Market Highs do not necessarily mean Market PEAKS
P/E ratio is always influenced by Cost of Capital
Looking at data from the US, for the Long Term period 1962-2017, PE ratio of S&P 500 Index has been inversely correlated to the 10 Year GSEC Yield

Source: Bloomberg
Average PE Ratio is a moving target

Average PE Ratio over a period is inversely proportional to the prevailing interest rate regime

Sources: Bloomberg

US Market: 10 Yr GSEC Yield vs PE Multiple of S&P500

LT Average PE of the S&P500 index is 16.5x

But the 10 year average PE varies around this as per the prevailing interest rates

As a result, the PE of the index can remain very high or low for extended periods depending on the prevailing interest rate regime

Source: Bloomberg
Indian Markets appear Expensive, but ARE they?
INDIA: Market is at an all time high
But are we at a market top?

Sensex Index

Source: Bloomberg
Sensex appears expensive

in terms of PE Ratio

Source: Bloomberg, internal research

SD - Standard deviation
But to a lesser extent

*in terms of PB Ratio*

Source: Bloomberg, internal research
Current Valuations may not be stretched
Lower Global cost of capital

Downward shift in US rates post the 2008 GFC has caused upward shift in the average PE Ratio

Till 2007,
Avg 10 Yr US Yield: 4.6%
Avg SENSEX PE Ratio: 15.3x

Post 2007,
Avg 10 Yr US Yield: 2.6%
Avg SENSEX PE Ratio: 18.1x

Source: Bloomberg, internal research

GFC - Global Financial Crisis
Reason 2

Valuations not only dependent on price

Current Valuations appear expensive also due to depressed EPS

- SENSEX EPS at same level as March-14
- EPS suppressed due to losses posted by Metals and Corporate Banks
- Sensex EPS CAGR Mar-12 to Mar-17: 4% vs Mar-01 to Mar-12: 17%
- PE Ratio optically expensive as Earnings haven’t gone anywhere

Source: Bloomberg, internal research
Reason 3

More proportion of high PE sectors in 2017 as compared to 2007

PE of 2007 is very different from PE of 2017 due to change in index composition

Weight of Low PE commodity stocks – Metals + Energy has reduced from 24% to 11.6%

Weight of High PE Consumer stocks & Pvt Banks has increased from 26% to 49%

Change in Sector composition has caused an upward shift in the ‘normal’ PE

PE of 22.0x in 2007 was much more expensive than a PE of 22.0x in 2017
Markets not at Peak,
As economy close to bottom
Latest period earnings growth is much lower than historical averages

<table>
<thead>
<tr>
<th>Period</th>
<th>3 Yr Gr Rate</th>
<th>5 Yr Gr Rate</th>
<th>7 Yr Gr Rate</th>
<th>10 Yr Gr Rate</th>
<th>LT Gr Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latest Period</td>
<td>-0.1%</td>
<td>3.9%</td>
<td>7.2%</td>
<td>3.9%</td>
<td>13.1%</td>
</tr>
<tr>
<td>Hist Rolling Average</td>
<td>13.5%</td>
<td>13.7%</td>
<td>13.6%</td>
<td>13.8%</td>
<td>15.2%</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Strong EPS Growth over next 3-4 years needed to push LT Growth Rate to Historical Average

Source: Bloomberg, Internal research
Market tops coincide with overheating of economy
Economy nowhere close to a top, more at the mid of the cycle

Source: Bloomberg, internal research
Most macro variables are much lower than their 2010 peaks

Source: Bloomberg
Valuation Snapshot

|----------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-----------|----------|
| NIFTY INDEX | 22.9   | 11.5   | 24.3   | 18.1   | 15.8   | 15.5   | 16.4   | 19.7   | 20.1   | 20.4   | 21.7   | 20.6   | 22.5   | 22.6   | 18.5     | 18.9
| NSEMCAP INDEX | 21.0   | 9.4    | 14.6   | 11.4   | 16.1   | 14.3   | 15.3   | 18.7   | 24.3   | 32.7   | 32.5   | 25.2   | 28.1   | 30.2   | 17.6     | 20.6
| Difference with NIFTY | -1.9   | -2.0   | -9.6   | -6.7   | 0.4    | -1.1   | -2.1   | -1.1   | 4.1    | 12.3   | 10.8   | 4.6    | 5.6    | 7.6    | -0.9     | 1.7
| NSESMCP Index | 11.4   | 20.2   | 15.1   | 633.1  | 48.4   |        |        |        |        |        |        |        |        |        |           |          |
| Difference with NIFTY | -4.4   | 4.7    | -14.6  | 613.4  | 25.8   |        |        |        |        |        |        |        |        |        |           |          |
| Positive PE Ratio |        |        |        |        |        |        |        |        |        |        |        |        |        |        |           |          |
| NIFTY INDEX | 22.9   | 10.9   | 21.0   | 18.1   | 15.4   | 15.1   | 15.8   | 19.6   | 18.4   | 19.9   | 20.5   | 19.4   | 21.8   | 22.3   | 17.9     | 18.3
| NSEMCAP INDEX | 19.7   | 7.1    | 13.4   | 10.4   | 13.0   | 11.0   | 14.0   | 17.1   | 17.1   | 18.7   | 17.7   | 16.5   | 19.1   | 22.4   | 14.8     | 16.3
| Difference with NIFTY | -3.2   | -3.8   | -7.6   | -7.7   | -2.4   | -4.1   | -1.9   | -2.5   | -1.3   | -1.2   | -2.8   | -2.9   | -2.6   | 0.1    | -3.1     | -1.9
| NSESMCP Index | 10.3   | 7.8    | 7.0    | 13.6   | 13.2   |        |        |        |        |        |        |        |        |        |          |          |
| Difference with NIFTY | -5.1   | -7.3   | -8.9   | -6.0   | -5.2   |        |        |        |        | -4.5   | -4.8   | -4.1   | -3.9   | -2.9   | -6.0     | -6.1
| 1 Yr Fwd PE Ratio |        |        |        |        |        |        |        |        |        |        |        |        |        |        |           |          |
| NIFTY INDEX | 21.9   | 11.2   | 21.7   | 18.0   | 15.1   | 14.5   | 16.2   | 18.6   | 18.3   | 17.5   | 18.2   | 18.1   | 21.0   | 18.4   | 17.3     | 17.2
| NSEMCAP INDEX | 19.6   | 7.8    | 15.9   | 16.0   | 14.6   | 15.6   | 14.8   | 20.6   | 20.3   | 19.0   | 18.9   | 20.2   | 25.8   | 20.1   | 16.6     | 18.3
| Difference with NIFTY | -2.3   | -3.5   | -5.7   | -2.0   | -0.5   | 1.1    | -1.4   | 2.0    | 1.9    | 1.5    | 0.6    | 2.2    | 4.8    | 1.7    | -0.8     | 1.0
| NSESMCP Index | 10.8   | 12.9   | 28.2   | 28.8   | 16.0   |        |        |        |        |        |        |        |        |        |          |          |
| Difference with NIFTY | -4.3   | -1.6   | 12.0   | 10.2   | -2.4   |        |        |        |        | -5.3   | -4.6   | -4.7   | -1.6   | 0.8     | 2.0      | 3.8
| PB Ratio |        |        |        |        |        |        |        |        |        |        |        |        |        |        |           |          |
| NIFTY INDEX | 6.0    | 2.2    | 3.4    | 3.1    | 2.7    | 2.6    | 2.5    | 3.0    | 2.5    | 2.7    | 2.8    | 2.6    | 2.9    | 2.9    | 3.2      | 2.7
| NSEMCAP INDEX | 4.0    | 1.2    | 2.5    | 1.8    | 1.7    | 1.4    | 1.6    | 2.1    | 1.9    | 2.0    | 1.6    | 1.7    | 2.1    | 2.2    | 2.2      | 1.9
| Difference with NIFTY | -2.0   | -1.0   | -0.9   | -1.3   | -1.0   | -1.1   | -0.9   | -0.9   | -0.6   | -0.7   | -1.1   | -0.9   | -0.8   | -0.7   | -1.0     | -0.9
| NSESMCP INDEX | 1.5    | 1.0    | 0.9    | 1.2    | 0.9    |        |        |        |        | 0.9    | 1.1    | 1.0    | 1.3    | 1.4     | 1.1      | 1.1
| Difference with NIFTY | -1.1   | -1.6   | -1.7   | -1.8   | -1.7   |        |        |        |        | -1.7   | -1.7   | -1.6   | -1.6   | -1.5    | -2.1     | -1.7

Valuations appear expensive when compared with LT averages; but Nifty PE needs to be looked at in the context of near term average (19x).

In the current regime of dramatically low cost of capital, valuations though on the higher side, aren’t as expensive.

Market is in the initial stages of recovery with recovery in earnings growth expected.

Source: Bloomberg
The current Sensex PE ratio appears optically high when compared to Long Term average as:
- Market PE ratio is a function of global cost of capital. Given the current low cost of capital globally, the average PE ratio has been shifted upward
- Low earnings growth in the past 5 years (4% CAGR) have resulted in suppressed EPS

- Earnings growth is expected to rebound in the near future and catch up with its LT average of 13-14%, closer to nominal GDP growth

- Various macro-economic variables like fiscal deficit, credit growth, PV sales etc indicate start of a recovery and not a market top

- Given the higher PE multiple, market may witness correction going forward. Any correction would give investors a good opportunity to participate in the long term earnings growth story of the Indian market
Disclaimer:
MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.

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