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Expert view: Indian stock market not in a bubble, still below the long-term trendline, says Devina Mehra of First Global

Nishant Kumar

Expert view: Devina Mehra, the founder, chairperson and managing director of First Global, believes the Indian stock market is not in a bubble zone. She points out that in price-to-earnings ratio (P/E) terms, the domestic market is neither at very low levels nor at extreme levels.

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Expert view: Indian stock market, at least for the large-cap mainstream stocks, is not in a bubble, and they are still below the long-term trendline, says **Devina Mehra** of **First Global**. Devina Mehra is the founder, chairperson and managing director of First Global, a PMS and Smallcase manager in India, that also manages Global funds and portfolios. In an interview with Mint, Mehra shares her views on the key triggers for the Indian stock market and how one should play the midcap and smallcap segments. She also discusses sectors she is positive about at this juncture.

Edited excerpts:

What is your overall medium-term outlook for the Indian stock market? What are the key triggers that will move it? What are the key factors that can limit the upside?

I remain positive on the Indian market for the medium term, although there may be interim volatility. We are playing this by being fully invested in First Global's PMS (portfolio management services) portfolios but being partially hedged.

The broad reason for this is that the Indian market had a very poor performing decade from 2010 to 2020 where instead of the 15-16 per cent compounding that we expect, the Nifty and Sensex compounded only around 8.5 per cent - hardly beating Fixed Deposit returns.

This created room for a bull market during the present decade.

However, I am less positive about the outlook for some of the frothy areas in the market, such as microcaps and small caps.

On triggers, my view is stories are often found post facto to explain market moves, and exactly the same reasons can be found to justify both an upmove and a decline!

Of course, one concern area remains: the poor growth in private consumption (the largest segment in GDP), which grew at only 4 per cent in the previous year.

This has an impact on the earnings of companies, especially those selling to any segment other than the affluent class.

Before the Lok Sabha elections, there were expectations that the new government would take bold steps to boost India's economy strongly. As the BJP has failed to secure a majority on its own and a coalition government is at the Centre, do you think the scale and pace of policy reforms will be curtailed? Do you think there could be a major shift on the policy front?

Data shows that coalition governments are good for the country, economy, and markets - somewhat unexpectedly, not just coalitions that lasted a full five years but even unstable coalitions like when Deve Gowda and IK Gujral were Prime ministers.

My view is that this is because taking multiple viewpoints into account - for example, those representing different parts of the country, communities, castes, genders, etc. - improves decision-making.

It is the same in companies, where taking more diverse views into account means better decisions rather than when only one or two people make all the decisions.

I do not see reforms slowing down. However, I have an issue with the very definition of reforms, whereby measures that benefit businesses or investors are considered reforms, whereas spending on basic food, health, and education for the masses is considered populist and freebies.

Again, as in the case of company management, the short-term and the long-term have to be balanced. Spending on nutrition, education, and health improves the quality of human capital.

That is needed for long-term capital economic growth, as you need employable people; only then can employment and, in turn, consumption get a boost.

Ultimately it also benefits businesses and markets, except that this impact may not be seen on a one-year basis.

What is your view on the current market valuation? Are we in a bubble?

I do not see valuations having reached bubble proportion, at least for the large-cap mainstream stocks.

In price-earnings ratio (P/E) terms, we are not at very low levels, but we are not at extreme levels either. (P/E is calculated by dividing the price of a stock by its earnings per share.)

Also, remember that looking at the Nifty or Sensex PE is not very meaningful as, over the years, the composition of each of these indices has undergone a huge change.

To give only a couple of examples: About 20 years ago, PSUs used to dominate these indexes, and then they were forgotten for a long time. There was a time when there were almost no banks or financials in these indexes, and now they have the highest weight.

If you want to look at PEs at all, we should look at sectoral indexes, whether for autos, IT, metals, and so on. In none of these do we see that the PE ratios are very high relative to history.

As I said earlier, in the 2010-20 decade, ₹100 became only ₹230. Contrast this with 1980, when ₹100 became ₹700 in 10 years.

This decade of big underperformance created room for the stock market to grow. However, if we plot the market's returns, we will see that they are still below the long-term trendline. The risk of a big crash is when you are way above the trendline.

What should be the investment strategy for the next two to three years? Should we allocate more to large caps? How should we play the mid- and smallcap segments?

I certainly think that if you look at microcaps and stocks below ₹5,000 crore market cap, there is more than a little froth there, and investors should limit their exposure there.

It is also because risk management measures do not work well for this segment as neither can you hedge those via Nifty options (as those stocks do not necessarily move with the Nifty), nor do stop losses work well here as the stocks can fall very rapidly without allowing you to sell.

Remember, in every small cap bust, hundreds of stocks disappear, never to come back again.

Just to inform investors who may be relatively new to the markets, the Smallcap index fell 78 per cent in 2008-2009 and did not recover those levels for eight years.

Even though the index crossed those levels in 2016, the composition was completely different. Many stocks that fell never came back.

Then, after a one-and-a-half-year boom, there was another two-thirds fall in the Smallcap Index.

Also, remember that when something falls 80 per cent, it can compound 50 per cent for three years, and at the end of it, you will still be down 33 per cent.

Remember this when smallcap managers and advisors tell you they have compounded 50 or 60 per cent for two or three years. If you go back five or seven years the picture may be completely different.

This is a risky area of the market, and if you are lucky enough to have made money here, book most of your profits and reinvest in steadier stocks.

What sectors are you betting on at this juncture? What do you think about the PSU space?

We did not change our sector allocation after the election results as we did not think they changed anything fundamentally.

The sector we have been overweight on for nearly three years now has been industrial machinery and capital goods although most other fund managers seem to have discovered it only in 2023.

However, a considerable part of the move in this sector is now over, and we have been cutting back, although we are still overweight.

Over the last year and a half, we have added automobiles, auto components, pharmaceuticals, and some construction names.

We also added some metals a few months ago, but I may not necessarily recommend them now.

Very diverse companies are under the PSU umbrella, from PSU banks to oil and energy to defence and manufacturing - all with different dynamics.

The sub-segments that we are relatively overweight are PSU banks relative to private banks.

Do you see value emerging in the IT sector?

I do think that sometime this year, the IT sector will bottom out and will provide a good investment opportunity.

We do have some investments in the sector, but we are not currently overweight this sector in the First Global PMS. We are still waiting and watching.

Gold and equities both have gained significantly over the last year. Why are both asset classes rising simultaneously? Is it time to perceive gold beyond its safe-haven appeal?

The image of gold as a safe haven is not deserved. In dollar terms, gold has had huge losses from the peak more than once.

For example, the gold price in the early eighties did not come back for nearly 25 years, with a 60 per cent loss in the interim. Thereafter it again had a 40 per cent loss in this century.

The picture looks better in Indian rupee terms simply because gold provided the only accessible currency hedge for Indian residents in the past. Thus, the Indian fascination with gold was not really irrational. But now, with the generous Liberalised Remittance Scheme (LRS) limits, direct investment in global assets is possible.

The linkages between asset classes can also change. For example, in the developed world, people think that fixed income and equities move in different directions, but this has been the case only for the last 20 years.

For the rest of the last century, these classes moved together, as is beginning to happen again now.