Volatility creates opportunity in Indian equities

By Nimesh Shah

March 23, 2015

Periodic volatility is healthy and good for the markets; it keeps the herd mentality in control

Global currency shifts, a slow economic recovery and richer valuations have led to volatility in the Indian markets intermittently. Use these to build your corpus.

For some time now, the Indian equity market has been on a batting wicket, scoring ever higher. These periods of batting excellence, though, have been scarred by dry spells. In other words, the market often witnessed volatility. There were many reasons behind this.

Recently, the Reserve Bank of India's neutral credit policy, with a hawkish tone, saw a immediate reaction in the stock market. As further rate cuts were expected, markets were disappointed. Stock market reactions to events such as this are turning commonplace.

Currency movements and a stronger dollar are other factors that are driving greater volatility globally. Cross-currency movements—one currency getting stronger and another weaker—against the Indian rupee is also playing occasional havoc in the markets.

Despite the fact that the Indian rupee is one of the better behaved currencies, helping toward robust fund flows, a strong dollar and possible interest rate tightening in the West in 2015 have also been responsible for the intermittent market volatility.

Even the recent earnings season for Indian companies wasn't as optimistic as expected. This quarter, the financial year 2015's estimated earnings growth ended on a low note with consensus earnings growth estimates for BSE 100 companies dropping to 10.1%, down 600 basis points (bps) since the end of the last earnings season (as on 17 November 2014). One basis point is one-hundredth of a percentage point.

Even though earnings have been showing signs of bottoming out, equity prices are a shade higher. Fortunately, valuations haven't yet gone overboard; though they are not necessarily inexpensive. Nevertheless, because of the richer valuations, stocks are going through corrections

The good in volatility

The thing to remember is that periodic volatility is healthy and good for the markets; it keeps the herd mentality in control. It provides opportunities to investors who are on the look out for good entry points, which arise only during volatile times. That's the beauty of the market. Investors can accumulate high quality assets on the decline as prospects for equity markets are rosy for the period 2016-2018.

Over the next few years, the Indian economy is expected to bounce back from its slow-moving growth rates. While the new gross domestic product (GDP) figures look good (showing growth rates of 7.4%), the investment cycle is yet to pick up to the desired pace. But we are optimistic that the growth cycle will begin to increase sooner rather than later.

In a few years, the Indian economy is poised to record some of the highest growth rates in the world. In the other big economy (China), growth rates are plateauing. The euro zone economy is struggling, while the rest of the world is much below peak level growth rates. The only country that is turning out decent growth numbers is the US—and that benefits India immensely.

Deflation is clear in the global economy, especially in commodity prices such as oil and metals. With oil at $60-65 a barrel, Indian economy saves about $45 billion a year

And if we get the supply chain right, interest rates could go down much more significantly. This would be very good for the capital expenditure cycle and the return on equity in the long run.

Most Indian investors are still under-invested in equity. So, high volatility for any reason, whether global currency or supply of paper through equity issuances such as divestment or institutional placements, it's an opportunity to pick up Indian equities for the long term. Corrections aren't something that one should worry about if you are an Indian equity investor.

In a unique position

Purely from an investing point of view, the recent correction in technology stocks gave one the opportunity to invest in the sector with a three-year role. Among the cyclical sectors, the correction in commodities, too, provides an opportunity to invest with a three-year horizon.

We all know that the stock market is not a one-way street that goes up all the time. But, unfortunately, most of us don't act on it. Those who do are likely to reap significant rewards in the longer run. Investors who feel they have missed the bus can, and should, look forward to market corrections.

It will, however, be a bumpy ride. That's because though we have an economy that's on the cusp of growth, concerns persist about large pockets of global economic trouble. But again, given that the growth dynamics in India have changed in the recent past with oil at $65 and further economic reforms on the anvil, Indian equities will deliver better returns than other investments. Therefore, whenever the market runs into rough weather, ensure that you use the opportunity to stuff some sound assets in your kitty.

This article has also been published in Mint on 10th March 2015