

'Current stock valuations warrant bullish, not bearish, stance'

Holding a contrarian view and backing it up with conviction and facts - that's Pathik Gandotra's forte. At a time when almost everyone is convinced that the stock market is on a downward spiral, the head of institutional equities at IDFC Securities sees definite signs of improvement, not only in the markets but on the macroeconomic front. From now on, he says, the markets will likely form higher tops and higher bottoms. And valuations remain juicy. Which is why, he discloses to Nitin Shrivastava, he has been advising his clients of late to increase beta (risk-buying propensity) in their portfolios. Excerpts from the interview:

What do you make of the sharp pullback in the markets in the last two weeks?

The rebound has happened because one of the fundamental views - that interest rates are bound to fall - has changed. It's very difficult to make a call when this (rate cuts) may happen. But certainly one year down the line, interest rates would be significantly lower than where they are today.

Because of this, there has been some amount of short-covering, particularly in banking stocks. Also, with relaxation in investment limits on government bonds, some FIs would have bought the same. And when this happens, banks - which are a logical proxy to government bonds as there is a high correlation between the two - also get positively impacted.

Apart from this, there are signs of hope from the government on the reforms front. The meeting the Prime Minister had with power producers would also have helped. There has been good news on the corporate front as well, with Reliance Industries announcing a share buyback, and earnings falling in place, as seen in a few results announced so far.

And finally, the euro crisis doesn't look like it's going to turn into a catastrophe. Globally too, market sentiment has received a boost from the initial signs of a US economic recovery. All these factors have helped the markets.

Do you see this rally sustaining over a consistently large duration?

Definitely yes, over a span of two years. But we may see some corrections for a shorter duration of three or four months for a num-



ber of reasons.

There may be some disappointment with regard to the pace of policy action. Say, if the RBI doesn't cut interest rates in line with expectations, there could be some negative reaction. Similarly, fuel and fertiliser price hikes are a logical step to reduce the subsidy burden, but such aggressive action may only be taken after the upcoming state elections. But I would daresay that the market trend has changed - so, from here, the markets would form higher tops and higher bottoms over a period of time.

What are the changes you see in terms of macros? Which factors could trigger a sustained upmove in the markets?

There are definite signs of change, though they may not be in every sphere. For example, the meeting between the PM and power producers was quite effective in terms of creating the right noise, unlike earlier occasions where action did not match words.

Nobody expects the economy to start rebounding to GDP growth levels of above 8%, but valuations are cheap even for near 7% growth, within the context of a normalised global environment. What India needs is investments. And if the government gets it act together and provides an environment conducive to investments, the investment cycle would resume.

Apart from benign interest rates, this will be a very big catalyst, and both these factors should lead to a sustainable rally in the markets.

How do you see corporate earnings shaping up next fiscal?

Corporate earnings this quarter have so far been alright. Overall, earnings growth may be in single digits over the next two quarters. Next year, this could accelerate to low teens with some amount of luck.

These numbers are consistent with GDP growth forecast, and after considering the possible earnings downgrades likely over next two quarters.

What are you advising your clients at this point in time?

Current valuations warrant a bullish rather than bearish stance. At a time when negatives are so obvious, it's better to focus on positives and see if you can make some money in the market. We believe that positive news flow will outweigh the negative news flow. We are buying risk and advising investors to increase beta (high risk, high return) in their portfolio.

Stock prices have corrected drastically across sectors. Stocks of certain companies with good management and strong balance sheets make for good buys on valuations

alone, leave alone the environment. Even if the environment is not conducive for, say, six months, this will definitely be a good investment strategy over a longer period.

Which sectors are you betting on in the current situation?

We are positive on select stocks in the financials and infrastructure space, which include companies focused on government infrastructure sector and some capital goods companies as well. Also, we are still positive on the consumer theme despite expensive valuations. In prevailing uncertain times, consumer space in India would continue to do well for many years, in the face of rapidly growing consumption trends. Although urban consumption growth has slowed temporarily, we would still bet on select FMCG companies. But we are not positive on consumer durables.

What kind of reforms do you expect over the next 12 months that could cheer the markets?

Of late, there have been some initiatives in the power sector. I think there is a chance that three out of every ten reforms may come through this fiscal. The reforms process could be initiated in the infrastructure space, as growth there has been hit drastically and their backs are against the wall. FDI in retail may also happen if there is political consensus. GST may be the next in line, though not immediately, but six or eight months down the line. All these three factors would be landmark reforms with a huge impact on future employment and long-term growth of the economy.

How do you see auto stocks performing in coming months, given the fact that they are also interest rate-sensitive?

In automobiles, it's a stock-specific issue. Although one may play the sector in a falling interest rate scenario, the competitive dynamics have changed in a big way within segments. For example, two-wheeler segment has turned fiercely competitive with a host of launches announced during the recent Auto Expo. It would only increase disproportionately in the coming times - ultimately having a bearing on the incumbents. Between two-wheelers and four-wheelers, we would definitely go with the former even as the latter may offer trading bets in the near term.

Q&A

Pathik Gandotra