# 'Among emerging mkts, India least linked to global cyclicals'

Q&A

**ANAND RADHAKRISHNAN**
Chief investment officer, Franklin Templeton Investments

Interest rates are expected to play a pivotal role in shaping corporate earnings and in stimulating consumer spending, **ANAND RADHAKRISHNAN**, chief investment officer, Franklin Templeton Investments, India, tells **Ashley Coutinho**. Edited excerpts:

**The equity market has seen a lot of volatility in the past few months. Your outlook for the year ahead?**

Though the current recovery is uneven, due to both internal and external headwinds, with accelerating urban consumption and public sector investment, potential improvement in rural consumption along with benign inflationary pressure and a reform-oriented government, we believe India could still continue to be among the fastest growing economies.

Although the recovery is yet to gather momentum, the building blocks required for sustainable economic recovery seem in place. With respect to the pick-up in investment cycle, while corporate capital expenditure has been weak due to low capacity utilisation, government spending has bounced back, wherein the quality of spending is much better, given the focus on capital spending. Going ahead, interest rates are expected to play a pivotal role in shaping corporate earnings, as well as stimulating the consumer spending. With markets valuations close to the long term average and expectations regarding the trickle-down effect of interest rates, corporate earnings are likely to improve in the next financial year and, hence, prospective market returns will be a function of corporate earnings growth.

**How is India placed among other emerging markets?**

From a structural perspective, we expect the share of global flows into India to increase in line with the rise in the share of global gross domestic product. There are a lot of global factors that will impact capital markets and the economy — many companies are in the commodity sector or have external linkages in the form of exports. But, among many emerging markets, India perhaps has the least linkage and earnings sensitivity to global cyclical factors. This should help our markets navigate the volatility much better.

Further, India stands less correlated to the synchronised challenges the developed markets face and, hence, provide a useful diversification from a global investor's perspective. These trends have generally played out in the past and will in the future, too.

India will also outperform other markets, for these very reasons. Today, the growth cycle hasn't really picked up and global volatility is very high. That makes the medium to long-term visibility on our growth a little muddled and is resulting in some outflow. But, once the growth cycle picks up, India should start seeing an increase in global flows.

**What is your assessment of the third quarter performance of Indian companies?**

Corporate earnings downgrades could continue for some more quarters. However, given the base effect and indications of economic recovery, the pace of these downgrades could be relatively lower. While there have been interest rate cuts by the Reserve Bank (of 125 basis points in 2015), the transient effect of these is yet to be seen. With the evolution of lending rate calculation, the economy and subsequently the corporates are likely to benefit from lower rates. Also, the base effect could lead to better year-on-year corporate performance in the second half of this financial year and, hence, a pick-up in earnings growth might be visible from FY17. The corporate profit cycle is close to all-time lows and, hence, valuations appear reasonable at the current stage.

**It's largely the domestic institutional players that supported the market last year. Do you expect this trend to continue?**

Domestic flows into equity funds have moderated meaningfully over three months. So, if selling continues from foreign investors, it might not be possible for domestic players to absorb the supply beyond a point. However, Indian households have a serious underweight position to equities in their savings pool. So, one expects the structured inflows to continue, despite the temporary slowdown.

**Which sectors are you bullish on?**

We believe there are interesting opportunities in the financial sector. Private sector banks are gaining market share and growing faster, compared to their state-owned counterparts. In general, private sector banks have also enjoyed higher levels of profitability and have tended to maintain better-quality balance sheets. We also believe a number of industrial stocks might be well-positioned for a recovery in economic growth, and we see some interesting potential opportunities in that space. We have also added exposure to consumer discretionary companies, as with the macro economic recovery cycle, the consumer sentiment will also turn positive. However, leaving out individual sectors, we expect that bottom-up stock selection is going to be key for generating alpha (abnormal return).

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