# Chaos and Opportunity

Cygnus atratus

atom privé
WEALTH MANAGEMENT

## BLACK SWAN

The Black Swan theory (developed by Nassim Nicholas Taleb) describes an event that comes as a surprise, has a major effect, and is often incorrectly rationalized after the event has occurred with the benefit of hindsight. The term is based on an ancient saying which presumed that black swans did not exist only to be reinterpreted later that they did exist after all. They are therefore characterized by their rarity, the harsh impact, and worse, the widespread insistence that they were expected in retrospection.

All of us have been inundated with information on Covid-19. It is truly a black swan event – something that none of us had predicted but is now seen as having a major effect on our communities, societies, economies and markets.

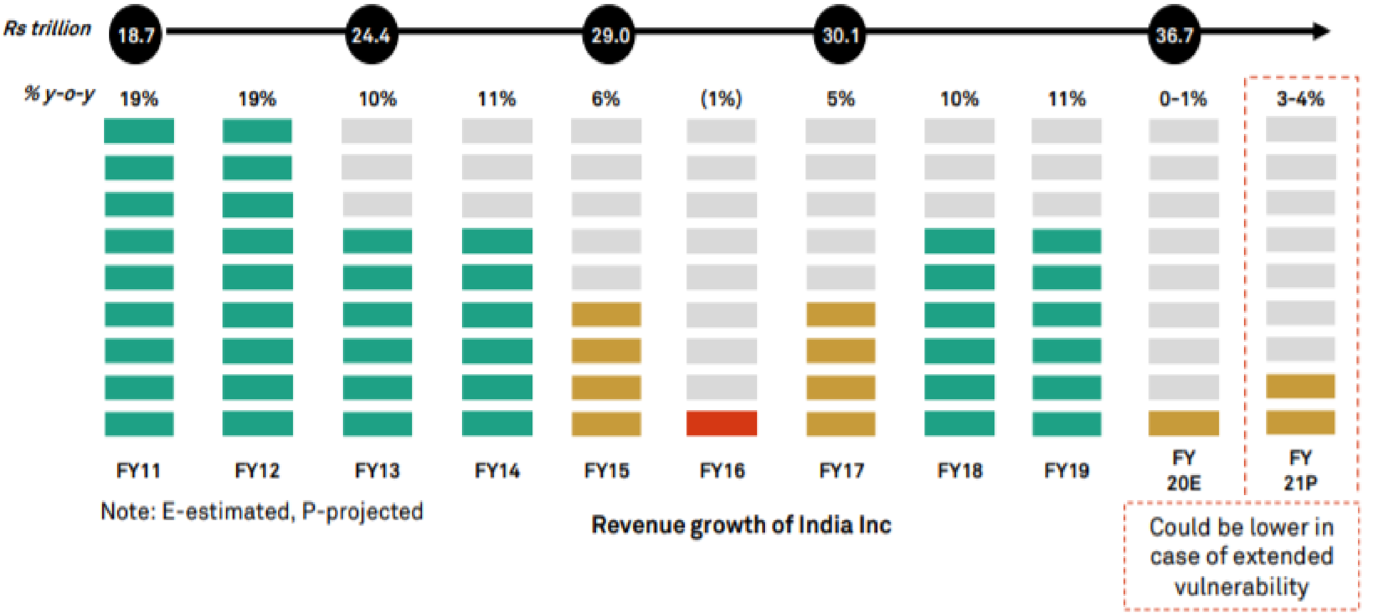
In less than 2 months, the virus has disrupted lives across the world, resulted in unfortunate deaths of thousands – and probably pushed global economy into recession.

With a drop in the business activity, supply chain disruptions, fall of demand, companies and economies will be forced to innovate and adapt. We will see a new cycle of 'survival of fittest' at play – right in front of our eyes.

## ECONOMY

CRISIL expects the Indian economy to grow at 5.2% in fiscal 2021, with risks tilted to the downside. External risks have risen significantly and the impact on India's exports is obvious. The situation is fluid and is basis the assumption that we will be able to contain the stage III / IV of the Covid-19 contagion. Indian government and RBI measures have so far been muted and unlike several governments across the globe.

If the virus spread continues, the Modi Government will be forced to deploy measures to support income and cash flows to the vulnerable sections of the society and economy. We expect India Inc revenue growth to be low single digits this year (FY19-20) and next year (FY20-21).

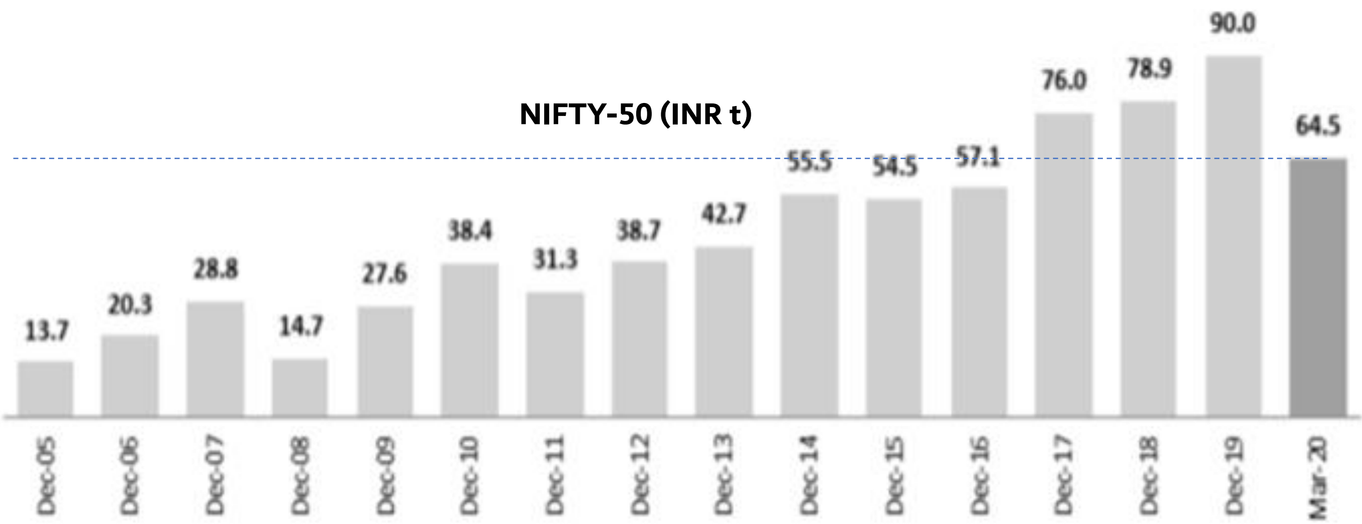



Note: E-estimated, P-projected

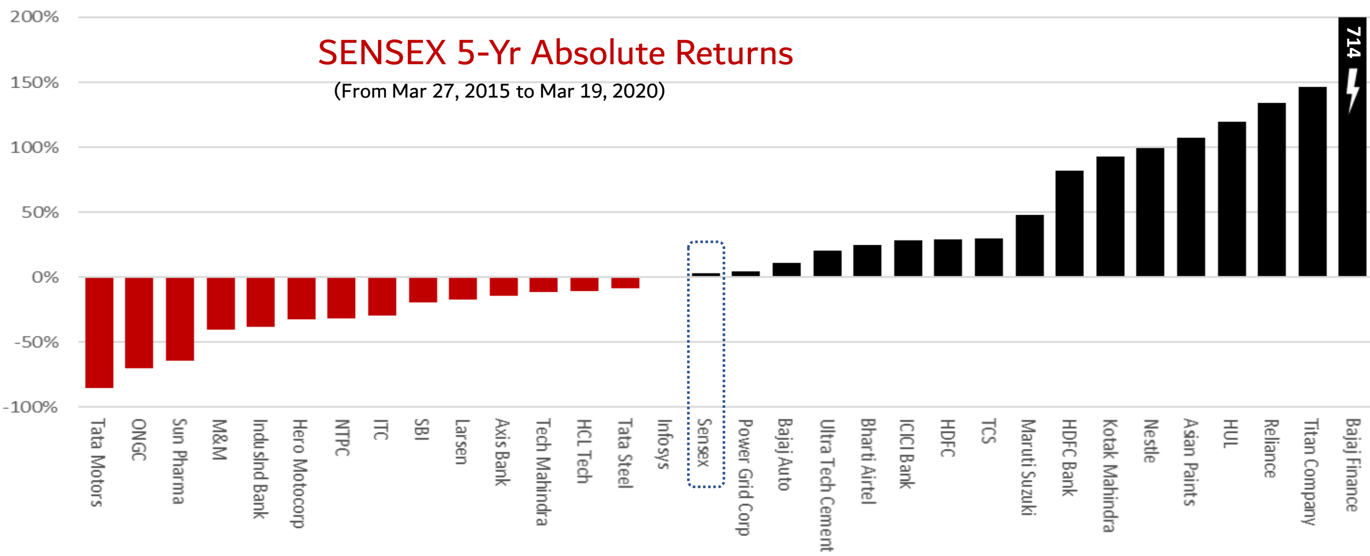
Revenue growth of India Inc

## THE MARKETS

The equity in India have corrected sharply and are now close to the Dec '16 levels.




While SENSEX has given a return of 3% in 5 years, there is a huge divergence in the underlying stocks. Well-run businesses, with strong cash flows continue to lead.




The dramatic fall in the equity markets has resulted in the crash of near-term futures market. Futures are quoting at a discount to the spot markets – a rare situation. **Arbitrage funds**, that make money due to the premium of futures over spot markets, are in a peculiar situation of probable negative returns for fresh allocations. Certain Arbitrage funds have suspended fresh inflows.

As IDFC has observed, India's perpetual impairment of lender balance sheets comes as a result of two successive **'boom-bust' credit** cycles over the past 13 - 14 odd years : the first pertaining to the 'old economy' corporate assets which ran for the first 5 – 6 years of this phase, followed by the massive expansion cycle in the non-bank space (which has had strong linkages with the banking system as well) which saw its own culmination of sorts from 2018. The current scenario has resulted in panic selling in bond markets – driving up yields and punishing any lender even with a whiff of poor credit quality in the books. Even liquid funds have given daily negative returns on a couple of occasions in the last few days.

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## Nifty Performance during and after market corrections (1996 to 2020)

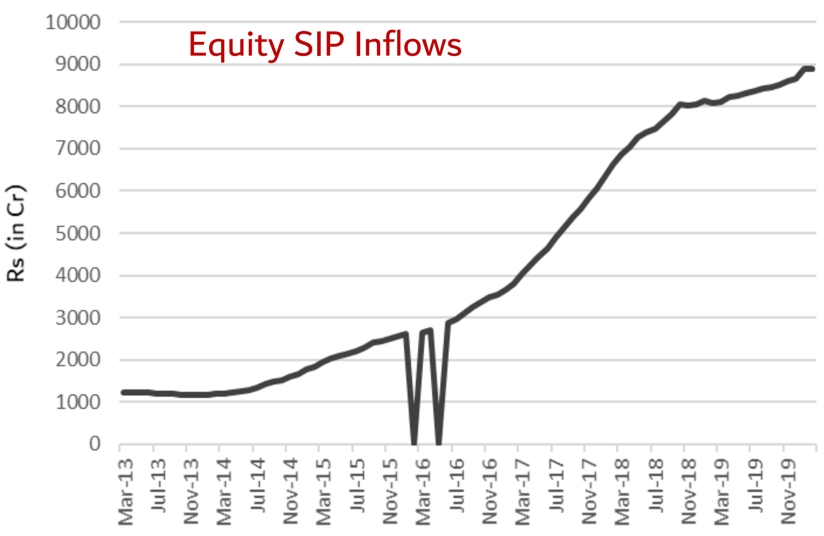
| Date (MM-YY) | Peak | Trough | Peak to Trough | +1M | +3M | +6M | +12M |
|---|---|---|---|---|---|---|---|
| Jun 96 -Dec 96 | 13/06/1996 | 04/12/1996 | -33% | 18% | 42% | 35% | 28% |
| Aug97-Jan 98 | 05/08/1997 | 29/01/1998 | -26% | 13% | 22% | -3% | 3% |
| Apr98-Nov 98 | 02/04/1998 | 28/11/1998 | -30% | 9% | 16% | 35% | 73% |
| Feb 00-May 2000 | 11/02/2000 | 23/05/2000 | -30% | 22% | 12% | 1% | -4% |
| Feb 01-Sep 01 | 15/02/2001 | 21/09/2001 | -40% | 14% | 24% | 35% | 14% |
| Jan04-May 04 | 14/01/2004 | 17/05/2004 | -30% | 8% | 15% | 35% | 43% |
| May06-June 06 | 10/05/2006 | 14/06/2006 | -30% | 19% | 29% | 46% | 58% |
| Jan 08-Oct 08 | 08/01/2008 | 27/10/2008 | -60% | 9% | 6% | 38% | 92% |
| Nov 10-Dec 11 | 05/11/2010 | 20/12/2011 | -28% | 10% | 16% | 13% | 30% |
| May- Aug 2013 | 17/05/2013 | 28/08/2013 | -15% | 10% | 15% | 17% | 51% |
| Mar 15 to Feb 16 | 03/03/2015 | 25/02/2016 | -23% | 11% | 14% | 24% | 28% |
| Aug 18 to Oct 18 | 28/08/2018 | 26/10/2018 | -15% | 5% | 8% | 17% | 15% |
| Jan 20 to Mar 20 | 14/01/2020 | 19/03/2020 | -33% | ? | ? | ? | ? |

Source: Motilal Oswal & Internal analysis

Past performance may or may not be sustained in future

## MARKET LIQUIDITY

*The total amount of about Rs. 8,900 Cr collected from Systemmatic Investment Plans has been predominantly invested into equities and accounts for healthy market liquidity conditions.*




Likewise, the passive mode of investment through exchange traded funds (ETFs) is increasing ground in India. According to the data from the Association of Mutual Funds in India (AMFI), ETFs attracted Rs 24,083 crore in the first eight months of FY20.

*In the year 2015, EPFO, the state-run pension fund, made its maiden investment of Rs 5,000 Cr into equities. With almost 15% incremental inflows, the total amount invested by EPFO into Exchange Traded Funds as on September 30, 2019 is Rs. 86,966 crore.*

## OUR OUTLOOK

While equity as an asset class is volatile in the near to moderate term, it contributes to significant wealth creation in the long run, regardless of market cycles.

The importance of Asset Allocation and Liquidity premium (assets that are not under lock-in) has once again been highlighted in the current crisis scenario. Buying into mayhem will help. We suggest investing in increasing size of tranches if market falls further.

Your asset allocation should be such that it is able to withstand a fall of such magnitude in the market as well as give you the flexibility to top it up with growth assets from a long-term investment perspective. It is also important to continue your SIPs patiently. In case you have lumpsum funds, it is beneficial to strategize with Systematic Transfer Plans (STP) over the next few weeks and months.

**Successful investing takes time, discipline and patience. - Warren Buffett.**

That should underline your investment philosophy always.

Data Sources:
Financial Times, Crisil Research, Motilal Oswal Research, Trading Economics, Bloomberg Markets