# TOP 5 REASONS WHICH LED TO EUPHORIC RISE IN MARKETS BUT NOW IT IS TIME TO TREAD CAUTIOUSLY: AJAY BODKE

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Triggers for the current rally in indian equities and why one needs to tread cautiously in this euphoric market

There are multiple triggers underpinning the current rally in the indian equity markets. But, the foremost is the torrent of liquidity inundating equity markets globally, india being no exception.

## GLOBAL LIQUIDITY RALLY

Firstly, global liquidity rally:

It is not just indian equity market but many other markets that are scaling lifetime highs. Between january and july 2017 foreign institutional investors (fiis) & domestic mutual funds have been on a buying spree and bought indian equities amounting to staggering rs 96,358 crores or roughly us $ 15 billion. (Fii purchases of rs 56,916 crore and mfs of rs 39,442 crore).

This surge of liquidity gushing in is forcing the hands of fund managers to deploy the inflows into equities (as per the mandate that most mutual funds & insurance companies have they cannot sit on cash holdings beyond a small percentage and cannot take 'cash calls' i.E. They need to deploy funds as they come in).

On the other hand, whenever there is a withdrawal of liquidity or redemptions from these funds, fund managers are forced to sell their holdings leading to intense pressure on the market.

How long this gush of liquidity lasts is anyone's guess but we need to start exercising caution because the us federal reserve (fed) has already started tightening interest rates after loosening them for 8 long years post-lehman crisis.

With economic growth almost stabilizing in the rest of the developed world, other central banks like the ecb, boe, boj etc. Are likely to follow suit sooner rather than later.

This would lead to a spike in risk aversion and ebbing of flows from developed markets to emerging markets (em). As india is one of the fastest growing em, we have seen large allocations of equity to india in the em basket.

## MINIMAL IMPACT OF DEMONETISATION

The crippling impact of demonetisation as feared by critics didn't materialize with the economy showing spectacular resilience and bouncing back within a quarter.

## REFORM PUSH

The government keeps on chugging along the path of structural reforms that would underpin sustainable growth in the medium term.

Thus passage of GST is expected to lead to massive cost efficiencies in terms of savings in logistics costs, reworking manufacturing & distribution architecture, less harassment at octroi posts and smoother functioning leading to an eventual boost in economic output.

Similarly, the implementation of Insolvency and Bankruptcy law is expected to start the much-awaited cleaning-up of the chronic non-performing loans dogging the banking sector.

Unless these dud loans are recognized and provided for in full the banking system (especially those lenders whose major exposure is towards corporate lending) will remain hobbled.

In the case of public sector banks, the majority owner i.e. the government will have to infuse massive capital to make them solvent again so that they can re-start the process of lending.

## GOOD MONSOONS

The rain gods have been smiling over the country this season so far and that has rekindled hopes of a surge in domestic consumption leading to buoyancy in shares of companies in sectors such as retail-focused banks, NBFCs, autos and auto ancillaries, consumer goods, house hold consumption etc.

Tepid demand, pricing pressure, the hostile regulatory environment is keeping IT stocks under pressure.

Intense scrutiny by the regulatory agencies like US FDA of manufacturing plants in India that supply generic drugs have led to delays in the launch of new high margin generics in the US by Indian generic manufacturers.

Consolidation of bulk buyers in the US has forced Indian drug manufacturers to lower prices of existing generics. This along with an increase in competitive intensity has lead to downward pressure on pharma shares.

Private sector capital expenditure is refusing to take off as most of the core sector industries like steel, aluminium, manufacturing, cement etc. are operating at around 60 to 70% capacity utilization.

The investment side of the economy will continue to flounder unless aggregate demand picks up in the economy either through lowering of interest rates by the RBI or pump priming by the government or take-off in consumption demand after monsoons & during the festival season.

## LASTLY, VALUATIONS

One must always remember that in the short term it is liquidity that determines the market direction but in the long term, it is only the earnings or profits that matter.

Earnings of NIFTY that represents India's largest 50 companies and is a broad representation of Corporate India have remained more or less flat over the last 4 years! (NIFTY EPS was Rs 405 in FY 13-14 and has crawled up to Rs 426 by FY 16-17-- a mere 1.7 percent CAGR).

Markets have been re-rated with NIFTY trading at 23.7 times FY 16-17 earnings (trailing multiple) with market consensus still baking in a robust earnings growth estimate of around 20-25 percent in FY 17-18 which looks a tad optimistic and tough to achieve.

Likelihood of a downgrade in consensual earnings growth (not very dissimilar to the last few years) looks quite likely.

One needs to tread cautiously in such a euphoric market. One cannot say with precision as to what will trigger a correction.

But, the rise in the market is getting narrower and narrower with only a few index heavyweights carrying the load with an extremely rich valuation of stocks in the most favoured sectors leaving no room for even the slightest under-delivery.

Any continued disappointment in performance is likely to meet with swift, sharp and savage erosion in prices.

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