Brace for Volatility, Raise Cash Levels

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The main risk with volatility is that it suddenly shatters the confidence and induces fear in the minds of general public. Volatility has the ability to change the sentiments overnight, and we have seen that in March 2020. Volatility peaked in March 2020 and since then it has been on the path of decline. Where volatility bottoms and where it peaks, is all dependent upon the prevailing scenario. It can go to as high as more than 90% and it can dip to as low as 9% or little below. This is also a known fact that these extremes are not sustainable, but they certainly send some signals.

Post the July quarter results, volatility has remained stable in between 15-25% in the month of August & September. Come October and November, there are enough factors which are indicating that volatility might be at the verge of taking a jump. However, it is also possible that the jump could be temporary in nature. Investors and traders should act with enough caution and without complacency.

There are few factors, which are enumerated as below, can lead to volatility and therefore risk in the month of October & November 2020.

- **Stock markets are near All-Time High –** Globally, indices are almost back to their pre-Covid19 levels. This has happened on the back of the belief that the worst is over and economic recovery is just a matter of time. While one round of worst is over, there are too many unknowns yet to be worked with. The Covid19 vaccine, which the whole world is working on, is as new as was the Covid19 itself. When Covid19 and its impact itself was misunderstood in the beginning, there is no guarantee that the vaccine will be sacrosanct. Further, there is no clarity on the shape of economic recovery, whether it is going to be V-shaped, W-shaped or K-shaped. While market is factoring a V-shape recovery, if it does not turn out to be so, then market will punish investors/traders accordingly too.

- **September quarter results –** Result month is never a straight forward one. Normally it begins with feel good factor and then disappoints at a later stage. This is because, it has been observed that good results are declared in the beginning while the shockers are parked for a later date. Until now, IT giants have created a euphoria in the minds of investors. Auto, Pharma & Banks may not disappoint as well but there is over expectations from FMCG. Also, there are laggard sectors which are badly impacted due to Covid19 and they could be a reason of disappointment. Overall, results could be in line with the expectations, but markets seem to have factored over expectations. Result season has just begun and it has been euphoric as of now; however, whether it continues in the same fashion, is yet to be seen. Apart from the September quarter results, the forward guidance of the management will also play an important role in defining the future trajectory of the markets because it will build expectations from December quarter results.

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- **Expensive valuations –** Valuations have run ahead of time. Though, this is not happening for the first time, it makes the situation more vulnerable to any negative news. When valuations are expensive, the sensitivity of the markets to any negative news is very high, as it happened on 31st August and 15th October, leading to sudden jump in volatility.

- **Border Tension –** Earlier we had to deal with Pakistan day to day. Now, when this issue has been addressed to a little extent, China has replaced them. Even if it just posturing, any aggressive statement or action makes markets volatile and works negative for the market. Though war is not an option for either of the countries, anything becomes a possibility when it comes to ego. War has the ability to push economy into doldrums, induce extreme volatility and pull the indices down by 10-20% and beyond depending upon the severity of the situation.

- **Covid19 Phase 2 –** As this is an unknown devil, if there is a second phase, then it could be a big blow to the confidence. A lot has already been lost due the lockdown. Economic devastation will be much deeper if there is a second round of lockdown. The intensity of second wave of Covid19 could be even higher according to the experts as winter is approaching. Depending upon how Covid19 shapes up in winters; optimism or pessimism will show their colors. Markets have already shown us the trailer on 15th October when Germany, France and UK started reporting high number of cases as second wave.

- **Impending Election in the US –** This is one of the events that the whole globe is watching. Whether Trump wins or lose, world will get many jitters as we move towards the end of October or in early November. US elections may induce heavy volatility in the stock markets as November approaches.

Time to raise cash levels – The reason I selected volatility as theme is that, there seems to be enough ingredients in place that can cause volatility in stock markets, in the month of October and November. And therefore, it requires a backend preparation. In light of this, it will be prudent to raise cash levels. As long as Nifty remains above 11,000-11,500 mark, it could be a good idea to maintain a 20-30% cash level. This may even mean foregoing some left over rally in the stocks, in case it happens, but that sacrifice could be a wise decision to buy some peace of mind in exchange.

So, it is time to take some profits off the table and build a cash level of about 20-30%.