

The billion dollar question: What to do in the markets now?

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Since I used the B (bubble) word in a social media post I've been getting questions like '*Should I get out of the markets?*', '*Should I go into cash?*', '*Am I predicting a crash?*'

While many of the points below have been made in at least some of my interviews and articles, I thought it was time for a recap, answering all these questions I have been getting.

Here are the questions, and the answers.

1. Am I predicting a crash?

I see high risk in several areas of the market, including certain industry themes, small & microcaps, IPOs, other fund raises etc. If you want to know which themes, the thematic schemes being launched off late will give you the list.

BUT I am not negative on the mainstream stocks or indexes on say, a 2 year basis. That's because those indexes are not even close to their long term compounding trend line. For example when the Indian

markets gave zero returns from 1994 to 2003, it was followed by the market going up six times in the 5 years up to 2007.

This time while the returns were not zero, you had a whole decade of subnormal returns in 2011-20, where the markets give barely more than fixed deposit returns. This created the room for the run up we have seen over the last four years.

The risk of big and sustained crashes is when the market goes way above the trend line. We are nowhere close to that level yet.

2. Can there be interim volatility? How to play that?

Yes, there can be interim volatility as equity markets are never predictable in the short run. For instance, I have been expecting possible corrections & volatility since March, but while there was volatility in March and June, markets recovered soon and are up significantly from February levels.

Had we moved our PMS portfolios to cash, we would've lost out on this move. While there is a risk to being invested in the markets there is also a risk to not being invested and missing out on an upmove. However what we did do was buy hedges via Nifty puts which was a form of insurance.

In case the market tanked significantly, our investors' losses would have been limited. As it turned out, the insurance was not used but we do not regret buying it.

3. One line advice for investors?

If you're invested in the areas and stocks which have done extraordinarily well over the last few months/quarters and where things are looking frothy, please book profits and move to a steadier portfolio. What is a steadier portfolio? Contact us for that.

4. But I am willing to take high risk, aren't you being too conservative?

Please repeat after me, "*High risk does not guarantee high returns*". All it guarantees is the likelihood of high losses.

The best performing mutual funds are those that outperform during market downturns. Schemes that do very well during bull runs are often among the very bottom on a longer term basis.

Playing conservatively is the **ONLY PREDICTABLE** way to make money in the markets. You win if and only if you don't lose (big money).

5. But the big returns come only in small caps and micro caps. Large cap investing is boring and never gives you great Returns.

Here is the data, as against the stories, of how many small caps become big:

While 45 companies went up a category (from mid/small to large or small to midcap), 78 went down a category or more. 5 large caps became small caps, 20 became mid caps & 53 mid caps became small caps.

This data is from the period from 2017 to 2024 which had a boom, a bust and then a boom in this smallcap segment. So still not two complete cycles. When the dust settles for this cycle, the numbers will look even worse.

A **MAJORITY** of companies ever listed on the Indian stock exchanges **DO NOT EVEN TRADE** anymore.

6. Further on the history of Smallcaps

The Smallcap index itself fell nearly 80% in 2008-9, then again it fell nearly two-thirds in 2018/19. When something falls 2/3rds, it can triple and you will make zero Returns.

The 2 or 3 years' CAGRs (Compound Annual Growth Rates) of various small and micro cap managers being highlighted are to be seen in this context.

While in theory the 2008 high of the Smallcap index was breached in 2016, it was not the same index or stocks.

Many small caps that fall, fade into oblivion. They NEVER come back.

The index churns 18-20% every year. In 5 years it's a new index altogether.

7. I want to remain invested in Smallcaps, how do I hedge the risk?

While putting stop losses limits losses in large caps, they don't really work in small caps - there is often no way to sell them when everyone crowds the exits. Stocks are often limit down everyday.

Neither can you hedge because the only liquid put available is on the Nifty. The small caps do not move along with the Nifty.

8. Fine. Agree that there is froth in Smallcaps, but I am choosing my stocks wisely so that I am not caught in this trap when the bubble bursts.

Near impossible to do this. So don't fool yourself.

How many smallcaps did not fall in 2008/9? A grand total of 1%!

In 2018/19, the number was 8%

Do not fool yourself that your portfolio would consist of only these.

That about sums up the answers to the FAQs (Frequently Asked Questions) I get on the markets. I have answered as clearly and unambiguously as possible.

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