The Professional Ticker Reader ®

Your accurate, authentic and affordable guide to profitable trading

March 25, 2012

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
Mumbai 400 026
India

State of the Markets - XXXIV

In the last SOTM edition (xxxiii) dtd Dec 18 2011, we had advocated an end of the decline even if the Nifty did not test the 4300 levels advocated in the prior SOTM dtd Oct 2011 but came within 3 – 4 % of that level. The Nifty indeed bounced from the 4531 levels, prophetically, from the very next day – Dec 20 2011 itself. Click here to view the SOTM xxxiii dtd Dec 18 2011, click here - http://www.bsplindia.com/files/archives/dec11/smxxxiii.pdf.

Currency cues

In the previous sotm edition we advocated a measured opening of the liquidity tap in the first calendar quarter of 2012 by the RBI and the Guv did not disappoint us, the CRR was cut by 75 bps. Under the circumstances, we feel a bigger largesse would have been too much to expect. We also advocated that with the onset of summer, food prices were likely to firm up as the heat causes higher supply chain losses and lower shelf life of perishables – which is happening along expected lines. Add to that the potential hike in fuel prices at the pump and you have a possibility of driving inflation noticeably higher. It is no surprise then that the INR has started weakening vis-à-vis the USD and threatens to exacerbate an already high "imported inflation" scenario. As the INR loses buying power vis-à-vis the global currency basket, imported commodities get costlier and trigger inflation. The increase in service tax and excise rates are also inflationary and the forex markets are already warning of a slowing in the upward momentum in the capital markets.

Inflation, employment & interest rates

We continue to remain hawkish on the inflation front as the calendar year 2012 can be called the year of elections – over 36 countries go to the polls this year, with the mother of all elections in the USA. Empirical evidence suggests elections are inflationary endeavors and are likely to be followed by rising commodity prices. Typically, economic data tends to get rosier ahead of elections and a "feel-good-factor" is seen in the markets. We feel the test of the economic data will be in calendar 2013 after the elections are done and over with.

Over the last two decades, India has shifted focus from creating manufacturing competencies to a service sector economy and therefore, consumer spending capabilities are increasingly entwined with employment rates. We feel the worries we expressed over the last three quarters over pay / job cuts are still present as the following hyperlink is a case in point - http://www.dnaindia.com/academy/report_45pct-mbas-engineers-from-class-of-2011-jobless_1665171. The FM touched upon the dwindling share of manufacturing activity in the component of total GDP and advocated that the same be raised to 25% in the coming 5 year plan. Till that happens, keep monitoring employment figures for signs of compression in consumer spending, and even thereafter. The combination of inflation and pay / job cuts are a serious threat to the India growth story, and need watching. The national food security bill (NFSB) has been deferred to the end of the year and we have been advocating the same to be inflation inducing.

The end result of the FSB exercise can only be a rise in food prices over the years and a shift towards an entitlement economy that will lead to inefficiencies. If the cues provided by edible oils complex are any indication, food prices are likely to climb higher over the years, to the detriment of the financial market sentiments.
The same has been discounted in advance by the forex markets, which are the most sensitive indicator of the economic health of the Nation.

The commodities angle

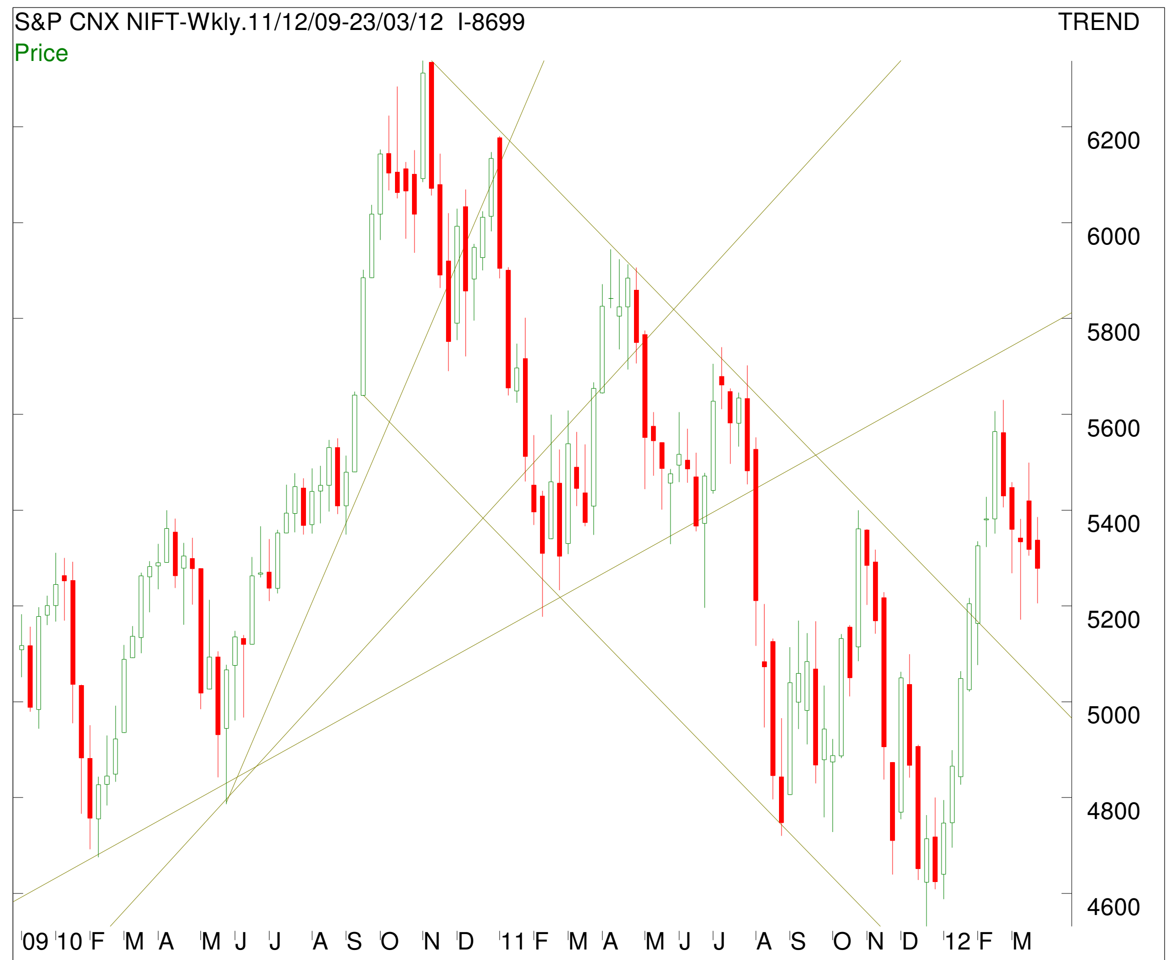
Investments in India are invariably subject to a “tunnel vision” methodology as the average investor thinks of equity markets as the only and / or final destination of investments. The co-relation of forex, debt, commodities and equity markets is largely ignored. The fact that equity markets are the smallest (in turnover terms) worldwide makes this approach to equity investments similar to putting the cart in front of the horse. Commodities constitute raw material costs for the listed companies and therefore must be put ahead of the equity markets in order to draw up an investment blue print.

In the last sotm edition we advocated that the base metals / industrial commodities were unlikely to test their all time highs anytime soon, which was vindicated by the markets. Energy prices continued to spook the markets as the Iran imbroglio kept crude prices simmering on the upper end of the 52 week band. While natural gas is easing towards the opposite end of the annual range, any potential oil shock can put equity market rallies behind by upto two quarters if a sell-off ensues. The expected economic recovery in the Euro zone coupled with improved industrial outlook in the USA is keeping industrial commodities’ prices firm and even managing to offset the weak data from China – Asia’s most influential nation and the world’s largest consumer of many commodities. With the debasing of fiat currencies, we feel hard assets are likely to appreciate in value and demand contraction may not necessarily cause a price crash immediately in base metals as investors place their trust in real assets vis-à-vis paper assets. As a worst case scenario, traders can expect a 10-15 % dip in prices if there is concerted unwinding. Historically, the onset of summer has seen a rally in industrial metals as the thawing of snow leads to higher factory output in the northern hemisphere. Typically, this period also witnesses some outage in global refining capacities as plants in Asia shut down for annual maintenance work. We feel higher commodity prices will weigh on equity markets, though sentiments may see the impact of such asset price inflation being muted by FII inflows and other factors.

Immediate triggers

The Union budget has come and gone, without much ado in the equity markets. The proposal to rope in retail investors by way of tax breaks in case of direct equity investments will in all probability add to the relatively high volatility in the Indian equity markets. Like the proposal to invite direct foreign retail investor participation in the Indian equity markets in last years budget, we feel the impact of this years proposal is likely to be muted as long as inflation remains high and savings rate compress. The markets are buoyant in no small measure due to the end of the financial year and the usual NAV boosting exercise by the mutual fund industry. The Indian meteorological department is already expressing some concerns over the coming monsoon which can add to the froth in the sentiments. Overall, the biggest trend determinant will remain overseas inflows and the markets may continue to ignore other logical triggers as long as money keeps pouring in.

Technicals – the Nifty remains above the falling channel top (currently at the 5000 mark) and is undergoing a corrective decline. The decline would be a routine correction as long as the bulls manage to defend the 4900 – 5000 band which is also a Fibonacci retracement support area of the recent rally. For the markets to get back into bullish mode, the Nifty must trade above the 5700 levels sustainably. We feel the concerns listed above may weigh on the sentiments but liquidity will be the over riding factor. The immediate supports to watch will be the 5000 – 4800 band in case the bears return. The worst case scenario would be the 4500 mark (incase of external factors like Israel / Iran conflict). The immediate best case scenario would be the ~5800 levels. Take a fresh long call only after the bulls manage to overcome the 5700–5800 resistance area convincingly.



Your call of action - our view remains constant on the sectors to watch – food, water, farm productivity and select essential services. Stocks recommended in these sectors have been market outperformers and are likely to remain so. Our bias remains tilted towards hard assets as a desired alternate asset class to have in your portfolio. We favour Silver vis-à-vis Gold, though we feel both can decline temporarily due to positive economic data (election year) and USD strength. In the coming months cut back on leverage and focus on delivery based investments as the volatility risk perception is likely to rise. Stock specific recommendations follow in the Flavours edition/s.

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 and only commodity trading manual.