Monday, 16 November 2020

AISA BHI HOTA HAI

(Markets Are Always Right)

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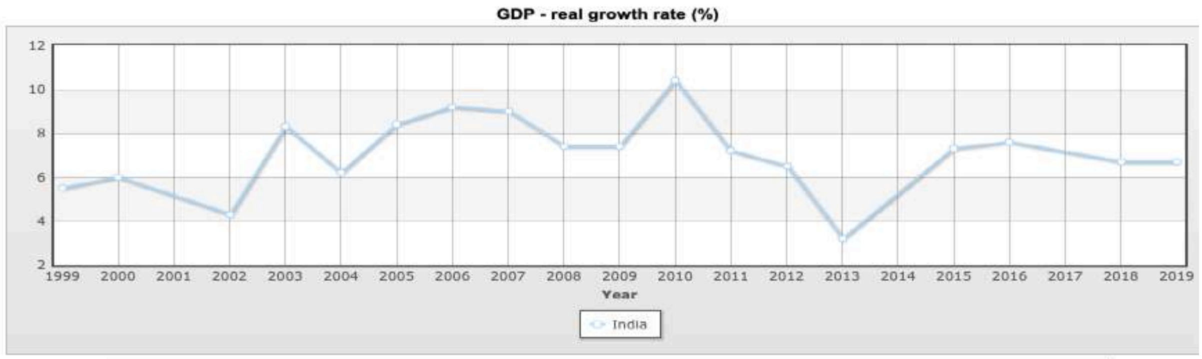
Year 2020 has taught us many things. We can do as much work from home as much as can we do from the office, from seminars to webinars, from a minimum 500 square feet office to 150 square feet of one room office, round table meetings to virtual round table meetings, from keeping a tight watch on employee to defining deliverables more objectively, from handshake to namaste, life is much simple without junk foods, the fun of having popcorn in theaters, the importance of free and pure air, from running in the house with shoes on to placing the shoe rack outside the door, prioritizing necessity over luxury, the importance of washing our hands, the importance of WiFi over Wife or Wife over WiFi (it's a general thought, not my opinion ☺) etc. What could have been missed? Well! May be the corridor talks and love triangles in the offices ☺. Never mind, it was just on a lighter note as we will be heading for content heavy discussion in a minute. Having said that, there are many benefits of working together in an office and they cannot be fully replaceable; however, some portion of it can be.

I will be completing this article in 3 series over a month or two. The first one is **"Aisa Bhi Hota Hai"** which will set the context, the second one will be "A Peep into Future" and the third one will be "The World Is Round".

The themes that I will be covering in this article are

- The dichotomy in between economic growth and stock markets
- Crude Oil, yes it can be negative
- The known devil is still a devil
- PE ratio, is just a number
- Greed & Fear, the bitter truth

The Dichotomy In Between Economic Growth & Stock Markets – Stock markets are lead indicator. They look forward and not backward. This is the reason that forward PE is more important than trailing PE. Individual stocks and the indices factor the earnings from a quarter to three years in advance depending upon the visibility of the earnings. The bull markets peak out or stagnate when about 2-3 years of earnings have been factored into the prices, while bear markets bottom out when the worst is factored into the prices. Therefore, a **bear market starts 3 months to 3 years in advance before the economy begins to perter down, while a bull market begins 3 months to 3 years in advance before economy begins to turn for better.**



Country	1999	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2015	2016	2018	2019
India	5.5	6	4.3	8.3	6.2	8.4	9.2	9	7.4	7.4	10.4	7.2	6.5	3.2	7.3	7.6	6.7	6.7

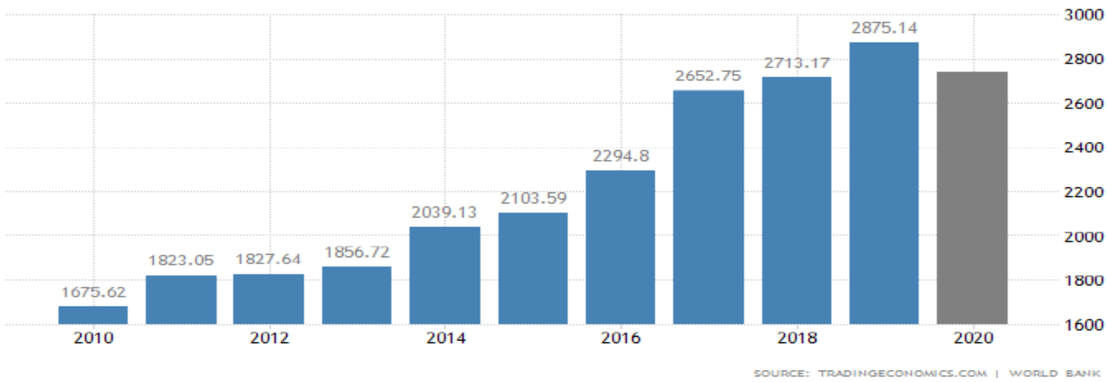
Definition of GDP - real growth rate: This entry gives GDP growth on an annual basis adjusted for inflation and expressed as a percent. The growth rates are year-over-year, and not compounded.

Source: CIA World Factbook - Unless otherwise noted, information in this page is accurate as of June 30, 2018

Source - https://www.indexmundi.com/g/g.aspx?c=in&v=66

Markets made a bottom in between 2002 – 2003 while the economic growth began to increase after 2004. Markets peaked out by the end of 2007 while the economic growth started to perter down from the 2008. Markets again made a bottom in 2008 while the economic growth came back after 2009. Markets topped out in 2011 while the economic growth bottomed in 2013. Markets again made a bottom in 2012 while the economic growth kicked in post 2013. Then markets peaked in early 2015 while the economic growth started falling after 2016. Markets made a bottom in 2016 while the economic growth remained flattish after that. Covid19 came in the news in December 2019 and markets made a peak in January 2020. When

GDP of India (USD Billion)



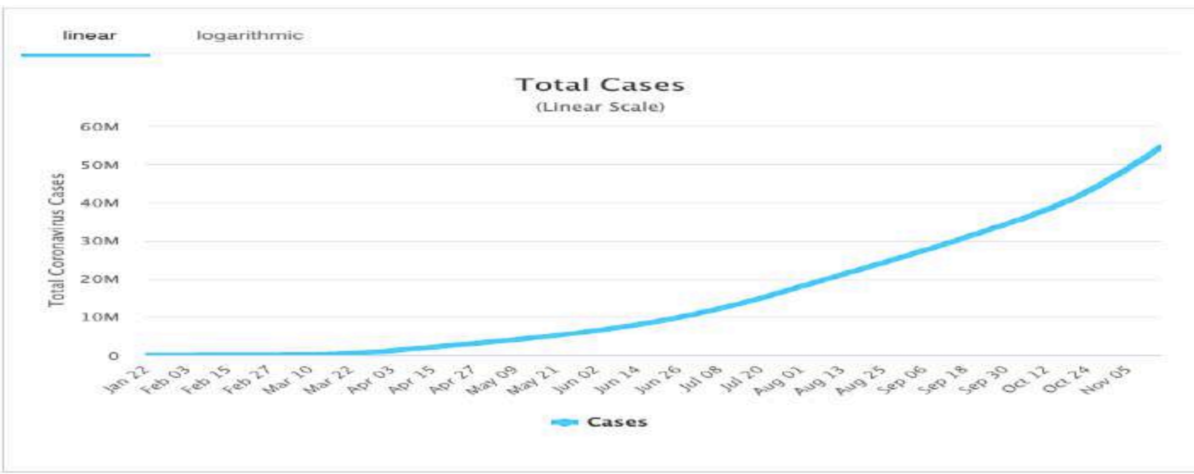
Source - https://tradingeconomics.com/india/gdp

Covid19 was declared as a pandemic, stock markets fell by about 40% in March 2020, while economy was not at its worst in March. The worst of the economy is going to get over from 4th quarter of FY21, as per RBI estimates. As of now and as per the indications of stocks market, world in general and India in particular are sitting at the cusp of economic boom. Nifty has made a new high but this may not be the end of bull market because as of now, the hint is that economic growth is about to begin. Markets will top out when we actually see the economic growth, inflation begins to trouble the policy makers and then finally central bank begins to raise the interest rates. We have not seen any of these. When these things are visible and the maximum potential of economic growth is factored in the value of indices, markets will top out and we will see the worst of economy much later of this happening.

Therefore, economy and stock markets will look disjointed most of the times and will have to be read accordingly. Markets will have to be looked upon as to how the economy is predicted to perform one quarter to about 3 years hence. So, when markets are in fierce bull mode, economy may be facing its worst and vice-versa; the dichotomy; **Aisa Bhi Hota Hai**.

Cure Oil, Yes It Can Be Negative – For the first time in our life we saw crude oil price plummeting into negative territory. It was not Brent though, it was WTI (Western Texas Intermediate) crude. WTI crude is sourced from Texas and is easy to refine because of its quality. There was a historic fall in WTI crude by around 300% in the month of March and it traded around USD **minus** 37 per barrel. WTI futures is a deliverable contract. There was a crash of demand for crude that followed Covid19 spread coupled with price war in between Saudi Arabia and Russia in the month of March 2020. This pushed WTI crude into negative territory. As the delivery date of WTI crude approached, investors started dumping WTI crude to get off the contract. This made the history as Crude, for the first time, entered negative territory; **Aisa Bhi Hota Hai**.

The Known Devil Is Still A Devil – For capital market players, as much as this year will be known for the pandemic, it will be equally known for the unexpected, unprecedented and spectacular performance of the stock markets. As professionals, we always work on alternative plans, identify unknowns and try to prepare a contingency plan; however, sometimes even the known one can present themselves in a form that we can be caught napping. We have seen many pandemics in the past but we could not manage to push away Covid19. All preparations, steps, estimations and calculations went in vain. When the pandemic hit us in November last year then firstly, it was not accepted and declared early enough that it is a pandemic. When it was declared as a pandemic, the world decided to go under lockdown. The lockdown did have its benefits but it could not control the virus spread fully. One size fit all, does not work as remedy for the globe as a whole which is so diverse in nature. The world got under lockdown from the month of March to contain the spread of Covid19. The logic used for lockdown was "break the chain" and the virus will stop spreading. I could never subscribe to this logic and that too for a populous country like India. My bone of contention was always that the purpose of lockdown should be termed as "reducing the burden on medical infrastructure" and not as an effort to break the chain. The chain cannot be broken because the enemy is sitting at the door and the moment door is opened, enemy is going to attack. Had the purpose been to prepare the medical infrastructure to combat infections when unlock happens, I completely agree, but breaking the chain is something which could not have been achieved with the way isolation and testing were being done. The objective behind the lockdown was to test and isolate infected people. But what about the population which is not tested and is yet out there to infect others, knowingly or unknowingly. Breaking the chain does not work this way. Breaking the chain means first lock everyone (almost an impossible task), then test all of them one by one and then allow only uninfected one to be set free while the infected ones should be isolated. Breaking the chain will not be effective if everyone is not locked because if even a small population goes out in the open, then the spread can be manifold.

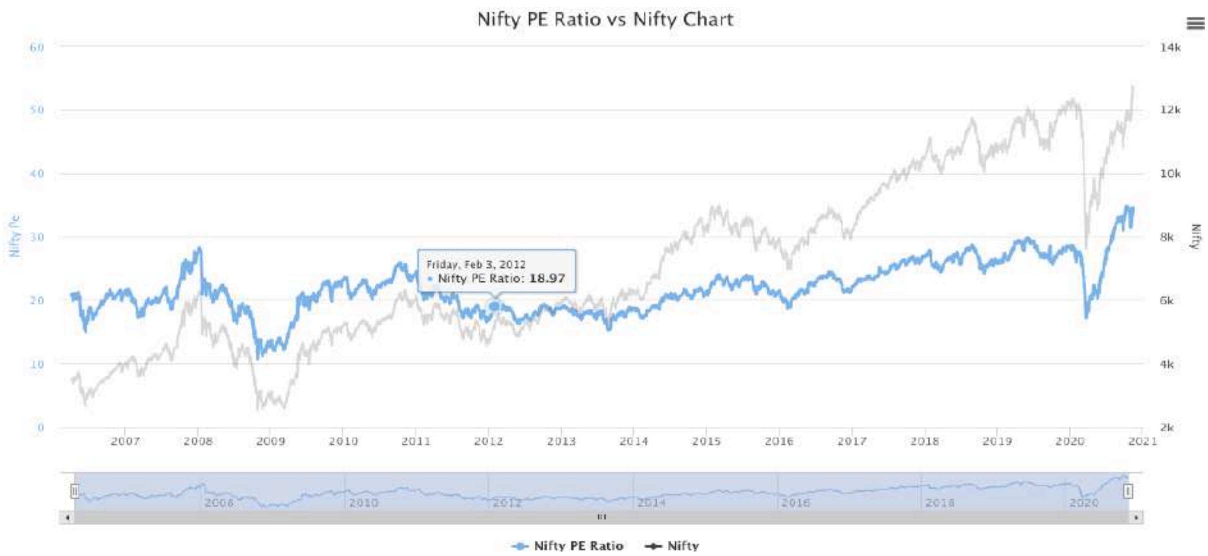


Source: Worldometer - www.worldometers.info

Isolation did not help break the chain as we are seeing second wave of Covid19 when lockdown is relaxed; however, it did help in better preparation to reduce the load on medical infrastructure and made it manageable. So, the basic premise of lockdown to break the chain failed but it did stop medical infrastructure from getting overwhelmed. The whole effort took a full circle and what is being recommended by some eminent medical professionals now is "Herd Immunity". The same was discussed in the beginning of the pandemic as well but was ruled out. And now, we are out to get the herd immunity because there is no medicine for the disease, lockdown is only hurting the economy and vaccine is still some time away, may be 6-9 months or more. So, one full circle from proposed herd immunity, to breaking the chain, to lockdowns, to economic instability, to unlock and then again back to herd immunity; **Aisa Bhi Hota Hai**.

Having said that; the time spent from March until now has also made us more aware about the virus, safety methods and made us more prepared. At the same time, it has also helped us understand that it may not be a deadly disease for healthy population and they can afford to get herd immunity. This is because the chance of losing the life could be extremely less for healthy population with high immunity level. However, the population with low immunity level will still have to be as careful as they had to be in the month of March when the disease was declared as a pandemic.

PE Ratio, Is Just A Number – PE (Price-Earnings) ratio works with law of averages. It could be depressing at 11 and it can be reassuring 35. It is all about what are the input stocks to deliver the output as the PE of an index. If the stocks constituting the index have low PE then output will be low PE of Index and vice-versa.



Source - https://www.equityfriend.com/investment-charts/nifty-pe-chart-nifty-pb-chart-nifty-dividend-yield-chart.html

When HDFC Life, SBI & Divi's replaced Vedanta, Bharti Infratel and Zee Entertainment, Nifty PE suddenly jumped as all new newly added stocks were growth stocks, while outgoing stocks were low PE stocks. PE in absolute term may not be correct way to read the relative valuation using PE multiple. Over time 10-year average PE has moved higher and now the average stands at around 22. It has to be read as how far it is trading away from the mean. Presently, Nifty PE is around 34.75 and this is beyond 3 standard deviation from mean, making market dangerously poised. However; there is justification for everything in this world unless proven otherwise. When Nifty fell to 7,500, the PE was closer to 17. This was not even 1 standard deviation from the mean and therefore targets were coming in the range of 5,500-6,000 for Nifty which would have taken PE closer to 1.5-2 standard deviation from mean. At 17 PE, the economic scenario looked even further weak and therefore, 17 PE might have looked expensive. At 35 PE, economy may be in the sweetest spot in its life time and therefore, even this number can be justified; **(Aisa Bhi Hota Hai).** But as I keep repeating, sanity prevails, so it will happen this time as well. Watching PE as of now is not the right place to be in. Time is to keep a watch on liquidity because that is what is fueling the rally even at these levels. Time is to keep a watch on yield, interest rate, inflation and many other macroeconomic indicators which will keep a tab on liquidity (squeeze) situation and would send early signal for a trend reversal.

Now, the market justification for high PE ratio is BEER (Bond-Equity Earnings Yield Ratio). This ratio is used to decide upon a switch in between Debt and Equity. If the ratio is close to 0.70 then Equities are preferred over Debt and if the ratio is 1.25 or more then Debt is preferred over Equities. This is not a sacrosanct indication for Equities to bottom or top out but it helps to take decision on risk mitigation. It is also not a very straight forward comparison. Some prefer comparing 5- or 10-year bond yield with 1-year forward equity earnings yield while some prefer to compare 91-day Treasury bill to current equity earnings yield. Equity earnings yield is the inverse of PE ratio. As I write this article, the BEER ratio stands at 1.10 considering 91-day Treasury Bill yield and current equity earnings yield.

Greed & Fear, The Bitter Truth – May 2005, May 2006, Jan-Oct 2008, March 2015 to February 2016 and now March 2020. There is one thing common in all of these time frames that markets made investors literally hopeless. However; market kept climbing all walls of worries and today it is sitting at a life time high against all the predictions of the world experiencing the fiercest recession in the recent memory. Economy at its worst while markets at their best; **Aisa Bhi Hota Hai**. Equity investors have got extremely short memory. Also, there are many lessons learnt in the past with lots of example that why we should "Buy the Fear and Sell the Greed". I will cover this section in the form of an article in third series i.e. **"The World Is Round".**

This article is the first one in the series of 3 articles. The next one that I will cover is "A Peep Into Future" and the third one will be "The World Is Round".

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