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ASPECTS OF STOCK MARKET VOLATILITY IN INDIA

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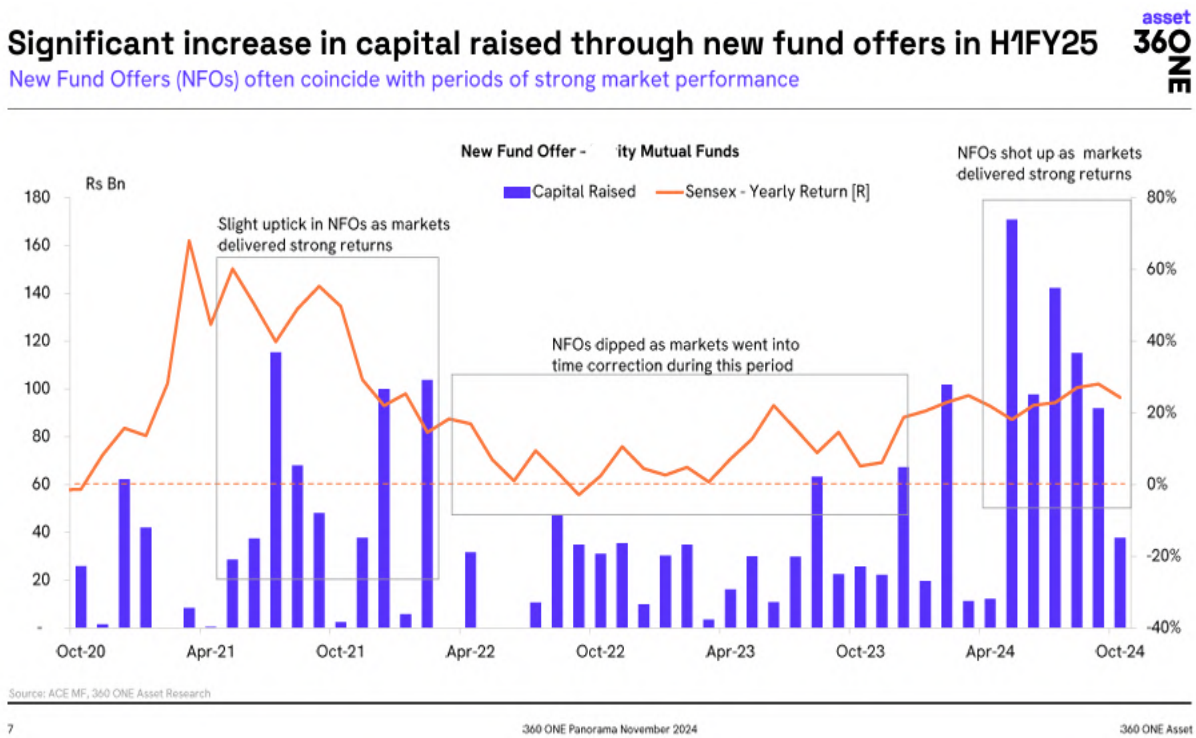
"Price is what you pay, value is what you get" - Warren Buffett

Historically, the 30-share Sensex, which breached the 25,000 mark in May 2014 and the 50,000 mark on January 21, 2021, smashed the psychological 75,000 barrier, zooming to 75,124 (intra-day lifetime high levels) on April 9, 2024. The BSE Sensex Stock Market Index reached an all-time high of 85,978.25 on September 26, 2024). Subsequently, the market fell to 78,233 on November 1, 2024 and further to 77,152.55 on November 21, 2024.

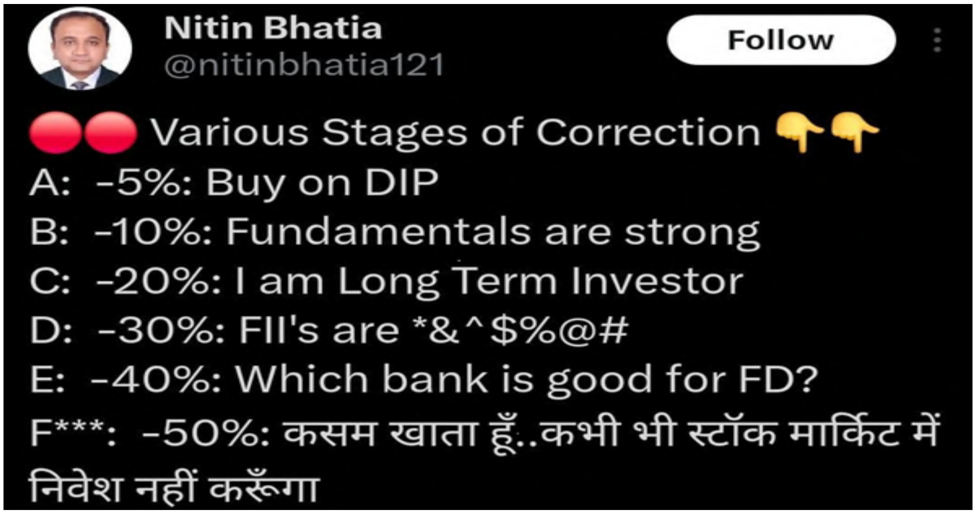
The NSE level recorded a similar fall. The fall occurred because of weak global overtones, a rise in the dollar index to a five-month high, the rupee sinking to an all-time low of 84.40, soaring domestic inflation hitting a 14-month peak above 6%, disappointing corporate earnings, and continued foreign investor sell-offs.

There was an element of "*froth*" and "*irrational exuberance*" in valuation with about 70% of small-cap and mid-cap stocks considered overvalued, declining corporate earnings, muted auto sector outlook, fund mobilization of ₹45,000 crores by initial public offerings (IPOs) and follow-on public offerings (FPOs) of Hyundai, Waree, and Swiggy, etc. and ongoing regulatory concerns regarding the ASM (Additional Surveillance Measure) and GSM (Graded Surveillance Measure).



There were also factors like higher Securities Transaction Tax (STT) and other tax measures, spike in the Dollar index and rising U.S. bond yields, Monetary Policy Concerns, depressed local investor sentiment, reallocation of investments by some FIIs from India to China, Currency and end of certain short-term trading strategies, such as lot size recession and weekly expiries leading to increased selling pressure· These factors individually and collectively dampened market sentiment, leading to widespread losses across sectors. However, the BSE Sensex again reached 80,482. 36 on November 25, 2024. Interestingly, Sensex has not slipped below the 70,000 mark since it breached its first on December 14, 2023.

These are tempestuous times, churn and disruption, VUCA (volatility, uncertainty, complexity, ambiguity) times. With multi-layered complexities, such times are difficult to envision and even more difficult to predict. This is why the mutual funds industry repeatedly stresses that past performance is not a reliable indicator of future results.



Robust India Growth Saga - The Macro and Market Consequences

India is likely to become a $10 trillion economy by 2030, potentially rising to the 3rd largest economy in the world. With consistent GDP growth and the government's robust Vision 2030, the stock market will be an integral part of the India growth story. According to 'Recap 2024, Crystal Gaze 2025' by Pantomath Group, India's fifth-largest global market cap ($4.5 trillion) is likely to hit $10 trillion by 2030. The US ($44.7 trillion, China ($9.8 trillion), Japan ($6 trillion) and Hong Kong ($4.8 trillion) have greater market caps than India. India could be the third-largest economy by 2027, and the market cap will reach $10 trillion by 2030.

Going forward, India will consolidate its position through important transformative triggers and drivers. Demand is boosted by the consumer boom, ascendant middle class, and green transition. Demographic dividend, corporate sector's return on equity exceeding the global average, greater access to finance, the coming to age of the financial sector, and streamlining of physical infrastructure (national road network grew by 60% over ten years, twice the previous decadal rate) and digital infrastructure, digital transfer-payments, modern capital markets, and banks, and a unified digital tax system drive the supply side.

The IMF has revealed that "*digitalization-driven productivity gains*" (e.g., monthly use of payment system by 300 million) in India have acted as a force-multiplier; a trend reinforced by macroeconomic growth, robust democratic and business frameworks, demographic dividend, sustained policy reforms, rising global significance, "*military-industrial complex*", space technology, logistics, fintech and AI. These innovative strategies in a world of globalization and technological progress provide a distinct possibility of sustained economic growth and structural transformation by creating value amid geopolitical disruption.

Heightened external uncertainty was exacerbated by global tensions, including Israel, Iran, Palestine, Ukraine, Russia, etc., and volatile crude oil prices and geopolitical tensions have emerged as one of the biggest risks to economic growth necessitating enhanced capabilities and recalibrated strategies to effectively respond to geopolitical disruption. But as Ms. Gita Gopinath, the IMF's first DMD stressed "*the disruptive effects of these swings on emerging market economies are much more muted than in earlier episodes… because emerging and developing countries have developed much stronger macro policy frameworks to be able to deal with shocks*". Viewed thereof, the Indian economy is truly on a sustained 7 % growth course. And, since the performance of a stock market is intrinsically linked to the broader financial and macro-economic landscape of a country, the capital market could maintain its steady upward climb and a secular bull run could not be ruled out.

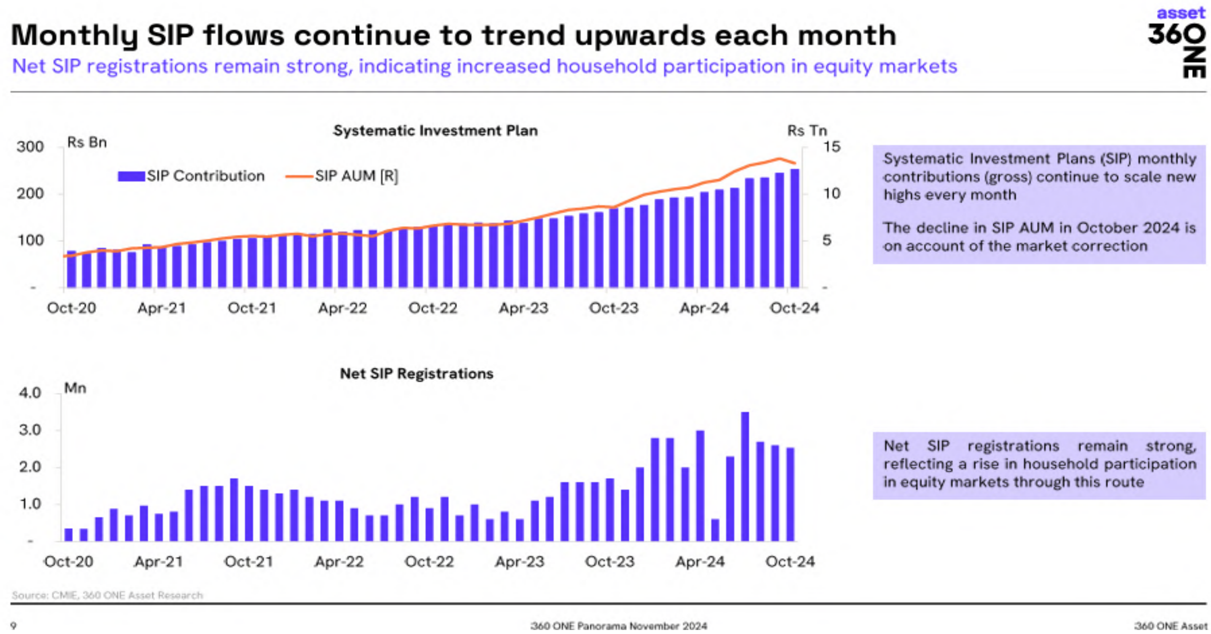
In other words, as the capital market is a microcosm of the broader Indian economy, there is a correlation between a stock market and a country's economic growth.

Surging Retail Participation

Of the three asset classes - equity, debt and gold, equity is undoubtedly becoming an increasingly important asset class because of higher return, high Liquidity, Option to start trading with small investments, and daily trading, which increases chances of more "buy or sell" transactions leading to fast profits/loss generation. Asset allocation strategies, however, work better at equity market highs.

It has often been debated whether this stratospheric level is a flash in the pan or is an integral part of a higher onward march of the capital market. Retail investors in India have been consistently investing in Mutual Funds through the SIP route with an average monthly investment of ₹20,000 crore, i.e., an annual investment of ₹2.50 lakh crore. 80 million unique investors are investing money in the Indian stock markets through the NSE. These 80 million investors constitute 50 million unique households, which is 17 % (about 5 % about two decades ago, nearly 60% share in the US) of India's all households cumulatively.

This steadily rising proportion (increment of over 12 crore demat accounts in a decade) has been facilitated by the burgeoning middle class, the higher penetration level of mobile phones, the growing popularity of trading apps, the soaring capital market, and a pandemic-driven digital thrust.



The growth saga is succinctly captured in the seven-fold rise in individual demat accounts from 2 crore accounts in April 2015 to nearly 15 crore in February 2024. This kind of transformed equity asset class, shifting paradigms, data analytics, and user experience with technology has created a silent revolution in the country. Most financial transactions, financial investments, and holding of financial investments are done digitally relegating the customary banking/investing system to a miniscule level, thereby enhancing efficiency and efficiency and slashing time and cost. This is the way to go because as Robert G. Allen pithily asked "*how many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case*".

Equity retail participation rose strikingly as the number of mutual fund folios grew from less than 3 crore in March 2014 to over 11 crore in Dec 2023. Retail investors, including high net-worth individuals, account for 91% of the Indian fund industry's nearly ₹ 22-lakh -crore equity assets under management (AUM) surging at 30% CAGR over the past decade. Further, monthly SIPs surged from a modest ₹1,200 crore in 2014 to over ₹ 19,000 crore in 2024.

Cause for Concern, Not for Alarm- "Greed is good" (Wall Street Movie, 1987)

In this movie, Gordon Gekko (Michael Douglas) says, "*Greed, for lack of a better word, is good*". Greed, which is central to the evolutionary spirit, characterizes the ascending surge of mankind in all its manifestations, including greed for life, money, love, and knowledge- Douglas' food for thought.

Volatility and disruption have an unsettling effect and such peaks and troughs in a short span are generally disliked. But if you play your cards well, you make the most kills in volatile times whereas the gain is usually capped in stable, predictable times. Every 5% correction in the market increases knowledge by 10% and reduces courage by 10%. After a 50% correction, one might have 0% courage and 100% knowledge. These figures are approximate and may vary on a case-by-case basis. Hence enjoy the roller-coaster ride with a smile on your lips and a prayer in your mind. Possibly a Zen Buddha type of life, a life marked by stillness of life, a mental equilibrium of sorts will help to make tricky decisions in a cool and objective manner, a manner, which is not swayed by forces and factors not truly germane to the ground realities to make a meaningful analysis of the overall scenario. Do not worry, nothing lasts forever- not even your troubles, particularly because of India's macroeconomic setting. In India, the stock market is a microcosm of a robust and growing economy. This too shall pass! Keep up the hope and don't throw in the towel.

In these unpredictable times, investors should not count their chickens before they are hatched. They should exercise caution and vigilance, do their due diligence carefully, and book profits when the going is good—make hay while the sun shines!

"An Investment in Knowledge Pays the Best Interest."- Benjamin Franklin

Some general rules of thumb are to buy on dips and sell on highs. While these principles are unexceptionable, they do not give a precise level at which to buy and sell. This call has to be taken by the investor. It's important to be careful, keep your eyes and ears open, and explore emerging opportunities but not be oblivious to building up systemic risk, macro and micro risk factors, transforming overarching global and domestic settings, and shifting paradigms.

The move towards a broad-based recovery in the capex cycle, labor law implementation, reforms in factor markets, such as, land and capital, and policy continuity are contextually significant and will, therefore, be carefully watched by the market.

Warren Buffett rightly stressed, "*Invest in yourself. The one easy way to become worth 50 percent more than you are now — at least — is to hone your communication skills — both written and verbal. If you can't communicate, it's like winking at a girl in the dark — nothing happens. You can have all the brainpower in the world, but you have to be able to transmit it*." The investor needs to be educated, constantly learn, and be well-versed in the basic concepts, viz., stocks, bonds, mutual funds, market indices, companies, securities and prices for systematic investment. Instead of blindly acting on tips or jumping on advice in a fool-hardy manner, the investing decisions should be based *inter-alia* on risk tolerance, risk appetite, investment horizon, and nature of financial goal- specific objective, retirement, or wealth creation.

In bracing for tomorrow, undivided attention on long-term growth through asset allocation, focusing on time horizon, asset allocation being a function of the individual's return-volatility appetite, quality assets, and time in the market over timing, i.e., staying invested rather than obsessively concerned with catching the top and bottom of the peak and the trough is required.

Carlos Slim Helu justifiably stressed, "*With a good perspective on history, we can have a better understanding of the past and present, and thus a clear vision of the future".* Financial literacy, knowledge, and awareness can be enhanced by education and information dissemination, an attitude to learn, and facilitating the development of a broader and more robust stock market. Given the changing dynamics, it is important to earmark a budget, build an Emergency Fund to avoid distressed sales during a market crash, and be patient.

Identification of the right broker with a reliable and user-friendly brokerage platform, responsive customer service, and a diversified portfolio across sectors, regions, industry mix asset classes, and geographic markets provides risk mitigation by spreading investments across multiple entities through pooling of a number of small investments into a large bucket. It thus helps diffuse risk and partially surmounts market uncertainty.

Initial forays in the stock market can be made by mutual funds, low-cost index funds, or exchange-traded funds (ETFs) and once the investor gains some understanding, confidence, and cushion, h/she could enter the stock market. Avoid making impulsive decisions based on short-term market oscillations, use index funds, reflect on the successes and failures of the investment decisions, fine-tune the investment strategy accordingly, and make mid-term course corrections, wherever necessary. In fact, short-term volatilities can be used to stockpile high-quality stocks at lower prices.

Concentration and over-leveraging in a few stocks and sectors is a mixed blessing and is generally fraught with risks. Being over-weight on a few scrips could help the investors make a killing. However, the flip side is that given the unfathomable outcomes, the headlong pursuit of short-term gains can translate into heavy long-term losses. As a general rule, investors should not put "*all your eggs in one ba*sket" to diffuse risks because different investments often perform differently in response to market events and thus avoid concentration risk.

Considering potential market dips, it is prudent for investors to build positions during these downturns. Investors should not gloss over the fact that the long-term India story is still intact, the growth saga is still on and the potential is still humongous. Sure, it has taken a hit but all is not lost.

Where do we go from here? Examine the risk-reward matrix, buy on dips, look for break-out points, place greater faith in large caps to contain losses because of the ebb and flow of the market, and follow the Buffett policy of a "*contrarian approach*", i.e., when you see blood on the street all around you, take courage in both hands, go ahead and buy. Buffett emphasized *"Be fearful when others are greedy and greedy only when others are fearful"*.

It is important to set clear perspectives and make a long-term plan by examining evolving industry and company performances, economic trends and regular portfolio monitoring and review. This necessitates desisting from any knee-jerk reaction, being disciplined and focused, and pursuing long-term investment strategies based on rational analysis rather than speculative expectations. It is also important to maintain a stop-loss because *"bottoms in the investment world don't end with four-year lows; they end with 10- or 15-year lows" (*Jim Rogers).

Sectoral Picks

Let me start with a disclaimer. I have not been an active investor in the last few years and my position has largely been that of a "*by-stander*", to use a Yankee expression. I have also long believed in long-term investing, also known as '*buy and hold investing*'. Another issue with the stock market advice is the inherent element of asymmetry here. When people make gains, it is held that these gains are because of their perceptiveness, an uncanny ability to read and analyze the market right, and their perspicacity; when they get it wrong, it is because of the wrong and stupid suggestions of the advisors.

Defence, railways, infra Sectors have been on a roll in the last few years. With the recent corrections, sectors, such as banking, automobiles, capital goods, defense, real estate, and railways could do well.

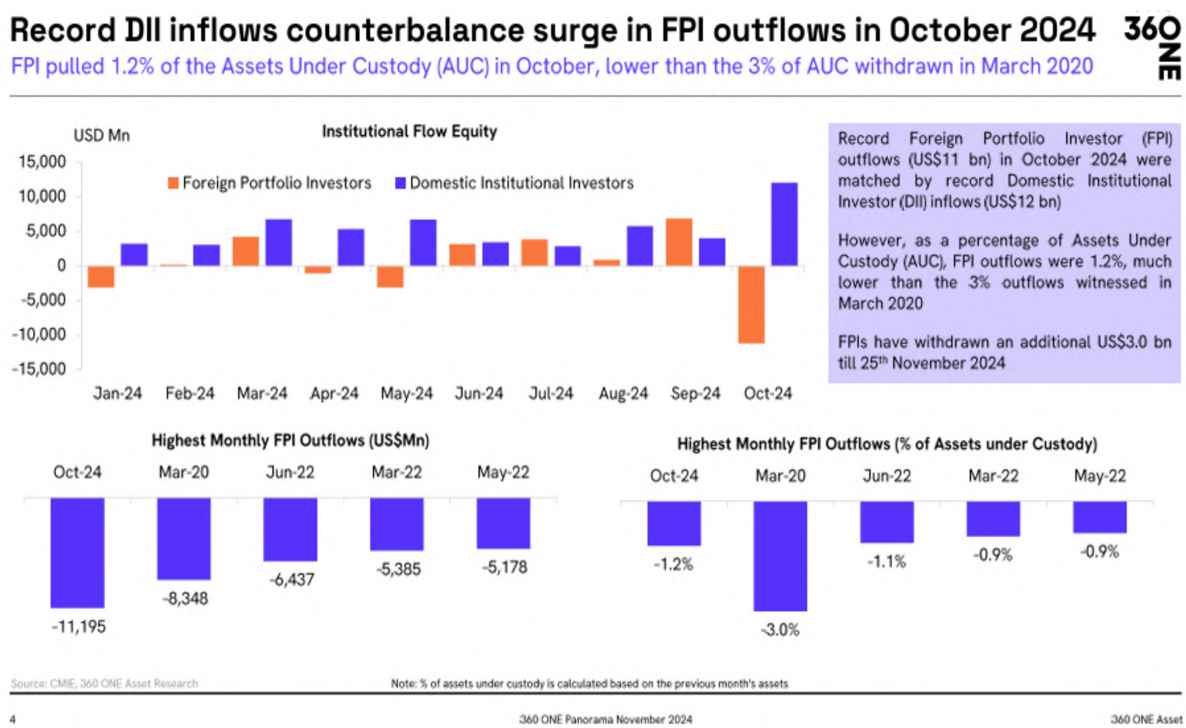
In recent years, concerted attempts have been made to streamline the form and substance of the regulatory architecture to make the stock market more robust and broad-based. Such measures include introducing stricter disclosure norms and simplifying the IPO process.

Debt-oriented mutual funds recovered strongly in October 2024 because of investments in liquid schemes and attracting a net inflow of ₹ 1.57 lakh crore after huge redemptions in September 2024. Out of 16 debt mutual fund categories, 14 fund categories had net inflows in October 2024, while medium-duration and credit risk funds maintained their trend of consistent outflows.

The positive inflow boosted the asset base of debt mutual funds by 11 % to ₹16.64 lakh crore in October-end from ₹ 14.97 lakh crore at the end of September. Debt mutual funds attracted inflows of ₹ 1.57 lakh crore in October, sharply reversing from the outflows of ₹ 1.14 lakh crore in September. Within the debt fund, liquid funds led the inflows with ₹ 83,863 crore, accounting for 53 % of the total, followed by overnight funds and money market funds with ₹ 25,784 crore and ₹ 25,303 crore, respectively.

Further, the ultra-short duration segment (less than 12 months) had inflow of ₹7,054 crore. Investors favoured funds with shorter maturity profiles for temporary placements, with low-duration funds, corporate bond funds, and short-duration funds attracting inflows of ₹ 5,600 crore, ₹ 4,644 crore, and ₹ 1,362 crore, respectively. Further, after four consecutive months, banking and PSU funds had huge inflows of ₹ 936 crore. In recent months, a rate cut anticipation has generated interest in active duration strategies, with these funds positioned to benefit from potential interest rate declines.

In October, gilt funds experienced inflow of ₹ 1,375 crore, while long-duration bonds saw ₹ 1,117 crore. With the onset of the rate easing cycle, inflows into these funds could rise further. Investors infused ₹ 41,887 crore in equity-oriented mutual funds in October as against an investment of ₹ 34,419 crore. Overall, the mutual fund industry had an inflow of ₹ 2.4 lakh crore in October because of investments into debt schemes, after an outflow of ₹ 71,114 crore in September.



Foreign investors withdrew ₹ 22,420 crore from the Indian equity market so far this month, owing to high domestic stock valuations, increasing allocations to China, and the rising US dollar and Treasury yields. With this sell-off, Foreign Portfolio Investors (FPIs) recorded a total outflow of ₹ 15,827 crore in 2024 so far. As liquidity tightens, FPI inflows are expected to remain subdued in the short term. A positive shift in FPI activity is unlikely before early January, keeping overall market sentiment weak. FPIs had a net outflow of ₹ 22,420 crore so far in November post a net withdrawal of ₹ 94,017 crore in October, which was the worst monthly outflow.

FPIs withdrew ₹ 61,973 crore from equities in March 2020. In September 2024, foreign investors made a nine-month high investment of ₹ 57,724 crore.

The FPI selling drive since October stemmed from high valuations in India, concerns regarding the earnings downgrade and the Trump trade. Foreign investors are shifting their focus from Indian to Chinese stock markets due to China's new stimulus package and lower valuations. FPIs invested ₹42 crore in the debt general limit and Rs 362 crore in the debt voluntary retention route (VRR) during the period under review. So far this year, FPIs invested ₹1.06 lakh crore in the debt market.

Stick with me baby, I'll take you places!

The stock market works in a way not always given to simple understanding. Peaks and troughs, ebbs and flows, economic downturns, and market volatility are the *sine qua non* of the stock market saga. Broadly speaking, some important factors could be identified as:

- Performance of the macroeconomy, industry, and the firm
- Global perception about the performance of the economy *vis-a-vis* the global economy and its sustainability
- Funds flow to the stock market by Foreign Institutional Investors (FIIs), Domestic Institutional Investors (DIIs), and retail investors (this category has become increasingly important).
- When the going is good, the stock market and most scrips hit the roof. This is well-captured in President John F. Kennedy's powerful words "*A rising tide lifts all boats*".
- In other words, the market gyrations depend on fundamental drivers and sentiments.

Investor Sentiment - An Invisible Force

The sentiments and the perception of prospects play an important role in the behavior of the stock market worldwide. Investor sentiment stems from irrational speculations about the future asset values driven by the market participants. The intrinsic value of a stock is a function of multiple factors, viz., the Company's projected earnings, potential growth, market setting, income statement, balance sheet, cash flow statement, discounted cash flow (DCF), and peer group analysis. Applying value investing strategies to real-world scenarios, such as evaluating growth potential, risk factors, and economic influences impacting valuation is complex, requiring transcending candlestick patterns and a granular examination of the Company's balance sheet to assess its growth prospects.

Pathway to the Future

The capital market does not progress linearly and progressively in a unidirectional manner. Despite the choppy data and negative shocks, the stock market direction over the long haul is unequivocally clear and positive. Should this trend persist, the power of enduring compounding could zoom Sensex to 1,50,000 by 2029-"*the best is yet to be*" (Robert Browning). But as Ben Graham said, "the individual investor should act consistently as an investor and not as a speculator". Similarly, Nobel Laureate Paul Samuelson stressed the quality of patience, when he averred "*investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas*". This is the holy grail of investing.

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