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While picking smallcaps, always go stock by stock: Devina Mehra

Synopsis
You have to be very picky when looking at smallcaps.

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*In **smallcaps**, you have to drill down and see because the ther can be issues of governance and a lot of other things. So be careful, says the Director & Chief Investment Strategist, **First Global.***

Shankar is making a very important point that the bull market is back and the bull market is here to stay. Do you think one should still take risk barring a little bit of volatility and can one expect double digit returns in the next three years?
Well for one I do not think anyone has got a double digit return in over three years. In fact, the interesting thing in India going back has been that if you go back five years, equity fund returns on the average have not even beaten savings account returns. If you go back 10 years, they have not beaten fixed deposit returns.

We have been a long way away from compounding in double digits. We cannot and we are not making a case for the market as a whole. This in particular is a market where you have to pick and choose and that is of course looking at only at the stock market level but the really big decision as an investor that people should look at is looking at the asset allocation so that you cannot look at equities and that too Indian equities as the single or only asset class you will be in.

If people have to take away one lesson from this, the most important lesson is equity is glamorous, it is interesting, it is fun to talk about. You go to a party and say that I told you at the last party about this stock and it is up 50% or it is up 500%. But you know on the average all the time if you are in equities does not mean that you are going to make great returns and especially on a risk adjusted basis.

2019 was a year in which you had gold going up 25% and government securities going up 15% while equities went up only some 7% odd.

This year again, gold is up another 30%, equity **markets** are still down about 8-9% for the year. Even within that, you see you or your fund manager or as you know a financial advisor had advised you to go out of equities last year and that is the thing to think about. That is India only but really if you look at asset allocation and this is again coming back to what we talked about in the beginning, that some of the learnings sink in a little late in life.

This is something that is there on page one of every investment book that almost all your returns will come from asset allocation and not from the security selection. Almost all means 85% to 90% whereas everybody tries to find that one multi-bagger or five multi-baggers instead of focussing on the top down level.

You have to have everything in your portfolio not just Indian equities but government and other debt. You have to consider at least at every point you will not have everything but all that has to be in your consideration set and then gold and other commodities. Most importantly, you have to look at global markets again -- equity, debt, REITS -- all of that.

The flip side to that is that it is not easy to do that because it is not good enough. Global means that you go out of India and you buy one NASDAQ etc but you are still not really out of what we call stars -- a single country, single currency, single asset risk. If you add one more country that is marginally better than having only one country but only marginally and if you look at longer term, you will see that every year really the leadership in which stock market does best in the world varies.

One year it might be Denmark. Last year, for example it was Russia which was up almost 50%, 48%, Brazil was very high and this year for the first half both of these markets were down near the bottom till at one point, when the commodity cycle turned and they started to do better. It is a very dynamic market and it actually has taken us 20 plus years to get a grip of global markets because we started doing it end of the 90s post the Asian crisis.

We know exactly how complex it is and companies there also tend to be much more complex than companies in India.

It is still fairly simple like the same old steel and autos and IT services all of which are very model-able but there it is a different matter but having said that as I said that if you really want to have a proper risk return balance in your portfolio you have to look at asset allocation and you have to look at global diversification.

Considering that the tide is shifting, there is a Covid crisis, what happens to the smallcap space in India because some of them may not survive, some of them may not revive and very few actually will now flourish?
Smallcaps are usually in that framework where you cannot buy everything because smallcaps are much tougher than even largecaps in general because that is not a homogeneous kind of a basket. As you said, some of them may not survive, some of them might flourish. So you have to be very picky when looking at smallcaps.

You had the smallcap rally which was making up for this large long period of underperformance. You have to pick and choose within that whether it is pharma, chemicals or maybe some other commodities; maybe there is a shift in certain commodities where either import from China would be affected or exports from China to other countries will be impacted and where certain companies might have an advantage.

But in case of smallcaps, it has to be a stock by stock approach even more than industry by industry; large caps you can still play sector wise, small caps you have to drill down and see because there can be possible issues on governance and a lot of other things can also be there. So be careful.
