CNBC TV18

This rally belongs to the FIIs

The relentless rush for stocks has triggered worries about the rally's sustainability. But, FIIs still find Indian stocks cheap. Analysts say this rally is different!

The Sensex has crossed the 4,400 point mark today, and the Nifty has gone beyond 1,400 points. But, whose money is propelling the Indian stocks up in this relentless fashion? This question is relevant for the Indian markets, as there were two earlier mega rallies — the one in the early 1990s, and the one in 2000–01 — which were discovered to have been built on money wrongfully redirected to the markets from the banking system. The two rallies collapsed when unlawful money routes were blocked.

But the mantra of the present market is, "This rally is different". Just about all stocks have gained in this rally, and much of the cash needed to feed this rally has come from abroad.

The net foreign investment in Indian stocks has crossed Rs 15,000 crore (Rs 150 billion) in 2003, against Rs 3,677 crore (Rs 36.77 billion) last year. Many new foreign institutional investors, FIIs, have joined the action in the Indian markets. The number of FIIs registered with the Securities and Exchange Board of India, SEBI, has gone up to 513 in July from 507 in April, when this big rally took off. According to Morgan Stanley, about 12% of the Indian market and 35% of the free float available has been bagged by FIIs — despite the fact that they invest in just a few highly liquid stocks.

Sajiv Dhawan of JV Capital Services told CNBC-TV18 that foreign funds in the US and Europe are getting rather large money inflows and they have no choice but to invest the money in markets like India, which have delivered rather high returns over the last four months. "While the short term investors, who have seen the market run up 50% over four months, are finding it difficult to buy index heavyweights at risen prices, medium term investors, particularly FIIs, are still finding them relatively cheap," he told CNBC-TV18.

Jon Thorn, managing director at Hong Kong-based India Capital Management, confirms this. "The strong foreign inflows into India and the rest of Asia will continue. These markets are attractively valued and are still available at discounts to investors in the US and Europe. These markets offer much higher growth to them," he told CNBC-TV18. He sees the Sensex crossing 5,000 points this year provided the good news continues.

Thorn argued that earnings of Indian companies are likely to be up 18-20% this year and that would take the current valuations of Sensex companies from 14 back to 10 times of earnings. "The market is way too undervalued and on a comparative basis it is looking very cheap. Only Korea and Thailand in Asia, are cheaper...The IT sector has underperformed and has become underowned domestically and by FIIs. The old economy still has legs...Look at Hindalco. Its valuations are at a discount to its peers in China and Europe, and the US, while its outlook is even better," he said.

FIIs have also shed their inhibitions about putting money into smaller stocks, particularly where companies have a chance to earn dollars. "Though the research on smaller stocks is pretty much sub par in terms of coverage and quality, that is now changing. Midcap pharma stocks are one of the most attractive sectors and is still pretty cheap at 10 times. The best idea is not to buy one of them, but a basket of three to five stocks," he said.

Software stocks are beginning to add to the rally as FIIs have started picking these stocks as well. **Thorn pointed to the fact that the Nasdaq has been getting a lot of money of late, and Indian software stocks could only gain because of that.** Dow Jones Newswires' Abhijit Basu said that the Citigroup Smith Barney talked of Infosys turning down business for lack of manpower recently, indicating enormous amount of work flowing to Indian software services companies, even though at low prices.

So, the assurance for greenhorn investors seems to be that it is not dirty money organised by local market manipulators this time, but foreigners' money, chasing higher profits. It is that's driving the current rally. This may be the reason why this rally has gained strength and sustained is the way that the earlier two rallies did not. A number of FIIs who were new to the Indian markets, had got burnt in both those rallies. There is a saying in the market that without new faithfuls there would not be any revolution, and without new investors, there wouldn't be any big bull market.

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