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**Vijay L Bhambwani**

**Tel –**

91-0-9323720291

**E-mail –**

vijay@Bsplindia.com

**Url** –

www.Bsplindia.com

**Snail mail –**

**Bhambwani Securities (P) Ltd**

5 Kala Niketan
47-C Warden Road
(Breach Candy)
Mumbai 400 026
India

# State of the markets - XXXIII

In the previous edition of the SOTM (dtd Oct 28 2011), we had expressed concerns on the depreciating INR, rising deficit, food security bill and Eurozone problems. We expressed our opinion on Libya as being unable to ease Crude Oil prices lower as it barely provided 2 % of global requirements. In the technicals segment, we advocated a weak outlook for the Nifty as the benchmark was trading in a bearish channel. All these concerns have been vindicated by the markets. Click on the hyperlink to view that file – http://bsplindia.com/files/archives/oct11/somxxxii.pdf.

We take a broadside view of the factors that can impact the near / medium term sentiments of the markets as the calendar year 2011 draws to an end –

## INR / US $ peg

The RBI Guv was acting along expected lines when he refused to cut CRR / interest rates on Friday, Dec 16 2011. The specter of the Indian central bank pledging it's physical gold to the Bretton Woods institutions in the early 1990's haunts every succeeding RBI Guv. So do memories of the Asian currency crisis of 1997, which did not hit Indian shores thanks to a vigilant RBI and a non-convertible INR. India has ~ 300 Bn $ external debt, of which ~ 22% is short term in tenure. The RBI is keen and / or concerned about repaying the short term debts without having to strip / pledge assets. In order to attract NRI $ deposits, we feel the RBI may keep rates high even at the expense of blunting domestic industrial growth in the near term. That the GOI 10 year bond yields have softened from 9.1 % to 8.55 % reflect USD inflows which will buffer the INR partially, over time, from any outflows. Stock markets however, do not like higher interest rates as corporate profits compress, we feel it's a short term worry and the markets may come to terms with it. We feel the RBI may ease monetary reins in the first calendar quarter of 2012 – barring fresh negative events unfolding.

## Inflation

We have been concerned on this issue since 2007 and have advocated investing in alternate asset classes to protect your capital from this problem. While the food inflation is seemingly coming down as per statistics, the relief is likely to be temporary as the winter season results in slower decay in perishables and therefore a longer shelf life. Refrigeration costs come down and food prices ease cyclically. What will be crucial to watch is whether prices stay down when summer sets in. We feel high food prices are here to stay. Barring cyclical and periodic regulatory measures which may see temporary easing, the long term trajectory is upwards. The FAO (food and agricultural organisation) and IFPRI (international food policy research institute) reports are available in the public domain that we draw inferences from. My meeting with the country head of IFPRI, Mr Ashok Gulati at the food ministry, and agri economists at New Delhi re-inforce my belief that our anti-inflationary investment blue print remains on track. The food security bill is likely to be tabled on Dec 19 2011 in the parliament again, maybe even passed as law before the winter session of parliament ends soon.

The bill has inflationary impact and will drive up food inflation over time. Since there is a trickle down effect, providing grains to the poor will see associated items getting dearer – cooking oils, vegetables, pulses, milk and fruits will see firmer prices. Food and water remain our favoured investment avenues.

### Commodities angle

Commodities are raw materials for companies listed on the exchanges. Ignoring inter-market analysis of Fx, Commodities, Bonds and Equities is a road to financial ruin. So we invariably feature the commodities angle in our equations. We feel the industrial metals are unlikely to test previous lofty levels anytime soon as the consumption patterns may compress in the near / medium term. While the fiat currency gyrations may impact prices, the overall outlook remains that of consolidation and some downward bias. The most critical input cost will be energy and Crude Oil remains in the higher end of the 12 month period. A substantial decline will be needed in oil to boost equities – which maybe elusive for now. Winter demand coupled with the Iran stand-off threatens to keep oil prices firm. The coming 3 – 4 months will see refining capacity compression as annual maintenance shutdowns commence in Asia. Bullion though off from it's lofty peaks, still remains a net gainer and will provide a place to hide as the ultimate store of value for the long term, with capital appreciation potential thrown in for a good measure. We favour Silver compared to Gold as the return on investment over time is likely to be higher in the white metal. As advocated in the previous edition in Oct 2011, we feel buying Gold at current levels is aggressive and risky as the possibility of some profit sales do exist. Await dips before buying afresh. Await notification on the same.

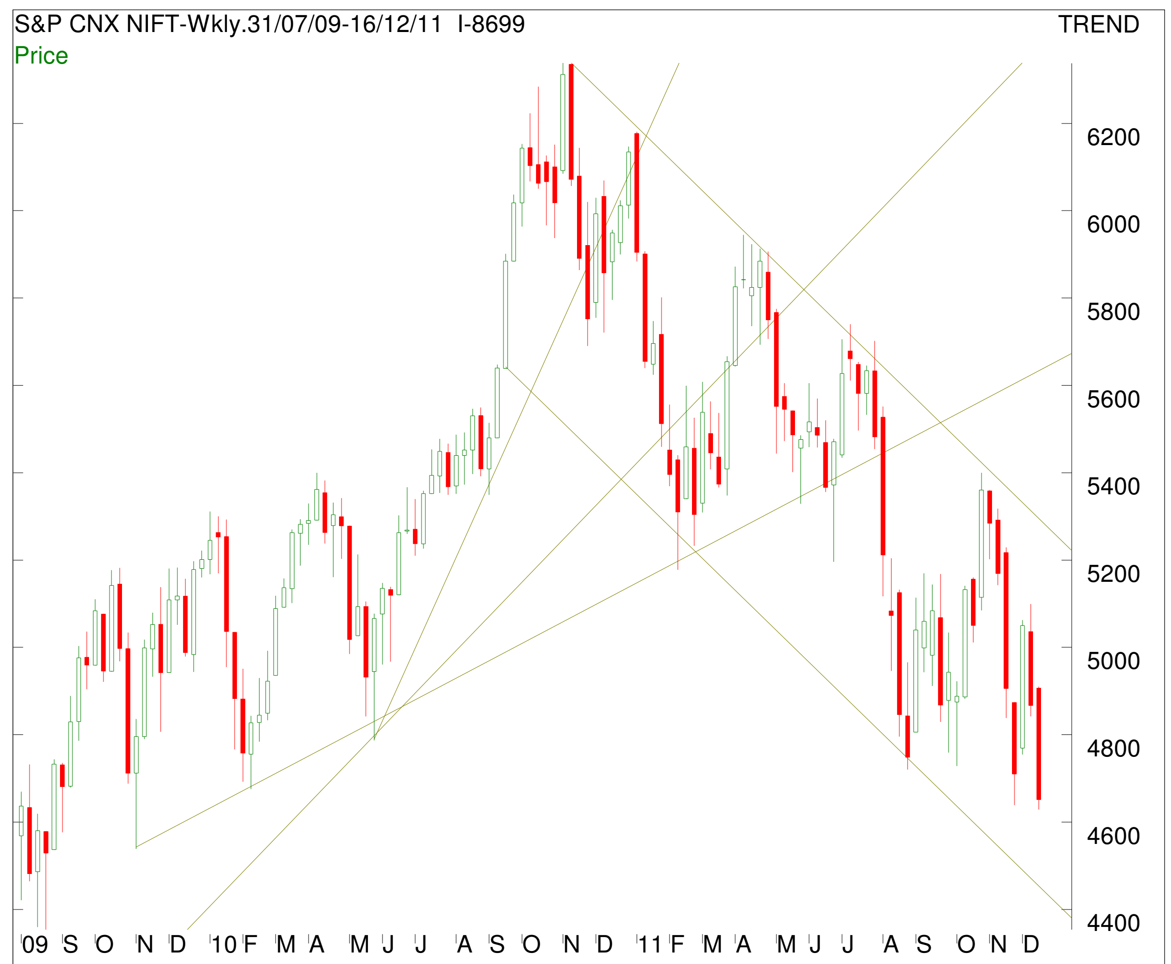
### Immediate triggers

The markets are seeking direction from the establishment in terms of the food security bill, interest rates, FDI in retail and the mother of all policy decisions – the budget. We feel the coming budget will be one of the most important after independence as the deficit figures will have climbed above expectations and management of these numbers will be a key to market sentiments. Going by the decisions to allow raising additional debt by oil marketing cos, raising the PPF limit to Rs 1 lac and freeing savings accounts interest rates, not to mention the PPF interest rates are signs of stress. The market players who know their onions want positive news on the deficit management front, stable currency and falling core inflation. Unless some of these events transpire, we feel the potential for upthrusts will be calibrated. If the loan waiver to weavers is anything to go by, we feel the establishment has eyes on the upcoming elections in Uttar Pradesh as a priority and may opt to tackle the economic issues thereafter. Issues like the decontrol of urea, nutrient based subsidy and under recoveries of the oil marketing cos that need urgent and immediate attention. Should the Kirit Parikh recommendations be accepted even partially, we feel the markets would react by rallying as subsidy burdens on listed entities would ease. In terms of timelines, we feel the markets will probably see a limited rally by year end as NAV management occurs as a matter of routine. Come January and FII allocation announcements should start trickling in. In the run up to the budget, the markets maybe most vulnerable in terms of trend determination.

### What to expect

A challenging year ahead, may just turn out to be <u>above average</u> provided the investor diversifies into commodities, fx and fixed income rather than a standalone equities route.

**Technicals** we look back in satisfaction at the Nifty's performance since the last SOTM edition on Oct 28 2011 (5360 levels) which is down ~ 15 % since we advocated levels of 4200 – 4300 levels as a possibility. Having tested the 4628 levels, we feel, the target maybe somewhat tested within a 3 % variation from the advocated levels. The Nifty remains constrained within a falling channel and the fall spans in to the 13 th month. Time wise, the coming 8 – 10 weeks will be crucial to watch as per chartical studies and happens to coincide with the budget in 2012. Investors should stick to sectors advocated in the last edition – food, water and related industries, bullion and edible oils. As advocated in the last edition, buying gold now at current prices would be adventurous, await declines. In terms of strategy on the Nifty, we feel sticking to the ETF route would make more sense as the futures segment would entail mark-to-market payouts and usual premium / discount to spot swings. Buying should be deliberately slow and measured.




Vijay L Bhambwani
Vijay@BSPLindia.com

The author of this piece is the author of "A Traders Guide to Indian Commodity Markets" – India's first commodity trading manual.