

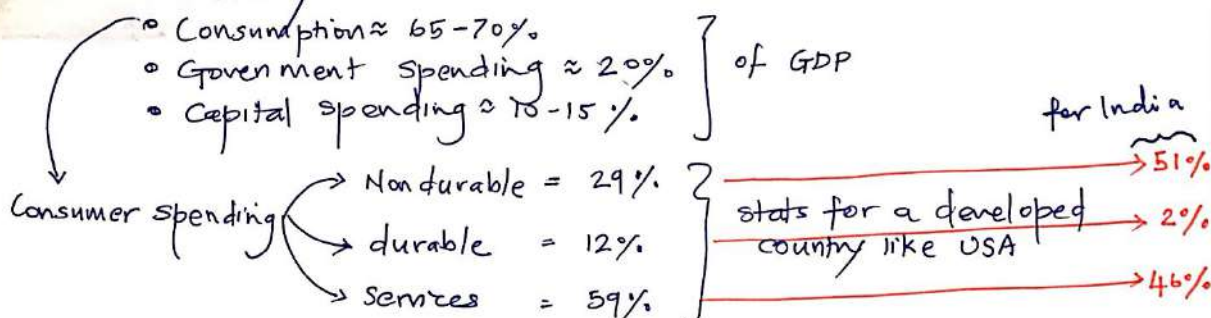


14th June 2017

How the Indian economic machine works?

A good teacher does not teach well, he teaches the student to think well. Below is an excerpt of my professor's (himself a very accomplished private investor) theory on markets, business cycles & economic cycles.

INDIAN Economy



But for India such stats cannot be spelt out so easily

- Indian consumption pattern is orders of magnitude different in Rural & urban areas.
- Even in urban areas one sees stark differences between Metros, Boom towns, Niche cities, Rest of urban etc.

N.B: Non-durable = Food, clothing, gasoline, Heating oil, drugs, stationery, cleaning supplies.

durable = Motor vehicles, furniture, home furnishings, sporting goods, tools, jewelry, books.

services = Housing, education, medical, transportation, recreation, financial services, religion, travel etc.

In India, 57% spending is from rural households while 43% is from urban spending households.

Indian Consumer spending:-

Rural (57% household)		Urban (43% spending)
54%	Non-durable	48%
2%	durable	3%
44%	Services	49%

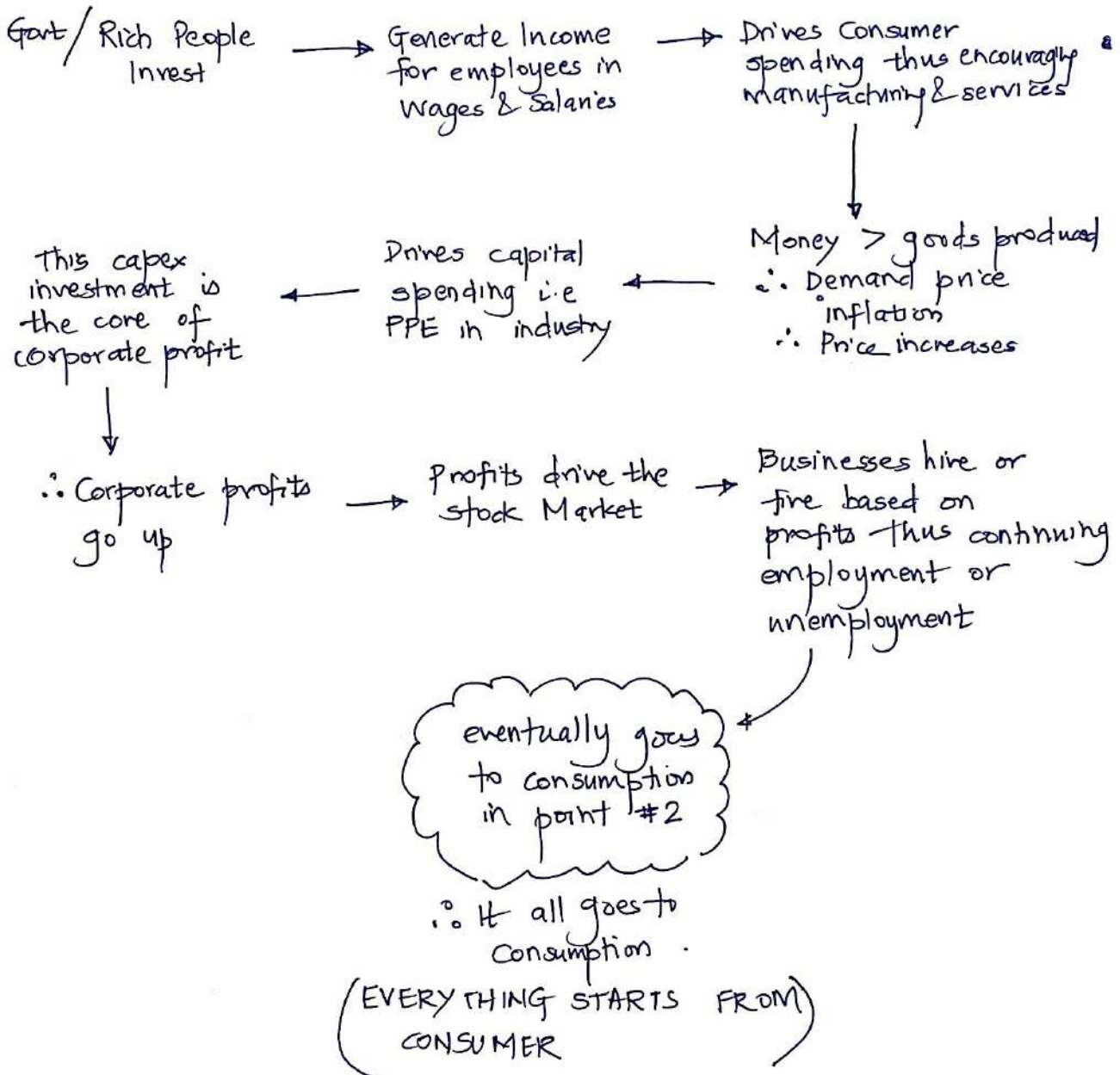
Thus for India on aggregate, the consumer spending is as mentioned above in Red (Weightage 57% R, 43% U)

Conventional wisdom states that reduced unemployment is the leading indicator in the stock market. However, India, just like the US is a consumption based economy & since consumption drives growth, it is really important to track the beginning of consumption cycle. Thus contrary to

common belief, unemployment is actually a lagging indicator. ∴ Always track monthly sales reports/consumption patterns to see where uptick lies.

In US you get it from - Bureau of economic analysis
- Pew research
- Global insight.

(Mankewar's economic cycle theory) + (My theory of consumption) ⇒



This Gets us to our theory on Business cycles.

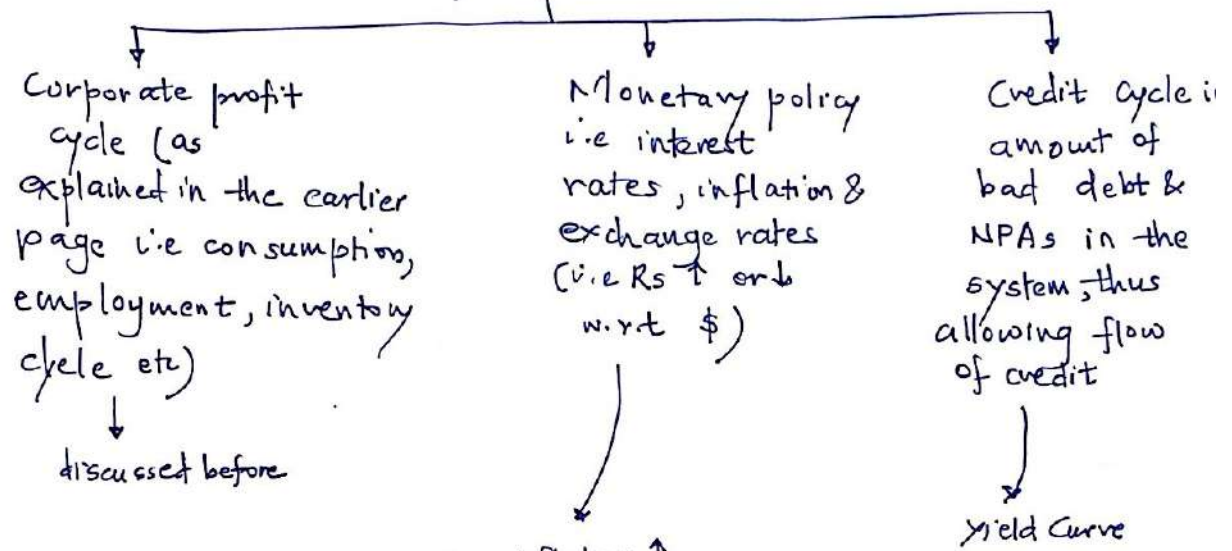
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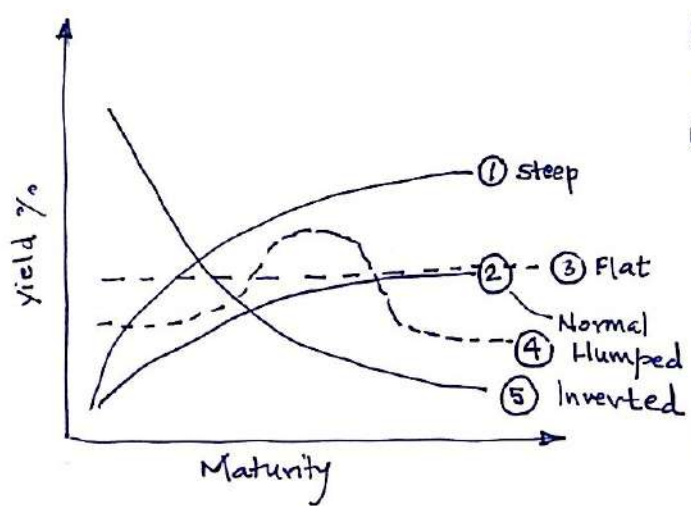
A Business cycle is controlled by 3 things. These in turn control the stock market (due to earnings)

Business cycle depends on:



expansionist \Rightarrow IR \downarrow \therefore maybe inflation \uparrow
contractionary \Rightarrow IR \uparrow \therefore inflation \downarrow

yield curve is the leading indicator for economic activity.
It shows the yield between Govt treasury bonds & pvt bonds. It compares bonds of same credit quality but different maturities.



- ① steep \Rightarrow Investors expect economy to pick up quickly
- ② Normal growth of economy expected
- ③ & ④ Economy at inflection
At this stage $\left\{ \begin{array}{l} \text{economy can go in recession} \\ \text{economy can pick up} \end{array} \right.$
- ⑤ Inverted curve suggests slowdown of economy

Economic cycles of early, mid, late, recession are best left to economists & statisticians. Since, we focus on India equities, let's see how sectors are influenced in India.

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NB: For theoretical description on business cycles, please refer to website by fidelity research. (www.eresearch.fidelity.com)

Indian equities cycle & sectors:-

(A) Sectoral equity performance

Sectors	95-2000	2001-07	08-2015	(Expected) 16-2022
Consumer discretionary (auto)	-	+	+	++
staples (FMCG)	+	+	+	+/-
Energy (oil & Gas)	-	+	-	++
Financial (Retail)	-	+	+	++
Financial (Corporate)	-	+	-	++
Health care (pharma)	+	+	+	+/-
Industrial (cap goods)	-	+	-	++
IT	++	-	+	-
Basic Material (Metal)	-	+	-	++
Real Estate	-	-	-	-
Telecom-	-	-	-	-
utilities	-	-	-	-

(B) Macro factors

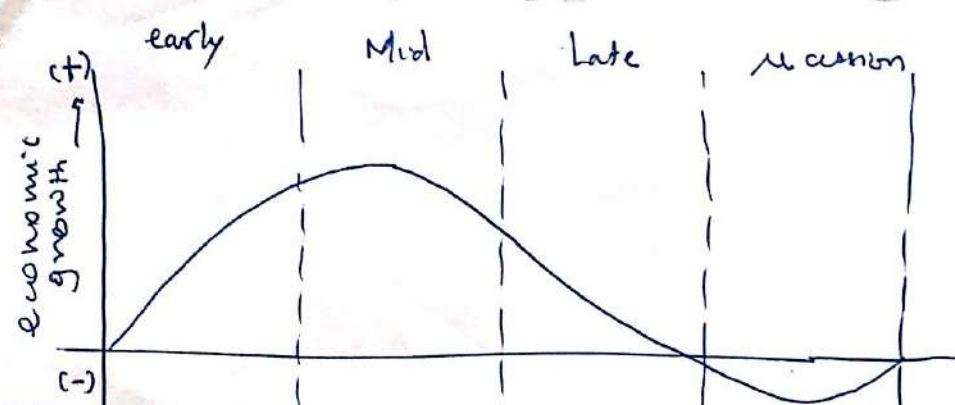
Central Government	Congress/UPA	NDA	UPA	NDA
Interest rate	High & rising	falling & Low	Rising	falling & Low
Exchange rate	₹ depreciate 35 to 42	₹ stable 42 → 40	₹ depreciate 40 → 70	₹ stable 69 → 64
Inflation	rising & High	stable & falling	rising & High	falling & stable
Capex	dry	goes up	dry	goes up.

APPENDIX - Academic treatise on Business Cycles
(Source: fidelity research)

→ (Pg 5)



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	early	Mid	Late	recession
Con. disc	+		-	
Con. Stap	-		+	+
Energy	-		+	
Fin.	+			
Health	-		+	+
Industr.	+	+		-
IT	+	+	-	-
Basic M.		-	+	-
Real Est	+			-
Telecom	-			+
Utilities	-	-	+	+
Economy	Bottoming out	Accelerate	decelerates	slow growth recession
Inflat ⁿ	Low	pressure starts	Rising	easing
Central bank	easing	neutral/tightening	tightening	neutral/easing
Asset class outperforming	Equities, HY	Equities, HY, commodities	Equities, industrial commodities	Govt bonds, Cash
Yield curve	Bull flattens	Bear steepens	bear flattens/inverted	bull steepens
Status	Recovery	Overheat	Stagflation	Reflation
	economic growth begins to pick up as govt tries to stimulate. Inflation still down	economic growth is strong, Inflation climbs as companies run out of capacities	GDP growth falters as inflation rises as workers want pay rise & cos want to protect profits	weaker economic growth, declining commodity prices, inflation falls



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