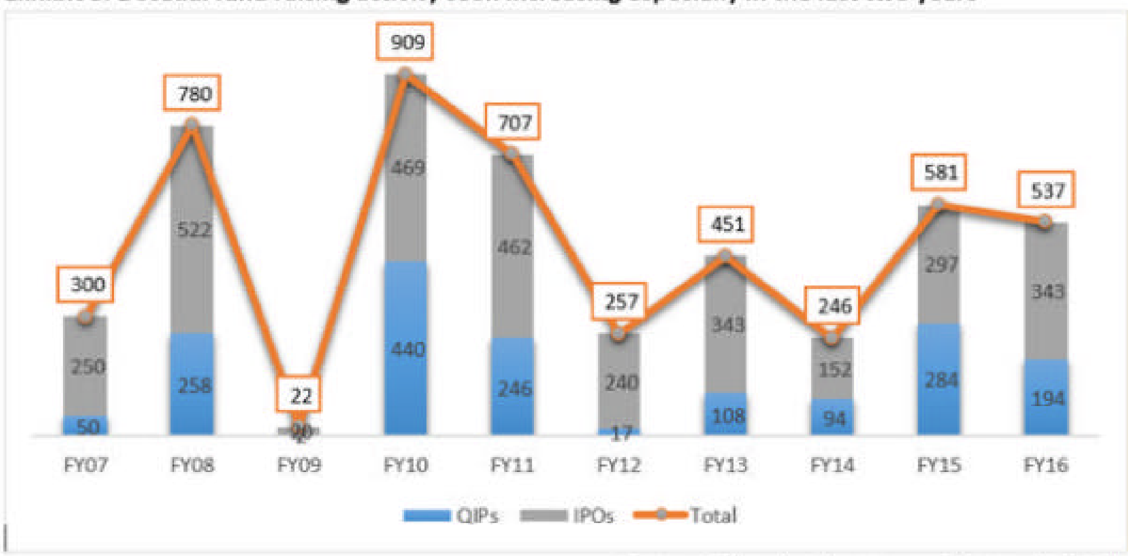
A strong financial market with broad participation, especially household savings, which is one of the highest in the world, is essential for a developed economy. With India's growth story poised for a resurrection, there is a clear and present need to raise resources for companies, especially at a time where debt is clearly not available as an option, given the bloated balance sheets of the banks.

The fact that issuers and investors are both looking towards capital markets is evidenced by:

a) One of the highest fund raising activity in over five years

Indian Equity Markets saw fund raising of over US$17bn of fund raising in FY15 and FY16, which was more than the three previous years combined. It was heartening to note that the primary markets saw a resurgence of the retail investor. In fact, large IPOs, which was in favour with investors, saw phenomenal responses, with some IPOs getting as much as 6-7 lac applications.

Exhibit 3: Decadal fund raising activity seen increasing especially in the last two years

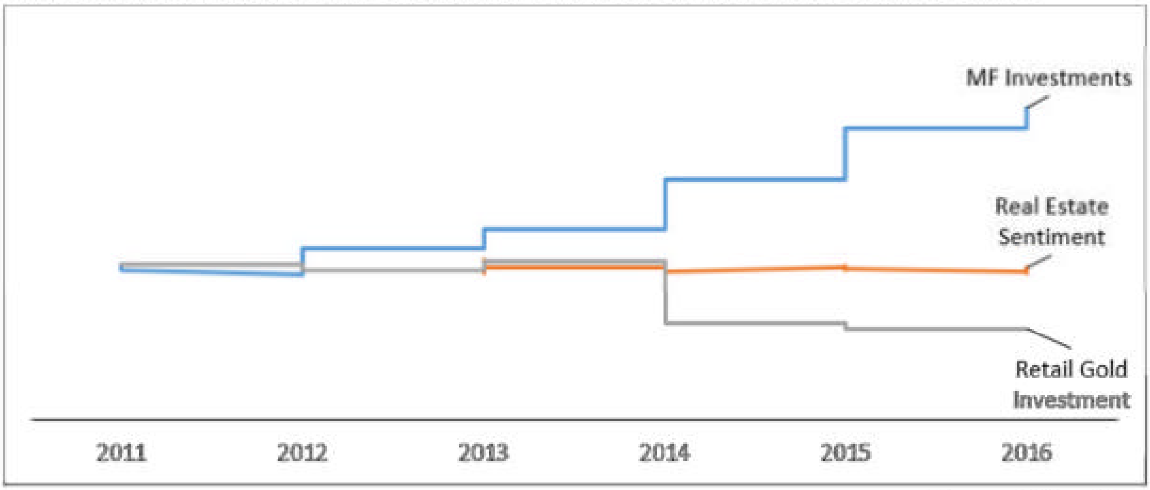


Source: Primedatabase.com; Figures in INR bn

This augurs well for fund raising in general and Indian Companies in particular that have several capital expenditure plans in the pipeline and have a huge appetite for funds. Which brings us to the second indicator of a capital market that is set for growth, the supply of funds.

b) Financial Instruments becoming a preferred avenue for investment over real estate and gold
If we use mutual fund AUMs as a proxy for retail investments, the following chart makes for interesting reading:

Exhibit 4: Financial instruments outstripping Gold and Real Estate as investment avenues



Source: Bloomberg

Gold and other precious metals lost glitter due to the fall in global commodity pricing. Retail investment in gold fell year on year and sentiment for real estate too was muted. The direct and undoubted beneficiary was the equity markets which saw a sustained increase in fund being invested by the retail class. This trend has been validated by several market participants, and if this continues, the next few years are likely to witness a trend reversal between equity and other asset classes leading to India broadly being in line with the global proportions in all asset classes.

In conclusion, the signs are there, we are at the cusp of a rerating of the markets, near term events such as global growth and stalled reforms seem to be increasingly priced in. While there could be mild stress based on events, significant weakness in Indian equities is unlikely to pan out and India remains the fastest growing major economy, which undeniably is telling us that it is time to go long.