New World, New Issues, New Solutions

(GeDeTeF)

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Nifty 10,000 gone, 9000 gone, 8555 gone, 8,000 gone, 7,500 is being talked & possible and 6000 targets have started coming. Welcome to the world of ETF and Algorithmic Trading!!! Well, all these numbers are possible when there is an absolute uncertainty. Everything depends upon how Covid-19 situation unfolds over next few weeks in India. Short term will remain painful and uncertain.

The world will not end but the world will change and therefore, our approaches to make money from the investments have to change. There was an unprecedented fall in capital markets in 2008 which even my seniors had not seen. Now, there is another unforeseen fall in 2020 which neither myself nor my seniors had seen in the past. There will be rise and fall even in future that none of us have/had ever seen. But one thing which did not change then and has not changed now and will not change ever is that, sanity prevails, finally.

Be ready for more UNKNOWN & UNPRECEDENTED events in future and build the ability to deal with that.

We are in the world where the way Equity investment analysis takes place, must change. If we want wealth creation, we all analysts will have to build the ability of what I call GeDeTeF.

Ge – General Conditions
De – Derivatives
Te – Technical Analysis
F – Fundamental Analysis

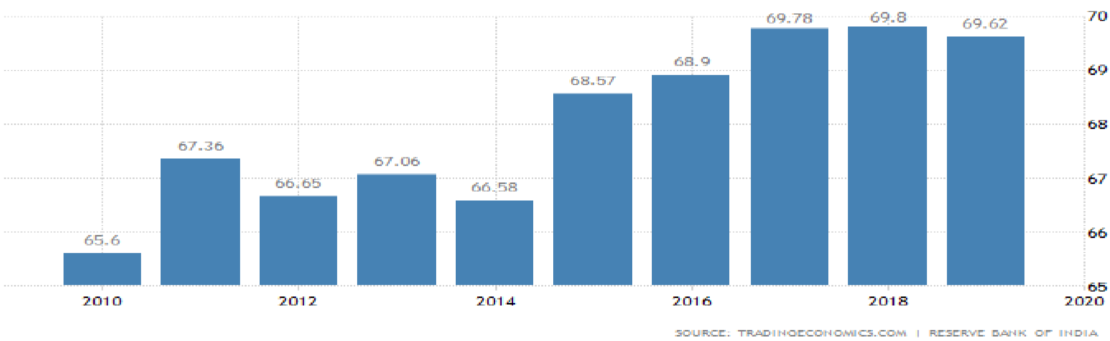
Any analysis without the inclusion of all of these factors will be an incomplete analysis, given the complicated ETFs and Algorithmic Trading having taken over the capital markets.

Market Cap to GDP Ratio - Nifty is now trading around 0.50 Market cap to GDP ratio and this is a historical low because the lowest was last seen in 2008 at about 0.54.

Source – www.ceicdata.com

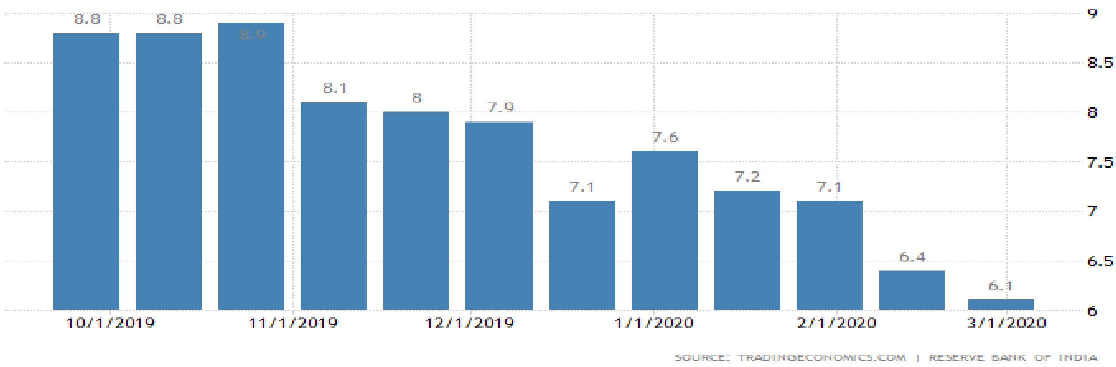
Fundamentally, now this should indicate that, enough is enough but still markets are searching for a credible bottom. Wait continues until clarity emerges on the severity of Covid-19 situation in India.

Debt to GDP Ratio - Further, India is an economy which is relatively less leveraged. The Debt to GDP ratio is about 69%. Even as per the world bank, if a country's Debt to GDP ratio crosses 77% and stays there for a long time then it can be a threat to the economic growth of that country and every percentage increase in debt from this level onwards, results in the corresponding slowdown of the economic growth by 1.7 percentage point. Given the comfortable position of India Debt to GDP ratio which is being maintained below 70% for last 3 years and is slowly trending down, I don't see 77% level coming. This means that we have a lot to room to push credit growth and perk up the economy. Any Debt to GDP ratio above 1 is a risky situation to be in. the chart below depicts the Debt to GDP ratio of India for last 10 years.



Source – www.tradingeconomics.com

Credit Growth - One problem that India and Indian government need to deal with is, Risk Aversion. This is not going out of the system and it is extremely important for credit growth to gets into double digits and upward to 15% to accelerate the economic growth. Currently, credit growth is in single digit and hovers in the range of 6-8%. The below chart shows the movement of credit growth for the year 2019.



Source – www.tradingeconomics.com

India VIX - India VIX has still not topped out. It moved to in excess of 92 in 2008. This also indicates that volatility still maybe here to stay before the sea calms down. For a bottom to be in place and a consolidation to follow, it is important for volatility to subside. We will have to watch out when volatility peaks out.

Source – www.investing.com

Markets will find the bottom some day and then it will consolidate. The staggered buying approach should continue in quality names and I suggest that **distance yourself from negativity as much as possible**. Only disciplined approach can help us win and not Greed & Fear.

This type of fall are seen in situations when there are expectations of an immediate recessionary scenario in the Global economy. An anticipated (not immediate) recession also sees steep fall, but there will be intermediate tops formed on technical charts which work as resistance while on the way back to the top. This time there are no intermediate top formations during the fall, it's just like a waterfall. The way markets have fallen this time, it is beyond the ability of any theory or analysis to predict but certainly a disciplined approach will help to make money in the long run. We have to be disciplined, continue to buy in tranches and keep entering at lower levels. People who are looking for quick gains or living for the day would find it difficult to survive because all that is earned in a decade is lost in a day due to the Greed & Fear. So, let's not do that.

I will list down my 10 Commandments which are important for Wealth Creation from Equities and we have to follow them at all times.

⇒ Don't Search for the Bottom and Don't look for a Top – No one has the ability to predict either the bottom or the top. Supports and Resistance levels can be defined using the Technical Analysis theory but bottom and top are something markets decide on their own basis the General Conditions. Another thing which will be true in a growing economy is that markets will go more up than down in long run so keep yourself prepared to benefit from that.

⇒ Avoid Herd Mentality – Don't buy because everyone else is buying and likewise don't sell because everyone is running for shelter. Take a rational decision with the help of available indicators. There is always some value available somewhere which the crowd does not recognise. That is the place to be and it would require patience too.

⇒ Don't run for Alpha – There is no point in running for Alpha. If someone is running behind enhancing the yield that will hit back some day. Look for a sensible return benchmarked against Bank Fixed Deposits (FD) and other Debt Market Instruments and see what additional return can be earned as compared to them on a sustainable basis. If interest rates go down then your return on FD will go down and accordingly you have to prune expectations from the Equity & Debt as well.

⇒ Define Relative Return Expectations – Keep a thumb rule of generating long term Post Tax Return i.e. over a period of 5 year and 10 year of investment cycle. One should try to

⇒ generate as much as twice the return as compared to Bank FD from a Quasi - Capital Protection plan, while the same expectations can go up to three times from the Equities.

⇒ Diversify – There are mainly two types of diversification which are required to be maintained. One is Sectoral and another is Market Capitalisation wise. I normally suggest a ratio of 70%, 20% and 10% for Large cap, Mid cap and Small cap stocks. The allocation to equity will also depend upon your age, earning's ability/visibility, current & future liability and the overall risk appetite.

⇒ Follow staggered approach to buy – Always have two plans running together i.e. Lump-Sum investment backed with a monthly EquiSIP. The monthly EquiSIP should be to the tune of minimum 1% per month of the Lump-Sum investment. This helps in **Forced Savings** as well as provide almost 12% cushion to the downside via the **Rupee Cost Averaging or Dollar Cost Averaging method**.

⇒ Buy into Fear & Sell into Greed – Time and again it has been proved by the markets the buy when there is fear and sell when there is greed but unfortunately we forget it every time when we actually encounter these scenarios. I have also given you evidence of the same in my previous articles.

⇒ Know your stomach – Equity investments are no guarantee and therefore you should be prepared for the losses. Always define the risk tolerance by keeping yourself aware of the risk taking/absorbing ability.

⇒ Be ready for extreme volatility, always – If there is anything which is going to be certain going into future, then it is "volatility". We all must be ready for this volatility which never knocks the door and will never knock the door in future too. But, this can be combated by adopting the staggered buying method as long as the fundamentals allow. Averaging without being certain about the fundamentals does not make sense. It just accumulates and magnifies the losses.

⇒ Maintain 5 or 10 years of investment cycle in Equities – Equities are sensible long-term investments. I have written in past too that a 5 year investment cycle has got 8% probability of loss while a 10 year investment cycle has got zero percent probability of loss. This is no guarantee that losses will not happen but there is enough reason to believe this as there is empirical evidence in place.

We are passing through unprecedented challenging times at this juncture and until we see the cloud of uncertainty withering away, it will be too premature to say that markets have stabilised or found the bottom. It’s market’s job to find the bottom and we should allow them to do it. Our job is to be disciplined in our investments and we should do that.

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