

Pessimistic markets, low P/E's

An opportunity for the long term investor

Indian Economy - The Big Picture

Key parameters	Past	Present	Future?
	FY 2001	FY 2011	FY 2020E
GDP (US\$ bn)	451	1727	6655
Global Ranking / (% of global GDP)	13 / (1.1)	9 / (2.9)	5 / (6.9)
Per capita GDP (PC GDP) in \$	445	1477	5017
Exports (US\$bn)	44.6	250	815
% of World Exports	0.70%	1.60%	3.40%
% of World Exports for China	4.2%	9.5%	14%
Mobile connections in Million	3.6	811	2031
Mobile Teledensity	0.40%	68%	135%
Price per minute of Airtime in Rs	5.18	0.43	0.37
2 Wheeler unit sales in Million	3.6	11.8	24.8
% Penetration per household	20%	35%	70%
Price per unit (Splendour) (\$)	800	1023	1500
2 Wheeler price to PC GDP	1.80	0.69	0.30
Car unit Sales in Million	0.6	2.5	7.2
% Penetration per household	3%	7%	20%
Price per unit (Alto) (\$)	7000	6250	8000
Car price to PC GDP	15.7	4.2	1.6

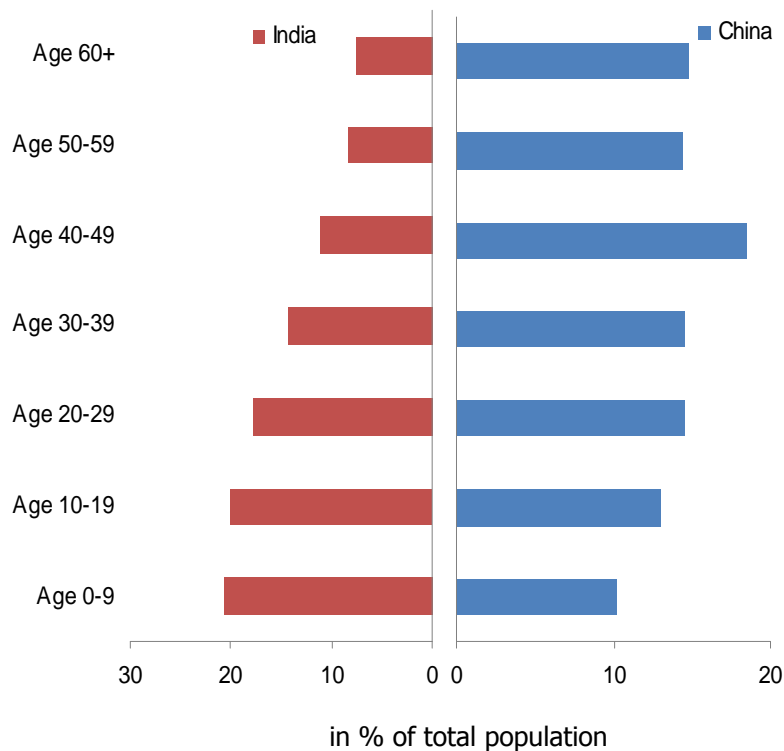
India should emerge as the 5th largest economy by 2020

Increasing affordability, low penetration of consumer goods, increasing credit, favourable demographics & increasing export competitiveness point to sustained economic growth ahead...

Source: BofA Merrill Lynch

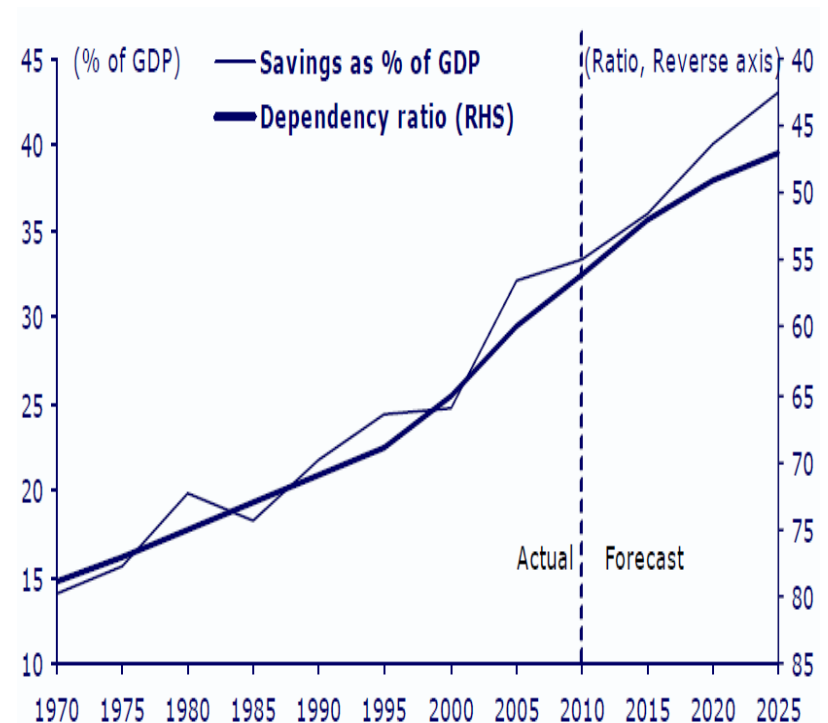
Indian Economy - Attractive demographics, turning better

India and China – Population Structure 2010



India has a very young population; a large number should move into working age in next 10 years

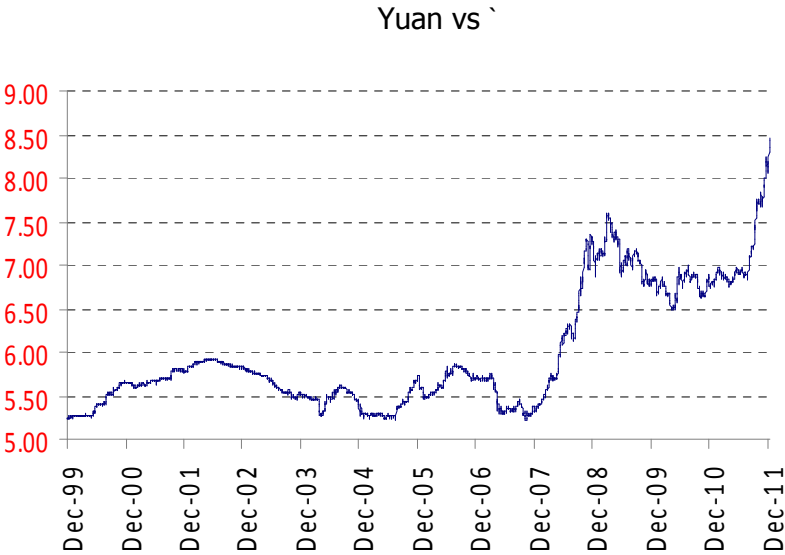
India's dependency ratio should continue to fall and savings rate should continue to rise, facilitating higher investments



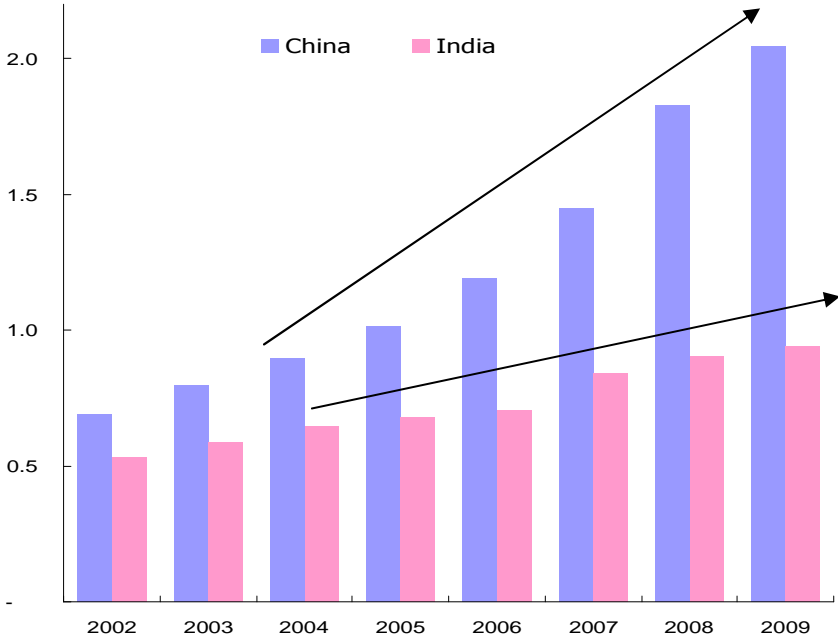
Source: CLSA research
 Dependency ratio is defined as proportion of population above 60 years divided by working population (aged between 19-59 yrs)

Indian Economy - Increasing export competitiveness

Indian currency has depreciated against Yuan by ~50% in last 5 years



Wage inflation in China is higher than in India



This is a big opportunity as China is 9.5% & India is 1.6% of global exports

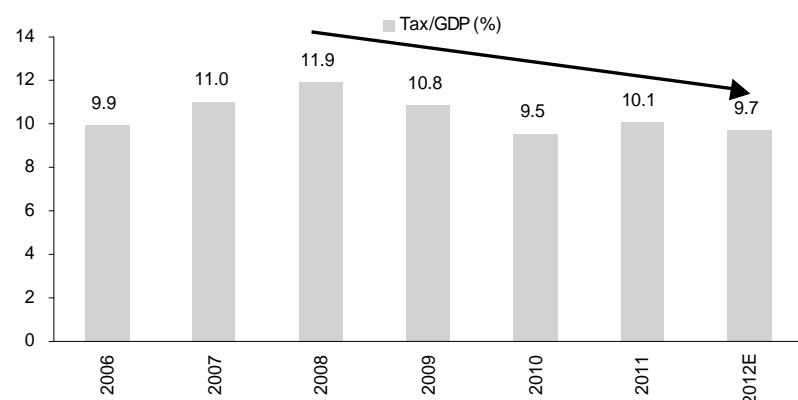
Hourly wages in USD

Source: Bloomberg

Source: US Bureau of Labour Statistics and Citi Investment Research and Analysis

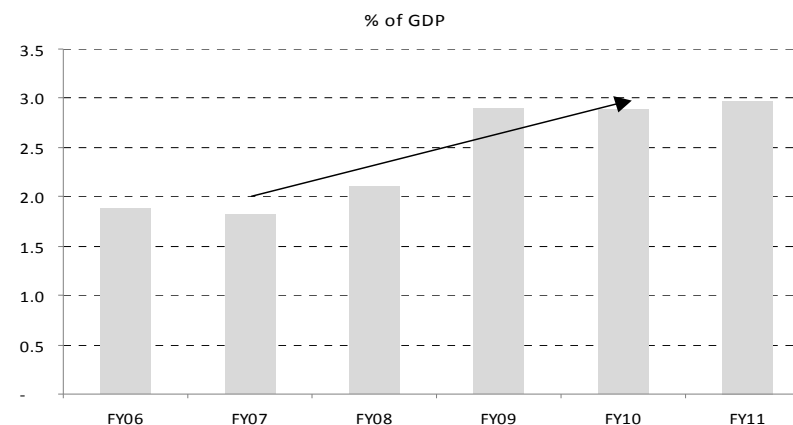
Indian Economy - Key pressure point is the fiscal deficit

India's tax-to-GDP ratio (based on Central taxes) has fallen by ~ 2% of GDP in the last few years



Source: CEIC, Kotak Institutional Equities

Rising Central Govt. expenditure on social services & rural development



Source: Anand Rathi

- Over last few years lower taxes and rising social expenditure / subsidies have increased fiscal deficit; consequently interest rates have gone up, impacting capital spending and slowing the economy
- This can be corrected by rolling back tax cuts and reducing subsidies; lower interest rates and higher capital spending by private sector should quickly follow, improving economic growth
- Fiscal deficit is the key issue to be watched out for in the coming budget

Indian GDP vs. World GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E
US	4.1	1.1	1.8	2.5	3.6	3.1	2.7	1.9	0.0	-2.6	3.0	1.6
Europe	3.9	1.9	0.9	0.8	2.2	1.7	3.1	2.9	0.4	-4.1	1.7	1.6
India	4.4	5.8	3.8	8.5	7.5	9.5	9.6	9.3	6.8	8.0	8.5	7.5
World	4.8	2.3	2.9	3.6	4.9	4.6	5.2	5.4	2.9	-0.5	5.1	3.9

- As can be seen from table above, there is low correlation between Indian and World GDP growth; impact of European crisis / slowdown in West should have marginal impact on India
- A majority of the issues facing the Indian economy are internal

Source: IMF, BofA Merrill Lynch Global Research estimates.

Challenging environment should lead to change

- Change is slow and difficult in a democracy ruled by a coalition government
- Every crisis has in the past resulted in change
 - Opening of economy in 1992, triggered by BOP crisis
 - Increase in diesel prices, led by unsustainably high subsidy burden
 - Improving internal security set up, driven by repeated terrorist attacks
- Current challenging environment should lead to changes for better
 - Transparency in land acquisition policy
 - Competitive bidding for natural resources
 - Reforms in power distribution, due to high SEB losses
 - Lokpal and other related bills to tackle corruption
 - High subsidy burden / fiscal deficit should lead to changes in subsidies and taxation

Equity Markets Review

- Markets are down ~ 25% from January 2008
This represents a large price correction and a long time correction of 4 years
- Markets have been impacted by
 - High fiscal deficits / high interest rates
 - European crisis
 - Signs of moderating economic growth
 - Corruption cases / slow pace of reforms
- Weak FII flows
- P/E's based on March 2013 earnings are ~12x.
This is ~25% below long term averages*
- Markets seem to be discounting most negatives

*Source: CLSA

Low P/E's – An opportunity for the long term investor

Past experience shows that investments made in times of low P/E's have provided good opportunities to long term investors as illustrated below

Time *	BSE Sensex Level	1 year forward P/E	Main news / reasons	Total Return of Sensex after 3 years #	Total Return of Sensex after 5 years #
Oct-01	2989	11	Terrorist attack on twin towers	91%	334%
Apr-03	2960	9	Slowdown in economy	306%	484%
Jun-06	10609	14	Govt. decides to review DTAA with Mauritius	37%	78%
Nov-08	9093	11	Sub-prime crisis - Lehman collapse	77%	N.A.
Dec-11	15455	12	US downgrade, European Crisis, slowdown in our economy	?	?

Source: Bloomberg, CLSA

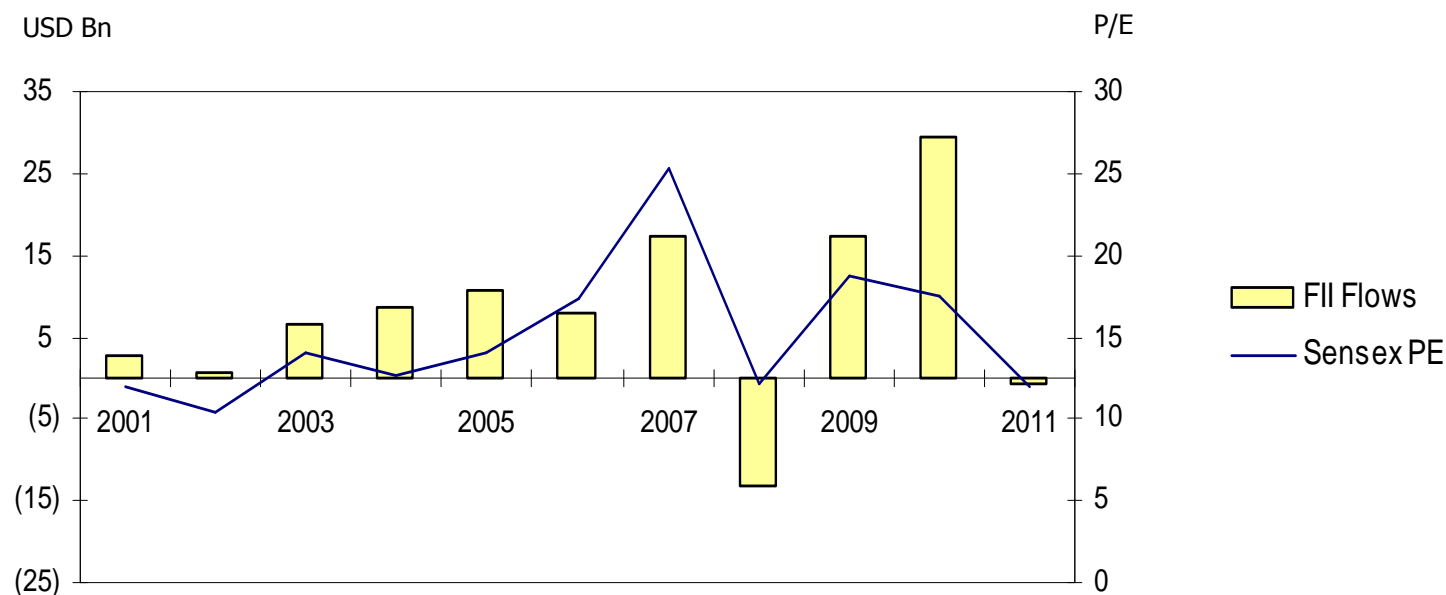
Dividends not accounted for * For reasons of simplicity and objectivity, index level is taken as on the next month end after the crisis / lowest closing index based on month end in that period.
 N.A.= Not Applicable. **Past Performance of the Sensex may or may not be sustained in future.**
 The above table is for illustration purposes only and should not be construed as an investment advice. It does not in any manner imply or suggest current or future performance of any HDFC Mutual Fund Scheme(s).

Significant room for P/E expansion



P/E's are significantly lower than long term averages; thus there is room for P/E's to increase over time

FII Flows to Equity Markets



- FII's have been regular buyers in India except in times of global crisis / uncertainty
- Market corrections and low P/E's at such times have provided good investment opportunities for the long term investor

Better environment for P/E's going forward ?

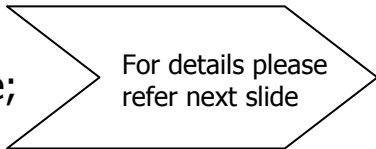
- There appears to be a sense of urgency amongst policy makers to take steps that are conducive to growth
 - Government has realized that high fiscal deficit is now hurting growth; forthcoming budget is the one to be watched out for
 - Currently, bond yields and earnings yields are nearly the same; this points to under-valuation of equities, as equities offer growth unlike bonds
 - Further, CY12 inflation and bond yields should be lower than CY 11; this is also supportive of higher P/E's
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Outlook for equities

- Good investments are typically made in challenging times and seldom in good times
- 1 year forward P/E's have corrected from $\sim 25X$ to $\sim 12X$, between January 2008 till date; these are significantly lower than long term averages
- In a year's time, 1 year forward P/E of Sensex at current levels, should be $\sim 11X$. P/E's in India, even in crisis situations have not fallen below 10 – 11x
- An 8.50% yield on 10 year G-sec's corresponds to a P/E of $\sim 12x$. In 1 year, P/E's of equities should be lower than bond P/E's at current index levels. This points to under-valuation of equities vis-à-vis bonds
- In view of the above, risk reward appears favourable over 1 year and longer periods

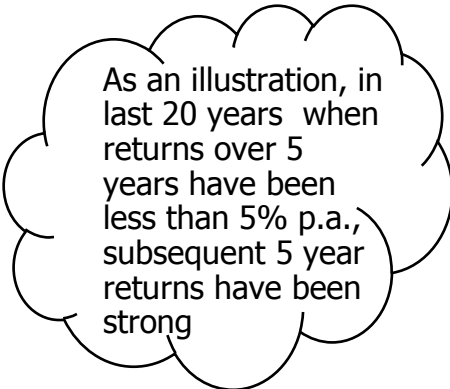
How to earn more from equities ?

- Equity prices and returns are volatile over short to medium periods
- In the long run, however, returns from equities are surprisingly predictable;
Equity returns = Earnings growth + dividends
- Whenever past returns from equities are less than earnings growth, future returns should be more and vice-versa



For details please refer next slide

Period ending March 31	Rolling 5 year returns of Sensex (%p.a.)	Rolling returns over next 5 years of Sensex (% p.a.)
1992 - 1997*	-5%	1%
1994 - 1999	0%	8%
1996 - 2001	1%	26%
1997 - 2002	1%	30%
1998 - 2003	-5%	39%
2000 - 2005	5%	22%
2007 - 2012	3%	?



As an illustration, in last 20 years when returns over 5 years have been less than 5% p.a., subsequent 5 year returns have been strong

- Given the low returns of last 5 years and the low P/E multiples, returns over next 5 years should be a combination of earning growth & P/E expansion

* In 1992, P/E's were ~ over 40 times and inspite of -ve 5 year returns, P/E's in 1997 were still around 25 times. Currently P/E's are 12 times based on one year forward (March 2013) earnings

Past Performance of the Sensex may or may not be sustained in future. The above table is for illustration purposes only and should not be construed as an investment advice. It does not in any manner imply or suggest current or future performance of any HDFC Mutual Fund Scheme(s).

Sensex Rolling Returns

Short term returns in equities are volatile; hence equity investments should be made with a long term horizon

Sensex /Equities are a great compounding machine
Rs. 100 = Rs. 16,000 over 32 years

No.	Year ending March	BSE Sensex on 3/03/XX	Rolling 1 year returns	Rolling 5 year returns	Rolling 10 year returns	Rolling 15 year returns
0	Mar-79	100				
1	Mar-80	129	29%			
2	Mar-81	173	35%			
3	Mar-82	218	26%			
4	Mar-83	212	-3%			
5	Mar-84	245	16%	20%		
6	Mar-85	354	44%	22%		
7	Mar-86	574	62%	27%		
8	Mar-87	510	-11%	19%		
9	Mar-88	398	-22%	13%		
10	Mar-89	714	79%	24%	22%	
11	Mar-90	781	9%	17%	20%	
12	Mar-91	1168	50%	15%	21%	
13	Mar-92	4285	267%	53%	35%	
14	Mar-93	2281	-47%	42%	27%	
15	Mar-94	3779	66%	40%	31%	27%
16	Mar-95	3261	-14%	33%	25%	24%
17	Mar-96	3367	3%	24%	19%	22%
18	Mar-97	3361	0%	-5%	21%	20%
19	Mar-98	3893	16%	11%	26%	21%
20	Mar-99	3740	-4%	0%	18%	20%
21	Mar-00	5001	34%	9%	20%	19%
22	Mar-01	3604	-28%	1%	12%	13%
23	Mar-02	3469	-4%	1%	-2%	14%
24	Mar-03	3049	-12%	-5%	3%	15%
25	Mar-04	5591	83%	8%	4%	15%
26	Mar-05	6493	16%	5%	7%	15%
27	Mar-06	11280	74%	26%	13%	16%
28	Mar-07	13072	16%	30%	15%	8%
29	Mar-08	15644	20%	39%	15%	14%
30	Mar-09	9709	-38%	12%	10%	6%
31	Mar-10	17528	81%	22%	13%	12%
32	Mar-11	19445	11%	12%	18%	12%
33	Mar-12*	15455	-21%	3%	16%	11%
Probability of loss			12/33	3/29	1/24	0/19

Long term returns are *less* volatile; risk in equities *reduces* as holding period increases

As holding period increases, chances of loss reduces

Past Performance of the SENSEX may or may not be sustained in the future. * Assume Index at current level (Dec 30, 2011) for Mar-12 for illustrative purpose. Returns for periods more than 1 year are shown on a compounded annualised basis. **Note:** The base year of SENSEX is 1978-79 and the base value is 100. Please visit www.bseindia.com for the SENSEX calculation methodology

Why is it a good time to start / increase SIPs ?

- Index has given low returns over the last 5 years (2.31% CAGR* for BSE Sensex)
- P/E's have thus corrected significantly and are currently at ~12X based on March 2013 earnings versus the long term average P/E of ~17X **
- Future returns should thus be both from earnings growth and increase in PE's
- Equities are a unique asset :
In a growing economy, generally, the lower the past returns than earnings growth, the higher should be the future returns and vice versa
- In view of the above, we recommend continuing / enhancing / starting SIPs as a prudent strategy for equity investments

* As on Dec 30, 2011

** Source: CLSA

Summary

- Indian economy is a long term growth economy and is likely to be the 5th largest in the world by 2020
- The current challenges facing us are mostly internal and the economy should do well again, when these are overcome
- Low P/E's of today represent an opportunity for the long term investor
- Good investments are made in bad times and seldom in good times
- Key risks are spike in oil prices and lack of serious effort to curtail fiscal deficit
- Allocation to equities should be increased in a phased manner with a medium to long term view

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Thank you

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Season's Greetings for 2012

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