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"Expect rebound in earnings in second half of 2017-18"

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Equities generate robust risk-adjusted returns in the long-term. However, there may be some years of sub-optimal returns. Investors should stay invested in equities for a longer period to earn expected returns, Sanjay Kumar tells ***Hiral Thanawala.***

Where are the equity markets headed?
Equity markets have run up significantly this year, led by high domestic and global liquidity. This has been despite disruptions like demonetisation and GST implementation. While the impact of demonetisation is behind us, GST-led disruptions should normalise over the next few months. We expect a rebound in corporate earnings in the second half of 2017-18. It will be led by pick up in consumption, supported by low interest rates, robust government spending and a favourable base. Increasing formalisation of the economy and continuing shift in household savings from physical to financial assets bode well for equity markets in the medium-term. This, along with robust domestic liquidity, is likely to keep investor sentiments strong, providing support to current market valuations. In the near-term, we expect equity markets to consolidate at current levels.

With GDP growth rate at 5.7%, do you think there are flaws in India's growth model?
GDP growth has slowed to a three-year low. The slowdown is largely attributed to inventory destocking in the run-up to GST implementation. This, in turn, dragged manufacturing sector growth to a five-year low. Further, gold demand surged in the June quarter as consumers and traders advanced their gold purchases ahead of the GST rollout. This led to a meaningful negative contribution of net exports to the headline GDP. Both these events are expected to normalise over the coming months. As such, GDP growth seems to have bottomed out and is expected to recover gradually on inventory re-stocking, pick-up in consumption, government capex and a favourable base.

What sectors are you investing in now?
We remain positive on India's consumption story. Low interest rates, a normal monsoon and government thrust on the rural sector are likely to drive consumption growth, benefiting the consumer discretionary space.

We are positive on private banks which have leveraged well on rising consumer affordability in the wake of low interest rates. Retail assets of private banks such as auto loans, personal loans, consumer durable loans, credit cards and housing loans have grown at a robust 20-25%. This trend is likely to continue given low penetration levels. We expect a shift in market share from PSU to private banks.

> ***"The expected housing boom, amid the government's strong push for low cost housing, augers well for housing finance companies."***

The expected housing boom, amid the government's strong push for low cost housing, augers well for housing finance companies. These companies have delivered strong loan growth and have fairly robust asset quality. We are positive on cement, as well as good quality infrastructure and construction companies, given the government's focus on roads and infrastructure.

We also have an overweight stance on oil marketing companies (OMCs) and gas stocks. A dynamic fuel pricing regime, coupled with robust growth in fuel consumption, is driving earnings growth for OMCs, while the government's thrust towards cleaner fuel is beneficial for gas stocks.

Do you think the merger of PSU banks will benefit investors?
We see the proposed merger of PSU banks as a positive development. First, it is likely to improve the government's fiscal balance. The weak fundamentals of mid-size and smaller PSU banks would make fund raising a challenge for these banks. As a consequence, the government would have been required to periodically infuse capital in these banks which would have adversely impacted its fiscal situation. Bigger PSU banks would be better positioned to raise capital.

Secondly, the bigger PSU banks have been able to demonstrate higher non-performing loan recovery and upgradations in the past. As such, bigger banks are likely to be better placed to enforce NPL recovery mechanisms post consolidation, particularly given that these banks would have a larger share of loan composition (collaterals) with them.

Lastly, consolidation of PSU banks may prevent market share loss facilitated by creation of a stronger balance sheet, fresh capital and bigger scale post consolidation.

What's your view on the telecom sector?
The telecom sector has been undergoing consolidation over the last couple of years. From 10-12 players, the telecom industry now has three large players.

Post the entry of new incumbents with significant 4G capacity; we have seen a sharp increase in competitive intensity in the sector. Falling tariffs, increasing leverage and decline in profitability have compelled several small players to scale down expansion plans. Bigger players with strong balance sheets have started the process of consolidating into nationwide players. Industry dynamics are likely to remain challenging in the near-term given high competitive intensity. We continue to remain cautious on the sector.

What is your advice for investors?
Equities, as an asset class, generate robust risk-adjusted returns in the long-term. However, there may be some years of sub-optimal returns. Investors should, therefore, stay invested in equities for a longer period to earn expected returns. Additionally, investors should invest on a regular basis so as to generate superior returns in the long run. Investors with limited market information should seek guidance of experienced advisers to understand their risk-return profile.

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