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Smallcap rally nowhere close to danger mark: Devina Mehra

"Remain cautiously bullish on smallcaps as it is a risky asset class, I always say that investing is a loser's game. Your first perspective has to be to prevent the big losses which means not being overly concentrated in equity and not being overly concentrated in smallcaps and not be overly concentrated in terms of stocks or sectors," says **Devina Mehra, Chairperson & MD, First Global.**

How are things, hope all is well with you in Dubai?

Yes, it is and UAE is the number one performing market of the globe year to date. So, from the market point of view also, UAE is good.

India is the second-best performing market, and you have presence in both the markets now.

India is not, India's small cap is number two or three. It is a remarkable thing that every year the leadership in the globe has been changing, but India has been pretty steady. Last three four years, it was number 19 in one year, number 21 in another year. Right now, in NSE -0.62 % terms, it is 18 I think with 12 and odd percent on the Nifty. Of course, in rupee terms, it is 14 plus but even so, UAE is more than 50%, Vietnam is 37% and so on. So, it is still a long way off from being the best performing but in small cap yes.

At First Global, you believe in the power of cycles which is that everything that goes up has to mean revert and everything that is down has also got to revert to the mean. What is next for us, now that we have seen a formidable comeback in small cap stocks in India and good steady outperformance by US tech stocks?

If your question is if it is close to the danger level, we have the lake of returns theory which is that it is only when the markets reach a danger point can you say that there is danger of overflow and flooding. Yes, the Indian market has gone up a lot from the March lows last year but if one steps back a bit and sees over the longer term, a 10–15-year period, one can see that all equity markets or equity mutual funds for that matter for 10 years upto Dec 2019 had given less than fixed deposit returns. So, we are still talking of 5-6% return.

Yes, it is a big rally from the lows and one can say the returns have gone up but if you look at longer term perspective, we are still way below what the long-term average for the market is -- between 13% and 15%. It is the same in small caps. This year, they have been great performers but longer term, that was coming out of a big bear market. It is still nowhere close to the danger mark. Danger mark means a prolonged bear market. Yes, there can be corrections after a big run up; that often happens. But if you look at a very sustained bear market right now. the danger signs are not there for that.

What would be the danger signs, would it be valuations, interest rates or historical returns? What would compel you to say markets have peaked out or are about to peak out?

I never make Nifty projections. We are always focused on the stocks, the sectors, and the view on that and even there we say never be permanently bullish or bearish, change direction if signals change. So that caveat is always there that this is how it looks just now but you have to be careful and not the least because the macroeconomic indicators will take a long time to get completely sorted out. It would have an impact at least significantly on the large cap space.

You have to keep it in mind that the economy is still hurting, businesses are still hurting, people are still without work. All of that will definitely have an impact on the earning stream of a number of companies. The return part is one part of the story, but definitely there are enough things to keep an eye on. Interest rates per se both in India and let us say the US which sets the stage for many others, are low. Just to give you context, some of the emerging economies have already been raising interest rates. I do not think that is an imminent danger either in India or in the US because the central banks will try to keep the interest rates low.

This Fed statement that they would do tightening next year or year after is a meaningless thing. It has no meaning at all. The markets have the Fed in their grip that if you change the easy money policy, we are going to fall, and you will have to roll it back. Right now, as things stand, most Central Banks are in a bind, including even Europe. When we were growing up, the whole image and truth also was that the German central bank, Bundesbank, used to be extra-extra careful about inflation and they would do just about anything to prevent inflation. But today, there is inflation in Germany with negative interest rates for the bank depositors and still the easy money policy has not changed. So, something fundamentally has changed with the central banks of the world.

At First Global, you have always avoided single country, single currency, single asset risk. For those who are looking at just the India market standalone and want to ride the trend, they are fully and overexposed to just equities as an asset class. What is your piece of advice for those who want to ride the trend?

Everybody tries to jump in when you already have seen the performance so definitely at this point, I would not say a) be totally and overly exposed to equities. Do have other asset classes in your portfolio always; and b) when you have a bullish stand on small caps, be cautiously bullish because it is a risky asset class, and it is a risky asset class all through the world. I was looking at statistics even for the US market and in mutual funds. Longer term statistics showed that small cap mutual funds in the US had done better than overall mutual funds or large cap mutual funds. But once you adjusted for the schemes which had gone out of business -- either wound up or merged with other schemes -- the small cap space had not given better returns. So smallcaps will always remain a risky space. I always say that investing is a loser's game. Your first perspective has to be to prevent the big losses which means not being overly concentrated in equity and not being overly concentrated in smallcaps and not be overly concentrated in terms of stocks or sectors. My advice always is to diversify. Do not have all your eggs in one basket. That is always very tempting. When things are going well, people say that the Indian market is doing better. Should I have any global exposure at all? That works even for people who do look globally but all statistics show that when you are chasing, whatever is in the asset class or in geography, you are likely to have below normal returns.

How would you bifurcate the pie in terms of percentage allocation because itis no longer the traditional asset classes? It is not as clean and simple as real estate, gold, equities and fixed income. There are various other fixed income assets, crypto currencies. The pool of the asset classes itself is so large now?

That is true but the broad classes are not that very different. I tend to be biased towards liquidity and that is also a part of managing your risks. So, by nature we always concentrate on liquid markets and not just the exchange traded. In our funds, we have just about 10% in small caps which is below Rs 5,000 crore market cap. So liquidity for me is number one.

Coming to real estate, I think unless you are in that business, you should just have your own home and not much more than that. But one should have fixed income and also gold. Gold is an asset that suddenly wakes up. There was a whole phase from 1980 to 2003, when gold did nothing and then suddenly it had a big move. Indians anyway like to hold some gold.

A lot of people are jumping into crypto and they are taking way too much exposure than should be taken. We had done an analysis. It is an extremely volatile asset class. Adding a sliver at times improves your returns but sliver for us means 1-2- 3% maximum. It is not something that you should have 20% of your portfolio till the asset class itself stabilises and is no longer so volatile. But the exact percentages depend on your objectives and stage of life. In your pie, you must have a real pizza, you must have slices from everywhere.

There has been a plethora of unicorns emerging in India. Everyday a new billion-dollar IPO is being announced and investors are investing in these companies. When you say it will kill the golden goose, what exactly do you mean by that? How are you approaching these new age tech companies given that your second largest holdings are in tech?

Yes, of course. But that tech and this tech is quite different. It's true, one of our large exposures is to IT services, relatively speaking. We never have outsized exposures, but IT services is a whole different kettle of fish from these new age IPOs.

Just to give you a context, we had identified IT services last year when FMCGs were very much in fashion. I thought the IT services companies have very good returns, are fairly steady and predictable. All these things are also said for FMCG stocks and yet the valuations are way below. Plus, in an uncertain environment, their growth was a little more certain and they also gave currency protection. So that is a different kettle of fish.

Coming back to tech IPOs, as far as the market or the companies are concerned, it is great news that the Indian market is ready to look at companies which are not in the conventional mode of looking at the same parameters of EBITDA and ROE and all that and looking at loss-making companies. It is good that these companies are able to list in India rather than list anywhere else in Singapore or Nasdaq or so on.

But as far as the investors are concerned, I said in a tweet that maybe it is a negative to have too long a memory but remember the previous IPO frenzies. Right now, being a good time for companies, one after another they are firing the DRHPs or one step before that. That is scary and also what valuations do you give to these companies? There are two things; one is on the valuation, leave aside earnings, what's reasonable on a price to sales basis. The other is that most of these companies are in the mode of being loss-making. While going into an IPO, they try to reduce this loss which means that there is pressure on revenues and on market share which we have seen in both Zomato NSE -1.37 % and Paytm. On the other side, you are competing with players who are still not in the public market and so they have VC money to burn. So, it becomes a little bit of an unequal race and that is the other concern area. That does not hold for everybody.

Nykaa never went to a discount model or heavy discount model that is profitable. Also, let me tell you what is the sort of negative to going in with profits. Once you have earnings, you have a benchmark PE and that also is a different thing but overall, I think lot of investors are jumping in and investing in what they think is the IPO process, rather than the company thinking that whatever comes, if I get it, I will get a chance to make some money off it that becomes a risky enterprise.

I always say that do not be in the market with FOMO (fear of missing out). that if this goes away, there is always another bus coming along. It is great for the companies, great for the markets but some caution is advised for the investors. Also, if you look at global listings, Zomato had parallels like Grubhub or Uber Eats which is part of Uber or Doldash and those experiences internationally have not been great in the listed markets.