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SMART INVESTING
Street Loads Up On Sugar with Industry Set for a Rebound

CREDIT RATING agencies have been criticised for being late in identifying stress in the system

Das Gives a Rap on Rating Cos' Knuckles

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Mumbai: Credit rating firms came under sharp criticism from the Reserve Bank of India (RBI) for failing to identify financial troubles in various companies, especially in the case of IL&FS.

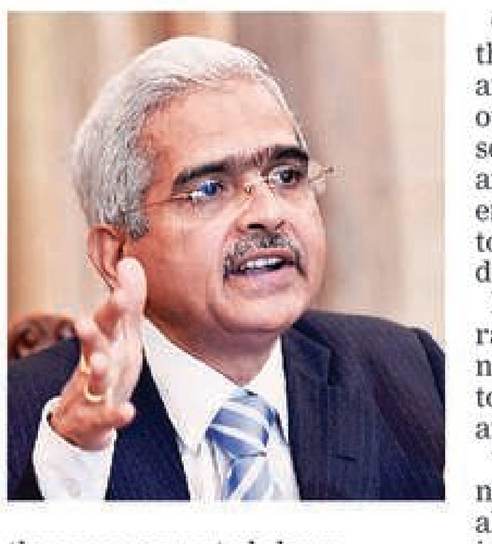
In a meeting with top credit ratings officials on Thursday, central bank governor Shaktikanta Das and the deputy governors expressed concerns over rating agencies' inability to assess credit risk and take timely rating actions, said people who attended the meeting.

"RBI said that ratings are supposed to be forward-looking, but they are always a laggard," said one of the people quoted above.

The central bank is said to have told credit ratings officials that the abrupt ratings downgrades in recent months have hurt investors and banks. RBI declined to comment on an email query by ET on the matter.

Credit Rating agencies have been criticised for being late in identifying the stress in the IL&FS Group, which defaulted on its loans from banks, mutual funds and provident funds. Various debt mutual fund schemes saw erosion in their net asset values, or NAVs, because of the defaults. The crisis soon spread to other non-banking finance companies — mainly housing finance — which have been struggling to sort out their asset-liability mismatches.

"RBI said one third of the total NPAs (non-performing assets) in the system stemmed from investment grade ratings," said one of the persons quoted above.



Total stressed assets are about ₹12 lakh crore in the banking system. Das was concerned over the "conflict of interest" in the country's credit rating agencies, the person said.

Globally, rating agencies limit themselves to ratings and research related to credit ratings. All other businesses like market research, training, risk solutions are carried out under separate entities with no common directors, employees and shareholding from the rating entity.

In India, the same rating agency rates and provides valuation opinions to the same set of securities to investors like mutual funds and provides advisory services.

"In many instances, the business origination employees are also common. In RBI's view, this is conflict of interest and RBI is looking at suitable regulations to address this issue," said one of the persons quoted above.

The central bank governor disapproved of the practice of "rating shopping"— where companies migrate from one rating agency to another for better ratings. "RBI was also concerned about issues such as rating agency CEOs being part of rating committees and rating advisors who promise better ratings to an issuer due to their special relationship with rating agencies," said the second person quoted above.

RBI is examining the matter and along with Sebi, it will bring out regulations to address this, the person said. Though credit rating agencies are registered with the capital market regulator Sebi, they are jointly regulated by both Sebi and RBI as these firms rate bank loans which constitute 70% of their business.

On short-term instruments like commercial paper, RBI feels that the ratings do not reflect the pricing these papers command.

Market Trends

STOCK INDICES		% CHANGE
Nifty 50	11058.2	0.05
Sensex	36725.42	0.24
MSCI India	849.64	0.38
MSCI EM	2356.21	0.55
MSCI BRIC	625.42	0.74
MSCI World	8597.16	0.13
SX 40	21653.49	0.10
Nikkei	21456.01	0.65
Hang Seng	28779.45	0.89
Strait Times	3229.48	0.21

Values in US $, Gross — At 7 pm IST

OIL ($) DUBAI CRUDE 66.62, 1.16 (Absolute Change)

BOND 10-YR YIELD 7.39, 0 (Figures in %)

GOLD RATE

Prices per Troy Ounce ($)

	US	India
OPEN	1287.3	1418.55
LAST*	1286.9	1416.68

*At 10.30pm, After adjusting for import duty, Indian spot gold lower by $ 1.09 to US Comex gold price on Thursday. The premium on local gold is due to tight supply following import curbs.

FOREX RATE (₹-$ Exchange Rate)

OPEN	LAST*
70.09	70.01

Market on Twitter@ETMarkets

Nifty's Positive Momentum Likely to Continue

Source: Bloomberg, compiled by ETIG

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ET Intelligence Group: The Nifty50 has recovered about 10% from the October low, which on technical charts indicates a case for trend reversal. In addition, several technical parameters such as Relative Strength Index, MACD, Bloomberg Greed and Fear index and moving average shows that market is far away from overbought zone.

The index is just a few points away from the Golden Cross level where the short term moving average crosses long-term average reflecting bullish trend. This would be the first time since February 2017 when the Nifty delivered 37% return from trough to peak level in the following 25 months. The current difference between the 50-days moving average and 200 days is just 31 points.

The Moving Average Convergence and Divergence (MACD) is another indicator that shows the continuation of the current positive trend. The MACD line of the Nifty 50, which is derived from subtracting 26 day moving exponential average with 12 day average, has crossed above the signal line (the exponential average of the nine-day reading), which is regarded as a buy indicator.

The Relative Strength Index (RSI) is currently at 65, and only 10% of the Nifty 50 stocks are trading above the RSI. The reading of RSI above 70 indicates overbought level and less than 30 is perceived as oversold zone. The comfort zone for traders lies between 30-70.

The Bloomberg's propriety Greed and Fear index which indicates the degree of emotions among trader shows the optimism has just started to improve. It has a reading of 22. The index had fallen to negative 998 in October 2018, the lowest reading since the global financial crisis in 2008.

These indicators reflect a near term positive trend in the benchmark index.

ODDS ARE MORE IN FAVOUR OF MIDCAPS

Midcaps are Not That Expensive Anymore as Valuations Ease

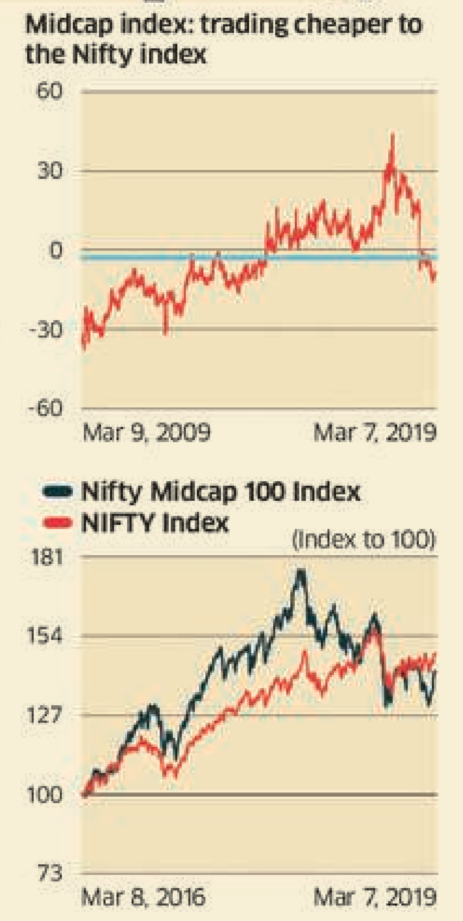
In the past one year, only the most intrepid investor would have rustled up the courage to buy into midcaps. Buffeted by governance lapses, battered by earnings misses and bruised by relentless de-ratings, midcaps plunged from stratospheric heights they had reached last January.

A year later and in the run-up to the nationwide balloting, these stocks are very much back in favour – due to cheap relative valuations. The flight toward quality last year caused midcaps to significantly trail the large-caps – a 23% underperformance relative to the Nifty since January 2018. The market capitalization of the Nifty Midcap 100 index even dropped below the December 2014 level.

So, midcaps are not that expensive now. The valuation difference between the Nifty Midcap 100 and Nifty 50 has turned to a discount for the first time since May 2014. Nifty Midcap 100 is trading at an 8% discount to Nifty 50: At 15.85 times, the price-earnings ratio is lower than the 10-year average. The consensus earnings growth of Nifty Midcap 100 index is expected to be 23% in 2020, compared with 16% growth in the Nifty 50, according to Bloomberg's data.

Motilal Oswal research data showed that the spread between large-cap and mid-cap one-year trailing returns peaks out at 15-20%. Currently, this spread stands at 18%. Therefore, it is indicating a potential reversal of trade in favour of midcaps. Similarly, the peak-to-bottom correction of midcaps and the Nifty shows that the odds favour the former. The average difference in the peak-to-bottom correction between the Midcap 100 and the Nifty in the past 15 years has been around 12%. In the current episode, this difference stands at 23%.

– Ashutosh R Shyam



IMPACT OF 'SAFE HARBOUR' RULES

Eight FPIs may Soon Set Up Shop in India

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Mumbai: At least eight foreign portfolio investors (FPIs) are looking to set up shop in India and manage global funds from the country, four years after the government introduced 'safe harbour' rules. While the regulations still pose some tax-related problems, the FPIs will station their fund manager in India to operate global funds.

The government had in 2016 relaxed the rules around permanent establishment (PE) to attract global fund managers to operate from India instead of Singapore or Hong Kong, but most of them had stayed away becuase of ambiguities in regulations.

PE is a concept in taxation that determines in which country a company's income should be taxed. The fear was that moving a fund manager to India could lead to about 40% taxation on the global returns or global incomes of an FPI.

According to two people with direct knowledge of the matter, eight FPIs have been given permission by the government to shift their offshore fund manager to India. Most of these FPIs are set to start operations from April this year, they said.

Going ahead larger global funds could also move their base to India, industry trackers said.

"This development represents a turning point for the asset management industry and provides an opportunity for Indian asset managers to play a greater role in managing foreign pools of capital without worrying about creating tax risks for foreign funds," said Sameer Gupta, tax markets leader at EY India. "These approvals can pave the way for even greater opportunities for Indian asset managers in future – like managing an Asia-focused or an emerging market fund from India."

As per regulations and relaxations given to global funds under Section 9A of the Income Tax Act, which was inserted with effect from April 1, 2016, only a fund manager's income or management fees will be subjected to domestic law and not the income of the global fund.

As per this, if a fund manager based in Mumbai manages a global fund that invests in India and China, then only the management fees charged by the manager would be taxed and not the returns of the fund, tax experts said. That is, returns from Indian equities will attract normal capital gains tax and there would be no taxation on returns from China.

However, according to tax experts, the conditions are still a long shot from being ideal, and many FPIs and global private equity funds will continue to stay put in jurisdictions like Singapore, Mauritius and Luxemburg.

The government had, while announcing the outlines of safe harbour norms in the budget speech of 2015, laid out about 15 conditions that the fund managers had to meet if they wished to shift their base to India. Some of these have been relaxed thereafter.

Experts said three issues could still pose some problems.

One, the norms do not allow any connection between the fund manager and the fund. In most cases globally, though, fund managers tend to have some nominal shares in the fund.

Secondly, Indians cannot own more than 5% in a fund operated from the country. This disqualifies several funds that qualify as broad-based funds but where the immediate member is a single institutional fund such as pension fund, university or mutual fund.

▸▸ Continued on Smart Investing

PCR AT MULTI-YEAR HIGH

As Bull Frenzy Grips Market, Experts Say Be Cautious

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Mumbai : Even as the odds of the market testing its record high of 11760.2 have begun rising with each passing day, some technical experts are advising caution, citing the marketwide open interest put call ratio (PCR), which on March 5 hit an 8.5 year high of 1.59. This compared with 1.76 on September 27 , 2010, a month after which Nifty peaked at 6338 (Nov 5) and corrected to 4555 by Dec 2011, cites Sharekhan by BNP Paribas. Even on August 28 last year, when Nifty touched a record high 11760.2, the PCR was 1.41, lower than the recent high.

Marketwide PCR is the cumulative of all index and stock options' put and call open interest. Open interest itself reflects the outstanding buy and sell positions of traders. Nifty currently trades around 6% below its record high and the high PCR is being read with a tinge of caution by Rohit Srivastava, technical head of Sharekhan by BNP Paribas. He feels that though Nifty option writers have currently factored in a range of 11000-11500 for March, a probability of correction exists from the current 11058 or slightly higher. Other analysts like Rajesh Palviya of Axis Securities feel that the market might have entered a "pre-election rally mode."

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RBI Nominees' LVB Call to Set Trend in Bank-NBFC M&As

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Kolkata: The role of two central bank nominees on the board of Lakshmi Vilas Bank would be in focus on Friday when the highest decision-making group at the lender meets to possibly consider a merger with a non-banking finance company (NBFC).

An approval from the two nominees — Suvendu Pati and Rajnish Kumar — could set the precedent for the regulatory stance on the subject, as the central bank is unlikely to go against the recommendations of its own representatives at bank board meetings.

Smaller banks with low-cost liabilities are attractive bets for bigger para banks, and a successful deal involving Lakshmi Vilas could act as a template for Indian financiers.

"We have already sounded out the central bank and it seems to be positive about this idea, should the merger tick all the boxes," a person familiar with the matter said. "We are actively evaluating the possibility of the merger with Indiabulls Housing Finance. The board would discuss the issue, and this will be the first firm step towards the merger."

Indiabulls Housing's cost of borrowing is around 10.2-10.5% while that for Lakshmi Vilas is 6.7%.

To be sure, Lakshmi Vilas chief executive officer Parthasarathi Mukherjee said the possibility of a merger is "market speculation, at this point."

Given the challenges NBFCs face by way of access to low-cost financing in a tight liquidity market, the merger with a bank would bring synergy. This would also address capital concerns at smaller banks if they were merged with NBFCs that have asset books in excess of ₹20,000 crore. Lakshmi Vilas is also in discussion with two more NBFCs in the ₹20,000-crore assets club, sources said.

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Markets may Price In Positive Poll Outcome

Our Bureau

Mumbai: The Indian stock market could start pricing in a stronger election outcome in the coming weeks causing the Nifty to break its four-month range on the upside, while the broader market is likely to outperform, said Morgan Stanley. "The Nifty could be looking to break its 10,500-11,000 range to the upside, which it has respected since November 2018," said Morgan Stanley.

Sensex ended up 89.32 points or 0.2% from previous close at 36,725.42 on Thursday, while Nifty ended up 5.20 points from the previous close at 11,058.20.

The BSE midcap and BSE smallcap indices gained 5% and 8.4%, respectively, in the past two weeks. During the same period, the Sensex has gained 2.3%.

Morgan Stanley has attributed India's underperformance this year to rising oil prices and political uncertainty.

Both these issues have may have hit their peak in terms of negativity, Morgan Stanley said, adding that its global team does not expect oil prices to continue rising.

Morgan Stanley said the recent events on the political front including various pre-poll alliance formations, farm cash transfer scheme and military action across the border may cause polarisation in the upcoming general elections and increases probability of a stronger govenrnmment.

The firm's base case is that the election outcome, likely in May, may be too close to call.