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Bsplindia.com

February 11, 2010

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Run up to the budget

It's that time of the year when the Govt let's us ordinary citizens get a peek into the minds of the bureaucracy with a 12 month perspective. Though words and actions maybe poles apart, one gets a general idea on what to expect. We hazard a guess towards what to expect, how to utilize that knowledge and make investment bets accordingly, with a view to out smart the challenges presented by a high inflationary scenario. While I am no expert on policy matters and have a limited understanding of these matters (you may accuse me of suffering from tunnel vision – I tend to think of converting news to revenues, in select industries that I sort of understand), some issues are down right obvious and present good opportunities. I feel expecting a 20% rate of return should be a fair proposition on a conservative estimate.

Inflation

This is a killer, nothing less ! My conversations with money managers, market players and other active players in the last 6 months have been eye openers. Many do not even think of inflation as we at BSPL do. Everyone was unaware of the changes that one needed to make to charting / fundamental analysis in a high inflation scenario as compared to low inflation scenario. I had only one question to ask after asking about inflation techniques – do you accelerate your car equally on a heavy downpour rainy day as compared to a bright sunny day ? Many got my point after this !

The coming year will see high inflation dogging the markets. Your investment returns from fixed income securities will be negative – food inflation is above 35% at street levels (Govt WPI figure is close to 20%, CPI will be much higher and your grocery store will mark up price to incorporate profits), FD returns are below 7.5% and PPF gets you under 9%. Equities are known to be established inflation beaters (we read that in text books, many written by non market participants) but what no one tells you is that during the actual inflation onslaught, equities tend to tumble!

<u>The trick is to buy right stocks at the right prices to beat inflation by a wide margin – buy during this downtrend and gain in the following rally</u>.

The govt will try to curb inflation (rather un-successfully!) because so far the noises that are being made seem to indicate that the real picture escapes the decision makers. Those that do understand the writing on the wall are compelled by political reasons from acting pro actively. In the recent days, I have done some media interviews with some players in the decision making circles and am appalled at their chain of thoughts. Conspiracy theories, accusations of hoarding, speculation, banning commodity exchanges and political mud slinging are the only topics discussed. What escapes attention (maybe deliberately so!) is what dubyaman George Bush said – India and China are growing Countries (by population and wealth per capita) and the first things that a affording, erstwhile poor population buys are – food, shelter and clothing. If you think India is an emerging economic power, accept (food) inflation as a given.

Ben Graham has advocated the formula for calculation of GDP as – increase in availability of labour x increase in efficiency of labour x inflation. Inflation is accounted here as it decides the selling price of goods and services. In the Indian context, the first two factors are almost constant, though rising slowly, so when the Govt tells us about a rising GDP, it really tells us that inflation will be higher.

When you cant beat them, join them – buy stocks of companies that will be able to protect sales, pass on price rise to consumers as much as possible and are established players in atleast two previous inflation scenarios.

Resource depletion

This is a study that should be made compulsory in every school. Before kids are taught history / geography, they should be taught resource depletion. Lack of understanding on this subject compels academically wise and adult folks to issue statements like – water and food are infinite commodities and all talk of scarcity in these two areas is manipulation by capitalist forces ! The best game plan is to get into stocks of companies that are into dealing / manufacturing / distributing and associated with depleting resources. Some metals are rarer than others, these rarer metals command a premium over abundant ones (eg Copper over Iron ore). Go for depleting commodities and buy their stocks. Our thrust area in the last two years have been oil & gas and (recently) food & water. The government will try to move heaven and hell to boost productivity of depleting resources. Expect a major thrust on energy, power, farming, irrigation, water management, seeds, fertilizers, farm equipment, water pumps, electric vehicles and allied industries. We will update you in real time during the budget speech to place your bets via instant alerts (premium plan only).

Fiscal deficit

Major headache. That's the shortest description possible of a major burning issue. With the deficit threatening to hit 10%, expect major worries. All talk of disinvestment in PSU's, FPO's, IPO's and austerity measures are nothing but a refined way of saying – let's please worry ! Those who don't learn bitter lessons from history are condemned to re-live them (old saying). Remember how the house of cards came tumbling down in 2008 after Rel Power's mega IPO? Think of the mega line up in 2010 and also super impose the helplessness of the common man who battles pulse prices at Rs 125 / kg +, Sugar at Rs 45 / kg + and imagine how much will they really invest in primary & secondary markets. 2010 will be largely a year of institutional players. The retail player is likely to be conspicuous by his near absence. That is also why we feel you, as an investor, should be active through 2010. Institutions will pick bargains at will and so should you. Cash will be king so be stingy with it, don't buy at random and always have surplus in case of market declines. Buying on declining days only, raises your profits by atleast 10% annually ! That's a whopping figure. If you see markets rising 2 % in a day, don't buy. If you see upper circuits, go for a movie rather than buy stocks !

In a high deficit scenario, Govts are tempted to print money. That may happen here too. Remain open to the idea of re-rating downwards by international agencies. So cheap stocks can get cheaper and only free cash can help take advantage for you.

If Oct 27 2008 kind of scenario occurs again, we have a list of stocks that you can buy even after availing broker funding in the delivery segment. These are stocks where cash flows are robust, cash return on capital invested is high and stock prices have out performed the headline indices in bull **and** bear markets.

Commodities

If you exclude this asset class from your game plan, you risk lower returns. It's that simple. Commodities adjust for inflation, falling currencies and tend to out perform stocks during the actual period of rising inflation. Silver, Gold, Copper, Nickel, Lead, Zinc and Crude Oil in that loose order are our picks in hard assets. Gold was at No. 1 last year, this year it's Silver. In the agri space, only the cost of carry and regulatory bans worry us. We are clear (barring periodic corrections) that prices are in an uptrend. Wheat, Soybeans, Maize (corn), Sugar, Ref Soya Oil, Crude Palm Oil and Cardamom will rise over the long term. Stand by for weekly updates.

What / how much to expect

We feel you should get returns commensurate to your risk bearing exposure. High inflation times mean higher (near term) risk. Which should ideally be compensated by more than commensurate returns. If the Govts overall inflation figure is 7-8%, you should target a (net of inflation adjustment) 20 % from this budget to the next. Our efforts will be to provide you with such returns, on a bonafide best effort basis. I wish we could guarantee that, but equities are equities and there can be no guarantee. All I can guarantee is that most stocks that we will recommend will be owned by us in our individual capacity and corporate holding co as well.

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