

BY SHANKAR SHARMA

Correction? Yes; Bear Market? No!



MOST PEOPLE approach the markets expecting a reasonable amount of certainty, but the reality is that on a probabilistic basis, you can have a massive upswing, a massive downswing, or a flat market.

What are the probabilities one should attach to the event of a major crash or a bear market happening? In my opinion, one can have a correction, but the chances of a prolonged bear market are almost non-existent.

Why do I say so? It is very simple: We are not going to have a bear market in India any time soon because we have already been in a bear market for the past 11 years!

That may appear like a shocking

statement. But consider this data: the Sensex was around 21,000 in the January of 2008 when it peaked out. Today, the Sensex has just crossed 50,000. After 11 years.

This gives a compound annual return of approximately 6% over the past 11 years. Even a lay reader will understand, that is roughly equal to the return from a fixed deposit. And do remember that fixed deposits have no volatility, while the 6% compound annual return from the Indian stock market over the past 11 years has come with a minimum volatility of around 15% per annum.

When any particular asset class gives you returns that are below minimum acceptable levels (for Indian equities, this should be around 15% per annum), for an extended period, that asset class is in a bear market.

When you look at data in this manner, you can see that my assertion that the Indian stock market has been in a bear market for the past 11 years is supported by basic facts. Something that is already in a bear market does not go into a bear market.

In fact, quite the opposite might be true: something that has been in a fairly long-term bear market—like Indian equities—can only go into a



bull market.

What is happening right now is something called a Recency bias. What this means is that the most recent data points are given disproportionate value in the minds of investors while ignoring the wider data set.

Under these circumstances, the mind is only reading the rally from the lows of March 2020 and becoming apprehensive. However, let us think of a few reasons why this market rally could end:

(i) *Rising inflation forces the RBI to raise rates:* To my mind this appears to be the most serious reason that can derail the current rally. India faces the prospect of significantly higher inflation, and it is already seeing a very sharp upswing across the board in various commodities. A global



commodities rally, including one in which crude oil features prominently, is simply bad news for India.

However, it is my firm belief that the Reserve Bank of India will not raise interest rates even if inflation moves up significantly higher from the current levels. The central bank today is driven by growth considerations more than price stability, and it will tolerate a lot of inflation because it does not want to sacrifice any level of growth. Also, the fact remains that India has lost nearly three years of growth because of the pandemic and, therefore, the central bank will be extremely accommodative.

(ii) U.S. Fed tapers easy money policy: This is another big fear the markets have. And in my view, this fear is completely unfounded. Even if there is in-

deed some tapering, the markets have been informed of this and, therefore, these are already discounted.

(iii) Rising U.S. rates in 2020: In my decades of investing experience, the one realisation I have had is that markets are extremely short-term in nature. Markets never look beyond the next 12 months at the maximum.

Therefore, one should not worry about what policy the U.S. Federal Reserve will have after two-three years. It is, again, a very well-known and well-transmitted policy stance and unlikely to have much effect on markets.

My view is that the American monetary policymakers will have no choice but to continue with their easy money policy for a very long time. Since the great financial crisis

of 2008, this experiment with ultra-cheap money has worked like magic. And it has shown this magic in the last 12 months as well.

The U.S. Fed is unlikely to take any risk with the stock market rally since 2009—driven by ultra-cheap money—which has cushioned the impact of generally low economic growth worldwide in the last several years and in particular in the last 12 months.

This is a great drug to keep people happy on and I am willing to lay a bet that this drug will be in plentiful supply over the next several years.

(iv) Newer variants of the virus: This is a well-known and well-understood potential problem and anything that is well-known and well-understood does not cause a stock market crash. Last year this was an unknown animal and that is why it caused the devastation of March. No matter what variants come, stock markets are not going to react negatively to those because the problem is already understood.

In short, let me say this: stock markets do not go into bear territory for known reasons; they do so because of unknown reasons. As of now, all the above reasons are well-known and well-understood.

In fact I will argue to the opposite that every single correction must be invested into aggressively because we are nowhere close to bear market territory right now. ■



ABOUT THE AUTHOR

Views are personal. The author is co-founder and part of the fund management team at First Global, a global quantitative asset management company.