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State of the Markets - XXI

Friends,

The last edition of this newsletter was dtd April 11, 2009. When I went through it this morning, I was taken aback myself. I mentioned remaining with Petronet, Cairn, RIL, RPL and regretted being unable to buy L&T and HDFC Bank. All these stocks have almost / more than doubled. Base metals like Zinc, Lead, Nickel, Tin and Copper have jumped upto 30 – 40 %. Energy (Crude, CER's and Nat Gas) are also up smartly, though Gas continues to lag. Stocks that were recommended in the power, banking, sugar, infra and assorted industries have rallied significantly. <u>There lies the worry</u>! Cats and dogs have doubled in value. Professional analysts are telling me why shipping co's like G.E. Shipping will double in value from here by Dec 2009. The US is recovering they say, and exports will pickup. We need more ships, so who else but GES? When I asked one of these "non market participating experts" whether he knew that USA did not allow single hull ships after the Exxon Mobil Valdez disaster to enter US shores, I got a stunning reply – G E Shipping will then focus on Europe! The analyst had already decided what the management would / could / should do!

A real estate sector analyst was trying to convince me why stocks from this sector would triple if not more. He ofcourse didn't have an answer to one simple question – when I buy a flat, I need to pay cash to the builder. When I buy the co's shares, I only get a dividend cheque by mail. Why not some of that cash? And where is it going anyway? Or for that matter shares of any movie production houses which are known to have dealings in off the books transactions. So who knows what the real profit of the company is, or it's real value for that matter. All I know is that MTNL has more than doubled from it's lows. <u>That for me is a sign of caution</u>. Cracks have started appearing in BPCL, HPCL & IOC (wealth destroying disasters) which had jumped up in anticipation of dismantling of the administered price mechanism (APM).

Last fortnight was a tough one for me as a trader and advisor. I saw midcap stocks rally sporadically. Banking and select index heavyweights were being clobbered. Aren't these negative divergences? To me they are. I experienced a similar situation in Jan – April 2004 when we went into a shell as our in-house recommendation systems failed to give too many short term calls. We lost over 50 % subscribers and our own traded volumes fell over 80 %. But the markets collapsed in May 2004. <u>I am not advocating such a collapse, as a given</u>. But the possibility exists. A few arguments for such an event -

1. I had warned of a price hike in fossil fuels post elections. International crude prices are up and US non strategic petroleum reserves are down. China wants a reserve 3 times that of USA (meaning 1 Bn barrels) and OPEC wont hike output in a hurry. Iran is likely to vote it's hawkish anti-US president back to power and it won't help sentiments much. Recovery in the Asian region cannot come without a hike in energy consumption. The oil traders know that and crude is up 100 % from it's lows.

2. Bringing down inflation was a prime concern pre-election. Presenting the first budget will offer no pressure to the FM if he chooses to take "hard decisions". He's got 5 years to go. You want long term results, suffer short term agony, he could say that. We'll have to grin and bear it. The markets are unfortunately expecting a dream budget.
3. My biggest worry is the forecast of a 8 – 10% GDP growth by some sections in the capital. The GDP is computed is with a simplistic formula – increase in availability of labour into increase in efficiency of labour into increase in inflation (the final price of goods / services will be determined by inflation). We are assured of an increase in availability of labour, our ballooning population assures us so. I am not very impressed with the rate of increase in efficiency of our labour. We are not Korea / Taiwan / China / Japan. That leaves us the last variable – inflation. <u>Which means New Delhi expects high inflation in the coming quarters</u>. How it could benefit stock markets in the near term really puzzles me.
4. Interest rates are expected to rally around Diwali / Christmas. What with the rush to raise funds, even via QIP's, how many corporates will finally manage to garner actual finances at competitive coupon rates? Passing enabling resolutions at AGM's / EGM's to raise funds may assure immediate stock price appreciation, but will all managements manage to get the money? With stock prices so low compared to all time highs, will managements want to part with equity stakes? What happens when these expectations are not met?
5. What if oil goes past 80 $ / barrel and stays there? Are we prepared? What happens after the Nano when our fuel consumption spikes up? Auto makers offer cheaper loans, smaller EMI's and freebies. How long will crude prices remain subdued? All high profile launches of hybrid cars (Honda Civic was the most prominent) have died a quiet death. I was right! These cars cost a bomb to buy! Asia will go bankrupt trying to adopt alternate fuels as a viable energy source due to the huge capital expenditure alone. We don't have an immediate cheap option as yet. Oil prices can hurt equities real bad, and will do it suddenly. Keep a keen eye open at all times.
6. Every Tom, Dick, Harry and aunt Henrietta wants to launch an IPO, follow on public offers and rights issues. This can suck out liquidity from the system. It won't happen overnight, but you know what happened after DLF and Rel Power IPO's sucked in the billions?

Where do you stand on our reco's – <u>I have no fresh stock ideas to offer this week</u>. You may accuse me of intellectual bankruptcy. The core recos – RIL & RPL are a hold for the long term. Cairn is a hold. Any management that can sell a product that costs 10 paise to manufacture, at Re 1 is smart. With ONGC liable for royalty pay-outs and govt levies, Cairn gets to eat the cake and cream. <u>ONGC's liability remains even if it pulls out, as per the agreement</u>. HDFC Bank and Tata Power, maintain a hold and one may even start staggered buying at 10 % declines. Just don't sink in all your money just as yet. REC, PFC, PTC, Powergrid and NTPC are still a hold. Mount Everest and ION Exchange are still holds. Percy Siganporia wants to sell "Himalayan" mineral water to the South East Asian countries. My holdings will appreciate – hopefully. Export income is always welcome. That leaves out Petronet LNG. I have liquidated 20 % of my holdings (my only sale in many quarters). Partially to fund purchases on ION Exchange and Mount Everest Mineral Water and partially because of a nagging worry I received in the mail. The 11 th Annual report.

Refer pg 8, heading “Financing”, the Co plans to borrow Rs 1400 Crs from SBI and US$ 300 Mn from overseas markets to fund the Kochi terminal. Refer to Pg 22, the balance sheet. The Co already carries Rs 2282 Crs in secured loans. Which means the co. could wind up with debts approaching Rs 5000 Crs shortly. Interest costs could balloon and impact the bottomline by atleast Rs 250 Crs if the loan amounts come through. These are minor ailments if the topline really doubles as per management expectations for 2009 – 2010. Lets await the June quarter numbers and take a fresh view. Another minor concern – Mr Prosad Dasgupta (the public face of the Co in the media) has received Rs 18,21,162 from the Co for “treatment and hospitalization charges” as per the Annexure to the Directors report – Pg 9 of the report. If his contribution to the Co is affected, we would treat that as a red flag. He has been so far the only active buyer of the P-LNG stock from the secondary markets as we have been updating our clients. Our target on the stock stands modified from 120 to the 100 levels. A mild revision. Hold existing positions, but do not add for now.

Nifty – the headline index is approaching it’s Fibonacci retracement ceiling near the 4800 levels. We feel the closer we get there, the more significant will be the selling pressure. A breakout past the 4800 levels will surprise us. We may even liquidate some of our core holdings. Await updates on that front.

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End of the report