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Sitting it out is still more risky than being in the market: Devina Mehra

Synopsis
Devina Mehra, Founder and Chairperson of First Global, says Nifty 40-year return has been 15%. We are still not above the trend line and so the risk of a crash is limited. Still, the risk would be in not being invested rather than in being invested. So sitting it out is more risky than being in the market because at some point, you will miss out on a big upmove rather than the comparative risk of a crash from here on.

"As far as India is concerned, there is a little direct impact because even something as big as the financial crisis of 2008-2009 had limited direct impact on India other than the fact that the world growth slowed. But there was no contagion as such. That was a much more widespread problem. So in Indian markets directly, I do not see a big issue. Ultimately, once this plays out, the impact on the markets may well be positive because what the markets now are banking on is that because of all these issues, Fed will back off somewhat on rate hiking," says ***Devina Mehra****, Founder & Chairperson,* ***First Global***

How would you explain the banking turmoil for Indians?

Bank runs are essentially confidence issues because all banks run only on confidence. If all or most depositors come to get their money back, no bank in the world can pay it back and that is the basis. Of course, as far as the Silicon Valley Bank (SVB) is concerned, they had a lot of issues with their balance sheet and the banking crisis did not really start with credit. Normally we think that the banking crisis means that the banks have made bad loans. But in this particular case, it was not that; it was that the interest rates went up very rapidly. In fact, SVB had not given loans or credit to that extent. They had invested too much in long dated securities which were not so liquid and that created the problem. Of course, that was backstopped by the regulators by saying that deposits not just up to $250,000 but the entire amount will be insured.

A couple of days ago, I had tweeted flippantly that you cannot have a financial crisis where Credit Suisse is not part of it. They have been involved in a whole lot of scandals over time from laundering money to breaking sanctions. But then they are a systemically important bank. The Swiss regulators have said that they will provide all the liquidity that is required. So, as of now, the issue has been contained. But, of course, in financial markets you do not know whether there are some cockroaches or skeletons hiding elsewhere. So let us wait and watch on that.

As far as India is concerned, there is a little direct impact because even something as big as the financial crisis of 2008-2009 had limited direct impact on India other than the fact that the world growth slowed and that was a different thing altogether but there was no contagion as such. That was a much more widespread problem. So in Indian markets directly, I do not see a big issue. Ultimately, once this plays out, the impact on the markets may well be positive because what the markets now are banking on is that because of all these issues, Fed will back off somewhat on rate hiking.

In fact, many houses were even predicting that they will stop raising altogether. I am not quite in that camp. But definitely, the highest or the terminal Fed rate might come down. As we all know, if interest rates do not go up as much, that is a positive for the market because then the cost of capital does not go up that much. So there are a lot of moving parts.

Whenever the dust settles down for Indian markets, which set of stocks or which themes will emerge as clear winners? Every time a shakeout happens, it leads to a new leadership.

I do not think there is going to be a big shakeout in the Indian market because the dislocation is not really there in the Indian market. The list of stocks that we like has not changed very dramatically. Of course, next month, we look at a quarterly rebalance and so maybe something new will emerge.

But as of now, we are pretty much sticking to some of the things which I have spoken about in the past. After being zero weight on banks, we actually went to market weight on banks about nine months ago and that has done well for us. So that we still continue.

Capital goods, we continue to be overweight on. But of course, that story has been playing out for us for a year and a half. So while it still looks like an outperforming sector, it no longer has that big a room to go up. A lot of it has been filled by stocks going up two-three times. So we have added, as I said last time, some auto components, some pharma. That pretty much remains the thing.

I do not have the consumption theme playing out well yet. While people are saying that everything is looking good for the Indian economy, actually there are two categories in the Indian economy; the creamy layer is doing well and that is why we hear all these waiting lists for luxury cars and high-end hotels being full.

On the other hand, we have 80-crore Indians needing free food. Unemployment is still extraordinarily high, especially for young people and more. If you add the disguised unemployment where people have been shown as moving back into agriculture, there are a lot of things like that either on durables or FMCG with one or two exceptions, those still do not look great, nor the rate sensitives with the rates going up.

One has to be a little careful, like real estate and so on. Refineries, oil do not look particularly great. There are pockets which look fine and ultimately, it is also a bottom-up thing. Sometimes we end up being a little overweight in textiles or chemicals but those are bottom-up picks rather than sectoral calls.

Ultimately we are trying to define the terminal value based on interest rates. Interest rates sooner than later have to come down. Either they are nearing their peak or they will peak out very soon. If that is the construct, what happens to the sectoral outperformance and underperformance if interest rates a year or six months from now either are lower or top out?

Well, they have not. I do not think in India, we have seen the end of the rate tightening. And we should not because inflation still remains very high, especially if one looks at core inflation.

A couple of months of that moderation in inflation we saw was almost all led by food and things like vegetables and has nothing to do with the interest rate policy. That way, the RBI has a hard problem because inflation has not come down and growth is a serious concern in India. Also, unlike the US where there are plentiful jobs, here the labour market is also an issue because unemployment, especially unemployment for the youth is high.

I have done a lot of DCF analysis. I have gone into a lot of nuances of DCF but if you really look at it, all cash flow projections for most companies, barring a company which is currently making a loss, they all assume that it will continue to make profits and that profit will increase every year. But actually, very few companies do. You would be surprised how few that number is.

If you look at 15 years, 20 years, a company which shows profit growth every year is like a needle in a haystack. So who knows what interest rates would be five years from now? That is a very difficult call to make. But on the other hand, I do not think the Fed also will stop hiking very quickly because inflation, again, has not been tamed there.

What we got was a moderation in a lot of the low-hanging fruit, like housing and so on. But again, if you look at core services, the inflation still appears high. And from these levels, historically, inflation does not come down in like three or six months. It takes much longer than that. The Fed cannot really afford to signal that they have taken their eyes off the ball and let inflation run. It is a hard time to be a central banker. I do not think we can really pitch that because interest rates will come down, that is a reason to buy stocks because we are not there in the cycle yet. But there are enough other reasons why the stock market might look attractive.

For Indian investors, what should be the projected return for equities for next three years?

I never give projected Nifty targets or returns. But I can tell you that the 40-year return has been 15%. We are still not above the trend line and so the risk of a crash is limited. Still, the risk would be in not being invested rather than in being invested. So sitting it out is more risky than being in the market because at some point, you will miss out on a big upmove rather than the comparative risk of a crash from here on. There might be some downside, but I do not see a big crash from today's levels.