

# The Wise Investor

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UNEARTHING OPPORTUNITIES

## Equity markets in year five of the crisis



**T P Raman**

Managing Director

### Perspective

We took note of the global financial and economic crisis stepping into its fifth year in an official sense in The Wise Investor of September 2011. This month we take a look at how equity markets across the world have stacked up during this period.

The accompanying table provides a summary of where we are now as compared to the peak of 2007 and 2008.

Despite the sharp recovery of 2009 across all markets and a more

modest yet respectable numbers in 2010, equity markets worldwide are still \$ 11 trillion short of their 2007 peak.

With the exception of resource-rich economies such as Canada, Chile and Brazil, which have been benefited from the surge in commodity prices, the story is still deep double-digit distance from the peak levels. This encompasses the developed world and key emerging markets such as China and India.

After two lost decades, Japan still continues to suffer. As the U.S and Europe have pursued policies similar to Japan, their equity markets may well be on a similar track having already suffered one lost decade since 2000. In this period, emerging markets, have fared well.

The most sobering message from this summary is the fact that one year such as 2008 can ravage equity portfolios in a way that it takes years to get back on track. It is quite likely that this may happen sooner (relatively speaking) in the case of emerging markets than the developed world.

If the developed world collectively experiences another lost decade, it will have implications for liquidity flows into emerging markets. In this backdrop, a volatile ride is on the cards, but we are now used to it. From an investment perspective, investors must focus on their ability to bear risks in equity, examine if buy-and-hold is always worth the while and ensure allocation across asset classes.

#### A comparison with 2007 (close to peak), 2008 (close to bottom), 2009 (recovery) & the present

Region/Country	Market Cap (\$ Billion)					Returns (%)				Distance from Peak (%)
	Sept 2011	2010	2009	2008	2007	2011 YTD	2010	2009	2008	
World	44397	51988	49722	31901	60880	-14.6	4.6	55.9	-47.6	-27.1
United States	13766	15431	13748	10455	17660	-10.8	12.2	31.5	-40.8	-22.0
Canada	1793	2102	1609	992	1749	-14.7	30.7	62.2	-43.3	2.5
Brazil	1177	1445	1326	565	1273	-18.5	9.0	134.7	-55.6	-7.5
Mexico	368	497	363	247	398	-25.9	37.1	46.8	-37.9	-7.5
Chile	255	340	229	130	208	-25.1	48.6	76.0	-37.5	22.4
United Kingdom	2877	3336	2975	1981	4051	-13.8	12.1	50.2	-51.1	-29.0
France	1421	1759	1900	1480	2736	-19.2	-7.4	28.4	-45.9	-48.0
Germany	1207	1502	1371	1075	2208	-19.6	9.6	27.5	-51.3	-45.3
Switzerland	1064	1201	1076	848	1217	-11.4	11.7	26.8	-30.3	-12.6
Japan	3627	3997	3488	3268	4545	-9.3	14.6	6.7	-28.1	-20.2
Hong Kong	1992	2485	2268	1312	2655	-19.9	9.6	72.9	-50.6	-25.0
India	1215	1629	1294	640	1813	-25.4	25.8	102.3	-64.7	-33.0
Australia	1131	1484	1253	652	1415	-23.8	18.5	92.1	-53.9	-20.1
China + Others	12505	14780	16823	8256	18952	-15.4	-12.1	103.8	-56.4	-34.0

Data Source: Bloomberg; The last available figures for each year have been taken; Analysis: Sundaram Asset Management. End December 2007 figures have been reckoned as the peak as different countries reached the point on different dates.

## Volatile trends imminent



**Satish Ramanathan**  
Director & Head-Equity  
Sundaram Asset Management

Markets remained volatile in September with concerns on the Euro debt crisis and China's slowdown as main issues. Indian equities were lower by a considerable 3.5% on back of a significant bout of FII selling. The Indian Rupee saw a sharp fall during the month and nearly touched the Rs50 mark, after which there was some recovery to close at Rs 49.1. Although there may be pullback rallies, we remain cautious in the near term.

Euro crisis far from being resolved: The intricacies and inter-relationships of the global financial system were exposed yet another time during September. As fears of a Greek default gained ground, banks across the world fell on account of fear that French and German banks will not be able to take a hair cut and bear costs of an eventual default.

Italy's debt problem also gained prominence during this month. American banks in turn have loaned money to French and German banks, and hence American banks declined as well. There was a fear of liquidity crisis as well on account of American banks stopping short-term dollar credit to European banks and this resulted French banks becoming vulnerable.

All in all, September remained a nasty month better forgotten. To understand the impact of this confusion, MSCI Financials Index

has declined by 27% in two months.

Global recovery still tentative: Although, there are signs that consumption appears to be recovering in the US, economists remain concerned about a jobless recovery, as also the sticky unemployment rate which remains close to 9%. China's slowdown is also impacting sentiment and this resulted in a sharp drop in commodities as well.

The Reuters CRB Index declined by nearly 8% in a month. Even crude oil, one of the tight supply commodities, declined nearly \$10 (a sharp decrease of over 10%). While, a fall in commodity prices is actually a welcome relief for developing countries who have been trying to battle inflation, the immediate short-term reading by the market is that of a sharp slowdown.

China's commodity consumption is being closely watched as it is the barometer for its growth for the present. There are concerns on the state of Chinese banks that have loaned a considerable amount of money to state owned enterprises to manoeuvre the country out of the slowdown. A banking crisis in China could put the country through a sharp slowdown

India - more of the same: The problems in India have not changed over the past one month and remain the same - high inflation, high current account deficit and a higher fiscal deficit. A higher current account deficit resulted in the sharp decline in the currency, which annulled the benefits of a drop in the value of the currency.

Interest rates nudged up slightly, as the government announced an enhanced borrowing program that confirmed fears that the fiscal deficit is not as low as projected by the government. A detailed analysis of the government finances appears to indicate that the actual fiscal deficit of the government could reach 5.6% as compared to the projected 4.6%.

Finances of state governments are also not pretty and hence borrowing could surprise on the upside implying that interest rates could remain high.

Our trade deficit increasing, despite record exports, could be on

back of higher oil prices and imports of capital goods. India still remains vulnerable, as the overall trade deficit could expand should consumption remain buoyant.

There are short-term measures for the twin deficits, and high government expenditure will need to be curbed. Reduction of subsidies will be painful but the most desirable way to reduce the fiscal deficit.

There are signs that the government machinery is not making decisions as fast as it should and this could exacerbate the problem. For instance, fertilizer policy reforms are yet to be implemented and the same holds true for oil price deregulation.

A string of state elections in 2012 will ensure that the government will not be too bold in reforms and may actually be a tad populist, stressing finances. The only thing going for the government remains, however, fairly buoyant tax collections. This could cool off as corporate profits could come under pressure on account of weaker profit margins.

The banking sector, which contributes nearly a quarter of corporate India's profits, will also see muted growth, on account of higher provisioning costs to meet the revised guidelines, and hence there will be no respite from this sector as well. Moody's' downgrade of SBI, though not very damaging is a reflection

Market Outlook: We expect equity markets to remain volatile over next few months, as concerns over global growth will remain and India's core strength of consumption will help it pass through a period of slowdown. A growth crisis in China could definitely shake Asian markets, including India, though over the medium term, India will emerge a beneficiary.

Lack of political will to deliver on sustainable growth rather than pander to populist measures will eventually drag the economy into the problems of twin deficits time and again. We do not see an end to this issue very soon. Add to this dimension politics may gain the utmost importance in 2012, which means growth will go out of the window.

A global slowdown will, however, help India combat a sustained inflation problem. We continue to remain defensive, though there may be growth surprises and market moves on the upside from time to time.

If Euroland remains the key driver of market sentiment day to day, there has been renewed negative focus on China in recent days. Thus, CLSA downgraded both Chinese banks and property stocks this week.

The obvious risk is that these moves are too late since the Chinese banking sector is already 39% off its 2010 high and the Chinese property sector is 46% off its 2009 high). Still what the downgrades reflect are growing legitimate concerns about the fallout from the intensifying credit squeeze in China in terms of the high interest rates being paid in China's shadow credit system, particularly in the so-called underground lending market.

The odds of intensifying fallout in China are, obviously, growing with the news flow about the funding problems of Hong Kong-quoted Glorious Property hitting the headlines.

There is also the added potential for bearish sentiment to hyperventilate on this credit crunch issue in China given that investor sentiment is already very bearish on Euroland. In fact this is the most likely outcome in the near term. Still GREED & fear does not believe that this represents the end of the China story because the reality is that the authorities have a lot of room to ease should they choose to.

Still the PRC's political calendar means that the authorities would rather be easing around the time of the leadership transition scheduled for October 2012, rather than now.

GREED & fear has received a flurry of emails over the past week regarding the view on gold. No one should be surprised that gold has corrected in a US dollar rally driven by deleveraging; though as already noted GREED & fear is very surprised that oil has not yet corrected more.

The gold action certainly suggests that some players have owned gold on leverage. The advice here to investors who already own gold is to buy more if bullion hits the 200-day moving average, which is at present at US\$1,530/oz.

**Christopher Wood**, Managing Director & Strategist of CLSA Asia-Pacific, an independent research outfit and author of the weekly report GREED & Fear.

## Firm trend in rates in prospect



**Dwijendra Srivastava**  
Head-Fixed Income  
Sundaram Asset Management

The RBI hiked the Repo rate by 25 basis points (bps) to 8.25% in its mid-quarter policy review, in line with market expectations. This was the twelfth increase since it began raising interest rates in early 2010 and policy rates have effectively been hiked 500 bps since then (considering the fact that the operative rate was reverse repo rate at the beginning of the rate hike cycle).

The policy statement acknowledged that global developments and moderation in domestic demand are a matter of concern but rate hike was needed as inflation remained high and well above the comfort level- the stance also remained hawkish.

Inflation concerns are expected to dominate policy stance as near double-digit food inflation - despite a normal monsoon - reflects structural demand-supply imbalances and cannot be dismissed as a temporary phenomenon. Further crude oil prices remain elevated despite the weakening global economy.

Monetary transmission is expected to strengthen and the cumulative impact of policy actions to be increasingly felt. Consequently, a reversal of the inflation trajectory towards the latter part of FY12 can be expected. We expect the central bank to differ from the government in its growth estimate by announcing a cut of GDP growth target from 8% in the next policy statement.

Ten-year G-Sec traded in a range of 8.28% to 8.36% during the month before it spiked 10 bps to close at 8.44% after India's federal government announced a higher-than-expected market borrowing for 2H of FY12. The government will raise Rs 2.2 trillion in

October-March following the borrowing of Rs 2.5 trillion in 1H FY12.

Thus, the full-year market borrowing for FY12 will be about 13% higher at Rs 4.7 trillion compared to what was announced in the federal budget in February 2011

**Outlook:** Market players were surprised by the hawkish stance maintained by the central bank in the monetary policy, as most expected that it would be the last rate hike and the central bank will be dovish on account of global events. This has resulted in the market reading this as a possibility of further rate hikes if the inflationary expectations do not subside.

The loose fiscal policy of the government and supply constraints have resulted in inflation remaining stubbornly high, forcing the central bank to maintain a hawkish stance. In wake of the global situation being volatile and capital flows not keeping pace, it can be a challenging task to fund the current account deficit.

The sell off in the equity markets and the demand for dollars from importers (both oil and non-oil) has resulted in the rupee weakening (it depreciated 7.8 per cent in September and it is the second worst performing currency in Asia Pacific).

The central bank along with the government have responded to rupee weakening by suspected intervention by RBI in the forex market and relaxing norms for ECB (External Commercial Borrowing) rules as well as fast tracking FDI (Foreign Direct Investment) proposals by GOM (Group of Ministers).

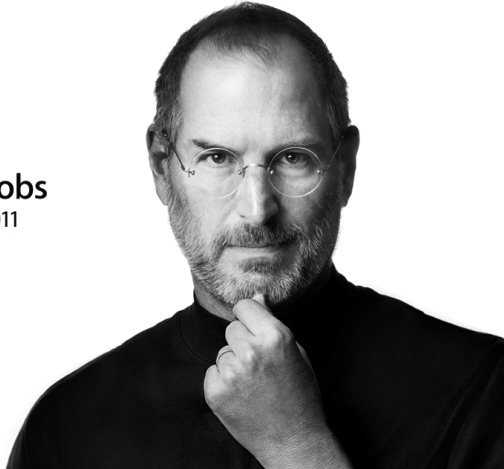
The y-o-y credit growth and deposit growth gap widened to about three percentage points after narrowing to one percentage point about a month back, but the YTD figures indicate the credit still lagging deposits. We expect the credit demand to moderate in wake of higher government borrowing and higher interest rates.

The higher borrowing program in the second half has also resulted in the government bonds coming under pressure with the yields rising by about 11 basis points post borrowing calendar announcement. We expect the ten year to trade in a band of 8.35% to 8.65% in the near term.

**Strategy:** We intend to largely continue our stance of maintaining adequate liquidity and lower money market durations, as the front end of the curve still looks under pressure on account of additional supply and possible liquidity squeeze in case of demand for money. We do not intend to lower duration in duration products though in the near term it faces headwinds.

# Steve Jobs

**Steve Jobs**  
1955-2011



No one wants to die. Even people who want to go to heaven don't want to die to get there. And yet death is the destination we all share. No one has ever escaped it. And that is as it should be, because Death is very likely the single best invention of Life. It is Life's change agent. It clears out the old to make way for the new. Right now the new is you, but someday not too long from now, you will gradually become the old and be cleared away. Sorry to be so dramatic, but it is quite true.

Your time is limited, so don't waste it living someone else's life. Don't be trapped by dogma — which is living with the results of other people's thinking. Don't let the noise of others' opinions drown out your own inner voice. And most important, have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.

When I was young, there was an amazing publication called The Whole Earth Catalog, which was one of the bibles of my generation. It was created by a fellow named Stewart Brand not far from here in Menlo Park, and he brought it to life with his poetic touch.

This was in the late 1960's, before personal computers and desktop publishing, so it was all made with typewriters, scissors, and polaroid cameras. It was sort of like Google in paperback form, 35 years before Google came along: it was idealistic, and overflowing with neat tools and great notions.

Stewart and his team put out several issues of The Whole Earth Catalog, and then when it had run its course, they put out a final issue. It was the mid-1970s, and I was your age.

On the back cover of their final issue was a photograph of an early morning country road, the kind you might find yourself hitchhiking on if you were so adventurous. Beneath it were the words: "Stay Hungry. Stay Foolish." It was their farewell message as they signed off.

Stay Hungry. Stay Foolish. And I have always wished that for myself. And now, as you graduate to begin anew, I wish that for you.

Stay Hungry. Stay Foolish.

Thank you all very much.

## Steve Jobs

*This is edited extract from an outstanding Commencement Address by Steve Jobs to graduating students at Stanford University on June 12, 2005. (Source: www.thehindu.com)*



# Performance Tracker Global

Index	Year-To-Date		One Month		Three Months		Six Months		One Year		Three Years		Five Years	
	Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank	Return	Rank
S&P 500	-10.0	8	-7.2	10	-14.3	10	-14.7	9	-0.9	6	-3.0	19	-15.3	21
Dow Jones	-5.7	4	-6.0	6	-12.1	7	-11.4	6	1.2	5	0.6	17	-6.6	18
Nasdaq Composite	-9.0	6	-6.4	7	-12.9	9	-13.1	7	2.0	4	15.5	10	7.0	13
Nikkei 225	-14.9	11	-2.8	2	-11.2	4	-10.8	4	-7.1	9	-22.7	25	-46.1	25
Dax	-20.4	15	-4.9	4	-25.4	21	-21.9	17	-11.7	15	-5.6	21	-8.4	19
FTSE 100	-13.1	9	-4.9	5	-12.4	8	-13.2	8	-7.6	11	4.6	15	-14.0	20
S&P GSCI Index Spot	-6.5	5	-12.4	16	-11.6	6	-18.6	13	8.2	3	-5.0	20	38.1	6
MSCI World	-13.8	10	-8.8	11	-17.1	13	-17.3	11	-6.4	8	-6.6	22	-19.6	22
MSCI Europe	-17.8	13	-4.6	3	-16.8	12	-17.9	12	-12.9	17	-12.4	23	-34.3	23
MSCI Asia ex-Japan	-21.6	17	-13.4	18	-21.6	19	-22.3	19	-16.5	20	20.7	8	13.2	10
Crude	10.6	2	-9.5	12	-6.6	3	-11.1	5	28.1	1	7.0	11	69.9	3
Gold	14.3	1	-11.1	15	8.2	1	13.4	1	24.1	2	86.5	2	171.4	1

## Emerging Markets (MSCI Indices)

BRIC	-27.7	24	-16.8	21	-26.3	23	-29.8	23	-25.2	22	1.5	16	12.2	11
Brazil	-30.2	25	-18.5	24	-27.7	24	-31.5	24	-28.4	25	-1.0	18	46.6	5
Russia	-25.5	21	-21.9	25	-31.0	25	-35.9	25	-13.2	18	-14.9	24	-34.9	24
India	-27.6	23	-6.6	8	-20.3	16	-23.6	21	-26.1	24	21.3	6	20.4	9
China	-26.3	22	-17.3	23	-25.7	22	-28.3	22	-25.8	23	6.6	13	27.4	8
Korea	-17.7	12	-12.9	17	-23.3	20	-22.7	20	-7.2	10	28.4	5	4.9	15
Taiwan	-23.0	20	-10.6	14	-20.4	17	-19.6	14	-9.6	13	21.2	7	-2.5	17
Singapore	-18.3	14	-6.7	9	-14.5	11	-16.3	10	-15.5	19	5.7	14	0.2	16
Honk Kong	-22.7	19	-16.8	22	-20.5	18	-22.1	18	-19.3	21	15.6	9	5.6	14
Indonesia	-1.3	3	-10.0	13	-11.5	5	-5.7	3	-2.4	7	88.4	1	117.9	2
Mexico	-20.6	16	-15.5	19	-20.0	15	-21.0	16	-7.7	12	6.9	12	10.6	12
South Africa	-22.0	18	-15.8	20	-17.7	14	-19.8	15	-12.2	16	29.8	4	37.4	7
Turkey	-9.4	7	12.1	1	-3.3	2	-4.4	2	-11.2	14	55.9	3	47.2	4

Top Performer	Gold	Turkey	Gold	Gold	Crude	Indonesia	Gold
Worst Performer	Brazil	Russia	Russia	Russia	Brazil	Japan	Japan

Source: Bloomberg; Analysis: Sundaram Asset Management; Returns is in percentage and in U.S. Dollar terms for each period and not on an annualised basis.

Analysis: S Vidhya

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This already goes down as the weakest recovery on record despite unprecedented policy stimulus. If you look at the monthly U.S. GDP data, it is already apparent that the U.S. economy is fraying at the edges. The economy contracted in both May and June and has shrunk now in four of the past six months. That sounds pretty recessionary to us. Over the past six months, real GDP has actually declined at a 1.5% annual rate, which is just about as bad as it got at the worst point of the tech wreck a decade ago.

**David Rosenberg**, Chief Economist & Strategist, Gluskin Sheff

I am the greatest bear on earth, but if you compare Treasury bond yields and equities, equities look reasonably attractive. I think we will have zero and below zero interest rates for the next 10 years. In other words, inflation adjusted to keep money in cash. Finally, the mood is so negative right now as a contrarian, you do not take a huge short position when people are as bearish as they are right now and when insider buying has picked up as much. I am as bearish as the greatest bear is. It is just that I do not believe stocks will implode.

**Marc Faber**, renowned investor and author of *Gloom, Boom & Doom Report*

The modern world has been built on an ethos of growth, improving living standards and growing prosperity. Growth has been our answer to everything. This is what drove us to the world of 'extreme money' and financialisation in the first place. The basic system – financialisation, debt and speculation driven growth – doesn't work. Now three things are coming together to bring that period of history to a conclusion – the end of financialisation, environmental concerns and limits to certain essential natural resources like oil and water. Living standards will have to fall.

**Satyajit Das**, an internationally respected expert on finance

Should more building blocks fall and a serious global double-dip develop, then the pattern of market behaviour this time may be more historically typical. Instead of quickly recovering, markets will become cheap and stay below long-term averages for several years. Twenty years is a long time, so most investors think that dipping to fair value for a minute and bouncing is normal. It is, in fact, highly aberrant historically. Markets staying down and washing

away a whole generation's false expectations, high animal spirits, and excessive risk-taking – that would be normal.

**Jeremy Grantham**, Co-founder & Chief Investment Strategist, GMO

The main fundamental reason that we question the resumption of the bull market is because of the tremendous household debt mostly taken on during the upswing from 2003 to 2007 when we had the double bubble of stocks and housing. And this was before balance sheets were repaired from the debt mania build up during the financial mania of the late 1990s. U.S. consumers spent well beyond their means for decades and now that they are so overleveraged their PCE will stay constrained for years.

**Charlie Minter**, founder, Comstock Funds

One of the factors prompting a benign response to what is now virtually certain recession is the hope the Fed will launch some new monetary intervention. Neither economic theory nor established economic evidence provides any basis for the belief that further monetary intervention and distortion would ease any binding constraint on the real economy. This does not, of course, rule out the possibility of speculation grounded in superstition and a misguided impulse to reach for yield, but the Fed's ability to weave yet another set of Emperor's Clothes is justifiably deteriorating.

**John Hussman**, President, Hussman Funds

An integral part of the Greek disaster recovery plan is to sell Greek assets on a grand scale. I just ask myself: With the ultimate outcome likely to result in a default, and with a possible exit from the euro to follow, isn't it probable that Greece will ultimately devalue whatever currency they introduce? Who will be buying Greek assets in the face of a 20-40% devaluation? Greeks are not exactly the most stupid people I have come across. Precisely when you realise that a default is inevitable, milking the cow for as long as possible seems to be the optimal strategy.

**Niels C Jensen**, Absolute Return Partners

Sources: Gluskin Sheff, Zero Hedge, Naked Capitalism, GMO, www.comstockfunds.com, www.hussmanfunds.com, Absolute Return Partners.

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### Investment Quiz

- 1 CHF denotes which currency?
- 2 What is the condition to be fulfilled by a mutual fund scheme to be treated as an equity-oriented fund for tax-free dividend and tax-free long-term capital gains?
- 3 Who is the author of the highly anticipated biography on Steve Jobs due to be published on October 24 2011?
- 4 The Investors' Advocate is neither the name of an English movie nor a book. It is used by which organisation connected with the financial markets as a punch line to sum up its role.
- 5 Who is the only individual to be allowed to float a mutual fund by SEBI?

PRIZE

**Answers must be mailed to [iq@sundarammutual.com](mailto:iq@sundarammutual.com)**

The first 25 responses with correct answers to all questions will receive a prize. Please mention your mailing address in your e-mail. Employees of Sundaram Asset Management, its Sponsors and Associates & Group Companies of the Sponsors shall not be entitled to prizes even if they participate and mail correct answers.

#### Answers for September 2011 Quiz

- |  |  |   |
|--|--|---|
| 1 Who has been designated as Governor of Reserve Bank of India for a two-year period ending in September 2013?<br><b>Dr D Subbarao</b> | <b>Kothari Pioneer Pharma Fund (both are now getting merged into Prima Plus)</b> | <b>Rs 50 per unit by Birla Sun Life Tax Relief 96</b>                                       |
| 2 Which is first sector-specific fund launched in India?<br><b>Kothari Pioneer FMCG Fund and</b>                                       | 3 Who is the author of Fool's Gold?<br><b>Gillian Tett</b>                       | 5 Which is the bank that started as Bank of Calcutta in 1806?<br><b>State Bank of India</b> |
|  | 4 What is the highest ever dividend paid by a mutual fund scheme in India?       |   |

Compiled by S. Vaideya Nathan

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