ET THE ECONOMIC TIMES
Jun 20, 2022, 03:38 PM IST

Devina Mehra on why there is greater risk in staying out of the market

Synopsis
"We often think of the risk of being in the market. There is also a risk of being out of the market. If you remain in Indian equity markets in the long term you will compound at an average of 15% plus. In 40 years of Sensex, your Rs 100 has compounded to Rs 44,000. If you miss out on 10 good days, suddenly your returns on that Rs 44,000 goes down to Rs 15,000. If you miss out on 30 days in 40 years, you are down to less than Rs 4,000, 90% of the gains are gone!"

"Most of the up days come in the middle of a crisis or after a crash. They are rarely part of a bull run and in India, the only time we have found them as being part of a bull run was in Harshad Mehta's scam time which was a rigged market," says **Devina Mehra**, Chairperson & MD, **First Global.**

It is getting bad. Will it get worse before it gets better?

Let me just step back a bit as we are right in the midst of movements like these and there is a lot of noise and one is trying to predict short term movements.

Just look at what has happened year to date globally and in India. Equity markets around the world have done very poorly or so there is only a handful of countries which are in the green year to date. These are primarily the commodity plays and so markets like Saudi Arabia, UAE, a handful of South American countries like Columbia and Brazil. Only about five-seven countries are positive.

Same time last year, everybody thought Nasdaq was a no-brainer and one could not go wrong on Nasdaq. Which is why we had all these Nasdaq ETFs and funds coming in, people opening Robinhood accounts or accounts with other brokers.

Nasdaq this year has been an absolute bottom performer. For the year to date, out of 40 indices, it is number 38 or something. It looks like suddenly the risks are very high there. That the risks are very high in India, risks are very high everywhere else.

But if you step back and have this thing in your mind that if you remain in Indian equity markets in the long term you will compound at an average of 15% plus because that has been the long term average.

In 40 years of Sensex, your Rs 100 has compounded to Rs 44,000. Suppose you missed out on 10 good days, which is one day in four years and suddenly your returns of that Rs 44,000 goes down to Rs 15,000. So two-thirds of the return is gone just for missing out on 10 days. If you miss out on 30 days which is less than one day a year, and you are down to less than Rs 4,000, 90% of the gains are gone!

We often think of the risk of being in the market. There is also a risk of being out of the market. The other thing which we found was that for S&P, the numbers are even starker. In 100 years, if you miss out on 100 good days, then instead of compounding from $100 to $21,000 you are

actually down to $40!

The other thing which we have found was that if you miss out on these up days, obviously you lose but the other incredible part was that most of these up days come in the middle of a crisis or after a crash. They are rarely part of a bull run and in India, the only time we have found them as being part of a bull run was in Harshad Mehta's scam time which was a rigged market.

Otherwise, you never get those 8% or 10% up days in a bull run. It always comes after a crash or in the middle of a crisis. So, the risk is more in sitting out rather than being in the market.

So, if you step back and not talk about one day, one week or even one month but are looking at equity as a long-term investment in your asset allocation pie, this is the time to be back in.

This has been the channel view that money is made or returns are generated in the equity market not by buying or selling but by spending time in the market. So we are perfectly aligning with the big picture risk. The question is that while it is important to stay invested in this market in the short term, should one also be mentally prepared that the fall is not over yet?

That could certainly happen. None of these big up days are predictable. One cannot say whether it is going to come next week or next month. So invest not just in one go, maybe over two-three months but stay invested. In equity markets, the downside risk is there which is why you should have a long term perspective, at least three years plus.

If you have a six-month perspective, you do not know whether the market will be up or down. That is always the case. Exactly I was telling someone, a friend of mine who just sold some ancestral property and he was saying maybe in six months or 12 months I will buy another property. So where should I park the money? Should I give it to you to manage? I said you put it in a bank FD because that is the only place where you know for sure that after six months you will get at least principal plus back.

So it depends on what your time frame is, what your objective is and as I said always look at it on an asset allocation basis. Not all your money should be in one asset or the other and it should be spread out geographically also and outside India as well. That has always been my advice.

For the equity lovers, what is the advice? What are the pockets which are looking interesting? Do you buy more of the same that you did in the previous peak or do you think newer leaders will emerge after the recent fall?

So again, take a long-term perspective. It is not always the same stocks or sectors that continue to do well. The Sensex has given this 15% compounding but if you look at the original Sensex and you had remained invested there, you would not have made that because that has all these Hindustan Motors and Scindia Steamships and the Paper and the textile companies and so on. Now we have a completely different set of companies. Some of which like IT which did not even exist then.

Again, if you look at the shorter term, even in 2021, it was like a rising tide lifting everything – some more and some less but everything went up. Now that is not the market so one has to be a little more selective. Currently, we look at our portfolios every three months on a zero base basis. Though usually 85-90% of the stocks remain as they were in the previous quarter, we still look at that as if we were investing afresh.

Right now, our overweight sectors would be capital goods, textiles, parts of chemicals and very selectively autos. We also had energy but that is not looking that great anymore. In telecom and IT also we still remain somewhat overweight even though year to date, that has not been a

great performer but given that my bet has been that this year a rupee depreciation will be significant - we have now started to see that. I have been saying it for over six months now and so the export oriented sectors continue to be in our focus list.

The other thing is what seems to have shaken up the world is interest rates and inflation. A) Have the markets priced in the worst and B) how critical are interest rates and inflation in the current scheme of things?

Yes suddenly they have become very centrestage. In India or other emerging markets, periodically inflation rears its head; but for the world, inflation has come back after decades. Literally for the first time, if not in the living memory of people, certainly in the career memory of people who are in the markets. In the US, it is at a 40-year high, in Germany at a 48-year high and Spain also at a 40-year high.

For most countries in the world, especially in the western world, inflation is at a 20-30-year high. Even in India, the Wholesale Price index inflation for FY21-22 was over 13% which is a three decade high. It is off the charts and therefore something which people had not factored in.

Interest rates matter to the markets. If I put it very simply, any security that you buy whether it is a bond or a share is valued as a discounted value of future cash flows. So as interest rates go up, the discount rate goes up and therefore the value of those cash flows, especially cash flows which are out further into the future, reduces. Which is why you say growth does not do well and which is why all these new age tech companies where the cash flows were out in the future, have seen the biggest hit because as interest rates go up, their value reduces most dramatically compared to companies which have cash flows and profits today.

So that will remain an overhang but it is a question of how much equity markets have already priced in. Nasdaq is about the worst index in the world today. The central banks will continue to raise interest rates no doubt. The Fed's remarks are quite clear that they have to bring inflation under control and historically, inflation in the US has almost never come under control without real rates being positive which means interest rates being higher than the inflation rate.

Currently inflation is 8.6% while the interest rate in the US after the latest hike is 1.75%. I am not saying that it will go up to 10%, but there is still a lot of room for interest rates to go up. In my opinion, India has been somewhat late in raising interest rates. Now, of course RBI has done two rounds but still it will take more to align interest rates to where they should be. So, definitely that is going to be an overhang on markets.

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