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Risk management does not work well in small and mid-caps: Devina Mehra

Devina Mehra, Chairperson and Managing Director, First Global is not surprised that there has been a sudden spike in the India Vix during the election period, as it has been the trend earlier as well. Mehra tells Joydeep Ghosh that she is not too worried about outflows by foreign institutional investors since their impact on Indian markets is nominal.…

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Devina Mehra, Chairperson and Managing Director, First Global is not surprised that there has been a sudden spike in the India Vix during the election period, as it has been the trend earlier as well. Mehra tells Joydeep Ghosh that she is not too worried about outflows by foreign institutional investors since their impact on Indian markets is nominal. Excerpts:

In the past couple of weeks, indices seem to be facing the heat of election uncertainty (even the Vix has been on the rise). Do you see elections being a trigger for the markets to enter a phase of consolidation, with some correction?

The upward spike in the VIX or the volatility index has not come as a surprise to me. On the contrary, a few weeks ago I was wondering how the VIX was this low as data from earlier elections showed that it normally spikes up around election time.

Nevertheless we simply took advantage of the lower VIX to buy hedges for the First Global PMS portfolios at favorable prices.

While we remain positive on the markets in the medium term, we are expecting some volatility till June end and hence have bought insurance in our PMS portfolios. However, given our overall positive outlook on the market we are not holding significant cash.

Foreign institutional investors ((FIIs) **have also turned net sellers (around Rs 25,000 plus net sales since May 2). What could be the reason for their change in stance?**

For decades now, I do not waste time tracking or thinking about what FIIs are doing or will do – for the simple reason that data does not show that FII buying has a positive impact on the market or FII selling has a negative impact on the market. There is no correlation between FII flows and market direction let alone one causing the other.

As a money manager, how do you look at this overall uncertainty coupled with FII outflows? Does it provide you with more opportunities or are valuations already too high?

FIIs did not have an impact on market direction even when these constituted most of the incremental flows in the market. What better example than 1994 to 2003 which is when FIIs started investing in the Indian market. This was a fresh new slew of money at a time when neither the domestic institutions or retail players were of size. Even then, this was the only 9-year period in the Sensex history when the market gave net zero returns.

Other than tracking it for balance of payment reasons, I no longer track FII flows.

Investor interest in PSU and infrastructure segments have already risen sharply in the past couple of years. Which are the new sectors that you are betting on?

Capital goods and industrial machinery have been sectors where our PMS has been overweight from October 2021. Most other fund managers discovered it only in 2023. The question we ask every quarter while re-balancing is whether this move is over or whether there is still some steam left as many stocks have gone up 2-3 times and even more. While we have cut back our exposure we still remain overweight on the sector.

In the past 12 to 18 months we have added in automotives, healthcare and construction, where we are overweight. Of late we have also added some weight in metals and cement but we are not overweight on these segments.

PSU is a very broad category with many different types of companies so we look at each company individually.

Despite regulatory concerns around mid-and small-caps, there seems to be significant investor interest in these counters. Do you see 'froth' in the valuations or one shouldn't worry too much about it?

I have been warning about the small cap and micro cap sector froth even before the regulator's comments. New investors are often unaware the kind of fall the segments can see even on an aggregate basis. In 2008, the small cap index fell 78%. It struggled to regain the same level by 2016. Then, after another 1.5 years' bull run, it fell 65% in 2018/19. Remember when something falls two-thirds, it can triple and you will be at zero!

The most important part is that risk management does not work well in this sector, as when the stocks fall there is no exit and many stocks disappear altogether. We manage risk tightly and hence restrict exposure in companies below Rs 5,000 crore market cap

Central bankers across the world, especially the Fed, have been keeping the markets on the edge. While the earlier commentary was that India will cut rates after Fed action, now some are saying India may actually cut rates earlier. How do you see this playing out?

RBI, maybe rightly so, has been concentrating on the growth side as unlike the US we have do not have a buoyant labour market. However, the flip side is that while food inflation cannot be directly controlled by interest rates, it is a big part of the consumption basket in India and it's particularly relevant in an election year. So no easy decisions.