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Need for speed as market looks beyond earnings

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With no major surprises in the earnings trajectory, fund managers and market experts feel non-earnings events will continue to drive the market in the interim, even as economic and earnings recovery projections are being pushed back to the second half or later.
Monsoons: Monsoon is critical for the country and, therefore, for investor sentiment. “A shortfall in rains has a bearing on inflation, rural income and sentiments. Rural income growth, in particular, has been sluggish in recent times and this has hurt demand for companies/sectors that have a consumption focus,” said Nitasha Shankar, vice-president of research at YES Securities. While sowing of crops has reached record level this kharif season, drought in some parts of the country and floods in other parts have led to crop damage. “By the time the impact of the crop loss is felt on prices, the base effect would have dissipated, leading to a potential surge in food inflation,” warned Kunal Kundu, vice-president and India chief economist, Societe Generale.
Rate cuts: SAMCO Securities CEO Jimeet Modi said one of the biggest non-earnings events that can trigger an outperformance in Indian stocks is lower interest rates. “This could propel demand,” he said. This view is shared by Jaspreet Singh Arora, senior vice-president, Systematix. The distinct downturn in both retail and headline inflation and soft inflationary scenario makes a strong case for the Reserve Bank of India to resume its accommodative policy stance and reduce interest rates even before the next money policy review. Wholesale price index has slipped to -4.05 per cent for July. This comes shortly after government data showed retail inflation, measured by the consumer price index, touched a multi-year low of 3.78 per cent in July.
Reforms: Legislative and executive actions taken by the government and progress of macroeconomic data are some of the important triggers that drive stocks. Investors are aware that actions taken by the government may take time to get reflected in earnings. “But positive developments (on these fronts) will increase their confidence on future growth potential of the Indian economy and this can lead to a PE re-rating of the Indian market,” said Hemant Kanawala, head of equity at Kotak Mahindra Old Mutual Life Insurance. Legislative actions like GST and land acquisition bill will improve productivity in the economy, while executive actions like direct benefit transfer (DBT) and auction of coal blocks can improve effectiveness of government spending as well as revenue collection, averred Kanawala, who oversees a portfolio worth $1 billion.
Naturally, any loss of pace in reforms will be negative for the market. “The government’s strength is not likely to improve by the next Parliament session, hence it is unlikely to provide any immediate traction to reforms unless the opposition is convinced to consensus,” says Vinod Nair, head of fundamental research, Geojit BNP Paribas.
But given the measures initiated by the government, things do not look that bad. Sunil Singhania, chief investment officer (equity) at Reliance Mutual Fund, said: “We are quite optimistic about the prospects of our economic growth, and therefore, the market. The government has initiated a lot of reforms in the recent past and is envisaging large investments in areas like roads, telecom, railways, and technology.”
Along with improvement in the macro variables — inflation below 4 per cent now, fiscal deficit under control, current account deficit decisively reduced and forex reserves at a

healthy $350 billion plus —steps taken by the government will result in economic growth and better market returns," said Singhania.
Bihar polls: Any negative surprise like the election of a Nitish Kumar-led government will trigger a serious correction in the market and erode the market's confidence in the government.
"This would be an indication that the government is unable to hold on to its gains and that the Delhi election drubbing was not a one-off," said Modi of SAMCO Securities. At this juncture, it is difficult to presage the outcome as the odds are evenly placed.
"Greater clarity is expected to emerge only after August, when the crucial seat sharing with the allies on either side is decided. Experts we met believe the 'Modi factor' still resonates with the youth and there are some crucial factors that can balance out BJP's handicap of upper caste bastion. Together, the JDU and RJD are a formidable force," said Dhananjay Sinha, head of institutional research, Emkay Global Financial Services.
US rate hike: Though the timing of this may be a question mark, globally there is consensus that the Fed will hike rates and the cost of capital will go up. In such a scenario, emerging markets like India will see some rebalancing and outflows, which could lead to a correction, albeit that might be a buying opportunity for long-term investors.
"However, RBI has built enough forex reserves that should cushion the impact on the rupee," felt Shankar of YES Securities. "The recent FOMC meet concluded with no clear indication for the near future. Fed indicated that the economy and job market continued to strengthen but there is no spike in inflation. Rate is likely to rise after 'some further' job market improvement," said Nair of Geojit BNP Paribas.
China trouble: Vikas Gupta, executive vice-president and fund manager, Arthveda Fund Management, hits the nail in the head when he says it will be acknowledged publicly more and more that the Chinese economy is facing significant difficulties going forward.
"Outflows from Chinese stock market will also impact Indian stock market in the near term, because emerging market funds would face redemption when the Chinese market drops, since they are the largest component of emerging market funds. Redemption would trigger selloffs in all emerging markets, when China drops. Eventually, India funds might get back the allocations separately and, hence, India would stabilise, while China could continue to face redemption pressures," Gupta added.
A lower yuan is a problem since imports from China are likely to rise and put pressure on domestic producers.
Investor strategy: Experts advice investors to look at sectors like discretionary consumption, cement and banking, which will benefit from the economic recovery. Also, they can look for opportunities in areas that will benefit from the executive actions taken by the government.
In this phase of consolidation, investors should avoid financially-leveraged companies, as they can be adversely impacted if there is a delay in economic recovery. "It is important to focus on the financials and management capability of a company to assess the longevity of one's investments," said Amit Nigam, head of equities at Peerless Funds Management.
Most experts agree this quarter is likely to be a volatile period for investors, but India is likely to continue is outperformance over MSCI-EM index. Interest will be more in defensive sectors like IT, pharma and FMCG. Interest is also likely in PSU oil firms due to the continued fall in crude prices as well as subsidies.

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