UNCATEGORIZED

Is irrational exuberance driving India’s stock surge?

Some investors desperate not to miss the rally could end up chasing a mirage as fundamentals fall short

By SUMIT SHARMA
DECEMBER 11, 2020

A woman walks out of the Bombay Stock Exchange in Mumba. Photo: Himanshu Bhatt/NurPhoto/AFP

An 80% surge in India’s benchmark Sensex since a March 23 low would suggest Covid-hit companies are roaring back to life after a devastating outbreak and lockdown.

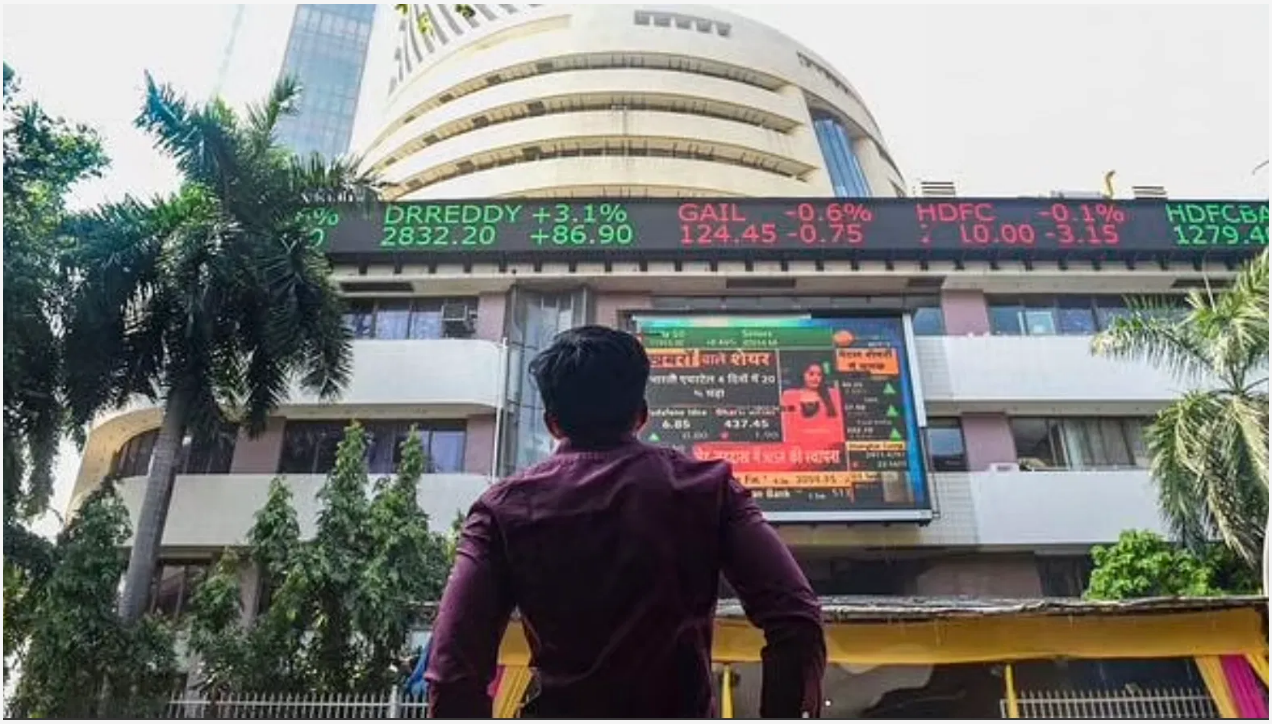
But even a cursory analysis of the companies driving the bull run shows clear symptoms of irrational investor exuberance – and the potential for a sharp correction when investors eventually and more clearly examine listed companies’ fundamentals.

Take, for instance, Biofil Chemicals & Pharmaceuticals Ltd, whose shares have surged from 6.55 rupees ($0.09) on March 25 to nearly 339 rupees ($4.6) this week.

Investors have piled into the company's shares on speculation that it may benefit from an increase in demand for medicines and injections that it makes, among others, and not just its underlying profitability.

While that payday may one day arrive, the company is barely turning a net profit, posting just 12 million rupees ($164,170) in the year to March 2020 on 297 million rupees sales.

Alchemist Ltd, with interests in agriculture, pharmaceuticals, and steel, has also skyrocketed to 8.8 rupees ($0.12), from 0.6 rupees ($0.008) last December – despite reporting a 467 million rupees ($6.3 million) loss in the year to March.



A punter weighs his stock options. Image: Twitter

Stock investors typically bet on a company's future expected earnings and so-called penny stocks are seldom if ever representative of any stock market trend.

But the speculative exuberance is now spreading well beyond the Sensex's top 50 blue-chip stocks.

The examples are many. Jet Airways, once India's largest airline and shut down since April 2019 on rising debt and losses and government's refusal for a bail out, has seen its shares pumped up to 83.3 rupees ($1.13) from 13 rupees ($0.18) on March 27, with punters clearly betting the carrier will soon again take to the skies.

Jaiprakash Associates, with interests in engineering, construction and real estate, has seen its shares rise to 7 rupees ($0.09) from 1.1 rupees ($0.015) on April 1. Yet the company turned in 8.93 billion rupee ($121 million) net loss in the year to March.

While stocks have surged, the economy collapsed, with an unprecedented contraction in two successive quarters of 23.9% and 9.5%. Gross domestic product for 2020 could contract 7.5% in the year ending March 2021, according to the central bank.

Economists predict positive growth will return at the earliest in the second half of 2021.

The blame for that economic underperformance can't be put solely on the pandemic. Indeed, the year began with a despondent outlook even before Covid-19's spread. GDP grew 3.1% in the quarter to March, the lowest in 40 quarters.

In the full year to March, growth slipped to 4.2%, the lowest level in 11 years, or half the rate in the year to March 2016.

A two-month, countrywide lockdown led to severe dislocation of manufacturing, sales, services and supplies, with almost 120 million workers losing their jobs.

The lockdown shook the confidence of even seasoned investors until the upward surge in shares seen in the last three months. So is the current exuberance driving up Indian stocks irrational?

"Yes and no," says Devina Mehra, co-founder of First Global, a global asset manager with about $700 million across countries and asset classes. Since January 1, the Sensex has risen just about 12% this year, she points out.

The initial rise, before the recent vaccine hope fillip, was because the Covid crisis created new opportunities for many companies, she said.

"Much of the rally for most of the year was in sectors that actually had a rationale for doing well," said Dubai-based Mehra. "However some of the beaten-down dog sectors have been doing well, which has made us cautious as that often happens in the late stages of an up move."

Besides sectors doing well fundamentally, the Covid crisis and lockdown created opportunities for firms in digital, healthcare, information technology, and chemicals.

"Globally this included many digital-oriented businesses, although in India there was only a limited way you could play this. But even in India there were sectors like healthcare which gained in this crisis or chemicals as China's trade issues with the West meant there were opportunities for India," she said.

"IT services had more opportunities and could also cut costs with 'work from home' and other changes, helping margins. Dollar weakness at various points of the year also helped commodity stocks."

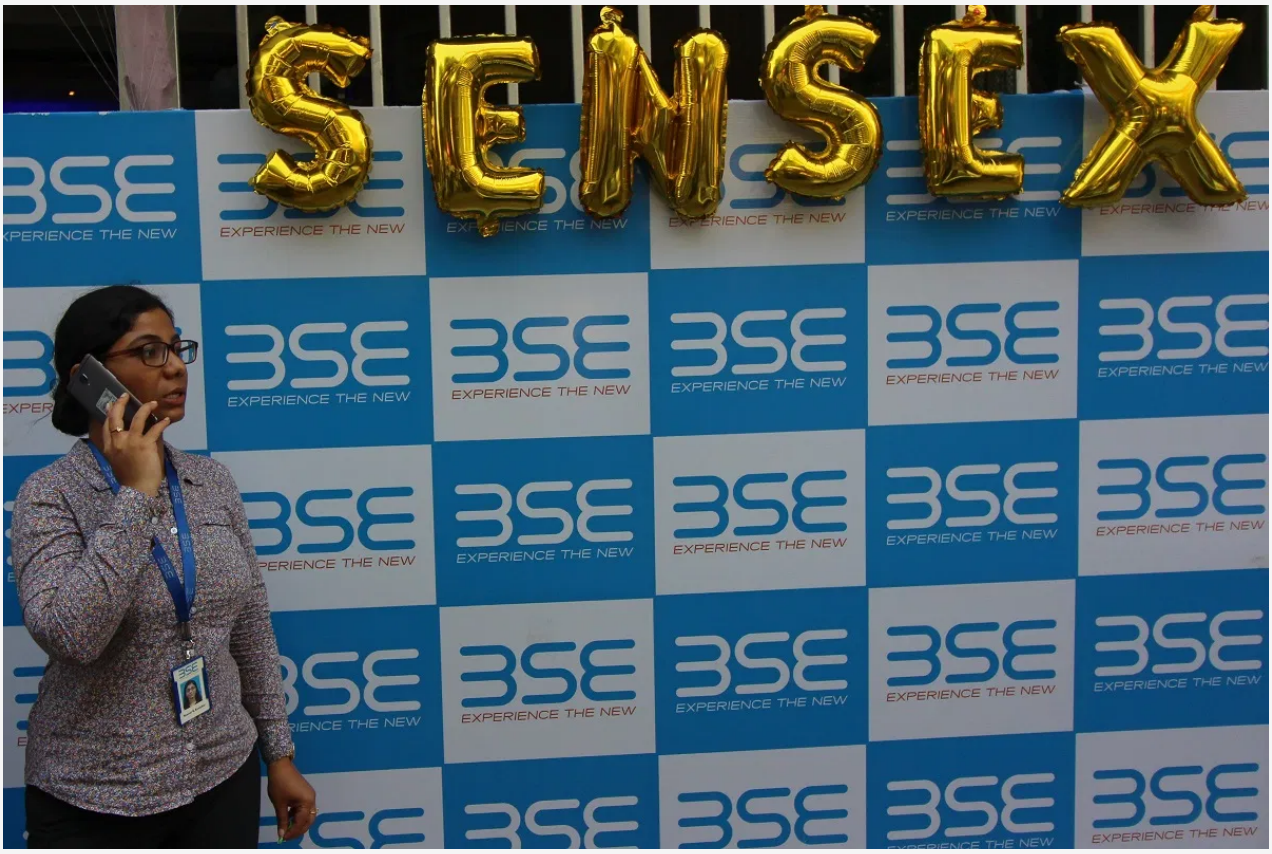
At the height of the pandemic and lockdown, Reliance Industries Ltd, India's most valuable company owned by Asia's richest man, led the way by raising $27 billion for its retail and telecom and digital units.

Its share prices rocketed to 2,368.80 from 867.82 rupees, showing investors a growth path out of the pandemic.

Reliance's surge, analysts say, drew investor attention to other well-managed stocks at attractive prices. Among Sensex indexed stocks, Infosys Technologies leads with a 59%

gain, HCL Technologies 52.5% and Asian Paints 41% since January 1.

Nestle India, Hindustan Unilever, Kotak Bank, Tata Consultancy Services, and HDFC Bank are also top gainers among a few dozen others.



A woman talks on a mobile phone in front of a logo of the Bombay Stock Exchange in Mumbai. Photo: Himanshu Bhatt/NurPhoto/AFP

Not all stocks are climbing. State-run oil explorer ONGC and the country's largest government lender, State Bank of India, are among the worst performers on the Sensex as investors lose faith in companies owned and guided by government-appointed directors.

With the US, Japan and other large economies cranking up liquidity to counter Covid-caused recessions, some of the cheap money has found its way into Indian assets. Foreign portfolio investors have so far this year pumped $18.6 billion into Indian equities, the highest level since 2013, when overseas investors bought $20.1 billion.

Domestic institutional investors, including local banks, insurance companies and mutual funds, have on the contrary been net sellers on most days since April.

Despite investor euphoria about the 80% rise from the year's low, India is a modest 37th among global market performers for the entire year. China, South Korea, Vietnam and Taiwan have all fared better than the 12% Sensex increase year to date.

Global investors are wary of investing in Indian bonds and have sold $14.4 billion of debt as interest rates plunged when the Reserve Bank of India (RBI) cut rates to revive the economy, cutting the repo rate to a historic low of 4%.

The largest government bank, the State Bank of India, offers 5.3% on fixed deposits for three years or more, while CPI inflation was last reported at 7.6% in October. The RBI predicts inflation to remain elevated at 6.8% in the quarter to December 31 and 5.8% in the quarter to March-end.

Low interest rates and lack of other comparable alternative investment avenues are also prompting investors to jump into buying equities. Not all study the company and industry before investing carefully, and that could prove risky.

Among other sector indexes, the BSE Utilities was probably the one which rose the least among all the 19 sectors. Others that have not risen in line with the Sensex include the BSE Fast Moving Consumer Goods Index and BSE Telecom Index, BSE Capital Good and BSE Consumer Durables.

The pandemic initially held back many individual investors from participating in the rally. Then, the lackluster performance of several mutual funds prompted many individual investors to sell their holdings to venture directly into the market. This is also reflected in a net outflow from equities mutual funds since June.

"The one-way rally from March onwards has made money-making look easy to the investors which is why we are seeing so many new entrants," said Mehra. "However many of these new investors do not understand risk properly and are likely to get caught out whenever the rally ends."

"The move itself to 'self investing' has come out of the frustrations with the performance of the professional fund management industry which has not been able to even beat saving returns on fixed deposit over long periods (even over a decade) of time," she said.

Mehra suggests investors should diversify asset class and also invest in overseas markets. She said Indian investors should get out of the "frog in the well approach, which increases risk and limits upside."