India well insulated from Fed rate hike; Sensex likely to hit 34000 by March 2015

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In view of the fact that there is significant mispricing at current valuation levels, the expected returns are much higher. In the bull case scenario, the Sensex is likely to move in a range of 26000-34000 by March 2015, says Vikas V Gupta - Executive Vice President at ArthVeda Fund Management Pvt. Ltd, in an exclusive interview with Kshitij Anand of EconomicTimes.com.

"The Sensex is expected to be in the range of 26000-34000 by March 2015. The bear view is 18000-21000."

Q) The rumours on the Street are spreading fast that the US Federal Reserve might just raise interest rates sooner than expected. Will it impact India or other emerging markets? Iif yes, then why?

Despite the rumours, the US Fed's rate increases are not a given in the next few days. It is possible that the Fed would wait a little bit after the bond buying stops and then start on raising interest rates. So we may have to wait for several months before the interest rates are increased.

The immediate reaction for emerging market investments will be a little bit of pull out. However, it doesn't look like it will be more than 5-10% correction. There will be an impact on the currency too due to the dollar demand in the near term.

However, as far as India is concerned, it is moving towards much better fundamentals compared to most emerging markets. Hence it is likely that money will start moving out of other emerging markets and India might start getting more allocations. Of course, that will depend on India's performance on the fundamental economic front.

Q) Where do you seen the Indian markets (Sensex/Nifty) heading in the next 12 months (December and March 2015). How valuations stack up compared to historic levels?

We expect the Nifty to be in the range of 8000-10000 by March 2015. The bear view is 5700-6000.

The Sensex is expected to be in the range of 26000-34000 by March 2015. The bear view is 18000-21000.

The current price to book ratio is 2.9 for the Nifty. Valuations are still below fair value as seen in the table below. Further, there is significant mispricing at these valuation levels.

So, the expected returns of the Nifty are high, as well as the chances of beating the Nifty are still higher for a systematic value investing strategy. However, most fund managers are unlikely to achieve that.

Q) Despite infusion of liquidity by the government, the worst is still not over for China. On the other hand, India has managed to revive growth and revive manufacturing output. However, CLSA in its recent report said that the Chinese economy will be as big ($21 trillion) as the US economy by 2020. Do you agree?

The Chinese economy figures are not exactly what they are stated to be. There are numerous instances in the past 3 decades when economists have been able to point out specific instances when the provincial and national GDP figures have been inconsistent.

Similarly, there have been inconsistencies in key economic figures like freight and electricity consumption, which are a necessary component of GDP growth when these have been highly uncorrelated with GDP growth.

So, while it is possible that the Chinese economy will be big, it is unlikely that it could cross the US figures that early. If the US economy slows significantly, then the Chinese economy will not be insulated from that either. So a faster Chinese growth means that the global developed market economy should do well (which are the customers of Chinese exports).

Given that Chinese fundamentals are not fully health, it is unlikely that it will have a faster growth rate over the next 5-6 years consistently.

Q) Everybody wants to 'Sell high and buy low'. But, does that always work for traders or investors? Is there a way of gauging the right time to buy or sell? If not, what should investors keep in mind while using this strategy?

There are extensive studies which show that hardly any trader gets this right. Probably 0.1% of all traders are able to do this and it is highly unlikely that they can sustain that performance for long periods of time. A look at the attrition numbers in the trading desk of any large trading outfit will show that traders cannot do this.

Value investing is probably the only consistent way of doing this. The correct way to gauge the right time to buy is when the market is pricing a stock significantly below its conservatively estimated intrinsic value based on a conservative projection of cash flows and an appropriate discount rate, i.e. buy with a huge margin of safety.

One sells when the stock is close to its conservatively estimated intrinsic value. An investor consistently doing this is going to come out ahead in the long term, i.e. over a full bull and bear cycle.

Investors should be cautious and not try to beat the markets every day or even every year. They should just stick to buying when they can find stocks below their intrinsic value and if they cannot, then stay under invested and not sucked in by daily highs of the markets.

Q) Give us five stock ideas that you are still liking and recommending to your clients?

We recommend a holding period of minimum 1 year and ideally 3 to 5 years. We do not believe in target price, but rather the undervaluation or overvaluation as a criteria.

Our current Best 5 are:

-NMDC (Highly profitable, zero-debt, cash-rich and monopoly position in iron ore. Indian infrastructure projects will require huge supplies from it. Significantly undervalued.)

-Coal India (Highly profitable, zero-debt, cash-rich and monopoly position in coal supplies to power sector. Indian GDP growth has to be powered by electricity production and consumption. This will need Coal India to supply coal. Significantly undervalued.)

-Bajaj Auto (Highly profitable, zero-debt, cash-rich. One of the top 3 two-wheeler manufacturers of India. Strong pipeline of products. Will continue dominating several regional markets and product niches. Significantly undervalued.)

-Wipro (Undervalued and will also gain from a growing US economy and a falling rupee.)

-Infosys (Undervalued and will also gain from a growing US economy and a falling rupee. New management is likely to take significant steps which will catalyse the interests of institutional investors)

(Disclaimer: We might be already holding, buying or selling the above stocks for our own or client portfolios. Readers are requested to do their own due diligence before buying or selling.)

Q) What is your advise to investors who want to invest in blue chip stocks which have already rallied quite a bit so far in the year 2014. Should they wait for corrections or buy look for stocks in the mid and small cap segments? What makes more sense?

They should start selling overvalued blue-chips and start moving into undervalued blue chips. As demonstrated through the 5 blue-chips mentioned above, there are numerous ultra-large cap companies which are undervalued today and are safe from a long-term buy and hold perspective.

However, none of our stocks should be thought of as speculative vehicles to invest in margin or to play with futures and options.

Q) Any stocks or companies that you have in mind which are not frequently discussed, but have the potential to give exponential returns in near future as the economy improves and reforms start taking shape? We also call them 'Hidden Gems'.

· HT Media

· Balmer Lawrie Investments

· Bharat Electronics Ltd.

· Oil India

· Bharat Heavy Electricals

The above are some of the companies which can give potentially high returns due to economic upturn. All are very safe in terms of having rock-solid balance sheets. All are well-entrenched in their sectors and markets with some kind of a virtual monopoly.

Q) The Indian markets have rallied close to 27 per cent so far in the year 2014. Do you think there are pockets (stocks or sectors) which have run ahead of their fundamentals and a correction is eminent?

We think construction, power, FMCG sector and some banks are ahead of their fundamentals and significantly overvalued. That does not mean that we are predicting a correction immediately. But eventually people will either lose money or make less money on these.

Historical Returns Under Different Market Valuations

Historical PB Band	5yr CAGR L50	5yr CAGR Nifty TRI	5yr CAGR Avg. MF
1.5x - 2.0x	41.3%	37.5%	37.5%
2.0x - 2.5x	39.0%	33.6%	36.5%
2.5x - 3.0x	28.7%	24.6%	23.6%
3.0x - 3.5x	19.1%	16.4%	17.2%
3.5x - 4.0x	21.6%	18.0%	16.0%
4.0x - 4.5x	14.1%	9.1%	7.7%
4.5x - 5.0x	11.6%	6.0%	5.2%
5.0x - 5.5x	10.1%	4.8%	3.9%
5.5x - 6.0x	6.9%	0.9%	0.4%
> 6.0x	6.5%	0.3%	-0.3%

(Views and recommendations expressed in this section are the analyst's own and do not represent those of EconomicTimes.com. Please consult your financial advisor before taking any position in the stocks mentioned.)