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Be picky about stocks and put risk control measures in place: Devina Mehra

Synopsis
"The day the war broke out on February 24, the markets fell 5% but our portfolios fell only 1.6%. That is where risk control kicks in. Any time there is panic, that is where you need to be also hedged. So whatever you are playing a) you have to be careful with sectors and b) have your risk control in place."

"This is a pick-and-choose market. It is not a market where you can be gung ho and I do not think the mood is gung ho just now. In terms of what investors should do, my advice would be that if you are looking to invest in something, you can start investing in three or four monthly tranches," says Devina Mehra, Chairperson & MD, First Global.

What is your strategy for this market? There is so much fear at the moment. One can see a sea of red across screens except when it comes to the commodity player?

Yes you are right. We started out 2022 thinking it will be a very sector specific, company specific kind of story and of course one did not know what Putin was thinking at that time but it is playing out that way.

Let me just step back a little as to what is the general impact of any kind of geopolitical crisis like this. This is an exercise we did going back 40 years and looked at all instances where something like this happened where there was some kind of geopolitical crisis whether it was the two Gulf wars or various incidents in Afghanistan or going back further to US bombing Libya or 9/11 etc.

The thing we noticed was that a year later, one could not that see that incident on the charts and I am not just talking the average or the median but in every single instance. Of course, if we go into World War III, then we will have more things to worry about than only the markets but other than that kind of scenario, there isn't a broad-based lasting impact directly on security markets that are far away from the action.

Where it does show up a year later often is crude and gold. Gold is the safe haven. And coincidentally or otherwise, a lot of these incidents have been in the oil or energy intensive areas of the world. So that is the backdrop. But what it does impact is whatever is getting directly affected.

In the case of Russia and Ukraine, there have been things which have been very much directly impacted and so oil and gas, agri commodities and potash which goes into fertilisers. There have been metals from aluminium to palladium where Russia or Ukraine are significant players. All those things will have an impact on whoever is either the user or the seller. That is why in India also we are seeing it playing out very much.

Companies which will be using these as inputs – either downstream chemicals from crude or commodities – will see margin pressure. Companies which are selling those commodities, there the benchmark prices will go up and the rupee depreciation is only helping further. If the dollar prices go up plus if the rupee depreciates, then the seller of that commodity in India benefits.

Coming to rupee depreciation, right from November-December last year I have been saying that in 2022, to my mind, the big risk in India is the rupee depreciation risk. It is a macro risk which is of course flowing out of the inflation risk and the fact that we maintained a loose fiscal policy in face of inflation and in face of the fact that many emerging markets have started rate tightening much earlier. Plus Rupee had been in a band for a very long time which it has now broken out of. All this has accelerated the rupee depreciation, but that was always a clear risk going into this year.

The other segment besides commodities is the companies which are either export oriented or import substitutes. That is why we continue to be overweight on IT services, which we have liked for more than a year and a half. Of course, January and February were not particularly good for that sector but we continue to like that. Then there are others where you have to be a little more picky – chemicals, textiles, commodities including metals.

So this is a pick-and-choose market. It is not a market where you can be gung ho and I do not think the mood is gung ho just now. In terms of what investors should do, my advice would be that if you are looking to invest in something, you can start investing in three or four monthly tranches. That would be my advice unless as I said the situation escalates into something much much bigger. In global markets, the impact will be more on countries which are directly impacted which is largely Europe, besides the commodity play, from banking to energy costs. Europe will be very much directly impacted and it comes at a time when inflation and energy cost were anyway off the charts. Energy costs were off the charts in Europe much before even this crisis deepened.

The new calls for the Nifty, the way the stocks are moving towards 52-week lows, the way the FIIs are selling it, there is panic setting in. Is this a time to hold on tight or is this a time to take cash off the table or is it a bit late for that as well?

I think it might be even time to start getting back in if you were holding on to the cash. Of course, put risk control measures in place because as I said, certain sectors and companies are going to be hit badly and one has to have stop loss levels in place. I always say do not try to second guess the market. If your stop loss levels are hit, just get out and sit on the sidelines for that particular sector or stock.

See what the market is telling you and at times, you might even get back at a little higher price and that is also okay. We have been following that strategy and the other strategy which we follow in our portfolios is that when things are this uncertain, we take insurance through put options. Right now, our equity exposures will be mostly hedged because that is important.

Anything I talk about is only what I think is the highest probability event sitting today. But there are many directions in which things can go and that's why risk control is important. The day the war broke out on February 24, the markets fell 5% but our portfolios fell only 1.6%. That is where risk control kicks in. Any time there is panic, that is where you need to be also hedged. So whatever you are playing a) you have to be careful with sectors and b) have your risk control in place. If the stock that you are holding has fallen 40% or something or 50% or anything like that, do not keep holding it all the way down because many sectors and companies will be impacted for a long time and not only smallcaps and midcaps but even largecaps.

There are whole sectors which have been underperforming for ages including some which are considered defensive sectors. FMCG for instance underperformed the up market in 2020 and 2021 and it has underperformed the down market also.

I think to add to that would also be this kind of spike that we are seeing across commodities baskets – be it crude or gri commodities like wheat, soya bean and so on. That will put further pressure on FMCG companies. Parle Products said they have no choice but to pass on escalated costs to consumers when the inventory runs out which eventually will impact their volumes.

Yes, it has already happened. Third quarter results show margin compression across the board in FMCG because both agri commodities and crude derived commodities were already going up and demand is not buoyant enough to pass on the price increases. Then towards the end of the quarter in December, there were price hikes.

The last data I saw from the market was that with the price hikes the volumes went down in several FMCG categories because a large chunk of the citizens are also still hurting and have no ability to absorb price increases. It becomes a tradeoff between demand destruction and margin compression. Now of course with the prices of the commodities going up even further, they may not even have a choice but to pass on at least some of the price increases.