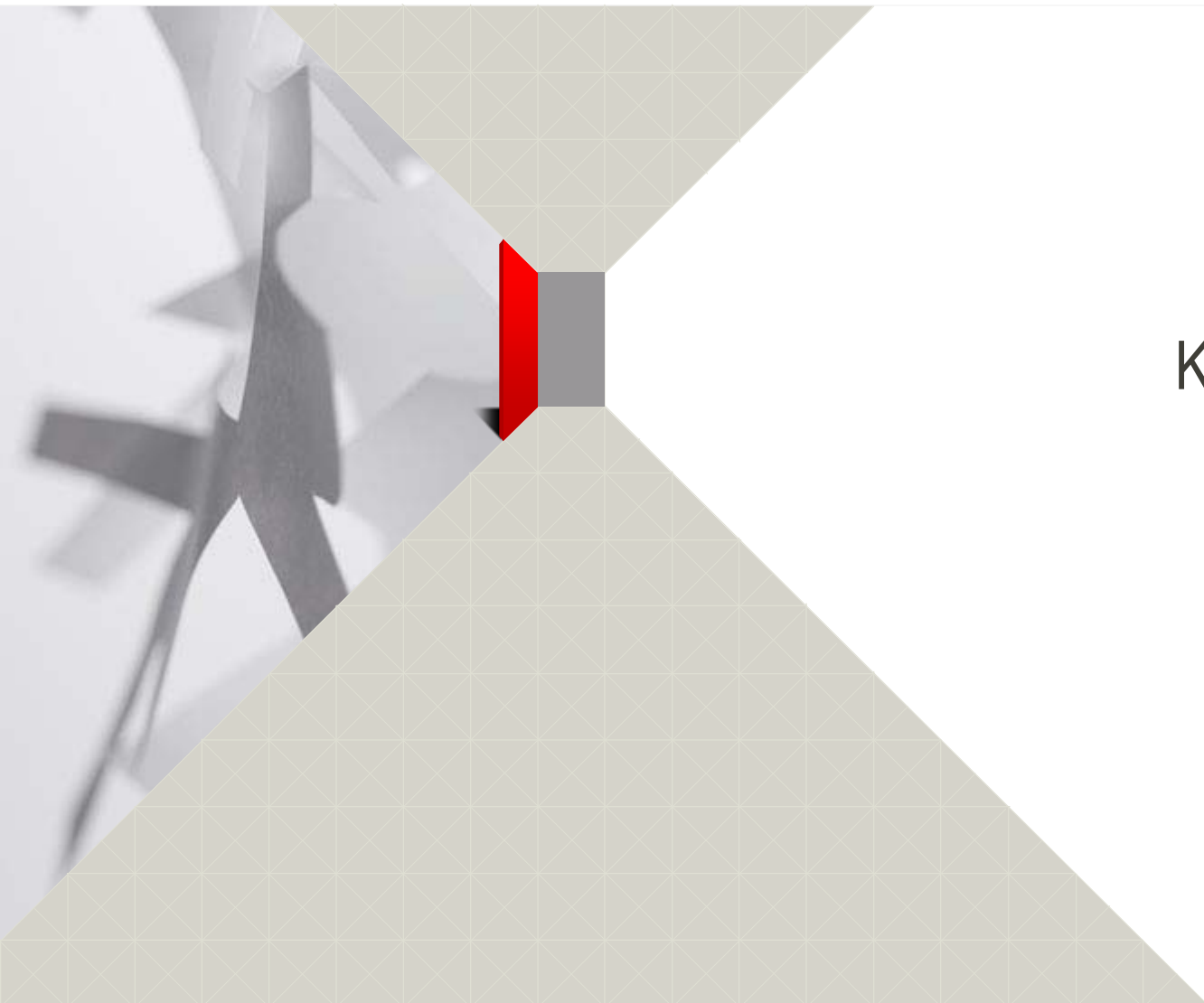


India Strategy

November 2011



Key Economic Forecasts

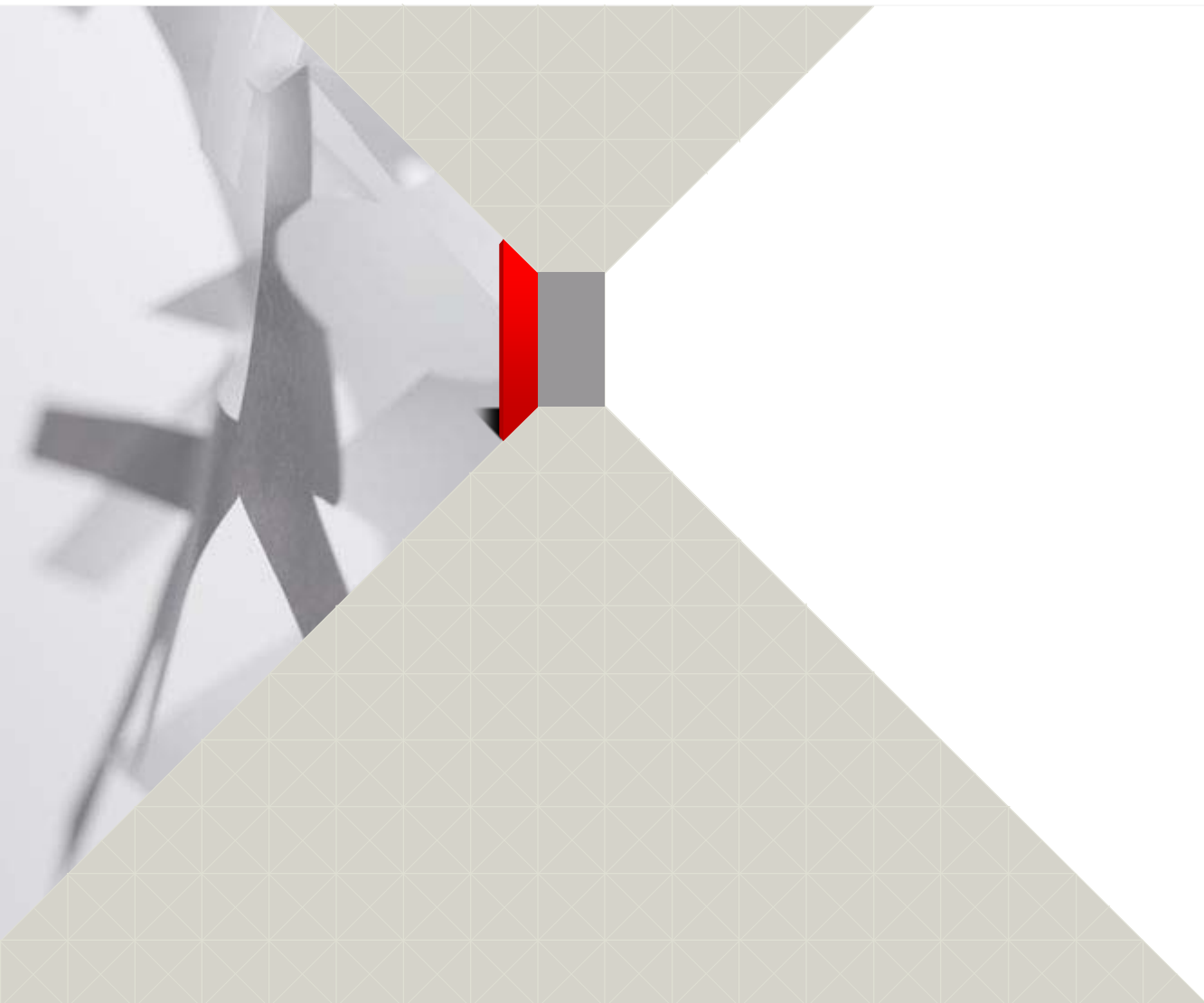
November – Strategy

India - Key Macro Economic Forecasts

▶ Snapshot of key Indian economic forecasts

	2007	2008	2009	2010	2011f	2012f	2013f
Production, demand and employment							
GDP growth (% y-o-y)*	9.3	6.8	8.0	8.5	7.4	8.1	8.3
Nominal GDP (USDbn)	1,220	1,252	1,353	1,720	2,067	2,500	2,751
GDP per capita (USD)*	985	1,027	1,083	1,347	1,586	1,906	2,158
Private consumption (% y-o-y)*	9.3	7.7	7.3	8.6	7.9	8.1	8.3
Government consumption (% y-o-y)*	9.5	10.7	16.4	4.8	3.7	3.8	3.7
Investment (% y-o-y)*	16.2	1.5	7.3	8.6	7.1	8.5	8.8
Net Exports (contribution to GDP growth, ppt)*	-1.5	-3.1	-0.8	1.2	-3.5	-1.2	-1.5
Industrial production (% y-o-y)	8.7	3.2	10.5	7.8	4.2	6.4	8.1
Gross domestic saving (% GDP)*	35.6	32.3	32.3	33.7	34.5	35.1	35.2
Prices & wages							
CPI, average (% y-o-y)*	6.2	9.1	12.4	10.4	8.0	7.7	6.5
CPI, end-year (% y-o-y)*	5.5	9.7	15.0	9.5	6.9	7.7	6.5
Core WPI, average (% y-o-y)*	5.2	6.6	-0.3	4.9	7.5	6.1	4.5
Core WPI, end-year (% y-o-y)*	4.4	4.6	1.1	6.2	7.4	4.5	4.5
WPI, average (% y-o-y)*	4.7	8.1	3.8	9.6	8.7	6.9	5.6
WPI, end-year (% y-o-y)*	7.7	1.6	10.4	9.7	7.0	5.2	6.4
Money, FX & interest rates							
Central bank money M0, average (% y-o-y)	15.0	18.9	16.1	19.2	18.0	15.0	14.8
Broad money supply M3, average (% y-o-y)	21.9	20.4	19.2	16.1	15.0	16.1	16.6
Real private sector credit growth (% y-o-y)	15.6	14.0	6.8	12.0	11.5	16.0	17.5
Policy rate, end-year (%)	7.75	6.50	4.75	6.25	8.50	8.25	8.00
5yr yield, end-year (%)	7.67	5.35	7.31	7.85	8.20	7.70	7.50
INR /USD, end-year	39.42	48.46	46.69	44.81	49.00	45.50	44.00
INR /USD, average	40.88	44.58	48.39	45.74	46.46	47.36	44.44
INR /EUR, end-year	57.55	67.35	66.76	60.04	67.62	65.52	63.36
INR /EUR, average	56.82	64.92	67.62	60.37	64.34	67.14	63.99

Source – HSBC Global Research , Asian Economics Q4 2011



Equities

November – Strategy

Markets in October posted their biggest monthly gains in seven months on hopes of a probable EU zone debt bail out. RBI indications of a likely pause in policy rates also lifted sentiments.

- ▶ Indian Equity markets recovered from their lows at the beginning of the month to close October on a strong note.
- ▶ Announcement of the Euro zone debt deal, RBI's signal of a likely pause in policy rates and short covering on F&O expiry helped the key benchmark indices to post their biggest monthly gains in seven months.
- ▶ However, momentum was characterized by high volatility. The BSE Sensex ended the month of October at 17705 (↑ 7.6% M-O-M) and the S&P Nifty closed at 5327 (↑7.8% M-O-M).
- ▶ Mid and Small cap indices under performed as the BSE Midcap and the BSE Smallcap indices were up by 2.7% and 1.4% respectively. Sector wise, Auto, IT, Realty and Metals were major monthly sector gainers. There was no sector loser during the month.

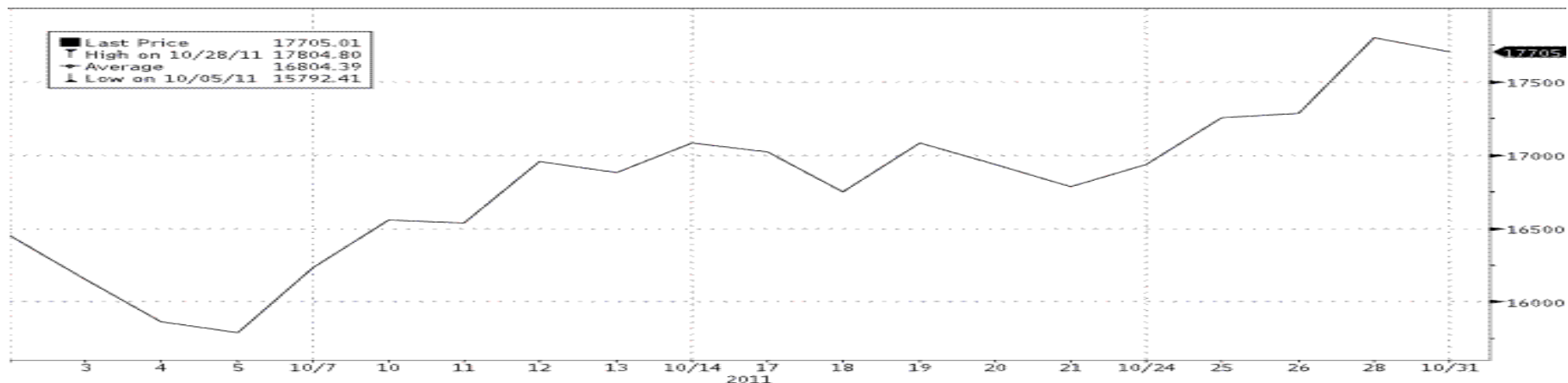
Index	% Change	Index	% Change
BSE Auto	11.5%	BSE 500	5.9%
BSE IT Sector	10.5%	BSE Oil	5.8%
BSE Realty Index	8.9%	BANKEX	5.6%
BSE Metal	8.3%	BSE Healthcare	4.6%
Nifty	7.8%	BSE Power	3.7%
BSE Sensex	7.6%	BSE Cons Durable	3.7%
BSE FMCG Sector	7.3%	BSE Mid-Cap	2.7%
BSE 100	6.8%	BSE Cap Goods	2.1%
BSE 200	6.3%	BSE Small-Cap	1.4%

Source – Capitaline/Bloomberg

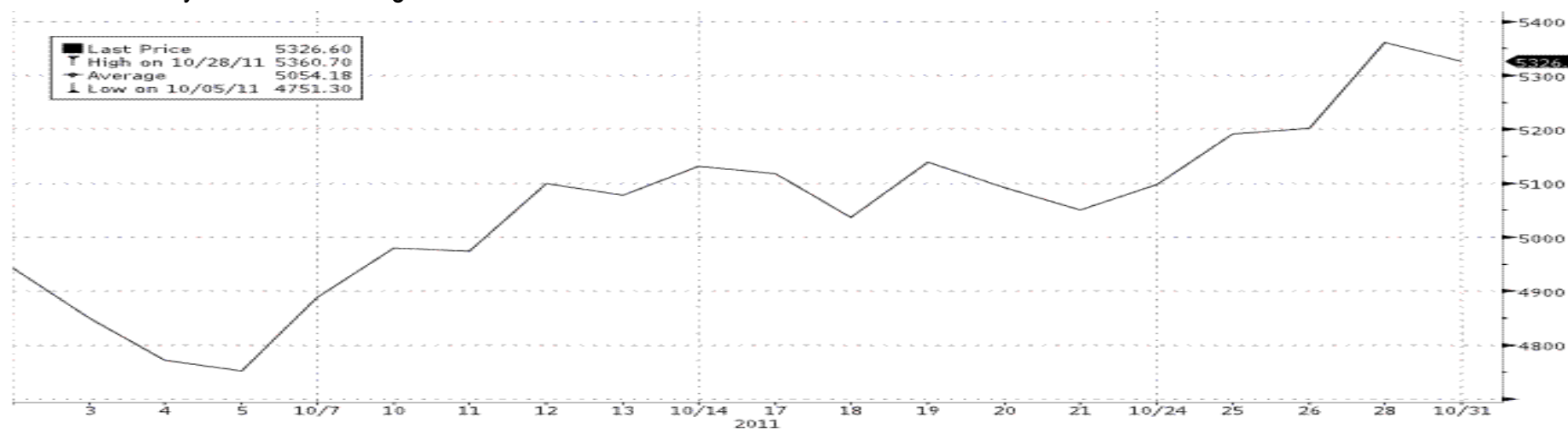
November – Strategy

Benchmark indices post decent gains from month's lows, but not without volatility!

BSE Sensex movement during the month



S&P CNX Nifty movement during the month

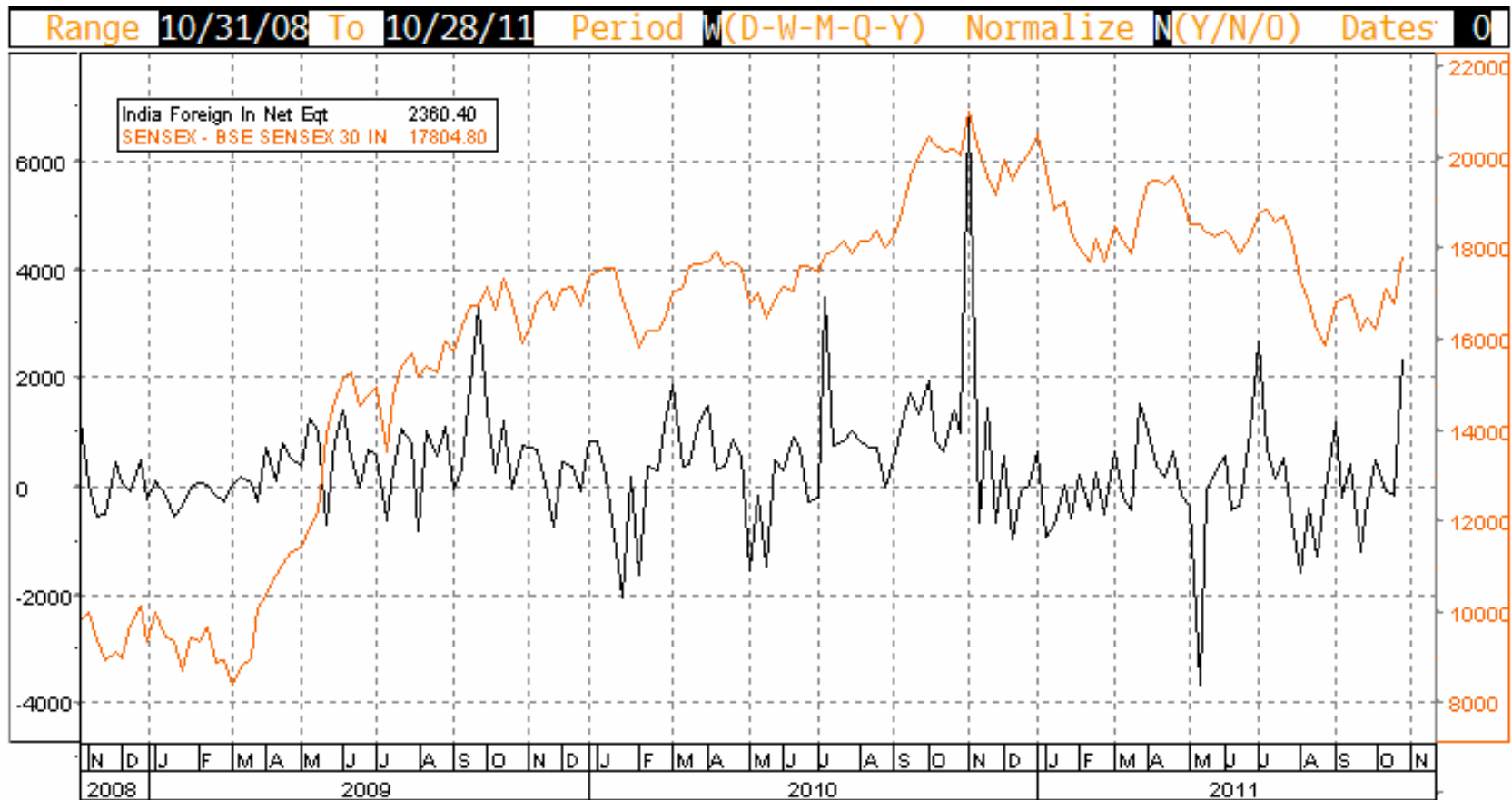


Source: Bloomberg

November – Strategy

Foreign institutional investors turn net buyers of Indian equities during October

- ▶ FIIs were net buyers of Indian equities in October. They net bought \$0.32Bn of Indian equities during the month. YTD, FIIs remained net buyers of Indian equities worth \$0.96Bn.
- ▶ Domestic mutual funds net sold equities worth \$0.08Bn during the month.



Source: Bloomberg. FII Flows in USD M

November– Strategy

Global economics: Risk of negative spiral cannot be overlooked

- ▶ Global economics –
 - As the Euro crisis builds and the US economy stalls, the developed world is succumbing to economic permafrost. The emerging world, however, looks better, but is not completely immune.
 - Unconventional monetary policies offered hope, but achieved little, undermined by the growing political uncertainty stifling economic growth.
 - We expect global growth of 2.5% in 2011 (compared to 3% in our last update). While the growth numbers remain positive (unlike the collapse post-Lehman in 2009), they are not sufficiently robust to suggest that we are approaching a decent recovery in economic activity. **Remain positive on the outlook for China and India.**
 - With already fragile investor sentiment, the risks of a negative spiral cannot be overlooked that could potentially feed into the broader economy.
 - We expect cautious investor sentiment to remain the main driver of markets in the coming months.

Source: HSBC Global Research/RBI/Ministry of Commerce/HSBC Private Bank Market Primer/Q4 2011 Global economics quarterly

November– Strategy

Inflation remains at elevated levels, impact of successive rate hikes to impact demand

- ▶ The index of industrial production (IIP) in August '11 picked up marginally to 4.1% vs. 3.8% in July, but was lower than expected.
 - Manufacturing (4.5% y-o-y vs. 3.1%) drove the improvement while electricity and mining were lower.
- ▶ Momentum in India's manufacturing PMI sprung back to life in October after successive months of marked deceleration.
 - PMI bounced back to 52 vs. 50.4 in September driven by an improvement in sequential output growth (52.7 vs. 51.1)
 - While a spurt in domestic orders pulled up other activity indicators, input and output prices continued to rise at an uncomfortable pace.
- ▶ WPI inflation eased marginally in September but remains at elevated levels
 - WPI headline inflation for September came in at 9.7% y-o-y while core inflation (non-food manufacturing) eased to 7.3% y-o-y vs. 9.8% y-o-y in August
 - The September WPI reading confirmed the persistence of inflation pressures with a suggestion that it is not going to turn south any time soon, especially when one factors in the historically high level of inflation inertia in India.
 - Core inflation continues to be the key driver, which, from RBI's perspective, confirms the need for continued tightening of interest rates.
- ▶ RBI hiked policy rates by 25bps, in addition, it also presented some developmental and regulatory policies, like savings rate deregulation
 - Repo rate now stands at 8.5% and RBI signaled a likely pause at the December meeting and possibly hereafter if upside risks to inflation do not materialize
 - FY 12 GDP growth forecasts now revised downwards to 7.6% from earlier estimate of 8% while inflation expectations (March '12) were maintained at 7%
 - Whilst we may be close to the end of the tightening cycle, the policy rate will have to stay elevated for quite a while before we can comfortably assume that inflation will slide into comfort zone. Inflation pressures from excess demand and pent-up cost pressures will continue to keep RBI inclined to keep rates high for an extended period.

Source: Bloomberg/HSBC Global Research

November– Strategy

High inflation & macro headwinds (US growth, Euro zone concerns), Q2 FY 12 earnings and policy initiatives from the government to affect market sentiments.

- ▶ Q2 FY 12 results so far have been a mixed bag. Private banks and IT reported earnings have been in line with expectations. Mid and Small cap stocks results reflect impact of higher interest rates and input costs.
- ▶ Markets are expected to trade in a range in the near term given the uncertainties on several fronts (inflation, political uncertainty, global macro risks) .
- ▶ However, India's long-term earnings outlook continues to remain positive given its robust economic growth prospects, while India's minimal exposure to global structural risks may result in continuance of foreign investment flows into the country.
- ▶ At 17,705 the Sensex trades at a P/E of 15X FY12e (Bloomberg Consensus EPS estimate of Rs.1,174). Our year end 2011 Sensex target is now revised to 16,500 from earlier estimates of 20,000 and for CY 2012 end it is 17,800.
- ▶ We advise staggered entry into equities to take advantage of the ongoing volatility in the markets.
- ▶ We continue to favour select large caps given the valuations at which they are trading, while a stock specific approach is advised towards mid-cap stocks. Key events that may impact the markets in the near term are: Inflation and policy initiatives, global economic data-flows (clarity on US growth prospects, progress on Euro zone debt deal) and corporate guidance on growth prospects along with the Q2 FY 12 earnings announcements.
- ▶ At the sector level, we favor Industrials, Materials, Utilities & Telecom. We are neutral on Financials, IT, Energy & Consumer Discretionary. We are Underweight on Consumer Staples & Healthcare

November – Strategy

Overweight – Industrials, Material, Utilities & Telecom; Underweight – Consumer Staples & Healthcare

- ▶ **Industrials – Overweight** – While near term order book inflows are expected to be muted valuations of the sector look attractive even in worst case scenario, after the recent correction. We expect order book to continue to pick up. Not a lot has changed in terms of the demand outlook, where in companies are positive on pricing but cautious on margins and market expectations.
- ▶ **Materials – Overweight** – While there are positive developments within the industry, ranging from steel mergers and government measures, we believe this is offset by risks to global demand for metals. While demand still remains weak given global growth uncertainties making it difficult for metal makers to pass on rising raw material costs, valuations start to look attractive with most of the stocks now trading their historical average P/BVs.
- ▶ **Utilities – Overweight** – With rising energy costs and stable electricity prices, the utilities sector is facing a margin squeeze, which has been the reason for our neutral stance on the sector in the past though we expect acceleration of power capacity addition (18GW in FY12 versus 31GW commissioned over the last four years) and high sector capex during FY12 (the last year of the 11th five-year plan). The sector will continue to face an overhang regarding project execution, fuel availability and financial health of SEBs (State Electricity Board). However, given the fact that the Indian players enjoy relatively better returns than most of their Asian counterparts and hence are in a position to safeguard their margins, raise the rating to Overweight.
- ▶ **Telecom – Overweight** - We expect the outlook for the Indian telecom sector to improve going forward, driven by progress on the regulatory front, stabilization of tariffs and launch of 3G services. Increasing penetration and consumer spending remain strong growth drivers for the sector. Better volumes and price stability offers increased earnings visibility.
- ▶ **Consumer Staples – Underweight** –Key themes for playing this sector are product re-pricing and earnings recovery. Things have changed during the last three to four months as companies have developed strategies to deal with rising food prices. Underweight largely due to stretched sector valuations and recent out performance

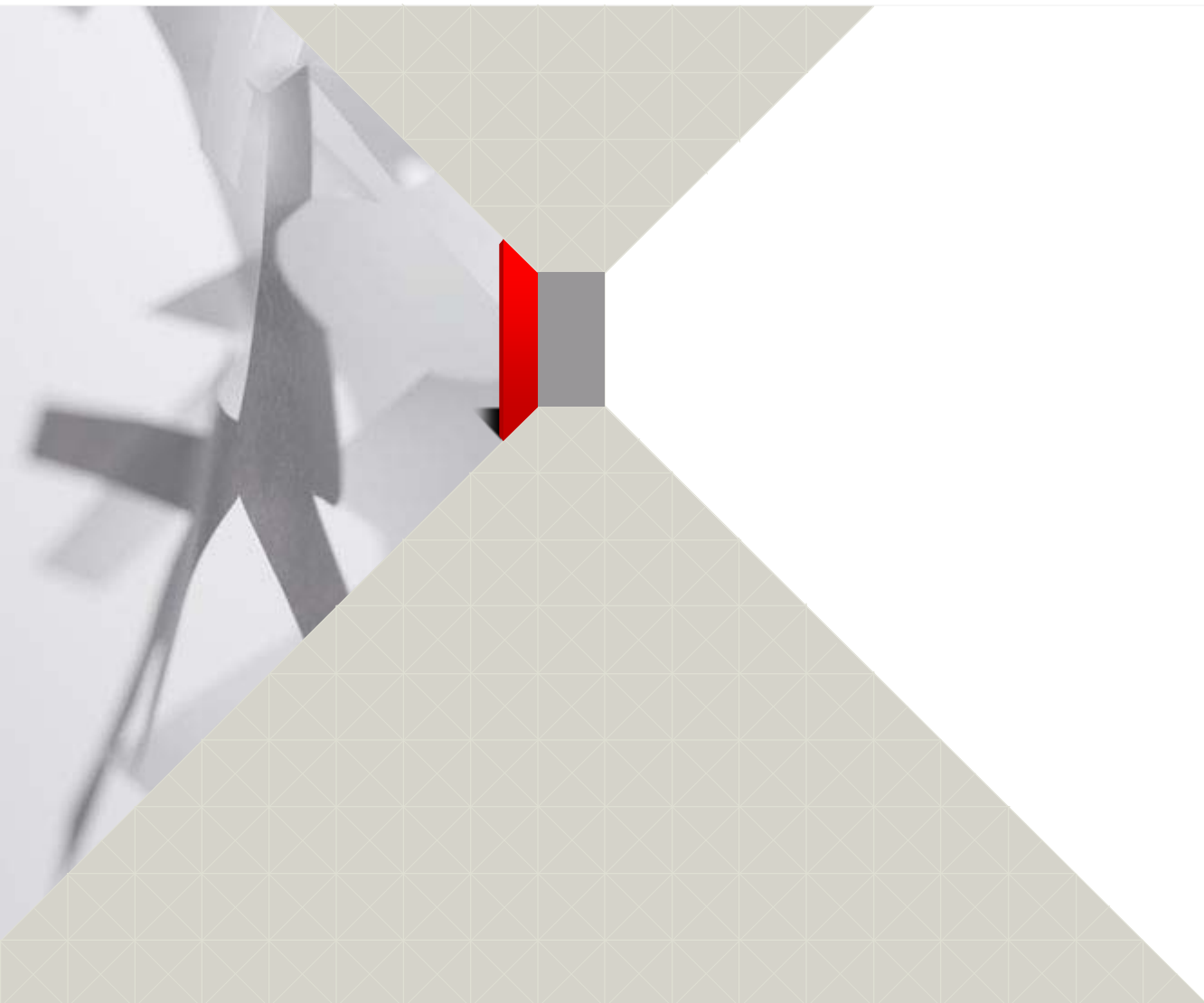
Source HSBC Global Research

November– Strategy

Neutral – Energy, consumer discretionary, Financials & IT

- ▶ **Healthcare – Underweight** – Key themes to play the sector are – strength in emerging markets, development of new growth areas such as bio similar & several block buster drugs losing patent exclusivity in the US and EU during 2011- 15. For Indian generic players, demand for cheaper generic drugs is set to remain healthy as western governments cut back on healthcare budgets. Underweight rating largely on the back of recent out performance and valuation richness and not on fundamental weakness.
- ▶ **Energy – Neutral**– Environment is challenging for upstream and refineries as margins are likely to remain moderate. Also the sector faces government policy risk. However strong economic growth would keep the demand strong.
- ▶ **Consumer Discretionary – Neutral** –Inflationary concerns and higher interest rates continue to be key near term concerns for the sector. Rising rates tend not to be conducive to discretionary spending. Indeed, the reaction to slower consumer spending often comes with some time lag particularly in the automobile sector. However increasing purchasing power would keep the demand strong.
- ▶ **Financials – Neutral** – Rising rates has been one reason for the weak performance of bank stocks. Another reason for bank's underperformance is concern about bank loans to the power sector, where projects have been delayed and the risk of NPLs is rising. However, we believe these concerns are overblown (NPLs remain low), highlighting that the combination of a peak in interest rate expectations, a recovery in working capital demand and low valuations could boost performance over the next few quarters. Hence rising the sector to Neutral from Underweight.
- ▶ **Information Technology – Neutral** – We believe demand momentum remains uncertain for 2012, as the macro data coming out of the US and Europe have been deteriorating. However, unless the macro situation deteriorates materially, we do not see significant downside risk to our average 10-15% USD top-line growth forecast for the sector. Moreover, we have not factored in any benefit from INR depreciation and margin levers such as lower variable pay. While stocks are likely to remain range-bound in the near term, unless macro data from the West improve, long-term investors may want to look for value buying opportunities on dips.

Source HSBC Global Research



Fixed Income

November – Strategy

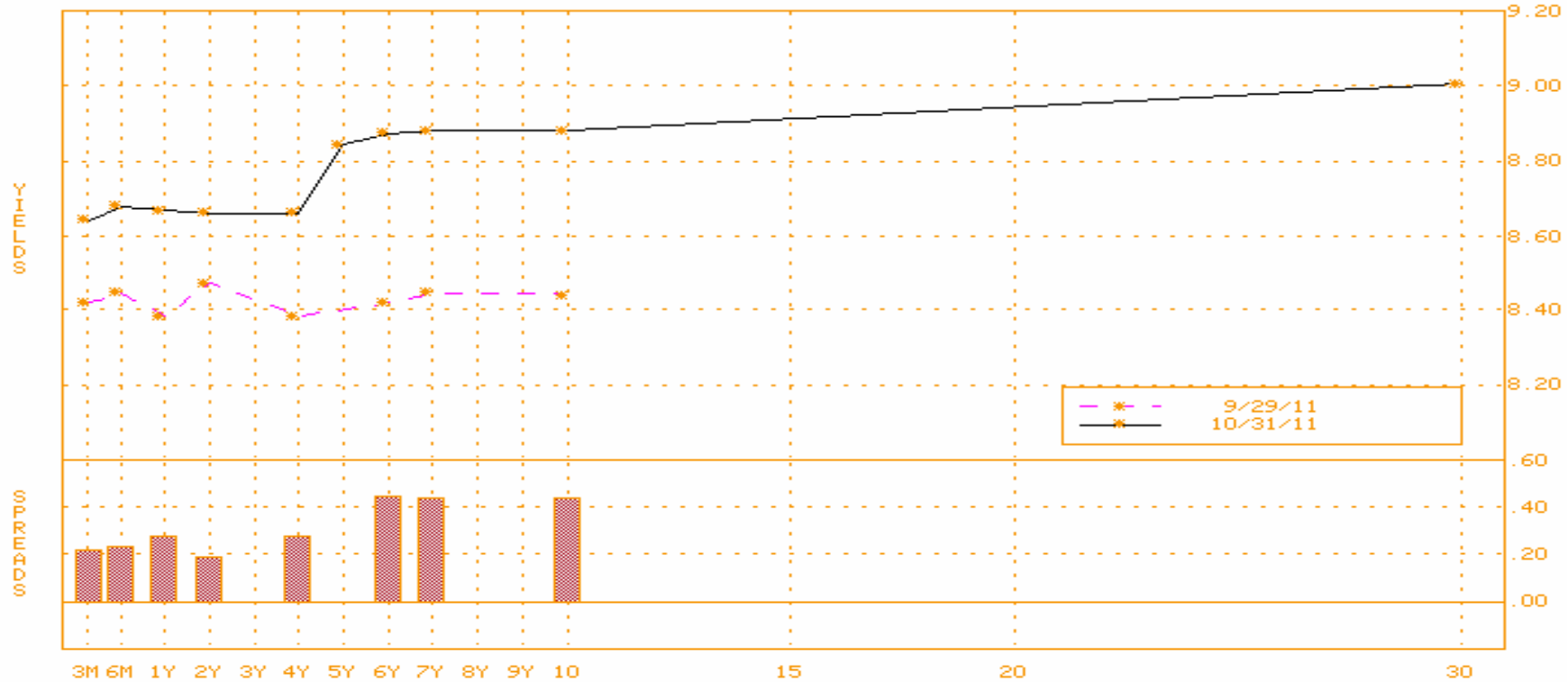
Fixed Income

INR India Sovereign

10/31/11

vs 9/29/11

3M - 30



Indian Government Yield Curve

Source: Bloomberg

- The ten year bond yield in October '11 traded in a range of 8.52% to 8.88% and ended the month at levels of 8.88% (Source Bloomberg) predominantly due to market expectations of slippage on the fiscal front, devolvement of select issuances and on RBI continuing to increase policy rates (repo and reverse repo rate).
- The RBI in October '11 on a daily basis infused liquidity amounting to INR 508B (month's average) as against INR 522B (month's average) in September '11 (Source: Bloomberg)

November – Fixed Income Strategy

Inflation to remain sticky – expected to ease from December

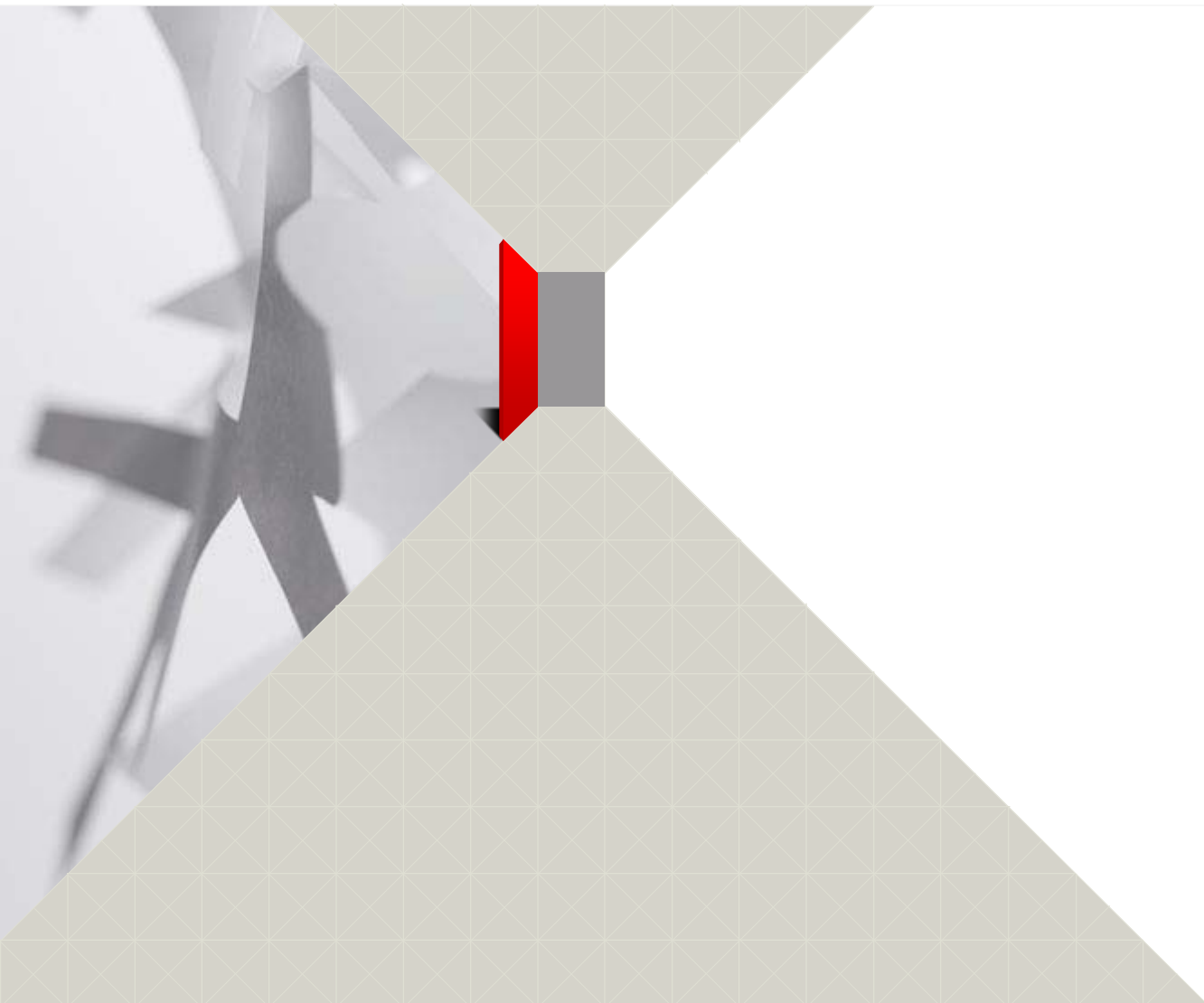
- ▶ The Reserve Bank of India in its second quarter review of the monetary policy has reduced its baseline growth projection for FY12 to 7.6% while its baseline projection for WPI inflation for March'12 remained unchanged at 7.0%. Inflation movement in the coming months will be broadly determined by demand and supply factors, international commodity prices and food items.
- ▶ The RBI while increasing policy rates stated that it expects inflation to start falling in December '11 and with the cumulative impact of monetary tightening yet to impact in totality, the likelihood of further rate hikes in their December policy review seems unlikely.
- ▶ The Government of India has completed in-excess of 60% of its borrowing program for FY12 till date. Select issuances in October witnessed partial devolvement which in turn led to volatility in the markets, thereby causing the 10 year G-sec yield to spike to nearly 3 year highs.
- ▶ WPI Inflation in September '11 was 9.72% (provisional numbers and on a year on year basis) as against 9.78% (year on year basis) witnessed in August '11. In September, primary articles, fuel & power and manufactured products rose by 11.84%, 14.09% and 7.69% respectively (on a year on year basis). WPI Inflation reading for July '11 was revised upwards from 9.22% to 9.36%. (Source: Government of India)
- ▶ Systemic liquidity in October'11 remained tight due to the ongoing government borrowing programme and the Reserve Bank of India during the month issued INR 100B worth of 48 days cash management bills at yield of 8.69%.

Data Source: HSBC Global Research/ Reuters/ Bloomberg

November – Fixed Income Strategy

Policy tightening spree seems to have come to an end

- ▶ We recommend investors to take exposure at the shorter end of the yield curve through ultra short and short term bond funds.
- ▶ Investors having a pre-defined investment horizon and are willing to lock-in their monies may selectively consider Fixed Maturity Plans.
- ▶ Investors having a medium term investment horizon may consider investing into products that maintain exposure to issuances maturing over the next two years as apart from earning accrual income, there exists the possibility of trading gains.
- ▶ Selective exposure maybe undertaken to longer tenure bonds especially the tax free issuances as consensus expectations are that the RBI has completed its policy tightening spree as the Central Bank expects inflation to ease from December '11, unless any adverse developments impact inflation.



Currencies

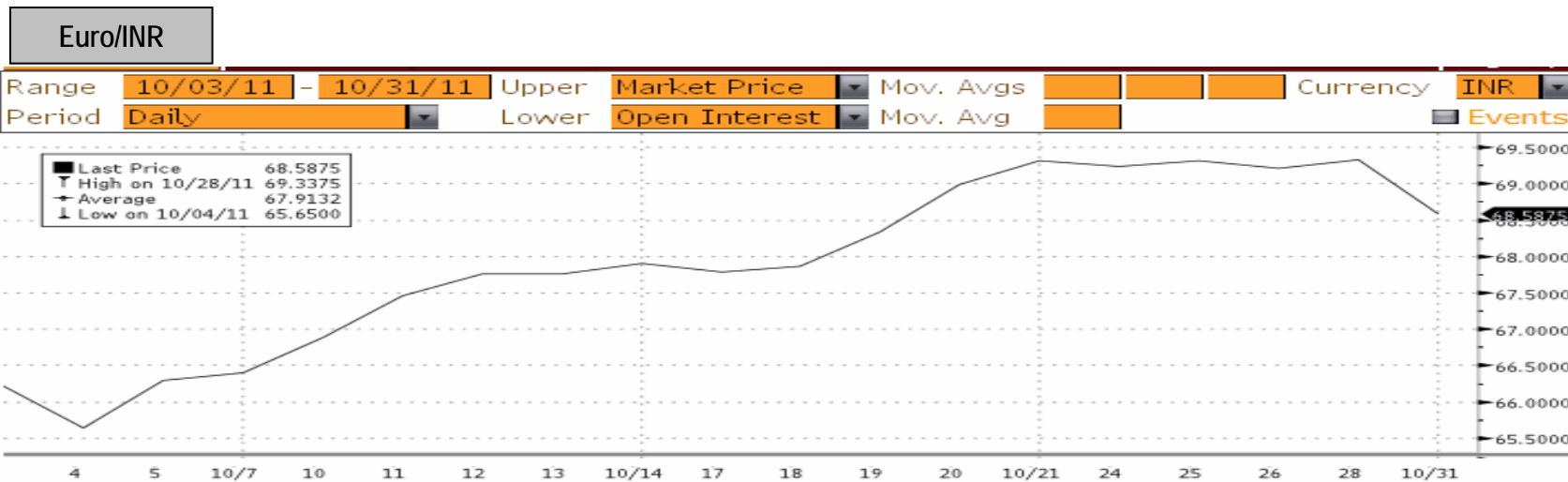
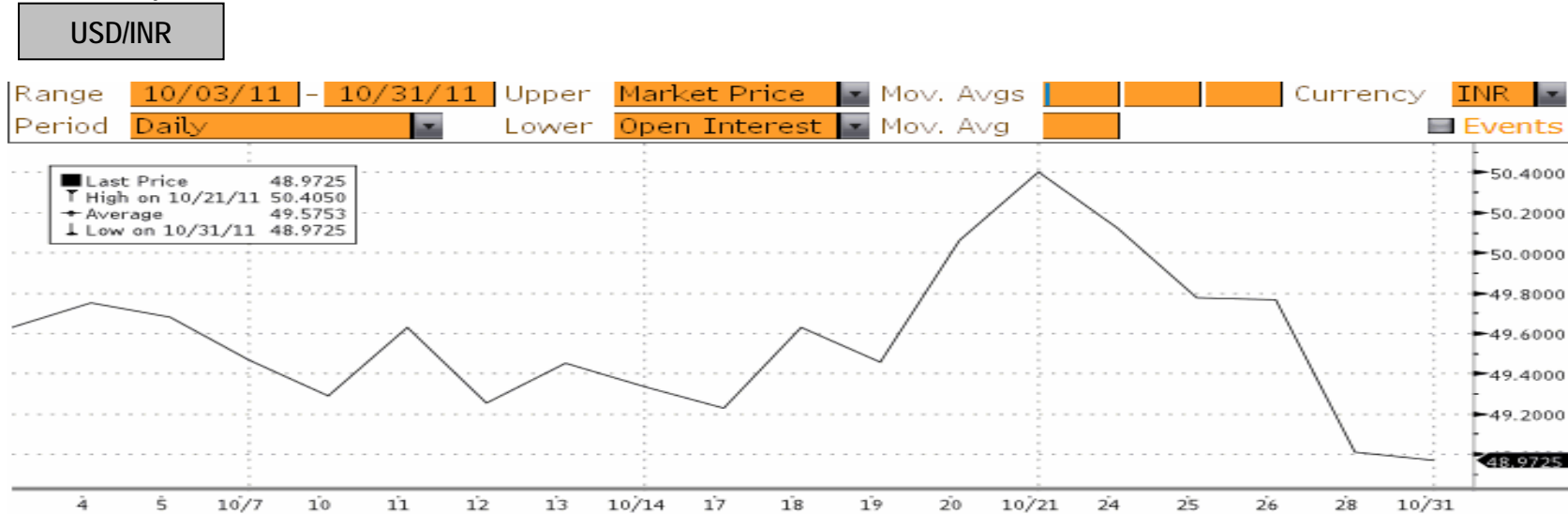
November – Strategy

Short term risk aversion should support USD

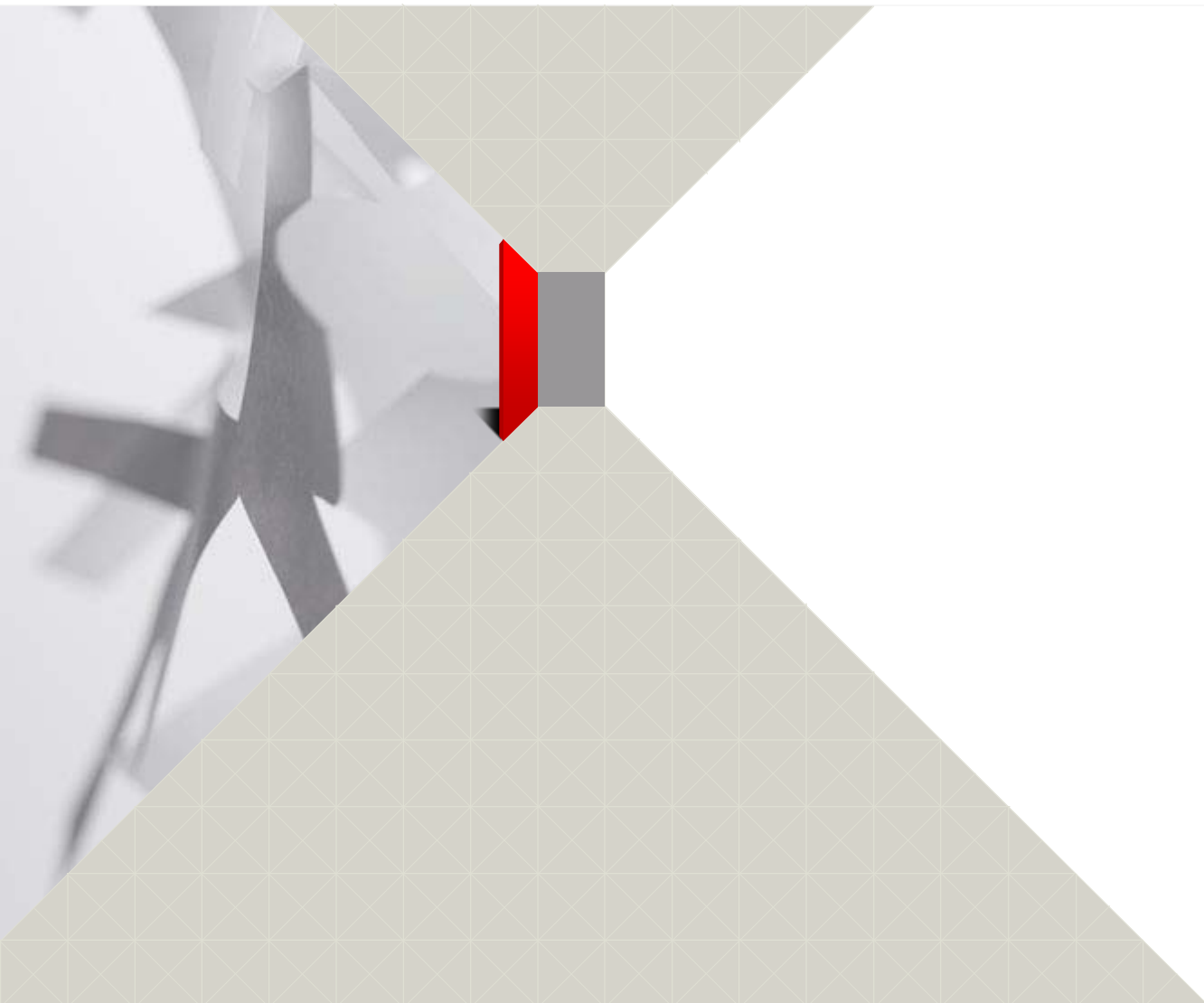
- ▶ **INR** - The INR strengthened during October and ended the month at 48.70 against the USD (Source: Bloomberg). Our December 2011 target for INR stands at INR 49.
- ▶ **USD** – In the short term, we expect the rise in risk aversion to remain the main driver of currencies, and therefore expect USD to continue to benefit in the coming months. We hold a Neutral view on USD for the next 12 months.
- ▶ **Euro**– We believe that the positive sentiment towards the Euro, driven by the interest rate hikes by the European Central Bank, is running into resistance, as sovereign debt concerns accelerate further. This may limit EUR strength and we hold a Neutral view on the EUR over the next 12 months.
- ▶ **GBP**- The weak economic backdrop may keep the currency in check as interest rate hike expectations continue to be pushed further out. In addition, renewed QE by the Bank of England may weigh on GBP. We hold a Neutral view on GBP with a negative bias for the next 12 months.
- ▶ **JPY** – Intervention remains a strong possibility given the strength of the yen and its impact on exporters. We hold a Neutral view on JPY for the next 12 months.
- ▶ **Emerging Markets (EM)** – While we maintain our positive outlook on emerging market (EM) currencies in the long run, we believe the current environment may impact these currencies in the short term. We focus on currencies with strong fundamentals for the time being. In the longer term, we continue to believe that strong fundamentals will support EM currencies. We hold a positive view on Emerging Market currencies for the next 12 months.

November – Strategy

Currency movements....



Source - Bloomberg

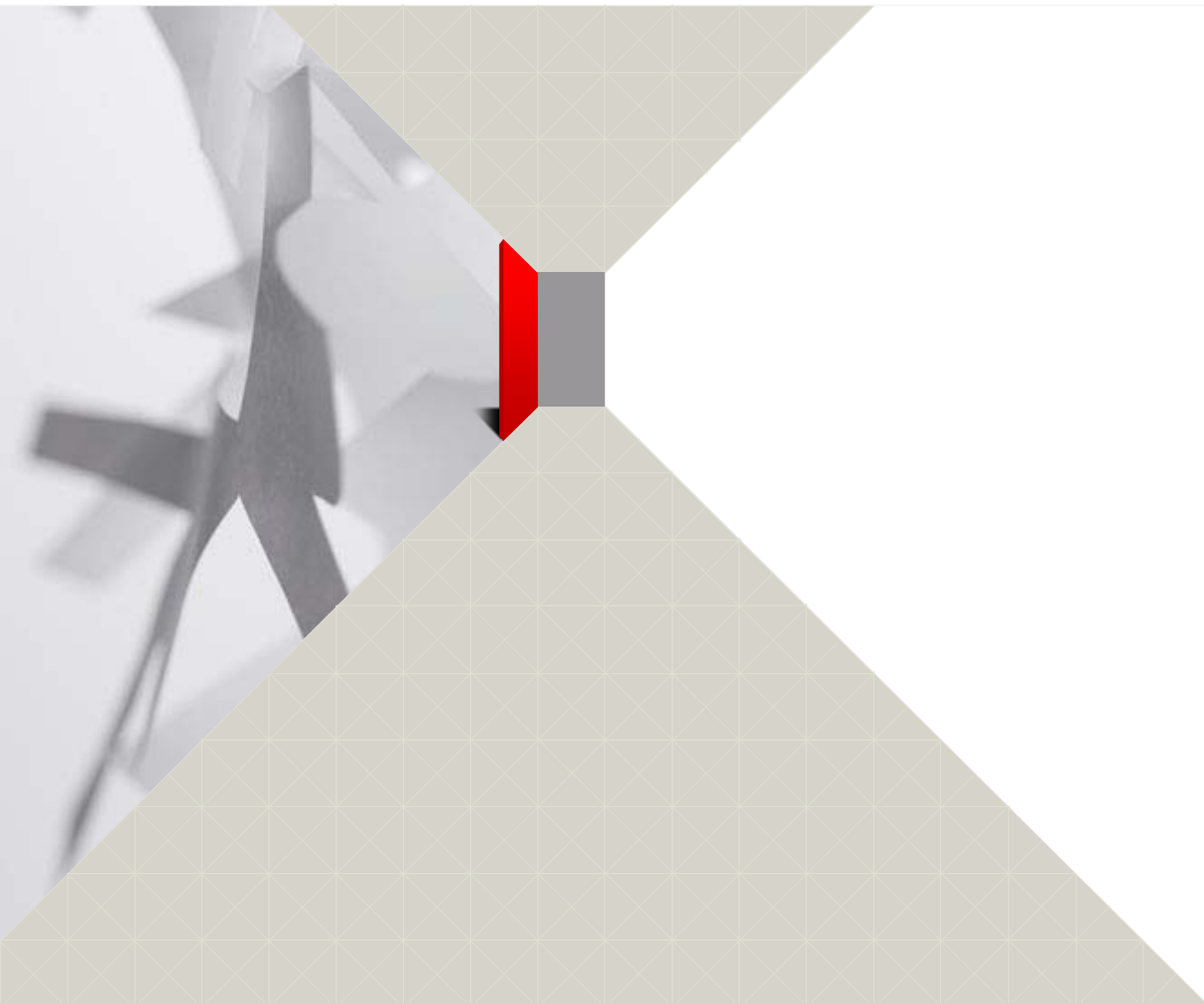


Commodities

November – Strategy

The uncertain economic outlook is likely to continue to weigh on prices

- ▶ We believe that concerns about the current slowdown in economic growth and residual tightening measures in the emerging markets are likely to weigh on demand for commodities in the coming months. In addition, USD strength is likely to be an additional headwind for commodities.
- ▶ **Gold:** Gold strengthened in October and ended the month at US\$1,715 (Source: Bloomberg). Demand for gold should remain underpinned due to its status as a safe haven. Ongoing debt concerns, particularly in the Eurozone and in the US should support gold as uncertainty persists. With commitment by Western central bankers to keep monetary policy accommodative for a long time, the 'opportunity cost' of holding gold remains negligible. Further, currency diversification should continue to support demand for gold, which still seems a good alternative to Western currencies, which see their value deflated by high government debt piles. However, we expect price volatility to remain high in the coming months as we could see more violent swings. This is in part due to extreme risk aversion, which is supporting USD. For the next 12 months, we hold a neutral view on Gold with a positive bias.
- ▶ **Oil:** Brent crude oil strengthened in October and ended at \$109.6/bbl (Source: Bloomberg). The slowdown in growth is likely to outweigh ongoing tensions in the Arab World and keep prices near current levels for now. In the longer term, we expect oil prices to remain supported by EM demand and this may take some time to materialise. For the next 12 months, we hold a neutral view on oil.
- ▶ **Industrial Metals:** In our view, industrial metal price appreciation may be subdued as growth slows, but underlying demand appears fairly resilient and should benefit from the strong Chinese economic outlook and growth in the emerging markets in the longer term. For the next 12 months, we hold a neutral view on Industrial Metals.
- ▶ **Agricultural Commodities :** We expect agricultural commodities to remain volatile given uncertain weather patterns, although the longer-term trend of growing demand from the emerging markets should provide some support to prices. For the next 12 months, we hold neutral view on agricultural commodities.



Summary of Views

November – Strategy

Asset Class	Sub Class	Current Month	Previous Month
Equity		=/-	=/-
	Industrials	+	+
	Utilities	+	+
	Metals	+	+
	Cement	+	+
	Real Estate	=	=
	Financials	=	=
	Information Tech	=	=
	Consumer Staples	-	-
	Consumer Discretionary	=	=
	Healthcare	-	-
	Telecom	+	+
Energy	=	=	
Debt		=	=
	Liquid Assets	=	=
	Duration	=	=
	Credit	=	=
Currency			
	INR	=/+	=/+
	USD	=	=
	GBP/ USD	=/-	=/-
	Euro/USD	=	=
	USD/JPY	=	=
Emerging Markets	+	+	
Commodities		=	=
	Gold	=/+	=/+
	Oil	=	=
	Industrial Commodities	=	=
	Agri Commodities	=	=

Guide to Symbols in this document

- Negative

=/- Neutral with a negative bias

= Neutral

=/+ Neutral with a positive bias

+ Positive

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