ET Q&A

SHIV PURI
MD, TVF Capital Advisors

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As Long as Earnings Grow, Market will Move Higher

Indian equities look attractively placed from a medium- to long-term perspective, said Shiv Puri, managing director of Singapore-based TVF Capital Advisors. In an interview with **Sanam Mirchandani** and **Nishanth Vasudevan**, Puri said India may get a disproportionately positive share of flows into emerging markets. Excerpts:

How long do you expect this liquidity-fuelled rally to continue?
If India can grow at this 7-8% range and the backdrop remains positive, there is potential for a lot of foreign capital to come in. There is $10-trillion worth of bonds with negative yield. There is lot of liquidity that is looking to be parked in the right direction. Over the medium-term to long-term time frame, the markets are still very attractively positioned. We have seen liquidity improve dramatically in the system. Inflation and fiscal deficit are still at manageable levels.
The earnings growth, which was confined to few sectors, is becoming more broad-based. For the index, if you look at operating margins, they are still 25-30% below their long-term average. When the operating leverage comes through, it will be beneficial.

You have been saying that India will get a better share of flows in emerging markets.
If the signs from fundamentals in India over the last six months continue, India will get a disproportionately positive share of flows. One of the reasons is that India's weightage in the MSCI is very low at about 2.5% whereas the economy's size is about $2 trillion. There is a complete mismatch between what it should be.
What I am gathering from US clients is that earlier they used to look at investing here in context of emerging markets or BRICS (Brazil, Russia, India, China and South Africa).
Now those terms are becoming quite obsolete as fundamentals of each country are different. Now people are saying let's look at India by itself rather than it as a part of emerging markets. When that starts happening, India will see more allocations.
Very few $2-trillion economies are growing at 7-8%. If you find that and there are good companies in there, people will start paying a premium for that.

Do you think valuations are stretched?
Valuations are a concern in select pockets like FMCG (fast-moving consumer goods) where companies are valued at 35-40 times earnings and the growth is a little questionable. The non-banking financial companies (NBFCs) and banks are starting to get reasonably priced. They will still compound in line with earnings growth and earnings are growing very fast for them.

ON FLOWS IN INDIA

> If the signs from fundamentals in India over the last 6 months continue, it will get disproportionately positive share of flows

What will be the key triggers for Indian markets going ahead?
After 2014, market has moved on a very 'show me' attitude which means that once actually something happens, then the markets move, whereas before that moves were on faith and hope rallies.
Over the next couple of quarters you will start seeing earnings growth broadening out across sectors. Once that happens, and it gets reflected in the numbers, that's when stocks will continue to do well. We may not necessarily need anything as significant as GST (Goods and Services Tax) to come out in the next six months but as long as earnings keep coming through, the markets will move higher.

When do you expect earnings recovery to start gaining traction?
We are seeing a massive dichotomy in the market. Certain areas like financial services, NBFCs are doing well, auto components are picking up, and two wheelers and four wheelers are starting to do well. On the other hand, PSU banks are in losses and commodities are still doing weak, which is pulling down the overall earnings. The average is coming to about 10%. It is important to look at it on a bottom-up basis and stick to companies that are growing, are high quality businesses. It is not advisable to look at low quality businesses as some of these are structurally challenged and do not offer the visibility of earnings growth that many of these other companies do.
The ones that were dragging this year, which includes largely PSU banks and commodity companies, they will show very rapid year-on-year growth in FY18 due to favourable base effect and that will help earnings growth of FY18 over FY17. You will see that kicker coming in next year.

ON BANKS & NBFCs

> NBFCs and banks are starting to get reasonably priced. They will still compound in line with earnings growth

Midcaps are trading at a high premium to large caps. Is it worrying?
In a good chunk of midcaps, there is some over valuation like in the poor quality companies, which are leveraged and have poor corporate governance. However, in the midcap space, NBFC, bearings and abrasives companies are reasonably priced.