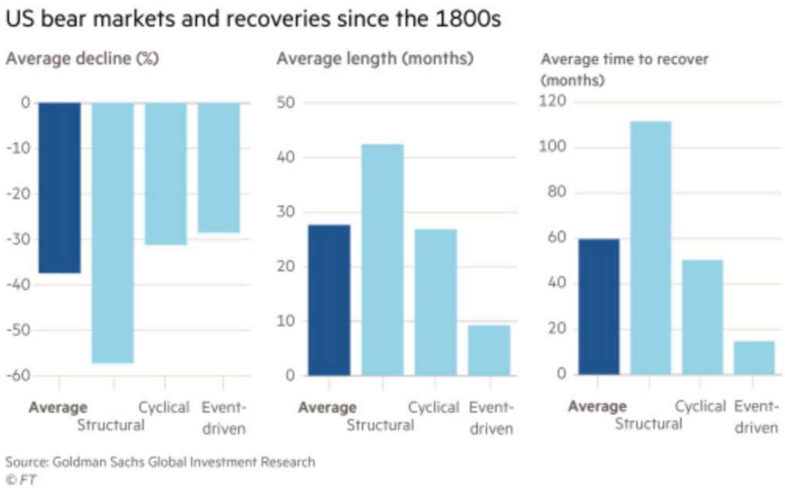
Capital League

Equity Market Overview

- Global markets have fallen by 30% to 40% in last few weeks. The pace of fall is unprecedented. The intensity of fall has been magnified due to the fact that globally a large part of trading is now algorithmic/machine based. Also the trend of institutional investors investing through ETFs leads to quick lumpsum buying or lumpsum selling of index based shares.
- Due to lockdowns and isolation- Coronavirus has led to huge economic shock to major economies like US, China, & Europe. There is both a demand and supply shock.
- Central banks around the world are taking steps to ensure smooth movement of financial markets. US Fed has brought interest rates to zero and announced billions of dollars of bond buying to support the economy. The Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve, and the Swiss National Bank have announced a coordinated action to enhance USD liquidity via the swap line arrangements.
- Measures announced so far by RBI include:
  - $4 billion in forex swaps to provide dollar liquidity.
  - Rs 40,000 crore in government bond purchases in March
  - Rs 1 lakh crore in overnight liquidity to banks via the repo window
  - Rs 1 lakh crore in long term repo operations where banks can raise funds for 1-3 years at the repo rate
- 

  An analysis of 27 bear markets since the 1800s suggest the effects of an event driven bear market could be relatively short lived.

- Indian equity markets are falling in correlation with US markets, like they did during the 2008 financial crisis. In the short term as large institutional investors try to pull out from various asset classes we see that equity markets of all large economies (developed or emerging) are falling together , gold, oil, bonds, commodities etc all being sold. Many large investors are leveraged and funds are being taken out from any asset which be quickly liquidated to meet margin calls or pay off debt.

- Indian equity markets and the economy are very different today compared to 2008. In 2008 the Indian markets had very high ‘Market cap to GDP’ ratio at nearly 150 and high ‘corporate profits to GDP’ ratio and one year forward P/E at 25. In 2020, pre Coronavirus correction, market cap to GDP ratio was 70 and P/E was about 15. Thus Indian markets have entered this global sell-off situation at fair valuations and the spate of selling has quickly led to ‘oversold’ situation with market cap to GDP coming down to a low of sub 50 levels.
- On the other hand, US markets to which we are correlated in the short term, have entered 2020 with a corporate profit to GDP ratio at an all-time high of around 400%. Hence the initial recovery/ rally in Indian markets are likely to be much quicker than in US, once the situation is under control.
- India mainly needs two things from the global environment – Oil and Capital. Oil is at historical low and US interest rates are at zero. Both these factors are a huge positive for India.
- Growth in consumption is likely to suffer for atleast about 2 quarters. This will lead to postponement of demand revival. Banking Index has fallen by more than 50% on expectation of fresh wave of NPAs coming out of this event. However, the fall is overdone by a wide margin and recovery can be quick once buyers come back to the market or the relentless selling stops. Strong banks should do well even in these times given recognition of NPAs and progress with IBC
- IT, Pharma, Capital Spending, Refineries are likely to be relatively less impacted by Corona slowdown.
- Most impacted industries will be services (Tourism and ancillary industries like Airlines, Hotels, Transport, etc), media and consumer discretionary and staples-due to potential income impact in hands of individual, lower income groups.
- Meanwhile Rural India is doing well. They have had a good Rabi crop resulting in rural demand picking up. This can provide a backbone to the economy.
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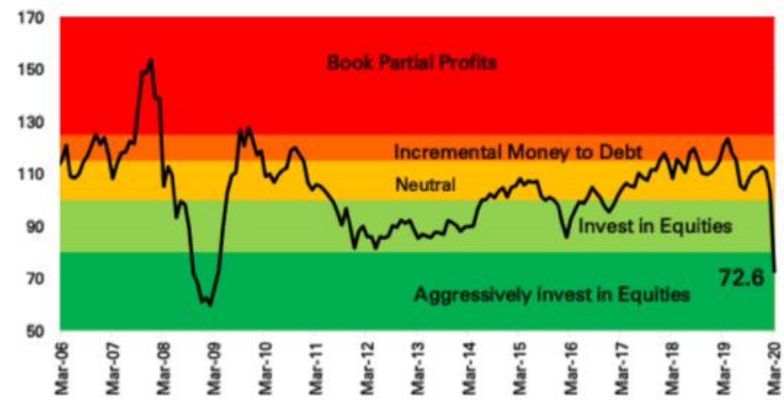

Equity Valuation index is calculated by assigning equal weights to Price-to-Earnings (PE), Price-to-Book (PB), G-Sec*PE and Market Cap to GDP ratio. G-Sec – Government Securities. GDP – Gross Domestic Product; Data as of Mar 23, 2020

Source : ICICI Prudential

- The above graph shows equity valuations by considering weighted average of Price to Earnings, Price to Book Value, Market cap to GDP etc. The graph is showing equities are available at very attractive valuations. Please see on this graph- last time the equities came into this zone (very low valuations) was during the time of 2008 global financial crisis.

Recommendation

- What should investors do? Selling at this point would be the worst decision because it would mean realising notional losses. It is impossible to ‘time’ re-entry into the markets when recovery takes place. The initial recovery in share prices is very fast, like the downward move. Markets are forward looking. The recovery in share prices is likely to start when the ground reality is still pretty grim.
- One should not change asset allocations unless there is dire need for funds. It is only at times of economic crisis, market panic that one can get equities at such low valuations. One should definitely ‘HOLD’ and if one has a 2-3 years’ time horizon and capacity to withstand further volatility, then add to equities gradually.