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'2016 will be a much better year for Indian markets'

Q&A

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With interest rates down and as growth in spending picks up, operating and financial leverage will kick in, leading to big gains for companies, says **SUNIL SINGHANIA**, chief investment officer, equity, at Reliance Capital Asset Management. In an interview to **Vishal Chhabria & Sheetal Agarwal**, he points to the FY02-08 period as an example and believes 2016 would be far better for the Indian markets, with both consumption and cyclicals leading the recovery. Edited excerpts:

How do you think markets will fare in 2016?

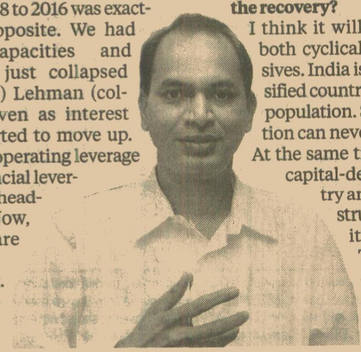
The outlook is positive. 2015 was obviously not as good as people expected but not bad, either. This is because India was standing out on a relative basis. Even in absolute terms, mid-cap and small-cap funds have given returns of 10-15 per cent and large-caps have been more or less flat.

We believe 2016 will be a much better year for Indian markets. Global commodities are already bottoming out and, so, you might have an uptick there. In India, we believe there is a high probability that reforms such as GST (the proposed national goods and services tax) will be passed. Also, demand trends have started improving, with air traffic, car sales and retail sales growing strongly in October and November. Hotel occupancy levels have also started to move up. Overall, urban consumption is picking up, though rural continues to be slow because of a consecutive year of sub-normal monsoon.

When do you see this optimism to reflect in earnings?

Frankly, we expected it this year itself but that has not happened. I will take you back a little bit. Between financial years 2002 to 2008, Sensex earnings tripled and the market went up six times. Part of the reason was that companies did not set up capacities between financial years 1999 to 2002. There was massive recession in the global economy, except the dotcoms. So FY 2002 onwards, when demand started to move up, the same balance sheet was able to generate higher sales. Huge operating leverage came into play and financial leverage kicked in around the same time, as interest rates had started to come down.

FY2008 to 2016 was exactly the opposite. We had huge capacities and demand just collapsed post (the) Lehman (collapse), even as interest rates started to move up. So, both operating leverage and financial leverage were headwinds. Now, things are again changing. So, companies have capacities but demand is not there, so sales growth is a bit subdued. Once the demand improves, the same capacity will be able to generate more sales. And, we have already had 125 basis points of a rate cut this year. We expect another 50 bps of cut in 2016. So, both operating and financial leverages should kick in. All we are waiting for is some growth in spending.



Do you believe cyclicals will lead the recovery?

I think it will be a mix of both cyclicals and defensives. India is a very diversified country, with a huge population. So, consumption can never be ignored. At the same time, we are a capital-deficient country and need infrastructure, capacity and so on. The first leg of spending will be from the government, due to the over-capacity in the private sector. Till that capacity starts to get utilised, corporates will not put new capacities. Government spending has already started picking up in areas such as defence, infrastructure and railways, among others.

The windfall gains from lower crude oil prices will be much bigger in 2016, as its average is higher than the current price in 2015. This year, we saved $45 billion. If oil prices continue the way they are, we will save at least $80 bn next year because the full impact will come in. Our view is that oil prices might not increase significantly.

What strategies should investors adopt in 2016?

I think equity as an asset class will do much better. In the past three years, real estate and gold have given negative return. Equity, despite all the headwinds, is still giving investors some positive return. That should continue in 2016. Within equities, large-caps offer a good opportunity for investors looking at stable returns. But, if you are willing to bear the volatility, then mid-caps and small-caps tend to give you slightly higher returns.

We believe a few themes might play out in the near future. One is to move away from physical assets and into financial assets. So, wealth management companies and select NBFCs (non-bank finance companies) will benefit. Second, we continue to be positive on the urban consumption theme. Saving has increased due to lower inflation and interest rates. The employment scenario should improve as the economy picks up pace and lead to higher income levels. The seventh pay commission will lead to a big bounty in the hands of people, which will again aid or incentivise more consumption, like we saw the previous time. So, we like plays on urban consumption such as multiplexes, brand companies, etc.

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