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Market Update

December 14 — December 18
Week that was...

A spike in inflation numbers took its toll on the markets as both the benchmark indices, BSE Sensex and NSE Nifty ended lower by 2.33% and 2.53% respectively. However the BSE Mid Caps and BSE Small Cap outperformed the broader indices, declining by only -1.58% and -1.04% respectively.

The market continued its fall throughout the week due to unavailability of any major trigger to take it higher. With the year end approaching investors are being very cautious. The week ended with major sell offs in financial and telecom sector along with weak global markets which pulled the shares lower. US markets remained weak after Standard and Poor (S&P) downgraded the long term credit rating of Greece, in the process weakening Asian markets as well. Also the Nifty ended below the psychological 5,000 mark for the first time in the last 15 trading sessions.

Inflation numbers were the biggest worry amongst the investors as it continued to inch upwards. The WPI inflation numbers for the month of November rose by 4.78% primarily led by 16.7% increase in food articles. Food inflation has been the highest in the country since 2006 as prices of potatoes, onions and sugar registered a sharp spike on a y-o-y basis. Consequently an increase in the Cash reserve ratio (CRR) and the lending rates is expected. This raised concerns of liquidity being sucked out of the market by RBI leading to massive profit booking by investors. Amidst this gloom the markets cheered after Dubai said that it received $10 billion from Abu Dhabi to help repay $4.1 billion in an Islamic bond maturing on December 14.

From a sectoral viewpoint, Health care and IT sector stocks were the only ones that were in demand and recorded growth amidst hopes of new outsourcing opportunities from the developed countries as the signs of economic recovery becomes evident. Health care stocks truly lived up to their reputation of being defensive stocks and recorded growth even as the market saw a drop in trading volumes. Dr. Reddy Laboratories emerged as a leader of the pack after the company announced that it has reached Phase III clinical trials for an anti-diabetic drug, which could become India’s 1st innovative drug molecule. Bank stocks were hit the most on concerns of possible increases interest rates to control inflation. There was a sharp sell off in banks and autos. Also index heavy weight Reliance industries suffered a setback of 5.47% leading to fall in the index. Software firms who get half of their revenue from US were strong due to strengthening of US dollar against rupee and on a robust earnings outlook.

India’s services sector expanded at a faster pace in first seven months of
The increase in credit flow till December 4 was 10.5% compared to a year ago. Credit extended by banks in the fortnight up to December 4 grew at a faster pace than during the previous three fortnights. The increase in credit flow was 10.5 per cent compared to a year ago.

Positive news also emanated from the government quarters. In its mid-year review of the economy, the government projecting a 7.75% growth in FY2010. However the government also stressed on the fact that prices needs to be kept under control. This pushed the 10-year benchmark bond yields to 7.72%, the highest in the past 13 months.

December 21st – December 25th

Week that will be...

Owing to Christmas holidays, the next two weeks are truncated coupled with the derivative F&O expiry of the December series. In the absence of any major triggers during this period, the volumes are expected to remain lower leading to a range bound sessions in the markets. Also fresh allocation of funds after the new year will thwart any serious downturn. We maintain a neutral view on the markets with a positive bias.
It was an extremely eventful week for the bond market. Bond yields reacted sharply to the inflation numbers. The bond yields for the benchmark 6.90-10 year government paper was 7.66% for the week ended Dec 18. Food inflation increased to 19.95% - the highest in the last decade. The continuously rising inflation numbers have strengthened the market expectation of hike in Cash Reserve Ratio, which is currently at 5%. The increase in CRR by RBI would reduce the level of free cash in the banking system. The government auctioned bonds worth 90 billion rupees on Friday. MIBOR and MIBID rates, for the week ended 18th Dec, increased to 3.22% and 3.29% respectively.

The bond yield curve flattened last week indicating the early stages of rate tightening cycle. Rate hike which sucks the liquidity out of the market typically increases the yield on the short term debt more than the long term debt which leads to flattening of the of the yield curve.

<table>
<thead>
<tr>
<th>Duration</th>
<th>11-Dec</th>
<th>18-Dec</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>MIBID</td>
<td>3.2</td>
<td>3.22</td>
<td>0.63%</td>
</tr>
<tr>
<td>MIBOR</td>
<td>3.27</td>
<td>3.29</td>
<td>0.61%</td>
</tr>
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</table>

Corporate bond spreads as on 18/12/2009

<table>
<thead>
<tr>
<th>Duration</th>
<th>AAA</th>
<th>AA+</th>
<th>AA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>89</td>
<td>109</td>
<td>129</td>
</tr>
<tr>
<td>3 years</td>
<td>70</td>
<td>90</td>
<td>110</td>
</tr>
<tr>
<td>5 years</td>
<td>88</td>
<td>108</td>
<td>128</td>
</tr>
<tr>
<td>10 years</td>
<td>94</td>
<td>114</td>
<td>134</td>
</tr>
</tbody>
</table>

December 14 - 18
Bond Markets
December 14th-18th

Forex Markets

On Monday, the rupee closed at 46.72/73 a dollar, having depreciated by 19 paise, backed by fresh demand for the US currency from banks despite weakness of the greenback in global market. The euro rose against the dollar in overseas market after Dubai's announcement that it had received USD 10 billion from Abu Dhabi to repay debts. Moody's Investors Services on Tuesday raised India's local currency rating to positive from stable, citing the country's strong external position and resilience to the global credit crisis, helping the rupee appreciate. On Wednesday, the dollar held near a 2½ month high on the euro and held steady against the yen as the market waited for the decision of the FOMC on the interest rates. The rupee hit its three week low on Thursday. The reason could be the purchase of US dollar by importers to meet their requirements that weighed against the rupee sentiment. The rupee on Friday recovered by 16 paisa to close at 46.72/73 against the US dollar due to selling by exporters and banks on the back of weakness of dollar overseas amid bearish equity market. This appears to be because of the late hour dollar selling by banks during the day after a fall in stock markets and weakness of dollar overseas supported the Indian currency.

<table>
<thead>
<tr>
<th>Rupee(INR)</th>
<th>18th December</th>
<th>11th December</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>US $ (USD)</td>
<td>47.15630</td>
<td>46.74820</td>
<td>0.87%</td>
</tr>
<tr>
<td>Euro (EUR)</td>
<td>67.67970</td>
<td>68.74330</td>
<td>-1.55%</td>
</tr>
<tr>
<td>Pound (GBP)</td>
<td>76.22920</td>
<td>76.11030</td>
<td>0.16%</td>
</tr>
<tr>
<td>Yen (JPY, 100)</td>
<td>52.37000</td>
<td>52.61000</td>
<td>-0.46%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FII Flows INR Crores</th>
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</thead>
<tbody>
<tr>
<td>Trade Date</td>
</tr>
<tr>
<td>18/12/09</td>
</tr>
<tr>
<td>17/12/09</td>
</tr>
<tr>
<td>16/12/09</td>
</tr>
<tr>
<td>Dec, 09</td>
</tr>
<tr>
<td>Since 1/1/09</td>
</tr>
</tbody>
</table>

The currency pair USD/INR is trending upwards since the 14th and slightly changed direction by going lower on the 18th. The currency pair seems to entering a narrow trading channel where the Bollinger Bands are narrower than usual. The support level is at 46.125 and the resistance level is at 46.9. The MACD crossing the zero line from below is a bullish sign and could see the currency pair move above 46.9 levels which has been a resistance level during the past month.
Corporate Speak:

Infosys Technologies Ltd.

Infosys announced the incorporation of its wholly owned Brazilian subsidiary, Infosys Technologia Do Brasil Ltda. The subsidiary currently has a mature IT services, BPO ecosystem and an established talent pipeline. Brazil being the largest IT and BPO services market in Latin America, will strengthen the companies position to address both Spanish and Portuguese speaking markets in Latin America.

In a bid to drive non-linear growth, the company announced the launch of 2 new products – Flypp and Finacle Advizor. Flypp is an application platform that will enable the service providers to offer ready-to-use experiential applications across various digital devices. This operator centric platform will help the operators monetize the digital demand by delivering personalized and interactive user experience.

Finacle Advizor on the other hand offers an integrated platform empowering banks to deliver products and services through a fully assisted self-service channels like Internet, Kiosk and ATM for real-time access. On one hand the product will enhance customer experience; on the other hand the product will increase operational efficiency at a fraction of the total cost of ownership. While the product will help bank expand services and geography footprint economically, it will lack personalized human touch.

HCL Technologies

HCL-AXON, the world’s largest services provider dedicated to SAP solutions has signed a five year Global Strategic Information Technology Master Services Agreement with GlaxoSmithKline (GSK), one of the world’s largest pharmaceutical companies. Through this agreement the company will provide system integration, SAP implementation and IT consulting services to GSK globally. The deal is set to fuel HCL’s rapid growth in the life science industry which is one of its fastest growing industry verticals.

ACC

ACC’s Greenfield project in Thondebhavi, Karnataka was inaugurated this week. The Rs350 crores cement grinding plant has a capacity of 1.6 million tones per annum and will also produce fly-ash based Portland Pozzolana Cement. The plant is fully automated and can be operated by a single button making it the first of its kind in India. The plant encompasses state of the art Vertical Roller Mill technology. The company has also taken the environment into consideration by incorporating sophisticated pollution control mechanism to prevent dust and fugitive emissions.

Tata Steel

Tata Steel’s biggest subsidiary, Corus secured a contract worth €350 million to supply rails to the French railway operator SNCF for renewal and maintenance of RFF tracks. The contract is for the initial 4 years with an option to extend it to 6 years. Following this the company announced that it would invest €35 million at its rail production facility in Hayange, France. This investment will boost company’s production capacity from 300000 to 340000 tonnes per year. The company expects about 400 contractors to be working on this project starting this New Year.

Mahindra & Mahindra

Mahindra announced its entry into the aerospace segment with the acquisition of a majority stake in two Australian companies, Aerostaff Australia and Gippsland Aeronautics. This acquisition has been made jointly with Kotak Private Equity with a total commitment of Rs175 Crores.

Aerostaff Australia is a component manufacturer of high precision close-tolerance aircraft components and assemblies for large aerospace OEMs. Gippsland Aeronautics has got an established presence in general aviation and has delivered more than 200 FAR certified planes across 32 countries. The company plans to retain the existing management and is all set to start a plant at Bangalore to complement these acquisitions.
Corporate Speak (contd.)

Suzlon Energy

Suzlon Energy, the world’s third largest wind turbine group, completed the payment of the entire outstanding Acquisition Loan facility of approximately USD 780 million. The company tapped two sources of funds for this – proceeds from the partial stake sale of Hansen Transmissions International NV and a five year US dollar denominated loan of USD 465 million from State Bank of India. This initiative is part of the various initiatives that the firm is taking to de-lever its balance sheet and make it sustainable for long term growth. With this the form has completed its first phase of refinancing.

Pair Strategy

The Stocks prices of Maruti and Mahindra & Mahindra have been historically correlated and have peaked above 90% 9 times over the past 4 years.

The Correlation between these two stocks over the past four years has a mean of .65 and a standard deviation of 0.32. Currently the pair has seen a rapid decline in correlation as the stock prices have tended to diverge over the past 4 months. During this period the correlation between the two stocks has fallen from 0.86 to its current value of 0.07 which is close to a two standard deviation shift. This strategy is based on the assumption that the correlation between the two stocks from the same sector will return to its normal values as it has done in the past.

During the past four months the stock of Mahindra & Mahindra has been on a steady uptrend while Maruti’s stock price has been rangebound and faces resistance at the 1600 level. In other words, the stock of M&M has been outperforming Maruti. A return to higher levels of correlations would see the outperforming counter have limited upside potential and higher downside risk. With the same logic the underperformer in the pair would have a higher upside potential and lower downside risk.

With an outlook of three months the calls that results from this strategy are

Buy : Maruti
Short : Mahindra & Mahindra
Risk adjusted returns.

Making the right investment decision.

Below we apply option pricing models to quantify the risk involved in an investment and derive the risk adjusted value of the investment.

Using the Resistance and Support levels as near term target and stop loss we apply this to pick the right investment in the realty sector.

Upside gains can be quantified as a the option premium on a covered call while the down side risk can be quantified as a covered put option strategy. The difference between the cost of covered call and covered put gives the risk adjusted value of the investment.

<table>
<thead>
<tr>
<th>Stock</th>
<th>CMP</th>
<th>Support Level</th>
<th>Resistance Level</th>
<th>Annualised Volatility</th>
<th>Upside Gains (Covered Call Premium)</th>
<th>Downside cost (Covered Put)</th>
<th>Risk Adjusted Value</th>
<th>Risk Adjusted Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>DLF</td>
<td>357.4</td>
<td>390</td>
<td>352</td>
<td>52.9</td>
<td>13.12013275</td>
<td>2.75399236</td>
<td>10.36614</td>
<td>2.90%</td>
</tr>
<tr>
<td>Unitech</td>
<td>80.2</td>
<td>92</td>
<td>79</td>
<td>64.22</td>
<td>4.355326122</td>
<td>0.6347189</td>
<td>3.720607</td>
<td>4.64%</td>
</tr>
</tbody>
</table>

The Realty sector is represented in the Nifty 50 stocks by Unitech and DLF. The Resistance and Support levels are identified with the help of technical analysis and applied to this model. By Quantifying the downside risk and the upside potential of these individual investments using the Black Scholes model, Unitech is judged to have the higher risk adjusted return of the two.
HINDUJA GLOBAL SOLUTIONS LIMITED CMP 459.50

Forecast: Buy

Buy HGSL with a Target of Rs 480 and Stop Loss at Rs 432.

Indicators:
- The stock of Hinduja Global Sol has been on a steady downward trend for the past month and is now showing signs of a reversal. This is indicated by the formation of an inverted hammer close to the last trading day.

- Positive divergence between the stock price and the MACD histogram is a bullish leading indicator and indicates that the downtrend is weakening.

- RSI crossing the 30% level from below is a strong oversold indicator and strengthens our bullishness on this counter.

- Cross over of the Stochs could see this stock make a significant upward move.
CORPORATION BANK CMP 421.35

Forecast: Buy
Buy Corporation Bank with a Target of Rs 445 and Stop Loss at Rs. 402.

Indicators:
- The stock of Corporation Bank has closed below its short term moving average. The stock is currently trading below 421 level, which has been a support level in the past. The short term moving average is currently below mid-term, and above long term moving averages.
- Bollinger Bands: The stock has closed above bottom band by 20.0%. Bollinger Bands are 11.8% wider than normal.
- The formation of Doji candlesticks indicates a reversal is on the cards for this counter. This is supported by the increasing volumes and the oversold levels of key oscillators.
- Strength Bar formed on the 17th of December. The stock has been in a down trend and an upbar with higher volume closing near the High is a sign of strength returning. The downtrend is likely to reverse soon.
Last Weeks Forecast

Score Card

- Buy call given on Kitply at Rs7.65 met our target of Rs8.45 giving returns of 10.5%
- Sell call given on BPCL at Rs622.35 met our target of Rs595 giving returns of 4.4%

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<thead>
<tr>
<th>Investments Period: 14 Dec—18 Dec 2009</th>
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<tbody>
<tr>
<td><strong>Nifty</strong></td>
</tr>
<tr>
<td><strong>Recommendation 1 : Kitply</strong></td>
</tr>
<tr>
<td><strong>Recommendation 2 : BPCL</strong></td>
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