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Equity markets will not give equal returns every year: Devina Mehra

Synopsis
"If you had put in Rs 100 in 2010, you would have got only Rs 230 in 2020, barely beating FD returns for that period. So you came so far below the trend line that you are still not anywhere close to the trend line. The big crashes come when you are way above the trend line. So that is not happening."

"If a smallcap index falls 80% as it did in 2008-2009, it can go up five-fold and you will have zero return at the end of it or like in the 2018 crash, it went down nearly two-thirds. If it goes down two-thirds, it triples, and still you are at the same place. And you are actually not even at the same place because the smallcap index itself churns so much that the stocks that finally cross that high again are a completely different set from the stocks that fell," says ***Devina Mehra****, Chairperson & MD,* ***First Global****.*

What explains the near capitulation that we have seen all through this week? Truncated one at that and expiry as well, were we falling under our own weight? Aligning with the rest of the globe? What explains this?

What explains it is what I call the theory and practice of equity markets. So in theory, if you ask anyone, they will say yes, equities give higher returns but they are a more volatile asset class.

But when you are living through the volatility it seems as if it is the end of the world. I mean, I was just looking at, for example our small case and for the past one year it is up 35%. Yes, eight days ago it was up 42%. But am I unhappy with the 35% versus the benchmark 10%? No, I am not.

So this is the nature of the beast. As they say in software, it is a feature, not a bug. That is the way equity markets are meant to be, that you will have corrections.

And all the people who at 20000 Nifty were saying that we will wait for a correction to get in, I hope they are getting in - that is the other part of it.

And this is an example I often give that people think that Rakesh Jhunjhunwala's superpower was identifying great stocks. I think his superpower which was like that one line in the book about him, was that he said: I made a lot of money in 1989 to 1992. I made a lot of money 2003 to 2007. But there were periods of even four or five years in between when I did not make money. So to really understand and be able to live through that, that equity markets will not give equal returns every year or even every decade that you have to understand.

And whereas, if you look at the mutual fund data, most investors do not even, I mean this is the majority of the investors, more than 50% of the investors do not remain invested for even two years at a time.

Therefore the compounding does not show up for them. It shows up when we look at the long-term equity charts, but it does not show up for equity investors - this much of volatility is par for the course.

If I look at the market positioning, it is quite unique. Retail activity is strong, SIP flow is robust, but the FII positioning in the cash market and the F&O market is just telling us a very different story. We are perhaps for the first time staring at two parallel markets where foreign investors who always bought into India, they do not have a great positioning in terms of commitment and retail investors who are always in a sense a harbinger of creating a market top, they are the ones who are really in a sense in the front row.

Actually, I would like to characterise this sort of two-tier market differently rather than from the investor's point of view. As I have said earlier also, not only is there no causation, meaning if FII flows go up and down, the market does not go up and down along with that, never has.

This was the case even when FIIs were a much bigger proportion of the market than they are now when mutual funds are large, direct retail participation is also much larger.

The first time FIIs came in from 1994, the market went nowhere for nine years and that was the only nine-year period when the Indian markets gave net zero return. I mean, it went up and down but net zero return, in spite of this new slew of money coming in.

But the part what I was talking about the two-tier part was that you have to be more careful on the small caps. I said it the last time that the small cap is the risky end of the market.

And I have begun to see these kind of things that so-and-so fund manager has given 60% compounding in small caps for the past two years or two and a half years and people forget that percentages are not symmetrical.

If a small cap index falls 80% as it did in 2008-2009, it can go up five-fold and you will have zero return at the end of it or in a 2018 crash, it went down nearly two-thirds.

If it goes down two-thirds, then triples, and still you are at the same place. And you are actually not even at the same place because the small cap index itself churns so much that the stocks that finally cross that high again are a completely different set from the stocks that fell.

The stocks that fell, a lot of them just go out and go to zero, essentially stop trading etc. So that part of the market I have been saying for the last month to month and a half, that is where you have the real risk part. The large caps, of course, you have to choose the sectors carefully, you have to choose the companies carefully.

But the market as a whole, the reason why the risk is not so much, as I said, decade-to-decade returns are very different. So in 1980, if you had put in Rs 100, after 10 years you would have got Rs 700 in Indian equity markets.

If you had put in Rs 100 in 2010, you would have got only Rs 230 in 2020, barely beating FD returns for that period. So you came so far below the trend line that you are still not anywhere close to the trend line.

So the big crashes come when you are way above the trend line as you said when there's froth. So that is not happening. And even if you look at retail SIP flows, they have been very targeted towards the small caps. The net flows have all been to the small caps so that is where the frothiness has built up with mutual funds. The small-cap mutual funds which may have been investing in a universe of 100 stocks, now have to look at 200 or 250 stocks just to invest the money that is coming in which means criteria are getting diluted and that is where the risk comes in.

We were just having an interesting discussion earlier today about the outlook when it comes to banks, private sector banks in particular, given that they seem to be in a very ripe position to buy at the current levels. Would that be a view that you concur with, given the fact that the growth is there, visibility is there, NPA concerns are behind us, and valuations as well look attractive?

Not really. And somebody tells me that on social media that this is something you repeat in every interview: I am a nervous investor in banks. So, I mean, I and my systems also do not still like private sector banks. In fact, the last rebalance we did, we cut back banking in general, and within banking, again, skewed a little more towards PSU banks.

And I am not so sure that everything is that hunky-dory also because see there is a lot of growth in non-housing bank credit and retail. I am talking not corporate credit, but retail, basically personal loans, non-housing personal loans.

And I am not sure, some part of it obviously is because more luxury homes and luxury cars are getting sold and getting financed. But I think there is also an element of people with not enough income funding consumption via these loans.

So, that is one area where I would like to keep an eye in terms of where that goes. So, I mean, we are not yet saying that pull the trigger on private sector banks. Banking, I mean, fundamentally for me, it is always that you do not know where the negative surprises are lurking, and periodically there are negative surprises in that sector.

The interesting macro data for all of us has been the US GDP data. Beginning of the year, the assumption was it could be a soft landing and it could be a mild recession. Forget recession, I mean, that economy is booming. 4% plus for a size of US, I think it is like the economy in some kind of bull run.

What is the importance of US economic growth? What does that mean in terms of sectoral positioning for global facing sectors like IT, pharma, exporters, metals?

As far as US is concerned, they have had a much softer landing than frankly I was expecting because the Fed also has been trying to bring down the growth and if not the GDP growth, even the labour market, how buoyant it has been and that has not changed still.

Hence, that part still remains good. Even inflation has moderated somewhat but beyond that it is not coming down because the economy is not slowing as much as the Fed would like it to.

And that still remains. As far as India is concerned, I mean, we are not such large players, except probably in IT, that overall global, or at least the US GDP plus minus will make a big deal for us because we have not been doing well in exports at all, anyway, for the past 10 years or so.

And the pharma exports are anyway not so tied to the GDP plus minus, 1-2% and if anything, theoretically, you can say that if there is a recession, people would want cheaper pharma and therefore it will be good for Indian pharma if you want to, I think it is a little bit of a stretch, but if at all the logic runs, that is the way the logic would run.

IT, I see a lot of press saying that the hiring is slowing and I think we are mixing up two things, that whether what is happening on the job market and what is happening on the demand side, which are two different things, so it may be that you are automating more, and not maybe, they are automating more, and using more AI, et cetera and therefore will need fewer bodies.

That does not necessarily mean the business outlook is bad, it might even be the other way around. The business outlook is good, but to me, the slowing down in IT hiring is more of a concern from the Indian economy point of view because the last 20, 25 years, a lot of the growth in the Indian economy has been driven more directly and indirectly by IT hiring, because each person that they hire also has a effect on the economy around them by hiring, maybe domestic staff, and so on and so forth, so if that slows, that can override. It is not going to happen in six months, but I am saying over a period of time, to me, that would be a macro concern because this has been such a big, direct and indirect employment generating sector.