

Market Mania for Indian Indices

October 4, 2010

Stock Market Scenario

STOCK MARKET - RATIOS													
	Sep 30		Sep 29		Week ago			Sep 30		Sep 29		Week ago	
	Yield	P/E	Yield	P/E	Yield	P/E		Yield	P/E	Yield	P/E	Yield	P/E
Argentina	6.6	10.8	6.6	10.9	6.8	10.6	Malta	5.6	4.5	5.6	4.5	5.7	4.5
Australia	4.0	14.1	4.0	14.2	4.0	13.9	Mexico	2.0	14.9	2.0	14.8	2.0	14.7
Austria	2.5	16.0	2.5	15.6	2.5	15.4	Netherland	2.5	14.0	2.5	14.0	2.6	13.9
Belgium	3.5	10.8	3.4	10.9	3.5	10.8	AEX †	3.1	14.1	3.1	14.2	3.1	14.1
Brazil	2.5	13.2	2.5	13.6	2.6	13.4	New Zealand	3.8	24.5	3.7	24.8	3.7	25.1
Bulgaria	0.1	7.5	0.1	7.6	0.1	7.5	Norway	3.0	12.4	3.0	12.4	3.0	12.3
Canada	2.6	18.3	2.6	18.3	2.7	17.9	Pakistan	5.4	9.6	5.4	9.6	5.5	9.4
S&P/TSX	2.9	17.0	3.0	16.8	3.0	16.7	Peru	3.3	40.0	3.4	39.6	3.4	38.8
Chile	2.9	22.3	2.9	22.3	2.9	22.0	Philippines	2.4	18.1	2.4	18.2	2.5	17.8
China	2.5	13.2	2.5	13.2	2.5	13.0	Poland	1.7	19.1	1.7	18.9	1.7	18.8
Colombia	2.3	21.0	2.3	21.0	2.4	20.3	Portugal	3.8	12.6	3.9	12.6	3.9	12.4
Cyprius	4.0	7.9	3.9	8.0	3.7	8.5	Romania	1.3	13.5	1.4	13.2	1.4	13.1
Czech Rep.	5.8	10.2	5.9	10.1	5.8	10.3	Russia	2.2	9.1	2.2	8.9	2.2	9.0
Denmark	1.0	26.7	1.0	26.6	1.0	26.7	Singapore	2.6	15.9	2.6	15.9	2.6	15.9
Finland	3.5	20.0	3.6	19.9	3.6	19.5	Slovenia	1.9	15.6	1.9	15.6	1.9	15.8
France	3.5	15.5	3.5	15.5	3.5	15.2	South Africa	2.6	17.6	2.7	17.4	2.7	17.2
Germany	2.7	14.6	2.7	14.6	2.7	14.5	South Korea	1.3	15.3	1.3	15.3	1.3	15.0
DAX 30 †	3.1	12.9	3.1	12.9	3.1	12.8	Spain	5.0	11.0	5.0	11.0	5.0	11.1
Greece	3.4	14.9	3.4	14.9	3.4	14.9	Ibex 35 †	5.6	9.8	5.6	9.8	5.5	10.0
Hong Kong	2.6	14.2	2.5	14.2	2.5	14.0	Sri Lanka	1.0	32.7	1.1	32.1	1.1	31.7
Hang Seng †	2.8	14.2	2.8	14.2	2.8	14.0	Sweden	2.6	14.2	2.6	14.2	2.6	13.9
Hungary	1.7	14.2	1.7	13.9	1.8	13.9	Switzerland	2.8	13.5	2.8	13.5	2.8	13.5
India	0.9	24.4	0.9	24.4	0.9	24.2	Taiwan	3.6	15.0	3.6	15.0	3.6	14.9
Indonesia	2.0	20.2	2.0	20.2	2.1	19.6	Thailand	2.8	15.0	2.9	14.9	2.9	14.6
Ireland	1.7	20.8	1.7	20.7	1.7	19.1	Turkey	2.0	12.9	2.0	12.8	2.1	12.5
Israel	3.9	12.3	3.9	12.3	3.8	12.5	UK	2.9	14.7	2.9	14.7	2.9	14.6
Italy	3.9	14.3	3.9	14.2	3.9	14.1	USA	2.0	16.3	2.0	16.4	2.0	16.1
Japan	1.9	16.3	1.9	16.6	1.9	16.6	Dow Jones †	2.7	14.7	2.7	14.7	2.8	14.4
Topix †	2.0	15.6	2.0	15.6	1.9	15.7	S&P 500 †	2.5	11.9	2.4	11.9	2.5	15.1
Luxemburg	3.0	16.4	3.0	16.5	3.0	16.5	Venezuela	12.2	3.1	12.2	3.1	15.8	3.1
Malaysia	2.5	14.8	2.5	14.7	2.5	14.7							

Where do we stand?

Indian markets continue to run ahead of themselves. The benchmark index seems set to form a new high sooner or later. This despite the fact that the Indian markets are quite expensive. This is evident from the table above. China and Brazil have a PE ratio of 13.2 while Indian index is at a PE ratio of 24.4. This implies a premium of 84% for Indian index. This is hardly justified given that after last quarter results the growth in S&P Nifty was around less than 7%. The EPS for Nifty stock had reached 238 after June 2010 results. This compares with an EPS of 220 after September 2007 results. That translates into growth of less than 3% per annum. Such profit growth can hardly justify premium valuation.

In course of any market mania there is a tendency of financial securities prices to disconnect with reality. This is what has happened in Indian markets. The quantitative easing of US Federal Reserve has provided funds to a number of global players. These funds are chasing momentum rather than value. Emerging markets in general and Indian markets in particular seem to be prime destination of these funds. That these funds are chasing prices are clear from the kind of buying that is happening in Indian markets during last two months. The leading indices have just been going in one direction, which is up. The large cap index (Sensex) of Bombay Stock Exchange has gained 12% in last one month while small and medium cap indices have gained only 4%. The large cap index is also at least 20% more expensive in terms of PE ratio compared to other two indices. The members of large cap fund are favorites of international funds. This has happened despite the anemic growth in profitability in recent years.

Where is this leading to?

The next stop for overheated markets is a spate of overpriced IPOs. This has already started. A number of IPOs have been planned. Till now we have seen smaller IPOs. Now we have a number of large IPOs lined up. The Coal India IPO is the largest one ever for the Indian market. A number of real estate IPOs are also planned as real estate is one sector which has seen strong revival in terms of prices if not demand.

An overpriced market will lead to number of overpriced IPOs ultimately leading to sharp correction because of

1. Non fulfillment of expectations (high PE ratios imply high earnings growth something that is not happening)
2. Funds being diverted into number of IPOs.

It is not clear when it will happen. The quantitative easing seems to be supporting the fund flow for now. How long this will sustain is difficult to predict. It is however important to remember that the Indian equity markets have reached the valuations reached In January 2008 and list of IPOs is also similar. At that time it was Reliance Power which set the record for largest IPO and now it is Coal India.