

Earnings growth will power the next stage of market rally

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While the outlook for the equity markets is optimistic given that fundamentals are looking up and the economy is growing, the next boost for stocks will come from company earnings, says Ved Prakash Chaturvedi, managing director at Tata Asset Management Ltd. Edited excerpts:

How do you view the current environment? There is a fair bit of volatility and the Sensex hasn't really moved up much since October.

Typically, after a period of

high returns, markets consolidate. Markets go up in anticipation of positive economic uptrend and earnings growth demonstration from individual companies backed by flow of money from domestic and overseas investors.

We are gradually moving into a period of higher economic growth, and companies are looking optimistic about earnings momentum.

However, given the global situation, funds flow to equities has been muted and this has been true for our markets also.

Thus, while the outlook is optimistic, fundamentals are

looking up, sentiment is turning positive, the flow of money to the markets is only gradually now turning up, and hence markets have been in a trading band of consolidation.

Earnings estimates aren't being revised upwards at the same pace as we saw some months ago. How is it impacting the markets?

As the recovery gathers pace and as a consensus emerges around the kind of growth that various companies are likely to deliver, significant earnings upgrades are fewer and far in between. I suspect analysts will wait to see how companies perform in the June quarter and in the September quarter

of 2010 before looking at further revising the earnings number for fiscal year 2011 and fiscal year 2012.

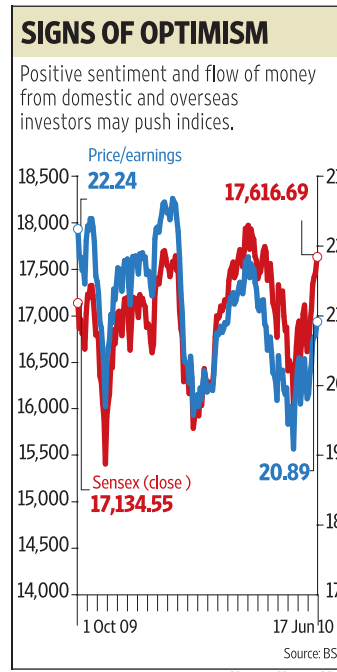
Where do the markets go from here? What are the factors you think will justify the next stage of the market rally?

Markets are driven by four fundamental drivers: an anticipation of earnings growth and economic events, sentiment, liquidity and fundamental earnings growth numbers.

At the moment, the earnings growth numbers have gradually turned optimistic, sentiment in the domestic economy is turning positive and factors like the monsoon are being closely watched.

However, liquidity or the flow of funds to markets is a cause of concern, given global concerns arising out of events in certain key economies like Europe (and) China.

In my view, the next stage of the market's rally will have to wait for delivery of earnings growth numbers for the June



quarter and the September quarter. Thereafter, based on the performance and expectations of earnings growth, analysts will take a view for fiscal

year 2011 and fiscal year 2012. If by that time we have a good monsoon and a more optimistic global outlook, we could possibly have some good cheer.

Which sectors look attractive at this point of time?

The Indian growth story is driven by four key drivers. First and foremost is the skill or cost arbitrage vis-a-vis global markets. Second is the infrastructure opportunity. Third is local consumption demand. And last but not the least is the financial intermediation opportunity.

Consequently, in our view, sectors like information technology, pharma, engineering, capital goods, construction, etc. will be under close scrutiny of the market from the medium-term perspective.

Clearly, equity investors are advised to invest in markets from a medium-term perspective as, after the sharp recent run-up, markets may be volatile in the near future.