Sensex at 100,000 by 2020!

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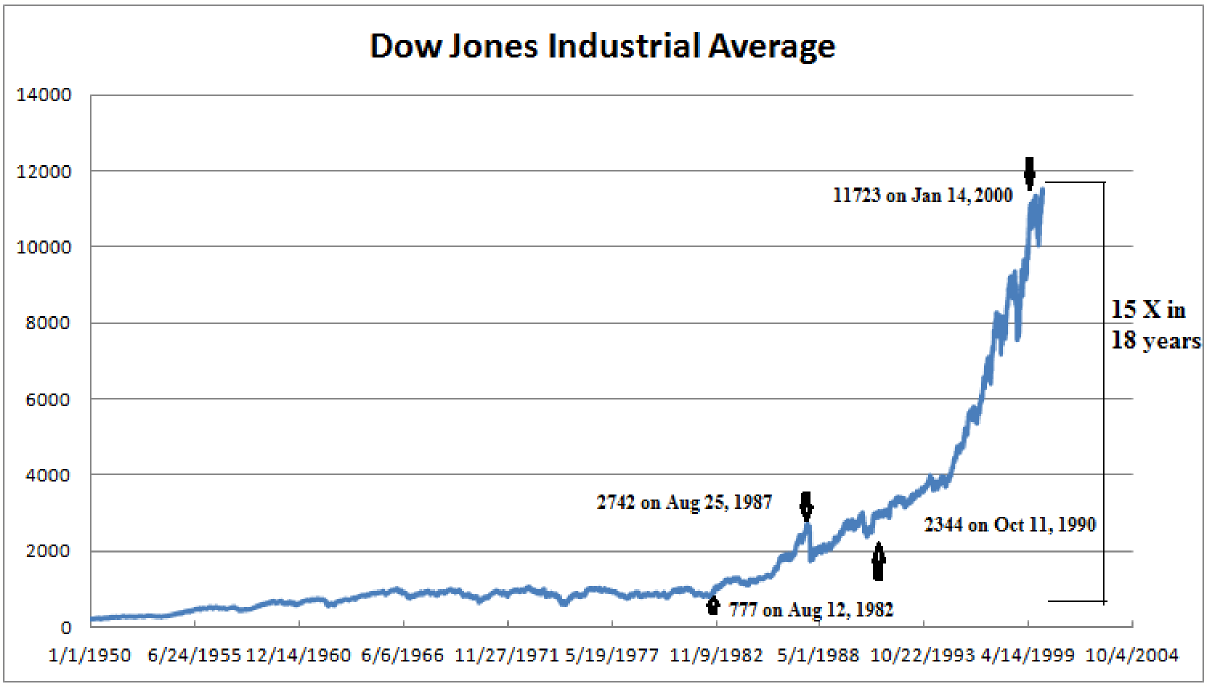
The past year turned out to be quite constructive for Indian equity. Markets made fresh life time highs on the back of improving domestic macros, supportive global equity and expected governance improvement in India after next general elections. Sensex crossed the level of 21,200 after a gap of almost six years. FII reaffirmed their commitment towards Indian equities with more than 20 billion dollars invested in 2013. We see 2014 bringing a new bull cycle into existence. A strong export sector, revival in investment activity, continued recovery in US & a stable Euro area are significant positives for equity markets. With domestic macro-economic data also on the mend, we are aggressive buyers of Indian equity.

Despite so many negatives plaguing the economy, corrective measures by the new government can quickly revive growth. The potential growth rate of economy is running around 6%. The growth rebound to those levels can take place quickly by reviving the investment demand. Once that has been achieved, the more arduous path of reclaiming the 8% growth can start.

From an equity market stand-point, macro-economic revival in India will open opportunities to make strong returns in the next few years. We would expect a GDP growth of 6% in FY15 and believe that economy will see a revival of growth and earnings cycle. The agricultural and services sector continue to show strong traction and gradually even manufacturing sector should pick-up as consumer demand revives. A real GDP growth of 6% along with Inflation of around 7% should lead to a nominal GDP growth of 13%. Sensex earnings growth has improved from 5% in FY13 to about 10% in FY14 on the back of INR depreciation. For FY15, we would expect a Sensex EPS growth of around 15%. We would believe that earnings growth for new five to six year business cycle should be atleast 20% considering the economy will revive from a very low base. If the infrastructure cycle revives quickly, the earnings growth revival will be faster with even 25% CAGR looking possible. A multiple rerating is also possible as cost of equity goes down in the next few years with the decrease in risk free rate. An earnings growth between 20-25% and multiple rerating from 15x to 16-17x in the next few years can lead to **a 25% compounding of Sensex returns, which will take it to 100,000 levels by Calendar year 2020!**

There have been several instances in the past with 20-25% compounding for long periods in other global markets. The Dow experienced its most spectacular rise in history in 1980s. From a meager

777 on August 12, 1982, the index grows more than 1,500% to close at 11,722.98 by January 14, 2000.



Dow Jones moved from 769 in 1982 to 2742 in 1987 (3.6 times in a span of 5 years). This was followed by a very sharp correction in 1987. After a period of consolidation, rally started again in 1990 from 2344 all the way to 11750 in 2000(5 times in a span of 10 years). This period of high returns in US economy was achieved as economy revived from a period of stagflation in 1970s resulting in aggressive monetary tightening by Federal Reserve Governor Paul Volcker which broke the back of inflation. It took until 1982 before a new economic recovery was born.

The 1980s economic recovery commenced without the industry leaders of the 1970s—agriculture, energy, and mining till reeling under massive balance sheet defaults. The 1980s recovery in US also transpired amidst a global financial crisis. Something which stands out is that the U.S. economy did not grow particularly quickly in the '80s, but the expansion lasted quite a long time by historical standards. An economic expansion which is prolonged helps consumers and companies heal slowly without stoking inflation and leads to more sustainable wealth creation.

In India too, we are not predicting a very quick economic recovery. The recovery shall be slow and steady with the RBI under Raghuram Rajan keeping a hawk eye on inflation not allowing the economy to overheat. The challenge for the new government In India is to quickly revive the investment cycle. Big infrastructure projects need to be provided quick access to capital, speedy environmental and forest clearances and policy support. Several large projects have got stalled in last few years. We expect that the new government will identify some large infrastructure projects and concerted push will be given to drive them to completion. Dedicated Freight corridor between Mumbai and Delhi is one such project. Quick execution of such projects will provide massive employment, provide quick transportation for goods, lead to productivity gains and will have large trickle down effects on the adjoining towns and villages leading to revival in consumption demand. Several 'shovel- ready' projects would be provided viability gap funding wherever needed. This will help construction companies, asset creators in Power, road and port space and engineering and capital good players. There will be trickle down effects of this massive infrastructure creation. The income and productivity of a large number of Indians will increase and infrastructure generation leads to massive employment opportunities, high efficiency leading to salary gains and higher purchasing power.

The other thing which can lead to increase in GDP growth is, making India a big player in the manufacturing space. The recent rupee depreciation can make Indian manufacturing competitive globally. With clever resource allocation, India can become a global manufacturing hub in sectors like Automobiles & auto components, pharmaceutical, textiles, gems & jewellery, leather goods, IT hardware and solar power. The SEZ policy was launched with this very intention. However, policy muddles and land acquisition issues brought this to a complete halt. There are expectations that under the new government, SEZ policy will be revived and several incentives will be given to the industry to expand in these sectors. Land acquisition bill has already been passed by Lok Sabha. Labour laws also need a complete overhaul so that producers are encouraged to hire more employees. Once Labour and land issues are streamlines and cheap finance is available to industry, Indian manufacturing will blossom and will lay the foundation of a virtuous cycle of productivity gains, high salaries and high growth.

Thus, there is no reason that India can't see a prolonged economic growth cycle with low inflation. The prolonged economic growth can create similar equity market returns in India as seen in United States in 1980s.

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