



# KARVY BAZAAR BAATEIN

A Weekly Investment Newsletter From **KARVY**  
A Research Product of Karvy The Finapolis

22 June 2009 to 28 June 2009

Volume 3 : Issue 12

URL: <http://www.karvy.com/market/mktnews.pdf>

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**NSE**  
52 Wk H/L : 4693.20/2252.75  
**Mcap** : Rs44,14,471 cr.  
**BSE**  
52 Wk H/L : 15600.30/7697.39

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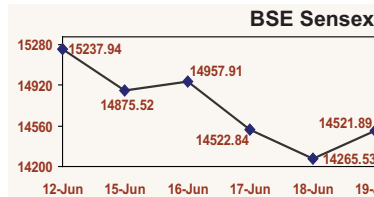
For advertising enquiries please contact **Pavan Katta** ☎:040-23312454 ext:152

Published from Karvy House, 46, Avenue 4, Street No.1, Banjara Hills, Hyderabad-500034.  
Printed at Harshitha Printers, 6-2-985/G, Yusuf Building, Adj. Railway Gate, Khairatabad, Hyderabad- 500 004.

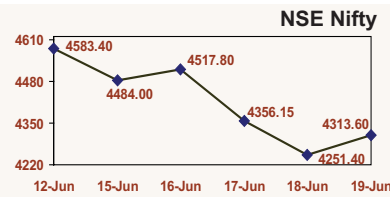
by **S. Gopichand** on behalf of Karvy Stock Broking Limited.

Editor: **S. Gopichand**

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**14521.89**  
↓ 4.70%



**4313.60**  
↓ 5.89%

### A healthy correction...

After a resounding rally since March 2009, the Indian markets finally took a breather last week, closing in negative territory on a week-on-week basis due to profit-booking at higher levels. After 14 consecutive weeks of spectacular gains, the BSE Sensex declined by 4.70% during the week to close at 14521. Meanwhile, the S&P CNX Nifty fell more sharply to touch 4313 levels, a drop of nearly 6% W/W. After what can be considered a spectacular rally triggered by a combination of positive global cues, better-than-expected quarterly results, and the installation of a stable government at the centre, the correction witnessed last week is undoubtedly healthy for the markets, in our view.

The key economic data points reverberating across the globe have remained positive, with the EU—for a change—showing signs of a recovery. In addition, key US economic data, including housing starts, industrial production, consumer price index, jobless claims and leading indicators, show a recovery in the US economy. Meanwhile, the World Bank upgraded the GDP growth estimates for China. The economists' opinion that the EU and China can achieve economic recovery without the need for additional stimulus measures indicates the strength of the respective economies. Overall, the economic data during the week strengthens the view that recession in the global economy may have bottomed out and an early recovery could be around the corner.

We believe that the triggers that led to the global rally are still intact for the long term and the correction during the week can be seen as healthy for the markets, both locally and globally. Moreover, it is reassuring to know that FIIs remain positive about the Indian markets in the long-term, with many upgrading India to Overweight status. However, in the near-term, participants have become increasingly cautious given the sharp run-up in the markets. Needless to say, FIIs were net sellers last week even as the market struggles to find a direction in the near term. Given the positive long-term outlook for the markets, investors who missed the bus earlier should take this correction as an opportunity to make a measured entry into the markets.

### KBB weekly recommendations for the week beginning 22<sup>nd</sup> June.

Scrip	Action	CMP	Entry	Stop Loss	Target	Time Frame
SBI	Buy	1724.60	1710-1720	1650.00	1825-1830	5-6 Days
GDL	Buy	100.45	97-100	94.10	118-120	5-6 Days
Central Bank	Buy	85.10	82-85	78.80	95-96	5-6 Days
IB Realestate	Buy	198.70	194-198	190.10	225-226	5-6 Days
Axis Bank	Buy	756.15	750-755	735.80	800-805	5-6 Days

**Disclaimer:** The above recommendations are purely based on technical analysis. Hence, the stop loss should be strictly adhered to.

### KBB weekly performance monitor

Scrip	Action	Entry	SL	Target	Shares(#)	P/L	Return	Remark
Tata Steel	Buy	452-455	445.10	488-490	-	-	-	NI
GMR Infra	Buy	156-158	152.00	170-172	-	-	-	NI
Bharti Airtel	Buy	820-825	800.00	892-895	280	-6,306.32	-2.74%	SLT
Bajaj Hind	Buy	220-222	214.80	242-245	1043	-6,467.39	-2.81%	SLT
Dhan Bank	Buy	100-102	94.00	119-120	2282	-15,977.40	-6.93%	SLT
Total						-28,751.10		

Balance on inception (26-Jan-09)	Balance last week (12-June-09)	Balance current week (19-June-09)	Abs. returns WoW (%)	Abs. returns since Jan 26, 2009(%)
5,00,000	6,91,593	6,62,842	(4.16)	32.57

TA - Target achieved; SLT - Stop loss triggered; CMP - Closing price as on last trading day; NI - Not initiated; # No. of Shares; SL - Stop Loss; P/L - Profit/Loss



### Technical view

#### Suzlon

**CMP: 111.05**

Suzlon has more than doubled from its October lows. It staged a strong breakout above the 70 levels and rallied strongly until 140 levels. Thereon, the stock slipped sharply and stabilized around its 200-day EMA at 104 levels and, on Friday, surged significantly amidst market declines; displaying the strength prevailing in the stock. The rally has helped the stock to cross all its moving averages, barring the 8-day EMA, which it recently breached on the downside and would be the immediate resistance level. The 14-day RSI has found support around the 45 levels and is heading north, indicating further momentum to prevail in the stock. However, the stock has a crucial resistance around 140 levels, which will be the critical point of observation. Investors are advised to assume long positions in the stock in the range of 105-110 levels for a short-term target of 140 and 180 levels. All long positions in the stock should be protected with a stop

loss below 90 levels on a closing basis which is also the 50-day EMA level for the stock.

#### LIC Housing Finance **CMP: 580.25**

LIC Housing Finance has been on a rising trend in the last three months. In the recent sessions, the stock moved to an all-time high of 620 levels. Thereon, it has witnessed a movement within the 550-600 range. The 14-day RSI has been hovering in the overbought territory since the initiation of the rally, and the consolidation has brought the scale to the lower support of 60 levels from where the momentum could further pick up. A move close to this level would induce fresh buying interest in the stock. The stock has an immediate resistance placed around the all-time highs of 620 levels beyond which it could move up to 700 levels in the short term. Investors are advised to assume long positions in the stock in the range of 550-560 levels for an upside target of 700 and 740 levels in the short-term scenario. All long positions in the stock should be protected with a stop loss placed below 520 levels on a closing basis.

#### HDIL

**CMP: 228.10**

HDIL witnessed a dream run during the recent market rally; however, the recent sessions saw a sharp decline in-line with markets. The stock corrected below the short-term moving averages of 8-day and 21-day EMA but stabilized around the 50-day and 200-day EMA levels. It has its 200-day EMA placed at 208 levels, which has to be observed closely in the near term. The 14-day RSI has found support around the 40 levels and staged a bounce-back, indicating momentum to return to the stock. A sustained move close to 200 levels could attract fresh buying interest which will guide the stock to test higher levels of 300 and 350 levels in the short-term scenario. Investors are advised to assume long positions in the stock in the range of 210-220 levels for an upside target of 300 and 350 in the short term scenario. All long positions in the stock should be protected with a stop loss placed below 180 levels on a closing basis.

- Kalyan C. Reddy

### Fundamental view

#### Axis Bank (Rs745)

We revise our rating on the stock to 'Outperformer' from our previous rating of 'Underperformer' to factor in our FY11 estimates. In FY11, we expect the CASA deposit share to decline slightly by 150 bps Y/Y to 39.5%, the net interest margin to be maintained at 2.86% level, the GNPA to increase from 1.76% to 2.43%, and the credit cost to remain at 1.3%. In FY10 and FY11, we estimate that the bank would report an RoAE of 16.7% and 17.5%, respectively. Hence, we upgrade our rating on the stock and increase our price target from Rs630 to Rs870 at 3.08x FY11E ABV (adjusted for net NPA and restructured assets).

In FY11, we expect the bank to report a business growth of 31.4% (CAGR FY09-11) on the back of a 28.2% (CAGR FY09-11) growth in deposits and a 28.8% (CAGR FY09-11) growth in advances. Furthermore, we expect the bank to report net interest income and operating profit growth of 28% (CAGR FY09-11) and 20% (CAGR FY09-11) while the bottom-line is expected to grow by 10% (CAGR FY09-11) to Rs21.9 bn. The performance on CASA deposits, gross NPAs

and restructured assets, and the amount of NPA provisioning the bank makes in FY11, would be critical factors for its valuation.

**Pressure on margins could reduce in FY11:** We expect the pressure on margins to continue due to a decline in CASA deposits' share. However, from 2QFY09 onwards, the re-pricing of deposits at lower rates on renewal could marginally ease the pressure. We expect the bank's margin to drift down from 2.96% in FY09 to 2.86% in FY10 and FY11.

**Fee income growth momentum would be healthy:** We expect the bank's commissions, exchange & brokerage (CXB) income to grow by 26.4% (CAGR FY09-11) to Rs34.7 bn while we factor in lesser treasury income of Rs1.55 bn in FY11 compared to Rs2.9 bn in FY09.

**Higher credit cost on increase in NPA level:** We factor in higher credit cost of 1.3% in FY11 (percentage to average gross advances) compared to 1.12% in FY09. Moreover, we expect the bank's gross NPAs to increase to 2.43% (to gross advances) from 1.1% in end-March FY09 while the net NPAs are expected to increase to 0.88% from 0.4% in end-March FY09.

#### City Union Bank (Rs25)

In Q4FY09, City Union Bank (CUB) reported a 12% growth Y/Y in net interest income to Rs597 mn compared to our estimates of Rs589 mn. During the quarter, the yield on funds and the cost of funds increased by 37 bps and 67 bps, respectively, while the CASA deposit share declined to 18.9% from 20.9% in 4QFY08 and slightly improved from the 3QFY09 level. In the quarter, the incremental credit deposits came down to 62% from 70% in 4QFY08 and 121% in 3QFY09 while the net interest margin (NIM) reduced to 2.71% from 3.0% in 4QFY08 and 3.14% in 3QFY09. The bank witnessed de-growth of 6.0% Y/Y on the core fee income front. In addition, the CXB income de-grew by 6.0% Y/Y to Rs47 mn while treasury income jumped by 2.6 times to Rs140 mn. Moreover, the foreign exchange gains increased four-fold to Rs24 mn.

In Q4FY09, the total provisions were higher, mainly due to much higher tax provisions of Rs130 mn compared to Rs44 mn in Q4FY08 while the higher effective tax rate was mainly due to higher treasury income. In the quarterly results, the bank's reported numbers were in-line with our estimates in regard to the core income level but lesser

### Market pulse

#### Bulk Deals

Company	Wt. Avg. Price (Rs.)	Traded Qty	Acquirer/Seller
<b>Buy</b>			
SREI Infrastructure	62.5	2850000	Reliance Capital Trustee
Ispat Industries	22.15	7860488	Excel Fincom
<b>Sell</b>			
Everonn Systems	403.51	82046	Taurus Mutual Fund
Maytas Infra	90.18	1091659	IFCI Ltd
Standard Industries	19.40	818500	Deutsche Securities Mauritius
Unitech	80.04	10501792	Goldman Sachs Invest Mauritius

#### Top Gainers (Weekly)

Company	19-June	12-June	%Change
PNB	642.05	593.00	8.27
Axis Bank	756.15	703.75	7.45
Reliance Infra	1262.15	1180.60	6.91
Cipla	265.45	251.05	5.74
SBI	1724.60	1634.60	5.51
Infosys	1770.40	1728.45	2.43
HDFC Bank	1558.85	1528.15	2.01
ITC	200.60	196.65	2.01
HUL	260.75	255.75	1.96
BPCL	422.75	416.65	1.46

#### Top Losers (Weekly)

Company	19-June	12-June	%Change
Sterlite	606.45	720.00	-15.77
Reliance	2041.50	2362.10	-13.57
RPL	127.15	147.10	-13.56
Hindalco	88.15	100.80	-12.55
ACC	749.10	845.85	-11.44
Power Grid	108.05	121.25	-10.89
NTPC	198.00	221.50	-10.61
SAIL	152.45	170.30	-10.48
ONGC	1009.35	1127.05	-10.44
DLF	330.75	367.80	-10.07

#### FII Invt (Rs.cr)

#### MF (Rs.cr)

Date	Purchases	Sales	Purchases	Sales
12-Jun-09	3581.80	2588.70	1011.00	1133.70
15-Jun-09	2931.90	2413.20	649.40	1131.10
16-Jun-09	2578.60	2791.90	789.20	780.50
17-Jun-09	1862.30	2574.20	531.40	711.00
18-Jun-09	2168.30	2394.80	862.30	732.70
<b>Total</b>	<b>13122.90</b>	<b>12762.80</b>	<b>3843.30</b>	<b>4489.00</b>

#### Corporate Actions

Company	Date	Purpose
Deccan Cements	23-06-2009	Audited Results/ Divi
Central Bank of India	24-06-2009	Audited Results
Bharat Electronics	24-06-2009	Annual Accounts & Divi
Tata Steel	25-06-2009	Audited Results/Divi
IFCI	27-06-2009	Audited Results

(Compiled by Krishna Veni M.)

than our expectations in regard to net profit due to higher provisions on account of tax and debt waiver provisions. We downgrade the stock to 'Underperformer' with a price target of Rs13 at 1.1x FY10E adjusted book value.

**Strong growth in business continues:** CUB's total business grew by 28% Y/Y to Rs141 bn due to a 29% growth in gross advances to Rs59 bn and a 28% growth in deposits to Rs82 bn. Current, savings and term deposits reported a growth of 12%, 18% and 35%, respectively, leading to a decline in CASA share to 18.9% from 20.9% in Q4FY08.

**Contraction in margin:** In Q4FY09, CUB's NIM reduced by 29 bps to 2.71% from 3.0% in Q4FY08 and 3.14% in Q3FY09, mainly due to higher expansion in cost of funds compared to yield on funds and much lesser incremental credit-deposit ratio. The yield on funds expanded by 37 bps to 9.95% and cost of funds rose by 67 bps to 7.24%.

	Q4 FY08	Q3 FY09	Q4 FY09	Chng (Y/Y)	Chng (Q/Q)
YoA	12.95	13.59	13.52	0.57	(0.07)
CoD	7.56	8.14	8.43	0.87	0.29
NIM	3.00	3.14	2.71	(0.29)	(0.43)

**Strong growth in treasury income:** During the quarter, CUB reported a strong growth of 28% Y/ Y in total other income to Rs363 mn due to strong performance in treasury income and foreign exchange gains.

	Q4 FY08	Q3 FY09	Q4 FY09	Y/Y (%)	Q/Q (%)
CXB	50	53	47	(6)	(11)
Profits on FX transactions	6	35	24	297	(32)
Profits on sale of investments	53	176	140	162	(21)
Other Operating income	175	120	152	(13)	27
Total Other Income	284	384	363	28	(6)

**Asset quality, a concern:** In the quarter, CUB's gross NPA increased by 23% Y/Y to Rs1.02 bn while the net NPAs rose by 37% Y/Y to Rs611 mn, mainly due to lesser provisions for NPAs. As CUB made lower provisions on NPAs, it resulted in a decline in coverage ratio from 40% in Q4FY09 to 46% in Q4FY08.

In the quarterly results, while moderate growth in NII and strong growth in total other income were the key positives, the decline in CASA deposits and lesser loan-loss provisions were dampeners. We downgrade the stock to 'Underperformer' with a price target of Rs13 at 1.1x FY10E adjusted book value.

### Jubilant Organosys (Rs167)

#### Analyst meet's highlights

Jubilant is the largest CRAMS company in India with revenues in excess of Rs20 bn and a strong presence in pyridines and its derivatives. Jubilant is among the top-5 in North America in CMO Sterile Injectables and has an order book of \$883 mn in life sciences.

The company has given a revenue guidance of 15% for FY10 and an EBDITA of 20%. The main growth driver would be the PLSPS business. Jubilant has set a goal to grow its revenue and profit by 1.5x and 2x, respectively, in the next three years which will be due to greater asset efficiency. The company has set a target of 30% ROE for FY13E.

Jubilant is all set to divest its polymer business, which is its non-core business and comprises 8% of revenues. It would start evaluating the process in the current calendar year.

The company plans to repay FCCB and YTM to the tune of \$68 mn in FY11E and \$203 mn in FY12E. The redemption in FY11 would be through internal accruals while the redemption in FY12 would be a combination of internal accruals and debt. Jubilant is hopeful of procuring new debt at reasonable rates. The company has structured its debt in such a way that the majority it would be rolled over.

Jubilant will incur a capex of Rs2.5 bn in FY10E and Rs2 bn in FY11E. Investments of Rs1 bn would be in APIs and Rs1.6bn in proprietary products and exclusive synthesis.

We maintain our FY10E estimates as the guidance is in line with our forecast. We introduce our FY11 estimates and roll over our price target to FY11E. The stock is currently quoting at a P/E of 7.8x FY10E, 6.2x FY11E, EV/EBDITA of 7.4x FY10E and 6.3x FY11E. This is mainly due to the high leverage in the company's books. We rate the stock as a 'Buy' with a price target of Rs215 based on 8x FY11E.

- Karvy Equity Desk

### InvestAssure Optima

InvestAssure Optima is a unit-linked life assurance policy from Tata AIG Life Insurance Company Limited.

#### Unique features

**Guaranteed additions:** The first year regular premium for the policy is utilized to provide 'guaranteed additions' payable either on maturity or on an earlier death of the life assured (as in combination with the policy fund value if this combination value is greater than the policy sum assured value)\*. The details of this addition, expressed as a percentage of the first year regular premium amount, are:

Policy term	Guaranteed addition as a percentage of first year premium
10 years	110%
15 years	130%
20 years	160%
25 years	175%
30 years	200%

\*refer to Death Benefit in the Policy Benefits section  
The guaranteed addition is not payable on surrender / lapse / termination of the policy.

**Premium holiday:** On completion of three policy years and payment of the initial three years of regular premium, if the policyholder is unable to pay subsequent premiums, the policy will be deemed to be on a premium holiday for a maximum period of two years (allowed for revival).

**Top up premium:** Payment of top-up premium is allowed anytime during the policy term. Minimum amount of top-up premium is Rs5,000 and premium payment shall be allowed for a maximum 4 times in a policy year. Further, the policyholder has the option to choose an additional sum assured equal to 1.25 / 2.5 / 3.75 / 5 / 'policy term' times the 'excess' top-up premium paid, subject to underwriting guidelines and decisions.

#### Policy benefits

**Death benefit:** In the unfortunate event of death of the life assured during the policy term, the death benefit payable to the nominee / beneficiary will be higher of the sum assured (less applicable deductions of partial withdrawals) or the regular premium fund value (plus the guaranteed addition).

**Maturity benefit:** The fund value (from regular premium and top up premium, if any) and the guaranteed addition comprises the maturity benefit when the life assured survives at the end of the policy term. This benefit can be received either as a lumpsum or in structured installments spanning a period of up to five years under the settlement option.

#### Eligibility parameters

**Age at entry:** Minimum – 30 days; maximum – 55 years for a 10-year and 15-year term, 50 years for a 20-year term, 45 years for a 25-year term, 40 years for a 30-year term

**Age at maturity:** 70 years

**Policy term:** Minimum – 10 years; maximum – 30 years. Policy term will be in multiples of 5 years within this range and hence policy term options available will be 10 years, 15 years, 20 years, 25 years and 30 years.

**Sum assured value:** Minimum – 5 times the regular annual premium amount; maximum – policy term multiplied by the regular annual premium amount

**Minimum premium amount:** Rs15,000 p.a. Premium payment term is same as the policy term

**Premium payment frequency:** Annual, semi-annual, quarterly and monthly

#### Investment funds

The policy holder can choose one or more of investment funds from the seven fund options, depending on his unique risk and return profile. The seven fund options are WL Mid-cap Equity, Select Equity, Large-cap Equity, WL Aggressive Growth, WL Stable Growth, WL Short Term Fixed Income, and WL Income. "WL" denotes "Whole Life".

The policy provides Systematic Transfer Plan (STP) which helps to average out the risks associated with equity investments to some extent. The premium re-direction facility is available to enable a change in the premium allocation of future premiums as per the changed financial and investment requirements. The policy provides the option to switch the investment value from one fund to the other. There are 12 free switches every policy year. This option is not available if the STP option is exercised and is not allowed in the first policy year.

#### Policy charges

The first-year premium is fully utilized for the provision of the 'guaranteed additions' and as such no charges are deducted from this premium. The charges applicable from the second year onwards are:

**Premium allocation charge:** The details of the charge expressed as a percentage of the premium amount, are:

Policy year	Premium allocation charge (as % of the regular premium)		
	For premium amount less than Rs50,000	For premium amount equal to or more than Rs50,000 but less than Rs5,00,000	For premium amount equal to or more than Rs5,00,000
1st year	NA	NA	NA
2nd year to 3rd year	8%	3%	0%
4th year to 5th year	5%	2%	0%
6th year to 9th year	3%	1%	0%
10th year onwards	0%	0%	0%

**Policy administration charge:** This is a fixed charge and depends on the premium value. For annual premium amount less than Rs50,000, the charge is Rs65 per month. For annual premium amount equal to or more than Rs50,000, the charge is Rs150 per month. This charge can be increased by a maximum of 5% p.a.

**Fund management charge:** This charge ranges from 0.65% p.a. to 1.20% p.a. depending on the choice of the investment fund(s).

**Mortality charge:** This charge is levied to provide life assurance cover under the policy and depends on the age, gender and sum assured.

**Switching charge:** A subsequent switch after 12 free switches is charged Rs100 per switch in a policy year. This charge can be increased to a maximum of Rs250 per switch, subject to prior approval from the IRDA.

#### Riders available

The various riders available under the policy are *Payor Benefit Rider, Critical Illness Lump Sum Benefit Rider, Waiver of Premium Rider, Accidental Death Benefit Rider, and Accidental Death & Dismemberment Benefit Rider.*

#### Tax benefits

The premium payable under the policy is eligible for deduction under the provisions of Section 80C of the Income Tax Act, 1961. The policy benefits are exempt from tax under Section 10(10D) of the Act.

- Atul Stanley Hermit

### Commodities review

#### Precious metals review

**Bullion:** Bullion prices closed marginally lower last week after trading in a broad range of \$926.5-944 per troy ounce. The most active August gold futures slid 0.64% to close at \$934.7. The performance of the US dollar was the major determinant for prices throughout the week.

Initially, the US dollar traded low due to the ever-increasing uncertainty over the BRIC nations' summit, poor economic numbers, and better performance of the euro zone. Meanwhile, the euro gained against the dollar as the Zew economic sentiment in the region increased to 42.7 against the expected level of 34. Moreover, the euro zone trade balance reported a surplus of 2.7 billion against the expected deficit of 1.5 billion. The US Housing Starts and Building Permits, too, increased more than expectations in May while industrial production, Empire Manufacturing and TIC flows declined.

Nevertheless, the surprise jump in US leading indicators and the Philadelphia Fed Index on the weekend, besides the sharp dollar fall in the past few days, resulted in a pullback in the US dollar, leading to subdued bullion

prices. Silver prices also mirrored gold's trend, although it declined by a higher margin of 4.54%, to \$14.2 levels.

This week, the US GDP and the FOMC interest rate decision will be crucial to watch out for. Overall, we expect prices to trade in the broad range of \$915-952.

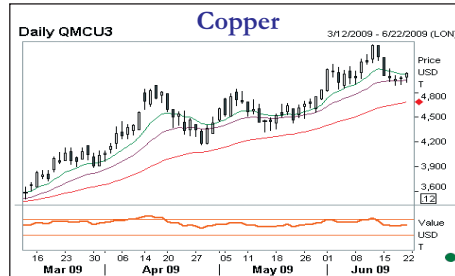
#### Base metals review

Base metals prices pared its penultimate week's gains due to profit booking as prices were in an overbought zone. The rise in the dollar index and accumulation of inventories in a few metals kept prices under pressure. Zinc prices fell the most—by 7.51%—followed by lead and copper, which lost 6.16% and 5.06%, respectively. On the economic front, the G8 ministers indicated that a long-term economic recovery is possible with a massive fiscal stimulus package. Russia plans to reduce its dollar holdings and has taken an initiative to source an alternative currency reserve. For the past few days, base metals prices have been correcting following the release of the US industrial production data, which posted a decline of 1.1% in May against a fall of 0.5% reported a month ago. Among other economic releases, the Empire Manufacturing Index fell 9.41% while the current account deficit rose to \$101.5 billion and the net TIC inflow fell

to -\$53.2 billion in April against \$23.2 billion recorded in the previous month. All these indicators exerted pressure on base metals prices last week. However, a rise in US Housing Starts and Building Permits restricted a sharp fall in copper prices. On the LME, aluminium stocks rose to 1,01,925 tonnes while copper inventory declined by 8,675 tonnes. As per the World Bureau of Metal Statistics (WBMS), in Jan-April 2009, the global production of copper, aluminium, nickel, lead and zinc were in excess of 1,33,000, 5,91,000, 61,900, 40,000 and 2,03,000 tonnes, respectively. Towards the end of the week, prices recovered following reports of stockpiling of metals by China. This week, weak economic data outlook suggests that metals are likely to trade sideways with negative bias.

#### Agri market review

**Turmeric:** Turmeric futures fell last week despite a firm opening due to strong selling pressure. Prices fell for a third consecutive week taking cues from the weak sentiment in the spot market. During the week, spot prices fell to Rs5,250 per quintal from Rs5,300 per quintal. Moreover, anticipation of increase in turmeric acreage by nearly 16% in the ongoing season and higher supplies coupled with subdued demand in the physical market acted as triggers for the fall in prices. Increase in open interest in the August contract and the decline of the same in the July contract indicates rollover to the August far-month contract. Declining open interest and prices signify that markets are in a bearish mode. Turmeric futures are likely to maintain its downtrend this week due to continued profit-taking.



- Commodities Research Desk

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### Introduction to commodity futures market

Are you new to the commodity futures markets? If so, you are probably curious to know more about just how the whole thing works. Else, if you are a seasoned player, you may still be looking for greater insights in what can be described as one of the biggest—yet one of the least understood—markets in the world. We will endeavor to apprise our dear readers about the myriad aspects of the commodity futures markets, particularly considering that it has come into the limelight in recent years and has the potential to touch a huge cross-section of investors and market participants.

Futures are derivative instruments that derive its value from an underlying asset. From this definition, it is evident that commodity futures derive its value from a particular commodity or commodity index. In such a scenario, to understand commodity derivative markets, it is necessary to comprehend the behavior of that underlying commodity.

#### Commodity markets: A background

Simply speaking, commodities are any goods that are common and unbranded. Commodity markets represent a formal system for the interplay of demand for (and supply of) commodities. These markets can be broadly classified into spot market and futures market. Commodities for immediate delivery are traded through the 'spot market'. The players in the spot market are the actual producers and consumers of the commodities.

On the other hand, the 'futures market' facilitates contracts for future delivery of the underlying commodity, either through a physical delivery (of the commodity) or a cash settlement (net profit or net loss from the transaction). The major players in the futures markets are hedgers, speculators, arbitrageurs and investors. There are various forms of commodity derivative products, but the most popular ones are futures and options. While commodity futures was re-introduced in India in 2003, commodity options are yet to take-off in the Indian markets. However, with a new, pro-reform government in place, market experts expect options on commodities to be introduced soon in India.

#### Role of the commodity futures market

Commodity futures markets are often believed to be efficient in the price discovery process. That is, the price quoted for a commodity on the futures market is thought to be the best measure of the actual price, either current or in the future. Therefore, if you are looking for a good predictor of what prices for a particular commodity will be four months from now, the prevailing futures price for the contract that is nearest to that period may be the best, aggregate price forecast for that commodity.

In addition, commodity futures helps to hedge price risk and also provides opportunities for speculators who are willing to make the necessary risk-return tradeoff. Moreover, farmers can benefit from its efficient price-discovery mechanism to decide which crops to grow. The commodity futures market also enables businesses to hedge commodity and currency risks, which, in turn, would help them smoothen their earnings as any failure to hedge these exposures could increase the quarterly earnings volatility.

#### Hedgers and the hedging process

So how does one explain the concept of hedging? Well, in today's dynamic environment, the stakeholders—along the value chain—are

exposed to the price volatility in commodities, particularly if the transaction (buy or sell) has to be made at some point in the future. Be it an auto manufacturer purchasing auto components for his cars, a jeweler buying gold bars to make jewelry, an oil refiner purchasing crude oil to manufacture different by-products, or a baker buying wheat from a farmer to make bread, the future price risk is real for every participant in the physical commodity markets.

Hedging plays an important role to mitigate the risks of both parties in the transaction. The process involves hedgers (as they are called) taking opposite positions in two different markets. Here is an example of hedging in the commodity futures market:

✂ A wheat farmer expects to harvest and sell his produce in three months time. Considering that he is long (he benefits from an upward move in prices) on the commodity in the physical markets, he does face the risk of falling wheat prices by the time his produce reaches the market in three months. To protect against this risk, he can take an opposite position in the futures market by going short (sell) on wheat contracts. On the other hand, a baker expects to buy wheat in three months time. While he would benefit from a downward move in wheat prices in the physical markets, he also faces the risk of rising prices from current levels three months from now. In such a scenario, he can take an opposite position in the futures market by going long (buy) on wheat contracts to offset his price risk in the physical market.

What is the payoff from this hedged position for the wheat farmer? Well, cash and futures prices tend to move in tandem. Therefore, if wheat prices fall in three months, then the farmer's loss in the cash market will be offset by his gains in the futures market. However, instead, if wheat prices rise, then his gains in the cash market would be neutralized by his losses in the futures market. The reverse applies to the baker. That way, a hedger is able to lock-in a fixed price for the produce he wants to sell (or buy) some time in the future. Hedgers typically comprise farmers, manufacturers, exporters, corporate treasurers, and individuals, who, at one point or another, may be dealing in the underlying commodity.

#### Speculators

Speculators have a high risk tolerance and usually trade with a short-term perspective in the futures market. They play an important role in providing liquidity to the market, thereby making it more efficient. Speculators are somewhat like middlemen—they usually do not own the actual commodity; they just buy from one and sell it to the other in anticipation of futures price movements. Moreover, speculators cannot be equated to investors (and investing) as the former takes on greater risk within a shorter trading horizon. Speculators risk their own capital to generate profit, and the resultant high liquidity in the markets allows other participants to effectively offset their risk.

#### Arbitrageurs

Arbitrage simply means taking advantage of the price differential between two or more markets. In other words, arbitrage can be defined as "risk-free profit". It involves simultaneous purchase and sale of similar or identical financial assets in different markets or in different forms. Arbitrage, in a way, ensures that prices across markets do not deviate from each other for long. For instance, during a volatile trading session, the price of a particular commodity in the cash market was significantly lower than its futures market price. In such a scenario, an investor can earn profits by buying in the cash market and selling in the futures market. As more market players identify these arbitrage opportunities, the price of the commodity in

the cash market (futures market) rises (falls), thereby neutralizing the price variation between the two markets.

### Commodity exchanges

In traditional markets, due to erratic weather changes and uncertain economic environment, a commodity shortage (or oversupply) in a particular season may lead to increase (decrease) in the price of the commodity. Neither farmers nor merchants were happy with this situation as they could not predict the prices on a given day or season. Therefore, farmers often could not find a counterparty to purchase their produce. It was in this context that farmers and merchants in Chicago started negotiating for future supplies of foodgrains in exchange for cash at a mutually agreeable price. This effectively started the system of commodity market forward contracts, and,

subsequently, the development of the futures market. The following table lists the major exchanges worldwide.

### Performance of Indian commodity exchanges: A comparative analysis

In 2007-08, the three national commodity exchanges—MCX, NCDEX and NMCE—recorded a combined trade turnover of Rs38,26,138 crore, just three years after India allowed commodity futures in 2003. Of this, Rs35,05,137 crore was contributed solely by MCX and NCDEX. The increasing awareness and popularity of commodity futures in India and the slowdown in equity markets have contributed spectacularly to the turnover in the market. The turnover of the MCX and NCDEX reached Rs63,62,603 crore for the period January 2008 until March 2009.

**Table 1: Major exchanges worldwide**

Exchanges	Abbreviation	Location	Products
Chicago Board Of Trade	CBOT	Chicago, US	Agricultural
Chicago Mercantile Exchange	CME	Chicago, US	Agricultural
New York Metal Exchange	NYMEX	New York, US	Energy, precious metals, industrial metals
Multi Commodity Exchange	MCX	India	Energy, metals, precious metals, agricultural
National Multi-Commodity Exchange of India	NMCE	India	Metals, agricultural
National Commodity and Derivatives Exchange	NCDEX	India	Metals, agricultural
Tokyo Commodity Exchange	TOCOM	Tokyo, Japan	Energy, precious metals, industrial metals, agricultural
London Metal Exchange	LME	London, UK	Industrial metals, plastics

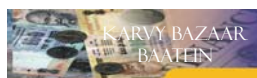
- Niti Kumar, Alka Bajaj and Satyan Nair

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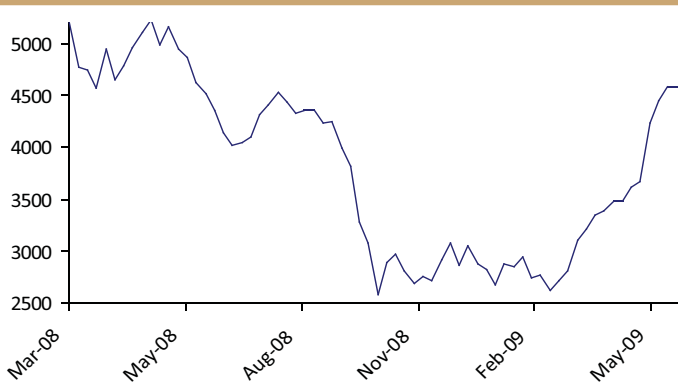
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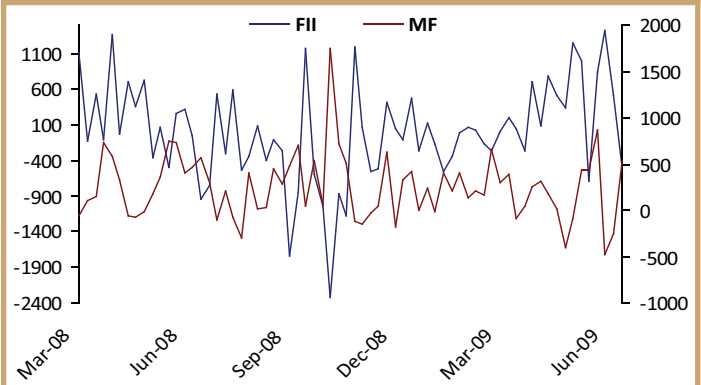


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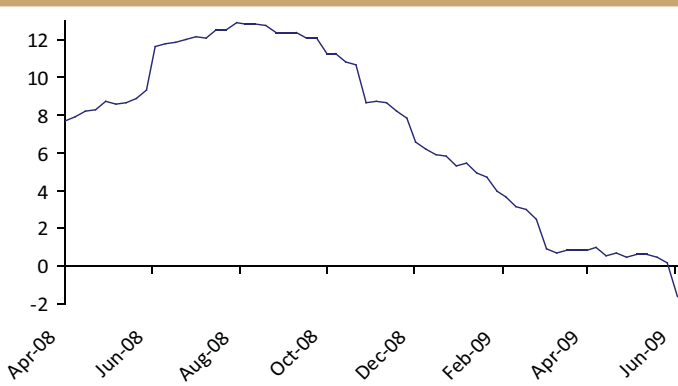
### Nifty movement



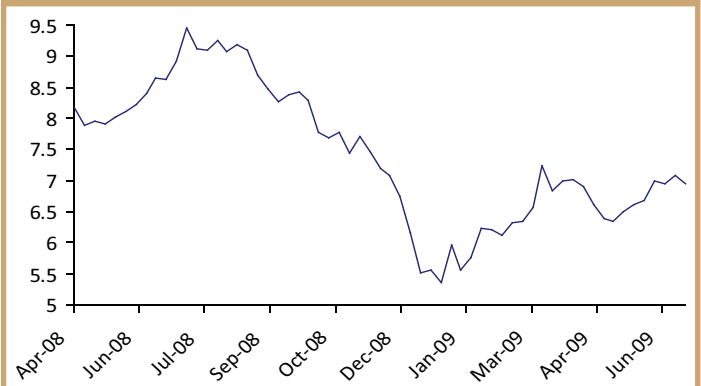
### FII and MF net inflows



### Inflation is at -1.61%



### 10-year bond yield



### Global indices: Weekly performance

	Close (June 19)	Close (June 12)	Weekly (%)	6M (%)	12M (%)	PE Ratio
<b>ASIA</b>						
Hang Seng	17920.93	18889.68	-5.13	18.47	-21.39	16.04
STI	2273.18	2377.07	-4.37	26.61	-24.04	12.09
S. Korea	1383.34	1428.59	-3.17	17.14	-20.53	29.28
Nikkei 225	9786.26	10135.82	-3.45	13.95	-30.74	-
<b>AMERICA</b> (closing as on June 18)						
Dow Jones	8555.60	8799.26	-2.77	-0.27	-29.08	11.30
S&P 500	918.37	946.21	-2.94	3.43	-31.61	14.46
NASDAQ	1807.72	1858.80	-2.75	15.56	-26.58	27.53
Brazil Bovespa	50903.02	53558.23	-4.96	30.08	-23.56	20.38
<b>EUROPE</b> (closing as on June 18)						
FTSE-100	4280.86	4441.95	-3.63	1.67	-23.65	29.69
DAX 30	4837.48	5069.24	-4.57	3.18	-27.90	25.91
CAC 40	3194.06	3326.14	-3.97	0.05	-29.70	11.44

Source: Bloomberg

### Domestic indices: Weekly performance

	Close (June 19)	Close (June 12)	Weekly (%)	6M (%)	12M (%)	PE Ratio
Sensex	14521.89	15237.94	-4.70	43.78	-3.75	15.55
Nifty	4313.60	4583.40	-5.89	40.17	-4.23	15.44
BSE 500	5466.33	5731.51	-4.63	47.18	-8.18	15.32
BSE Auto	4723.81	4897.83	-3.55	84.41	13.99	15.35
BSE Bankex	8111.04	8038.62	0.90	44.04	15.65	13.30
BSE Consumer Durables	2874.21	2999.77	-4.19	43.80	-26.84	9.00
BSE FMCG	2261.39	2249.92	0.51	10.07	-1.32	21.84
BSE Healthcare	3663.40	3655.58	0.21	23.74	-17.25	34.73
BSE IT	3276.83	3254.76	0.68	39.62	-23.90	15.34
BSE Oil & Gas	9387.19	10509.72	-10.68	45.68	-5.36	16.10
BSE Metal	11038.99	12220.45	-9.67	103.12	-27.05	7.32
BSE Realty	3289.90	3662.11	-10.16	30.28	-41.61	11.59
BSE PSU	7846.76	8342.67	-5.94	45.47	20.26	55.91
BSE Power	2831.76	2983.66	-5.09	51.95	8.71	27.62
BSE Teck	2621.76	2674.21	-1.96	31.25	-21.83	16.67
BSE Capital Goods	12259.94	12992.66	-5.64	70.37	5.08	25.70

(Compiled by Amit Chopra)

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