26 March 2020

Navigating The Equity Market Volatility

Key Takeaways
- Though there will be short term blips with regards to growth; India's long term structural story continues to be intact.
- Indian Market valuations have moved below the long term averages.
- Short term correction is an opportunity to invest in staggered manner for long term investors.

What Has happened

The recent correction in the global markets has been triggered by the fears emanating from the spread of Corona Virus. **All the global equity markets have corrected between 30-35% in the last one month** while the Indian markets have corrected close to 37% in the same time period.

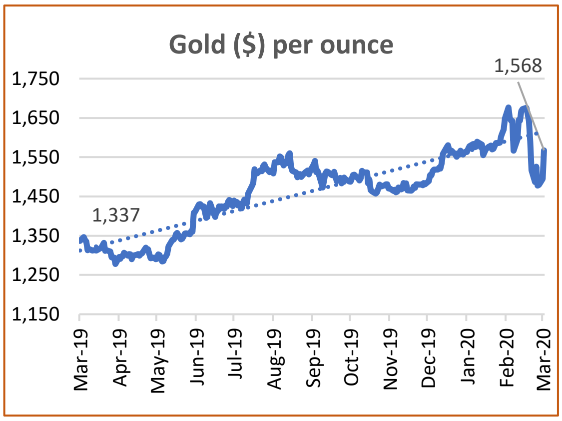
Global Equity Indices	Jan-20	Feb-20	March MTD
S&P 500	-0.16%	-8.41%	-24.26%
Dow Jones	-0.99%	-10.07%	-26.83%
Nikkei	-1.91%	-8.89%	-20.13%
FTSE 100	-3.40%	-9.68%	-24.11%
Shanghai	-9.95%	4.87%	-7.64%
NIFTY	-1.68%	-6.33%	-32.06%

Data as on 23rd March 2020 ;Source : Yahoo Finance

Along with equity markets, the **Crude has seen the second biggest single day fall in the history with crude declining 31.5% in a single day**, the biggest fall since Gulf War in 1991.

This has been prompted by decline in demand due to the globals fear and slowdown and also due to the breakdone of OPEC+ alliance with Russia not backing cut in crude prudction demanded by Saudi Arabia.

The biggest **gainer in all this turmoil has been Gold**. The metal has gained as much as 6.7% in the first week of March'20 itself due to safe haven buying. In the calendar year 2019, Gold has been the biggest gainer with 16% return delivered by the yellow metal.



Source: Investing.com

Prices of other global commodities like steel and metals have also got affected due to anticipated lower demand in the coming months.

The US Federal Reserve and other central banks unveiled emergency measures to prop up the coronavirus-battered global economy.

The US Federal Reserve attempted to stem the panic with drastic measures announced by slashing its key interest rate to virtually zero in its second emergency rate cut in less than two weeks in March.

While, the Reserve Bank of New Zealand (RBNZ) slashed rates to a record low; and Australia's central bank pumped extra liquidity into a strained financial system and said it would announce more policy steps in coming days.

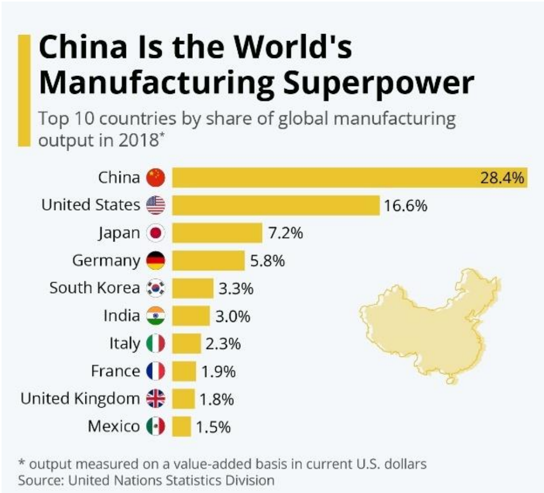
On the other hand, The European Central Bank (ECB) decided not to cut interest rates but did announce measures to support bank lending and expanded its asset purchase program by 120 billion euros ($135.28 billion).

In India, though the RBI has not yet announced an interest rate cut; however it has taken a slew of meaures to increase liquidity in the system through Open Market Operation (OMO), Long Term Repo Operation (LTRO), Forex Swaps.

Effect on Global Economy & Why China Matters

The epicentre of this outbreak has been China, which has been slowing down and facing economic headwinds due to trade war with United States. The virus spread will lead to China's economy to slow down further and take the world economy to slower growth path. Economists polled by Reuters expect China's growth rate to slump to 4.5 % in the Q1 of 2020 vas 6% in Q4 2019, which would be slowest pace since financial crisis. The way markets are reacting to this is such a negative manner is because of China's position in the global economies demand and supply.

- China is the world's second largest economy after United States with $ 14.4 trillion GDP.
- Its share in the global economy has surged from 8% in 2002 to 19% today.
- China accounted for 28% of the global manufacturing output in 2018 and manufacturing account for nearly 30 % of the country's total economic output. This makes China a vital part of global supply chain.
- China is one of the largest exporters in the world and one of the fastest growing consumer markets in the world.
- China is the world biggest oil importer.



All these point to the importance of China in the global trade and economy and if the economy of this size comes to a halt then it would have a big impact on global growth.

The organisation for Economic Cooperation & Development (OECD) has downgraded the global growth forecast for 2020 from 2.4% from 2.9%. The effect of the coronavirus will be seen in growth rates of all countries including India

How Markets have reacted in the past with similar events

The intensity all such out breaks differ each time and so is the market reactions. While in the last Zika Virus outbreak in 2016 resulted in BSE Sensex falling 13%, the average fall has been closer to 10-12 % in the past such events. **However, the markets have been quick to recover within 3 months from the peak of the outbreak in the markets where the epidemic broke.**

The below table shows 1 year returns post correction during previous outbreak of epidemics of India and US markets:

Virus outbreak	Estimated period of outbreak	Returns during outbreak (%)		1-year return post outbreak (%)	
		US S&P 500	Sensex	US S&P 500	Sensex
SARS	Jan 2003 to Mar 2003	-3.6	-10.1	+32.8	+83.4
Avian Influenza	Jan 2004 to Aug 2004	-0.7	-12.2	+10.5	+50.3
Ebola	Dec 2013 to Feb 2014	+3.0	+1.6	+13.2	+39.0
Zika	Nov 2015 to Feb 2016	-6.3	-13.1	+21.3	+24.1

Returns are absolute. Source: Bloomberg, Mint Research

Virus outbreak	Estimated period of outbreak	Returns during outbreak (%)		1-year return post outbreak (%)	
		US S&P 500	Sensex	US S&P 500	Sensex
Coronavirus	01 Jan 2020 to 23 Mar 2020	-31.3	-37.1	NA	NA

Returns are absolute. Source: ICRA MFI and Investing.com

26 March 2020

Impact On Indian Markets & Trade

The Indian markets have corrected in tandem with global markets with Nifty correcting by 32% March till date. While, all the indices have corrected significantly; the Bank Nifty has fallen the most due to both global and domestic issues like Yes Bank default.

The small cap stocks have fallen the most followed by midcaps and large caps.

While, markets have fallen in the last one month; the selling has been mostly driven by FII.

Indian Equity Indices	Jan-20	Feb-20	March MTD
Nifty 50	-1.68%	-6.33%	-32.06%
NIFTY Midcap 150	5.38%	-5.63%	-33.04%
Nifty Small cap 100	6.73%	-8.72%	-39.67%
Nifty Bank	-4.13%	-5.47%	-41.05%
Nifty Auto	-1.96%	-14.41%	-32.78%
Nifty Metal	-8.29%	-12.28%	-31.60%
Data as on 23rd March 2020; Source: NSE Website			

The Mutual Funds have been buyers to the extent of approx. Rs 23,000 cr; while, FIIs sold significantly worth Rs 53,000 cr of from March till date.

Segment	Jan-20	Feb-20	March MTD
MFs (Rs. crs.)	1,384	9,863	23,047
FIIs (Rs. crs.)	12,123	1,820	-52,960
Data as on 23rd March 2020; Source: ICRA MFI			

Impact on Trade

According to UN, India is among the 15 most affected economies due to coronavirus epidemic and slowdown in production in China with a trade impact of $348 million.

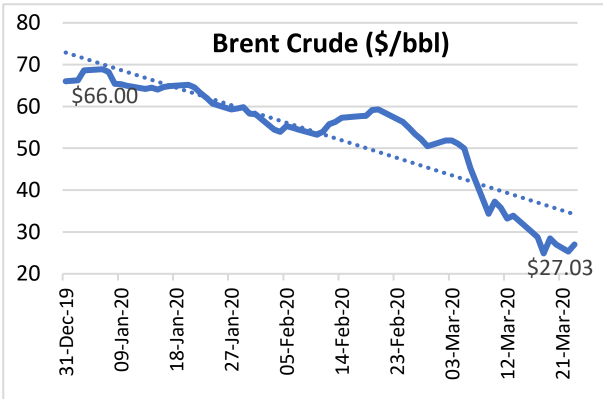
However, **the trade impact on India has been less as compared to other economies as EU, US, Japan, Russia**.

For India, the trade impact is estimated to be the most for the chemicals & automotive followed by electrical machinery, air conditioners, electronic items leather products, metals and wood products.

Positives for India

- **The biggest boost to India** can come from crash in the crude oil prices if the crude remains at lower levels for some time. With India importing 80% of its crude requirements the savings for India on this front can be quite large.

- **Crude has fallen by over 59% in this calendar year** – from $66 bbl to $27 bbl, on top of it; the government has announced an increase in excise duty. This will help the government to increase its expenditure to boost the economy and keep the fiscal deficit target within bounds.



Source: Investing.com

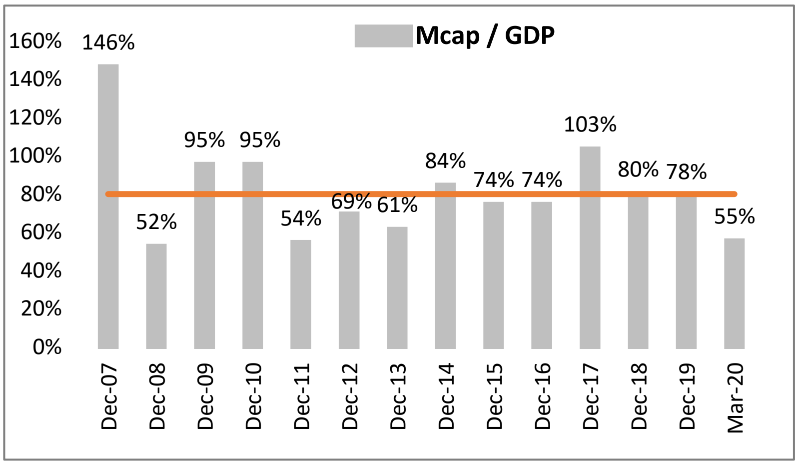
Along with this it may **help India gain in the long run** with lot of multinationals shifting their production bases to countries like India in order to hedge the concentration risk of having product in only one country being China in current scenario. With corporate tax cut also announced by the govt earlier India could become a favourable place to set up manufacturing facilities.

26 March 2020

Indian Markets Valuation

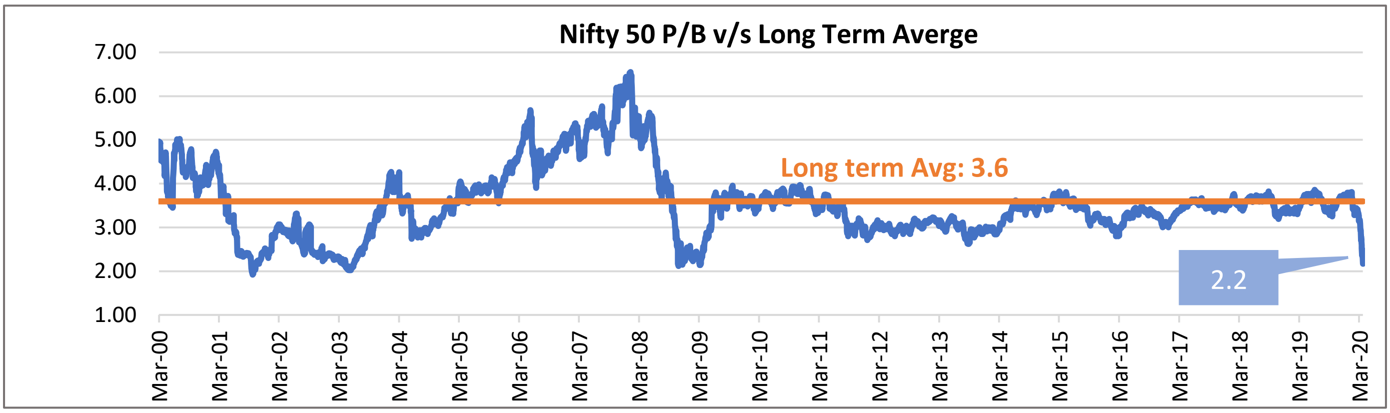
The Market cap-to-GDP ratio of India has fallen below long term average (i.e 80%) as represented by the orange line and is at 2008 financial crisis level.

From Dec-19 to Mar-20; the market cap-to-GDP ratio has fallen from 78% to 55%. This indicates that markets are nearing its bottom. And accumulating at these levels might lead to a good upside for investors who have a long term horizon. Valuations have now turned favourable for large caps after the correction.



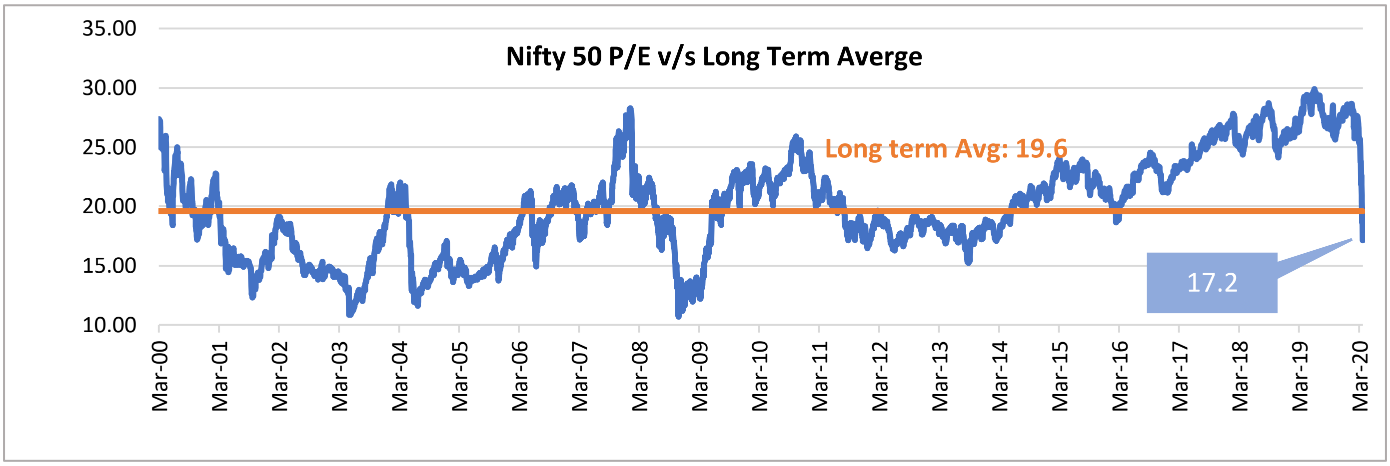
Source: Motilal Oswal

At 2.2x, the Nifty Trailing P/B is well below the historical average of 3.6 x.



Source: NSE India

Nifty 12-month trailing P/E of 17.2x at a 14% discount to its Long Term average of 19.6x



Source: NSE India

What an investor should do?

Equity markets are discounting mechanisms and the discounting happens quickly in anticipation of positive or negative events. Also, markets tend to swing between extreme pessimism and optimist at various points in time. While it may be very difficult and premature to guess the direction of the markets in such uncertain times, an investor can do the following to make the portfolios better and ready for the up move as and when the market rebounds:

1) Remain Invested

The nature of the equity markets is such that in every 2-3 years there is a period of high volatility due to global or domestic events. History has proven that all these events by and large have been short-lived and the economy and markets have bounced back from these setbacks. Long term investors should not book losses at these levels and hold on to current equity investments.

2) Align Portfolios to the decided asset allocation as per the risk-taking capacity

For example, a balanced profile investor may have 50% allocation each to Equity and Debt. In times, like these the debt portfolio would be valued at more than 50% of the portfolio and hence has got tilted from the desired asset allocation. It would be prudent to slowly shift money from debt to equity in such times when the equity markets are going down, and valuations are turning cheaper by the day.

3) Invest in Equities for long term goals

Equity investments tend to be volatile and hence are suitable for long term horizons, an investor should look at equity as an asset class with minimum 4-5 years' investment horizon and the Indian markets past data suggest that with horizon of more than 5 years the chances of losing money in very low in equity markets. For short term needs debt funds could be a better place to park money.

4) Shift to better Quality funds

This is a good time to sell underperforming equity funds and buy to the right funds in the portfolio. This would make the portfolio healthier and ready to bounce back faster as and when the markets rebound. Many times, loss aversion prevents investors from booking losses in their weak investments but if implemented most of the times this strategy would yield better results than holding on to your losers.

5) Continue with SIP

The idea behind Systematic Investment plans (SIP) is to invest at regular intervals over longer periods. This helps to provide better cost averaging to investors and accumulate units at different price levels. The corrections in the markets today is one such opportunity where units can be bought at cheaper valuations and this would help to give better returns over longer periods.
Additionally, investors should also look to increase their SIP allocations during such times.

6) Add to Investments in a Staggered Manner

Long term investors should invest in a staggered manner in the next 2-3 months in good quality funds to take advantage of this correction. Often the entry point in the markets have a significant impact on the final returns that an investor makes in his portfolio.

What's Attractive Now

All equity categories have witnessed significant corrections in the last one month. Looking at the current correction and state of the Indian economy, investors can look at investing in mutual fund categories which have significant large cap exposure. Accordingly, funds in the following categories can be considered:

- Large cap
- Large & Mid cap
- Multi cap Funds
- Focussed Funds
- Value

These categories have 50-85% of the portfolio in the large cap stocks and the rest spread out between mid and small cap categories. Investing in these categories would provide long term investors opportunity to invest in India's largest companies at lower valuations along with some high-quality midcap companies.

The below table shows the spilt of each of the categories across market cap viz, large, mid, small and others. Apart from Large cap mutual funds (87%), the highest share in Large caps is in Focused (73%) followed by Multi cap mutual funds (68%).

Category	Large Cap	Mid Cap	Small Cap	Debt & Others
Large Cap Funds	87.05%	7.32%	1.36%	4.26%
Large & Mid Cap Funds	51.62%	37.48%	5.70%	5.20%
Multi Cap Funds	67.90%	19.76%	9.25%	3.08%
Focused	73.15%	13.18%	6.40%	7.27%
Value	53.34%	21.00%	17.83%	7.83%

Data as on 28-Feb-2020 Source: ICRA MFI

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26 March 2020

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