

# Developing Trends

Oxus Research & Investments

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## Trades for 1999 - Recommendations

***Oxus wishes its clients a happy and prosperous New Year.*** This is a summary statement from two forthcoming newsletters - one on the Indian economy and the other on the world economy, with particular emphasis on East Asia. Some conclusions and trade recommendations:

1. World Economy: The conventional, and considered, wisdom of leading organizations like the World Bank, and IMF, is for world growth in '99 to equal this year's tepid growth of about 2.2 percent. Of the two, the World Bank is more pessimistic; it even perceives significant chances of a worldwide recession next year. Investment houses are cautious, if not fearful for '99.

2. Oxus's calculations suggest a fair chance of a significantly more optimistic outcome. The mean estimate for world growth is projected to be 2.8 percent, with about a 25 percent chance that it will top 3 percent.

3. Most forecasters, including Oxus, believe that the US economy should be slower than this year's robust growth of 3.6 percent. But the major difference in view pertains to Asian recovery. The various views can be summarized alphabetically - will the recovery be L shaped, U shaped, or V shaped? The center of gravity on this crucial parameter has veered towards an L shape Asian recovery i.e. a long and arduous process of adjustment which will entail close to zero growth for several years. This L shaped recovery pattern characterized the debt crisis countries of the early eighties - these economies took about 5 years to recover to pre-crisis levels. The V shaped pattern was characteristic of Mexico after its 1994 devaluation, when the economy took 1 year to slide down, and an additional year to recover to pre-crisis levels.

4. Oxus disagrees with the conventional view that the Asian economies will exhibit an L

shaped recovery. Comparison of East Asia with Mexico post 1994 (see Developing Trends, vol. 2, Nos. 8&9, August 24, 1998) shows more similarities than differences.

Oxus expects these similarities to continue - i.e. much as Mexico recovered to its pre-crisis levels 2 years after the crisis, so are Asian economies expected to do so. In other words, 1999 should be a recovery year with East Asian economies averaging a non-trivial positive growth rate. This "unexpected" bonanza should fuel world growth to be closer to 2.75 percent than 2 percent.

5. East Asian stock markets and currencies: BUY. Based on the above conclusion i.e. East Asian growth to substantially exceed expectations of negative to zero average growth, several trade recommendations follow. In particular, that in spite of the 30 something percent plus recovery witnessed in the last quarter of 1998, East Asian stock markets should continue to rally in 1999. The currencies should also follow suit, though in a relatively subdued fashion.

6. Dollar against majors: In end-August, we made our dream (and lucky!) call that the dollar would peak out at 145-147 yen. With the dollar trading at 116 yen, we would suggest that profits be taken, and that the short \$/yen trade be converted into a long mark/short yen trade. Vis-à-vis the yen, the dollar is in neutral zone. If \$/yen gets towards 123 yen, it should be shorted; if it gets towards 110 yen, the dollar should be bought.

7. India: There were several "bold" trades that were mentioned in the double Developing Trends issue of end August '98. Incredibly, almost all trades have turned out to be highly profitable. Except one trade - going long the Indian stock market. The rest of the world rallied, and India dived. Over the last month, the Indian stock market has moved in a

narrow range, and as clients have noted, we have gone short, long, and short again in this short period of time. All trades have been around the 2915 (Sensex) level, and while not much money has been lost, it, nevertheless, has been frustrating. Such quick trades are unusual for Oxus, but the Indian market, and December, have been anything but usual.

8. India: BUY. Oxus now believes that clients should not only go long the Indian market, but that they should do so aggressively.

Instead of our normal 1 unit trade, clients should be long 2 units. Why? There are four technical reasons. First is the whipping action mentioned above - a generally reliable signal for a turning point. Second, as we had mentioned in our last e-mail update, the Sensex had strong resistance at the 2975 level. In the last week, it has closed above this level twice, and on Friday, Dec. 23, the Sensex closed at 2964. Third, P/E ratios of major stocks are trading at single digit levels.

Fourth, most Foreign Institutional Investors (FII's) I have talked to have unanimous bearish views. This view is best exemplified by the comments of the leading manager of the largest foreign mutual fund in India, Morgan Stanley. At an Indian Capital Markets conference held on Dec. 21 and 22, and widely reported in the press, Morgan Stanley's representative stated that foreign investors continue to be neutral to negative on Asia, and India; and that an Indian stock market recovery can be expected in about three years! With such lemming like bearishness, the safest bet is to assume that the FII's are going to be wrong.

9. The reason the bet seems safe is because the Indian market has declined by more than 10 percent this quarter, while Asian markets have rallied, on an average, more than 40 percent. Thus, the Indian market has underperformed by a whopping 50 percent. Will India outperform East Asia in 1999? Not likely, but not unlikely either. Thus, next year is likely to be the year of the contrarian - in India, and in East Asia. An early signal of such an event will be indicated by the Sensex above 3300 by March '99.

10. There are also strong fundamental reasons supporting this bullish scenario. The last

legislative session, when important bills (insurance and patents) got introduced but were not brought to a vote, may have been the last hurrah of the neanderthals. Congress's betrayal at the altar on the insurance bill was a surprise - and after our article ("Don't Cry for the Congress", Economic Times, Dec. 18, 1998) several other articles have appeared, in different newspapers, condemning Congress's petty politics. These bills will likely be passed in the next parliament session in February. Further, the Finance Minister has been sounding like a major reformer by talking about reforms on indirect taxes. Expect rationalization of indirect tax rates and a decline in the average excise and customs taxes in the February 28 budget. Another bullish factor is the expected decline (at least by Oxus) in inflation. Wholesale price inflation jumped to close to nine percent on the back of a 200 to 400 percent increase in vegetable prices. Inflation (WPI) should head downwards to a 7 percent rate, year on year, by end march '98. The budget deficit may come in below 6 percent, especially if the oil pool surplus gets transferred, and/or some additional public sector disinvestment does take place. Economic growth should come in higher at 5.5 percent, a full percentage point above expectation of several market participants. And next year, 1999, should show improvement in all areas, especially if our forecast of a stronger than expected world growth turns out to be true.

11. To every forecast there is a downside. What could go wrong? The ruling BJP could continue to be inept, new elections could be called, and the Congress could obtain less than 210 seats in the next election. The funny thing about markets is that they tend to be more forward looking than bureaucrats and politicians (another reason to prefer a downsizing of government). This worst, along with slow world growth, is already "in the price". The stock market is down more than 20 percent in 1998 - and at Feb. 1992 levels in nominal terms! So dust off the savings certificates, cash them, and invest. Things cannot get worse in 1999 - and they might even get substantially better.

# *Developing* Trends

**Developing Trends** is a monthly newsletter published by Oxus Research and Investments (ORI). Fund managers and investment banks, both in India and around the world, are its clients.

- Since July, 1998, **Developing Trends** is being managed by Oxus Fund Management (OFM), a sister concern of ORI. Oxus Fund Management is a New-Delhi based one-stop financial services firm; it provides research, consultancy, fund management and institutional brokerage for the Indian stock market.
- **Track Record:** Trades mentioned in **Developing Trends**. The previous issue (vol. 2, Nos. 7 & 8) documented the accuracy of Oxus's currency forecasts. Other markets: *Indian Stock Market*: Nine recommendations were made over the last 20 months, out of which seven were profitable, for an average total unleveraged profit of 79.6%. *\$/Rupee*: Seven trades, six profitable for a total unleveraged return of 21%.
- **Track Record:** *Mulberry Fund*: From February, 1997 to end-Aug. 1998, one of the directors (Surjit S. Bhalla) operated a private fund of Rs.40 lacs (approximately \$ 100,000) with investments in the Indian stock market. The fund returns were greater than 40 %, and it yielded an excess return of 37% (over the "benchmark" Sensex). This broad-based fund had no more than 20 securities in its portfolio at any one time ( the average was less than ten securities) and had an aggregate turnover of less than 200%, i.e., no more than an annual average of 2 round-trip trades. The reasoning behind stock selection was stated in **Developing Trends**, Vol. 1, No.3, May 26, 1997, page 8: "...considerations of catch-up and differential productivity levels dictate that service industries – e.g., advertising, software, banking, will do relatively well in India." The fund has now moved to OFM and new portfolio management investments are planned after receipt of license from the Securities and Exchange Board of India..

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