It’s Enough Please

(Bulls, Time for you to Beware)

Shomesh Kumar
SEBI Registration No. INA200015088
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Does the above title remind you of something? Have you ever had the opportunity of having lunch in any marriage function of our very own Indian villages? Can you relate now? ☺. They serve us the food with a lot of love and right from tummy up to the neck. On the top of it, the food taste so good that “Dil maange more” but brain says “It’s enough please” and the person serving the food, filled with love, will say **“Have some more please”.** This is how our very own stock markets are also behaving as of now and they behaved in the same way in March 2020 too. When it falls, then also we say “yaar, ab to ruk jaa” and now when it’s going up then also people are saying “yaar, ab bas”. The word and sentences may vary but the meaning and intent remain the same.

Equity markets have made a stunning recovery since April 2020 which is certainly beyond belief but **“Liquidity is doing what it does the best”**. So, firstly, enjoy the rally and secondly, if you have been reading my articles (which are there on my LinkedIn (www.linkedin.com/in/shomesh-kumar-b172801a) or have been watching my videos then it should not come as a surprise to you. We were right there into the rally, at the right time and still riding it with a touch of profit booking at regular intervals.

Now, some the questions which are coming to me from investors are

- When will the rally stop?
- What do you feel about a potential crash in stock markets?
- Is it not that the economy and stock markets have got totally disconnected?
- I would prefer shorting the market, what do you feel?

Well, you will get the answer to most of it if you read my article “Nifty Story” once again. I will try explaining how I read the current situation; however, if you re-read the article then most of your questions will be answered.

- Benefit from the trend because when it goes, it goes for some time

A trending market is not guaranteed all the time. When it gets upset, it does not come back for months together and makes the markets and life boring as an equity loving person. Remember what happen from November 2019 to February 2020; Nifty traded in just 11,800 to 12,400 range for these 4 months. Times and so will the markets, not remain same all the time. Right now, it feels "All Euphoric" but next moment it can become horrific. So, make the best out of it and save enough cash as well to fill up the shopping baskets again when there is a decent correction; it will happen but right now there is no sign of a big correction in Equities.

- Crude oil indicates that the rally could have more legs

When we try to understand the impact of Crude oil on stock market, we cannot expect for a blanket correlation in between the two. They are correlated but in pockets/ranges and I will explain you why. We generally hear that a fall in Crude price is good for the economy and stock markets but when we look at the correlation, it generally is positive at around 70% at aggregate level. Here are the reasons for that.

Look at the chart and you will find them largely positively correlated. It is not 1-1 correlation but a very strong one. Why this happens? In general, the cost of production of Crude varies

in the range of USD 40-50 per barrel. Particularly, in the case of India, the price of Crude basket is considered around USD 55 per barrel for fiscal budget and therefore even if Crude goes up to USD 60 per barrel then it does not hurt the wallet of GOI much but if it goes beyond USD 70 then the pain beings and any level above USD 80 will surely be a reason for discomfort to the markets. We have seen Brent Crude about USD 150 and we have seen it around USD 15 as well (WTI Crude went in to negative territory this year). If Crude goes below USD 40 then it may not be economically viable to produce Crude oil and when it goes beyond, let's say, USD 80 then it may not be economically viable to run Indian economy efficiently.

For this reason, when Crude hovers in the range of USD 45-80, it may impact stock markets positively and more positively when it corrects down from USD 80 towards USD 45. But even up till USD 80, it may not impact too much negatively because the widening deficit may be compensated by the earnings from increase in economic activity. We may find some negative correlation in this range when Crude falls. Crude in this range does not hurt the economy much as well as it may boost the sentiments because it acts as a precursor to the potential economic growth. But if Crude falls below USD 40 then stock markets also fall accordingly as the fall below USD 40 may indicate a potential recession in the economy. Similarly, at some level above USD 80, it can work negative for the economy and the stock markets well and therefore a very low to a negative correlation is possible in pockets above this despite the indication that higher Crude consumption could indicate a potential economic boom.

As of now Brent Crude is hovering around USD 45-46 per barrel and the trajectory looks up. A level of USD 60 or thereabout looks possible over time as the economic activity picks up going forward. And, this may support the stock markets as well by sending positive signals about the economy. As a conclusive remark, "Indian stock market rally may not end yet by applying Crude and its movement as an indicator". There could be some more juice left. If Crude begins to rise again then either it may pull the Nifty up further or limit the correction on the downside as the situation may prevail at that point in time.

- The Chart View

Nifty is certainly getting tired and may take a pause around 11,700 to encounter a mild correctio and then move up again. There are no signs of trend reversal unless it starts closing below 11,100 mark.

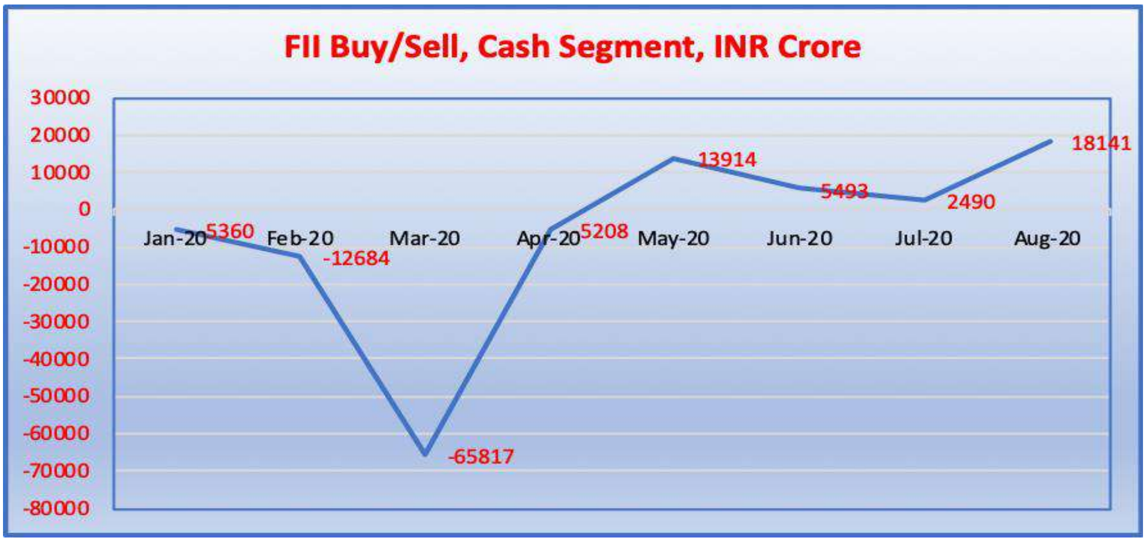
Nifty Bank has just gained strength and it is not even half way from it's top. If banking stocks keep participating in the rally then Nifty also may not correct much, rather it can keep moving up.

Even there is room for rally left in Broader markets i.e. Nifty Mid Cap and Nifty Small Cap.

- Emerging market flows remain buoyant and Dollars keep pouring in

Dollar index continues its downtrend. It did take support at 92 but has not managed to cross 94-95 range. As long as it remains in downtrend the money will keep flowing to emerging economies, including India.

There is a fair possibility of Dollar index hitting 88-89 before bottoming once. Unless 93-94 mark is breached on the upside the emerging market flows may remain buoyant and hence the stock markets. FIIs remain buoyant and the fund commitment has gone quite a bit up to INR 18,141 Crore (until 27th Aug) in the month of August even if Nifty inches closer to 12K.



Source – Shomesh Kumar Research

- The VIX Effect (The silent killer may be waiting around the corner)

The below graph is self-explanatory and will tell you its own story. Whenever VIX gets into 10-16 range, it's wakes up BEARS and Bulls are caught napping. May be the time is coming. Whether it will be around Nifty 12K or after 12K, only time knows but the warnings of a larger correction are written on the walls. I have cautioned all of you from October 2020 to January 2021 period. Don't forget them. Whenever Bears enter the town Bulls have always been caught napping.

The Conclusion

While the mood in the markets remain buoyant and Nifty is having gala time since April 2020, it is time to exercise "Caution" now. I have been euphoric too as per my GeDeTeF model; the same model indicates that a correction may be in the offing. It could start from here or after touching All Time High or after making a new high. But we should be able to take care of long positions (Trade cum Investments) with first hint of correction seeping in. As of now indicators are pointing towards the continuation of momentum but they are also indicating a capped upside anywhere in between 12k to 13K range of Nifty. I will be watching the behavior of all the parameters that I keep writing to you time to time (some of them included in this article). One thing is sure that investment positions should be cut down and profit booking should continue. A cash level of 30% is desirable at this level of Nifty and it should keep increasing by 10% with every 500 points upmove in Nifty. As I write to you today, 11,100 is my sacrosanct level for a wakeup call for correction. This level should keep trailing up as Nifty keeps moving up. Short term trading with stop losses is fine as long as the trend is intact. Chasing the markets will not pay but BAD (Buy At Dips) will pay. When I advised to keep buying below 10K and up to 7K, I used to get calls that 6K or below will come. It never came. Now, we can keep waiting for any level on the upside as the mood is euphoric and even that level may not come. Idea is to keep the eyes wide open and ears to the ground for first indication of trend reversal and be out. The long-term outlook remains positive and therefore BAD will help optimizing the return. Having said that, at this level and up, it will be a stock specific market and right set of skills to identify the potential profitable pick will be important. I have advised earlier too that the time for "Dart Portfolio" is over and Top Down approach of equity investment may not work, rather a mix of Top Down and Bottom Up will be required. This is because one need to be in the sector with potential to be relative outperformer and then pick stocks which could be the candidates for potential outperformance. Have a view for 3-5 years and equities should be able to reward provided one is sticking to quality.

Summary View

- The rally may continue but time to be cautious.
- Investments to be avoided at these levels and BAD to be put on work.
- Trade with the trend, with strict stop loss can continue.
- Investment horizon should increase to minimum 3 years and should be kept open up to 5 years now.

Crude Oil, VIX and Dollar Index are supportive of rally but they are also indicating that may be, the last 5-10% of rally is left before the deep correction sets in.

Shomesh Kumar (RIA)
SEBI Registration No. INA200015088

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