ET Q&A

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Fund Flows into India to be Healthy Despite LTCG Tax

Notwithstanding the concerns about high valuations and elevated oil prices, the Indian stock market is likely to benefit from recovery in earnings, strong fund flows and supportive government policies, said John Praveen, chief investment strategist at Pramerica International Investments. In an interview to **Sanam Mirchandani**, Praveen said he is positive on metals and materials, private banks and rural themes such as fertiliser. Edited excerpts:

Do you expect Indian markets to fall further from current levels in the near term?

While investors are concerned about valuations, lack of tailwinds from RBI and higher oil prices, stocks are likely to benefit from recovering earnings, supportive government policies and strong fund flows. Valuations remain well above long-term averages, and hence, the earnings recovery and continued strength of domestic inflows remain key for market performance. Further, the global backdrop is improving with global stock markets rebounding as the underlying corporate earnings and GDP growth fundamentals remain intact. The early February sharp sell-off and heightened volatility was driven by inflation concerns and rate fears, amplified by program trading. However, fears of rising inflation and more aggressive Fed rate hikes are exaggerated and we expect markets to fully recoup the February losses driven by strong earnings growth with boost from US tax cuts and solid global growth momentum. Finally, policy normalisation by the Fed, ECB and Bank of England is likely to be gradual, despite market fears.

What is the road ahead for fund flows into Indian markets after the government reintroduced long-term capital gains tax on equity last month?

We expect fund flows into India to remain healthy despite the government's decision to reintroduce long-term capital gains. Global investors are likely to be focused more on the fundamentals of the economy and companies, rather than being fixated on capital gains tax, which are common in other major markets. The imposition of a modest capital gains tax could even be a positive as it may limit extreme trading activity.

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ON INDIAN ECONOMY

Investors may focus more on the fundamentals of the Indian economy and companies, rather than being fixated on capital gains

Are you worried about the widening fiscal deficit in India?

We are not excessively concerned about the fiscal deficit widening. While the expectations were for a populist budget, the actual budget turned out to be less populist with a focus on the farm and rural sector and likely a modest slippage of around 30 bps in the deficit. We will look for the possibility of any further slippage due to the additional remuneration for farmers. Further, there is a possibility of a slippage of revenues from GST given it is still in earlier stages of implementation. However, once the GST revenues stabilise, the fiscal slippage can even be reversed. Overall, the budget assumptions look reasonable for now.

What is your assessment of the India's banking and financial system after the fraud at Punjab National Bank surfaced?

The recent bank scam in India has not changed our confidence in the country's overall banking and financial system. While the magnitude of the scam seems large on absolute basis, it is very small as compared to the overall size of the banking system. However, the scam shows that the supervisory processes at public sector banks failed to detect the fraud and there is a significant need for banks to improve the processes going forward.

What are your preferred investment themes in India?

PNB FRAUD

Recent bank scam in India shows there is a significant need for the banking system to improve the processes going forward

Within India, we are looking at metals and materials sector mainly because if you are having a lot of infrastructure spending on roads, there will probably be strong demand for the materials sector. We also like rural themes, like fertiliser, as the government is trying to shore up the income of the rural sector. The consumer sector story is still there but it is much more of a longer-term story. In banking, the bias is a little more towards the private banks. Globally, we like the Industrial sector, the financial sector, especially banks, and the IT sector.

What is your outlook on emerging markets?

This is still a positive environment for EMs because stronger US growth, Europe and Japan growing at an above-trend pace should lead to stronger commodity prices and that should support emerging markets and also EM exports. EMs have also been growing at a good pace. They will continue to grow at a solid pace. In India, growth slowed down a little in 2017. So, we should see a recovery in growth in India in 2018. In 2017, EMs were up 25-30%. We may not get 25-30% gains in 2018 but could get 10-15% gains for the EMs. The strong growth backdrop in US and Europe is supportive for EMs.

Is the phase of low volatility in global markets over?

Volatility has been artificially low and that may be reflecting in complacency in markets and also because some market participants were betting on volatility remaining low. However, we have seen a big rise in volatility in February this year. We may see volatility rising further, if we have more aggressive rate hikes by central banks or higher inflation or increased geopolitical tensions.