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‘Market momentum to continue in 2024 but stick to large-caps’

Jash Kriplani

In an interview with Mint, Devina Mehra, founder of First Global group, shares why she thinks the current market run-up was always in the offing and what her outlook on the markets is for the next year. .

Mumbai: After a difficult year, the stock markets are seeing a pick-up in the latter half of 2023. The S&P BSE Sensex is up 15.8% for the year. Up until 26 October, it had just delivered 3% year-to-date returns. What is expected next year? In an interview with Mint, Devina Mehra, founder of investment management firm First Global, shares why she thinks the current market run-up was always in the offing and what her outlook on the markets is for the next year.

Mehra, who is currently based out of Dubai, started her professional career in Citibank, working in the investment banking/corporate finance group and in corporate risk group from 1986-1993. In 1993, she quit Citibank and got membership of BSE. This proprietorship was later corporatized into First Global, along with her membership of National Stock Exchange, London Stock Exchange and National Association of Securities Dealers, US.

The market momentum in India should continue for now. There may, however, be some small corrections, says Mehra, adding investors should, however, continue to remain invested for the long term. At, the same time, they should be wary of small-caps, micro-caps and even be cautious when it comes to investing in initial public offers (IPOs).

Edited excerpts:

Geopolitical tensions, inflation, high interest rates have all been concerns in 2023. But despite all that, the markets are seeing a run-up. Why is this so?

The run-up has not come as a major surprise. And the reason for this is more long-term. If you look at the data for Indian markets, we all have this impression that equity markets compound returns at 15-16% because that has been the returns delivered by main indices like Sensex since they started 40 years ago. But what people don't realize is how much that return varies. For example, if you look at the 1980s. If you had invested ₹100 at the beginning, you would have got over ₹700 at the end of the decade. So, that translated into compounded annual growth rate (CAGR) of 21%. Whereas between 2010 and 2020, if you had invested ₹100, you would have got only ₹230 at the end of the decade or 8.7% CAGR. Fixed deposits would have fetched ₹190-200 during this same period. Hence, the excess return was not much.

In terms of returns, markets have been delivering much lower than the historical trend-line. So, there was always room for upside. Usually, there is risk of crash, when returns are much above the trend-line. But where the markets were, I was not worried about a major crash and in fact I have been positive on the markets throughout the year.

Do you expect interest rates to remain high?

I don't see interest rates in India being cut in a hurry because inflation continues to remain above 4%. And it has remained so for the last four years. Globally, central banks usually look at core inflation, which excludes food and fuel. The central bank's intervention would not help if it is coming from food, as rising food prices are normally a supply issue. But the Reserve Bank of India cannot ignore it completely in India as it forms a greater part of the consumption basket for the household. So, if food inflation is high, it crowds out a lot of other things, whether it is fast moving consumer goods (FMCG) or even entry-level consumer durables. You can see that in the overall economy. So, luxury cars are selling, but entry-level cars are not. Two-wheelers are not selling, affordable housing is not selling and more than 800 million people need free rations. That shows there is clearly a two-tier economy.

Do you see the recent run-up turning into a longer rally?

I am still positive on the large-cap side. In terms of historical returns, we are not even at the trend-line. In terms of valuations, we are not at the highest end. But I would say, investors need to be very cautious on the small caps. A lot of new investors are entering the market and might get carried away by the returns being seen in the small-cap stocks. For example, various small-cap indices are up between 45% and 53%, micro-cap stocks are up by 50%. So, that's where there is potentially a bubble forming. All kinds of companies are getting money. I was looking at mutual fund flows. There are net outflows from large cap funds and net inflows into small cap funds.

Do you expect market momentum to continue into the next year?

The momentum should continue for now. There may be some small corrections. Overall, I don't see a risk in the trend. However, on the small- cap side, you need to be careful. So, even when our systems signal that there is momentum in small-caps, we do not take any outsized positions there as we understand the risk of that space. So, we rarely would go above 20%. We never invest in micro caps.

What themes and sectors are you betting on?

Devina Mehra
founder, First Global group

▶ WHICH SECTORS ARE YOU BETTING ON?
Capital goods, industrials

▶ ARE SMALL-CAPS IN BUBBLE TERRITORY?
Potentially. Given the sharp run-up and investor money chasing these stocks

▶ WHERE HAVE YOU CUT OR EXITED POSITIONS?
Banks, mostly private banks

▶ HAVE YOU ADDED ANY EXPOSURES?
Auto, auto components, pharma, construction names

▶ STOCK PICKS THAT WORKED IN 2023
Nucleus Software Exports, Neuland Laboratories

▶ DO YOU EXPECT INTEREST RATES TO REMAIN HIGH?
At least for first part of the year

▶ WHAT'S YOUR ADVICE TO INVESTORS?
Stay invested. If you had missed 10 best days since 1986, missed two-thirds of returns

▶ WHAT'S YOUR OUTLOOK ON US MARKETS?
A year-ago, there was risk of recession. But it is not the case now.

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Our biggest overweight is in industrial and capital goods. It is not a one-year story for us, but a long-term story. Only this year, lot of people have started talking about capital goods, but we have been overweight on sector since a while (since October 2021). Our internal systems don't signal that the run-up in these sectors is over yet. Hence, we remain overweight.

Where we added during the current year has been auto, auto components, pharmaceuticals, few construction names also. Where we have cut back is banks. More so, the private banks. Our current position is skewed a little towards PSU (public sector) banks, but we are much lower than the market weights. Our systems are signalling that PSU banks are better alternatives.

What worked for you in terms of stock picks, what didn't work as well?

While some of the biggest contributors to our portfolio this year have come in pharma and industrials, the best performing one is actually in IT. It underscores that not all our calls are sector calls.

As we are clinical about our stop losses, we exit companies when the prices fall below certain thresholds. Sometimes the stock recovers after our exit, as was the case with a cement company and an agro-chemical company this year, where stock prices later traded above our buying price.

However, we stick to our process where it is understood that hit rate will not be 100%, but on the average it will provide outperformance.

What's your outlook on global bond markets?

As far as US is concerned, the hike in rates by the Federal Reserve is probably done. But what is happening is that ex-housing service inflation has proved sticky for them. Services is a large part of their economy. And part of the reason is that services have a large labour component and the labour market has remained buoyant there. And they seemed to have side-stepped the possibility of recession. The so-called soft-landing has happened there.

A year ago, if you had asked me, I would have probably said that the possibility of a recession is high. And recently the US Fed said that they don't want to make the same mistake of remaining tight for too long. So, this statement was more dovish that what we were expecting. Had you got back a year-and-a-half back also, we would not have expected rate cuts in 2023. That we were very clear. With inflation, once it reaches that high it usually doesn't come down in three-four quarters.

What is your advice for investors?

Investors should have an asset allocation in mind. Before fixing your target asset allocation, also know your current asset allocation. But whatever is your equity allocation, I would say since the risk of a market crash is not very high, remain invested. So, if you had invested ₹100 in 1980, you would now have around ₹56,000. But if you had missed out on even ten best days in the market, this comes down by two-thirds. If you missed out on 30 best days, your returns come down by 90%. So, instead of ₹56,000, you make ₹5,000. So, remain invested. And be very wary of small-caps, micro-caps and even be cautious when it comes to investing in IPOs.