FUNDAMENTAL VIEW

'Volatility is the new normal'

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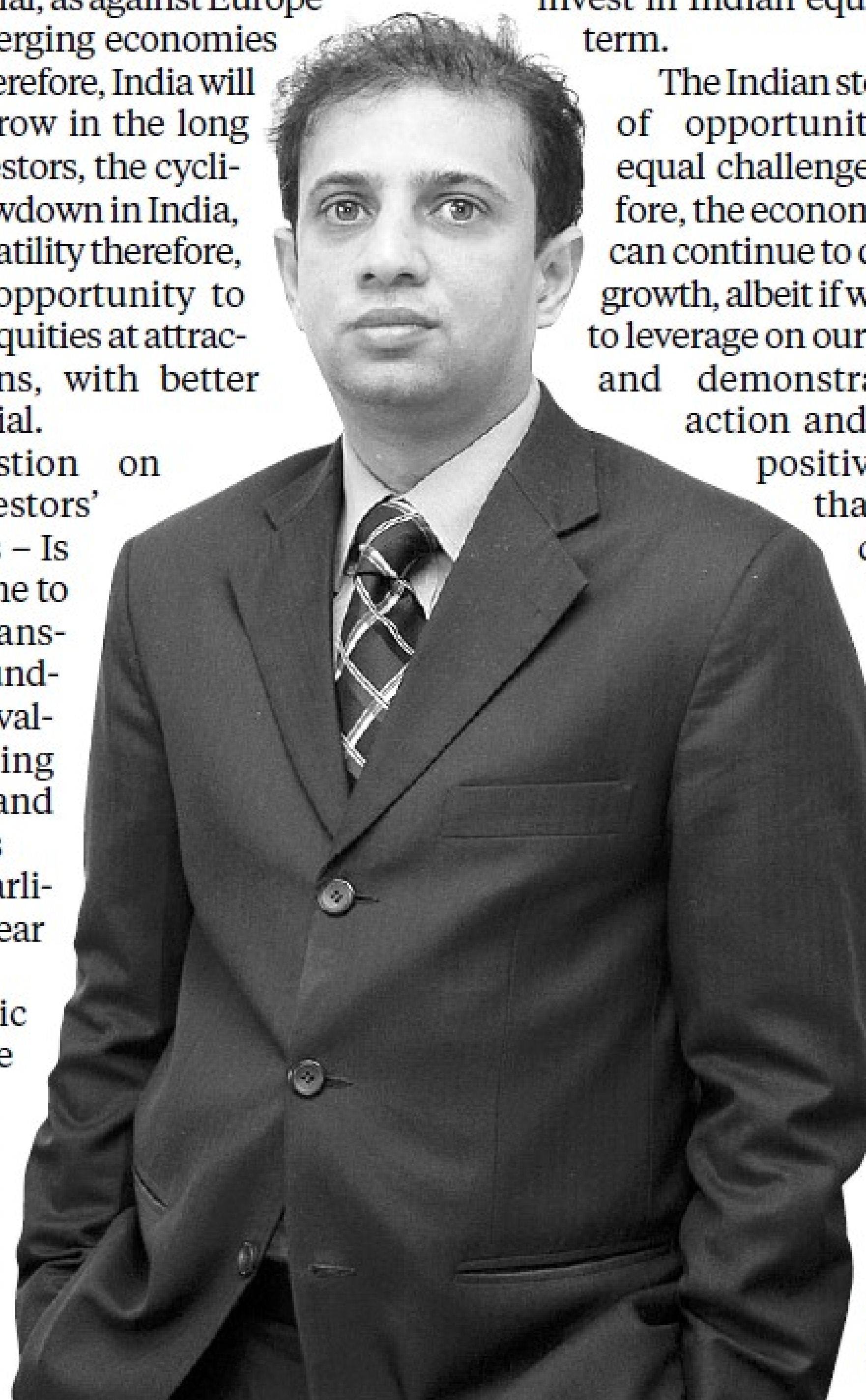
The Indian equity markets today represent a dichotomy where valuations are attractive and fundamentals, while improving, are still awaiting cues from policy reforms. Also, markets across the world and in India have been volatile in the past few years. A number of global and domestic factors have caused this volatility. While global factors, like the Euro zone debt crisis, and domestic concerns like the rupee depreciation have been key triggers, the most significant concern has been the high fiscal and current account deficits. We believe markets will continue to be volatile and be driven by flows from foreign institutional investors (FIIs) and oil prices, or domestic triggers, such as reduction in subsidies, monsoon, etc. This multiplicity of variables is contributing to increased volatility. Volatility has become the new normal.

The current cyclical growth downturn has been triggered due to a lack of structural reforms, policy inertia and corruption scandals that have hurt confidence and adversely impacted markets. The slowdown however, can be reversed by undertaking appropriate reforms, particularly in the energy sector. Constructive policy action by the government on reforms like a diesel price hike, lower interest rates to kick-start the investment cycle and rising savings rate for investment-led growth can provide the necessary impetus for the economy to trigger the growth cycle. The twin deficits also need an immediate and sustainable resolution. A much greater share of the financing of the current account deficit has to be long-term in nature and less reliant on risk-driven global capital inflows. This will have important implications for the pace of sustainable growth and exchange rate policy of India.

While there are challenges, positive cues continue to provide optimism. Most important, India is a structural growth story with favourable demographics, strong domestic consumption and strong balance sheets across banks and corporates. As the economy is not leveraged, there is no risk of credit bubble to impair the long-term growth potential, as against Europe and other emerging economies like China. Therefore, India will continue to grow in the long term. For investors, the cyclical growth slowdown in India, marked by volatility therefore, presents an opportunity to enter Indian equities at attractive valuations, with better upside potential.



The question on every investors' mind today is – Is it the right time to invest? The answer is a resounding yes. With valuations being reasonable and fundamentals better than earlier, there is a clear opportunity. Also, domestic investors have been completely underweight on equities in the last four years. The macro-economic indicators have weakened investors' confidence. It is however, imperative to note that every fall in the markets is followed by a recovery. While the past is no guarantee of the future, the years gone by have proved that investments made during crisis, specifically those triggered by global concerns, have the potential to provide superior risk-adjusted returns. Investors should therefore, seize this opportunity to invest in Indian equities for the long term.

The Indian story is that of opportunities and equal challenges. Therefore, the economy in 2012 can continue to deliver on growth, albeit if we are able to leverage on our positives and demonstrate affirmative action and execution. The positive is in the fact that home grown challenges are within India's control and historically India has tended to reform systematically, following periods of growth slowdown. Finally, the turning of the tide will depend on affirmative action and execution.

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