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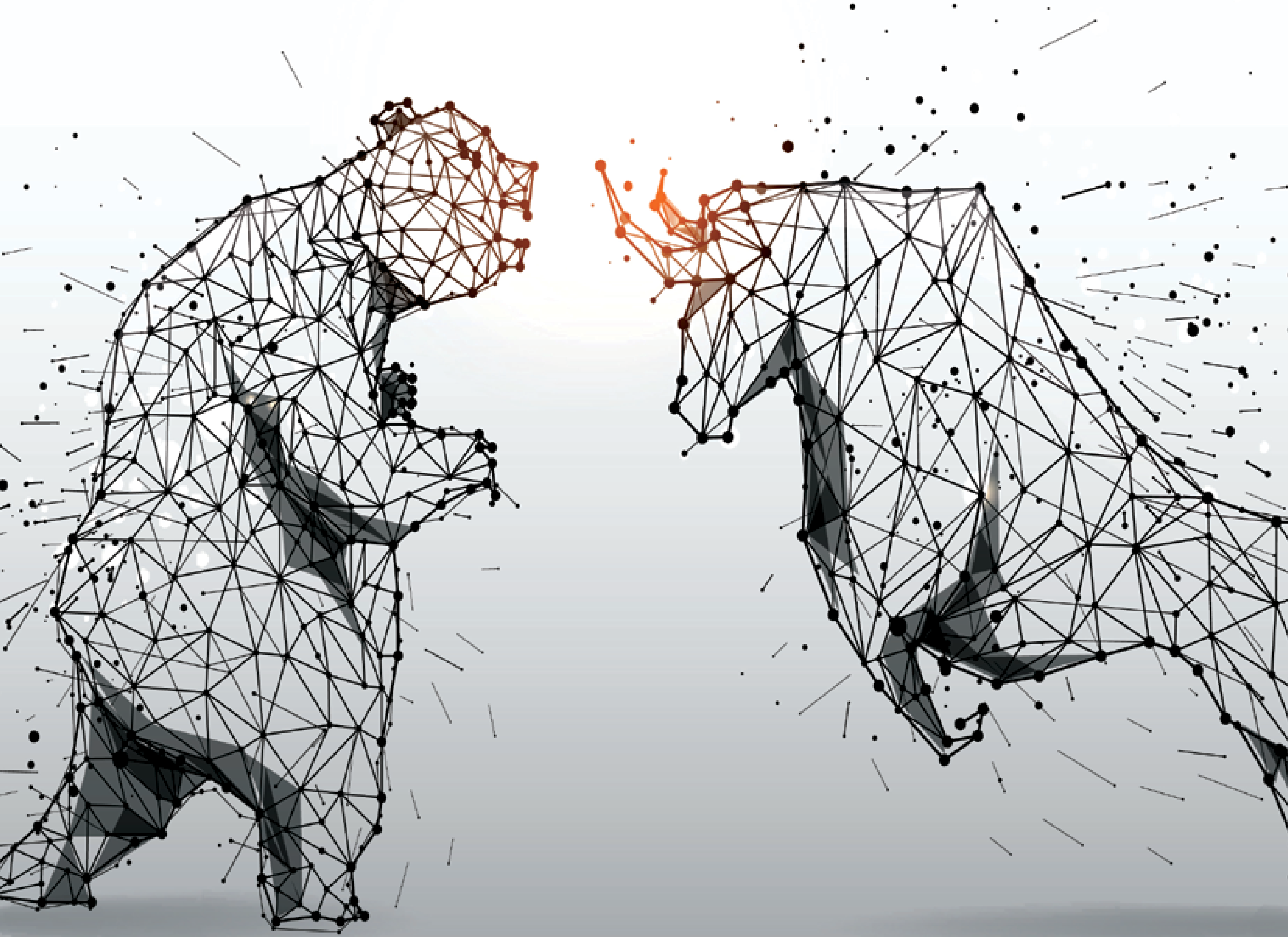
November-December, 2018

INVEST IN INVESTING

The stock market
What's trending?



From the Editor's Desk

The stock market is a dynamic organism. It fluctuates every day due to a host of unpredictable factors – oil prices, government policies, international trade dynamics, et al. For intra-day investors, day-to-day (even hour to hour) fluctuations matter so they should keep track of any immediate factors that may influence market sentiment. This is important to time entry and exit for maximizing return and minimizing risk. However, the same day to day trends are of little consequence to long-term investors as factors which may cause fluctuations in the short term may stabilize over a longer period of time.

Every investor believes that the market will go up based on some perceived or identified trend. While market fluctuations may seem arbitrary, there may be a pattern that can be identified. In fact, there are many small patterns nested within bigger patterns. Which pattern you see depends on what is the time frame you're looking at. For example, if you have the stock market graph in front of you and you zoom out considerably, you will be able to clearly identify the bigger trends the market seems to be following as opposed to the short-term micro level "noise" in the graph. Trends are, thus, a function of the time frame one chooses to look at. This is why the time frame you choose for your market analysis should match the time frame of your investments. That way you can make the best investment decisions towards your financial goals.

Best,

Team Meri Punji

Punji (*noun / Hindi*) - **Capital** *meaning, wealth in the form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing.*

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Why Diversified Equity Mutual Funds Make for the Best Long-Term Investment Route

Creating long-term wealth is a common investment objective but one that requires exceptional perseverance and grit. Equity offers one of the best avenues to achieve the goal, outperforming other asset classes over a long investment horizon. While equity does furnish higher returns, it isn't without its risks. If you're looking for a way to earn high returns but with risk lower than that of equity, diversified funds could be the answer. They serve as an excellent path for retail investors to create wealth in the long run, reducing risk by investing in stocks across sectors and market capitalizations.

COMBINING STABILITY WITH HIGH RETURNS

Equity stocks can be categorized on the basis of the market capitalization as large-cap, mid-cap or small-cap. While large-caps offer stability, mid and small-caps can be volatile but with the potential for higher returns. Stocks can also be categorized by sector or industry.

Diversified mutual funds protect investor assets by investing in non-related industries or asset classes. By investing in a large number of stocks across sectors and market caps, they diversify unsystematic risks (the type of uncertainty that comes with the company or industry invested in and can be reduced through diversification) and generate higher risk-adjusted returns than other undiversified investments. Thus, they combine the stability of large-cap stocks with the volatility and long-term-returns potential of mid and small-cap stocks.

Diversified equity funds buy and hold stocks to generate capital appreciation over a long investment horizon. Based on the fund mandate, managers may churn their portfolios at regular intervals. The profits thus booked are either distributed in the form of dividends to investors or reinvested to generate future profits through compounding.

Because different market segments outperform each other through different cycles, these funds generate higher returns owing to diversified investments in unrelated sectors. For instance, an industry could see better-performing stocks owing to a recent change in legislation while another may be seeing tough times because of, say, a disruption in the supply of a raw material. This way, retail investors can enjoy the benefits of a diversified equity portfolio through a relatively small amount of investment. This makes diversified equity funds an ideal choice for capital appreciation over the long term. They work especially well for investors with long-term goals like retirement planning, saving for a child's education or marriage.

WHY CHOOSE DIVERSIFIED EQUITY FUNDS

Diversified equity mutual funds come with a host of benefits for investors that are in for the long haul:

- **Shock absorber:** Such funds absorb shocks to the portfolio that result from market ups and downs. During a bear phase, large-caps will help stabilise the portfolio and during a bull phase, small and mid-caps will provide higher returns
- **Protection against volatility:** The power of diversification ensures industry-specific setbacks don't severely affect your portfolio and upset your long-term financial objectives
- **Better risk-return ratio:** Diversification helps achieve the same or higher returns with lower overall risk
- **Wide suitability:** Such funds are suitable for different kinds of investors, from risk-takers to safe players
- **Tax benefits:** Investment in the short term attracts a 15% tax on capital gain while that in the long term attracts a 10% levy on gains exceeding Rs. 1 lakh

TAKING THE DIVERSIFIED ROUTE FOR LONG-TERM GOALS

We've seen how diversified equity mutual funds make for one of the best wealth creation options in the long term, owing to their suitability for a variety of financial goals - retirement planning, saving for a child's education or marriage, and long-term wealth creation. Either on a standalone basis or in a portfolio with other investments, such funds can prove to be immensely useful for achieving long-term financial goals. Thus, they must ideally form a substantial part of the mutual fund portfolio of an investor with an appetite for equities. However, investors are advised to consult their financial advisors to determine the suitability of diversified funds for their portfolios ■

Securing Your Business Partnership

Insurance is commonly understood to cover health, life, and vehicles. When one runs a partnership business, it's important to conduct as much due diligence with respect to insurance as any other area. Let's take a look at partnership insurance plans to make the right business decision.

WHAT IS A PARTNERSHIP INSURANCE?

This is the insurance cover offered to a partnership business, typically purchased to protect business operations in the event of the death of a partner. The insurance cover enables the other partner(s) to buy out the deceased partner's share of the business from the inheritor. In the event of a partner suffering an illness or disablement, such a policy provides the other partner(s) with the funds to buy out the incapacitated partner's share from them.

KEY CONSIDERATIONS

Partnership insurance is important to protect one's business against adverse circumstances – the partner's sickness, permanent dismemberment, terminal disease or death. Having a plan in place is the sign of a responsible business owner. One should ask the following questions that are extremely relevant to every business partner:

- If one of the partners in the business were to become permanently disabled, sick or pass away, would the business survive?
- If a partner in the business were to pass away, who would own his or her shares? Would it be that partner's family or someone else?
- Would you and other partners be comfortable working with whoever inherits a deceased partner's shares? Would you be comfortable with this person being a partner in the business?
- If something were to happen to one of the partners in your business, would the other partner(s) be able to afford to pay him or her out?
- If something were to happen to one of the partners in the business, would his or her family survive financially?

DO YOU NEED IT?

Like any other insurance and investment decision, one should analyse the relevance of insurance plan according to their situation and needs. If you and your partner(s) are unsure about purchasing an insurance policy, consult a trusted financial adviser or insurance broker and take it from there ■

Contributed by
Aviva Life Insurance

Investing Right with Mutual Funds

It is important to invest the right way to maximise returns. Taking an informed route to mutual fund investments is one of the surest ways to achieve higher returns with low risk.

When it comes to mutual funds, there is as much uncertainty as interest amongst investors. As the asset class grows in popularity, it is important to invest the right way to maximise returns. Taking an informed route to mutual fund investments is one of the surest ways to achieve higher returns with low risk. Let's take a look at some key parameters for making the right investment choice.

DIVERSIFICATION

Don't invest in a bunch of similar schemes – this could turn your portfolio into a more risky than rewarding proposition. To begin with, get a comprehensive understanding of the scheme category and objective. It is important you diversify across categories and asset classes such as equity, debt, gold etc. to hedge your investment against market uncertainties, not to mention the higher reward potential of returns from different asset classes. Do maintain a cap on the number of schemes and safeguard yourself against the pitfalls of over-diversification that could adversely impact your portfolio in the long run.

RISK PROFILE AND FINANCIAL GOALS

Mutual fund schemes carry the risk of loss of the principal amount due to market volatility. To make the right investment decisions, consider your risk appetite. Younger investors can typically handle a higher level of risk and can thus earn high returns by focusing almost exclusively on equity. Because responsibilities and liquidity needs rise with age, allot a greater portion of your investment to debt and debt-oriented instruments as time passes by.

Equally important are an investor's financial goals i.e. the underlying reason for investing to choose suitable schemes. For instance, investors saving for retirement will find equity funds to be ideal while ELSS funds are the right choice for tax optimisation.

INVEST REGULARLY THROUGH SIPS

If you're new to charting the mutual fund territory or have an investible surplus every month, a Systematic Investment Plan (SIP) is ideal for you. SIPs allow you to make regular fixed investments without having to worry about timing the market. The significant benefits of compounding and rupee cost averaging also go a long way in maximising your returns and minimising risk. Because SIPs call for investing a fixed sum regardless of the NAV or market conditions, investors end up getting more units of a fund when the markets are low and vice versa. Perhaps the best feature of an SIP is the low capital requirement. You can start investing in an SIP with a sum as low as Rs. 500. You can also choose a scheme according to your financial goals. Over time, we've seen SIPs gain popularity as more investors flock to them.

DEBT FUNDS OVER A SAVINGS ACCOUNT

Instead of parking your corpus in a savings account, look at debt instruments for your lump sum investments. Large sums of money in a savings account will barely earn you 3.5% - 4% whereas an ultra-short-term or liquid fund offers superior returns, apart from the near zero risk. You can also make regular investments in other schemes by systematically redeeming your term funds through a Systematic Transfer Plan (STP). An STP features the likelihood of receiving higher returns on your investment compared to other similar schemes.

REBALANCING

Building a diversified investment portfolio is not a one-time activity and needs the investor's constant involvement. Thus, you must ensure the viability of your chosen investments from time to time. Periodically check your returns to stay informed of the returns on existing investments. If one or more investments aren't performing well, you can try reducing exposure to them. However, temporary market issues smoothen out in the long term so it's best to not panic and redeem investments prematurely. If you're new to mutual funds, consult a financial advisor to help you make the right assessment.

INVESTING RIGHT

While the market is unpredictable, mutual funds provide a safe harbor for your investments. Investors can earn high returns by following the right investment approach according to their risk profile and financial goals. Even though mutual fund investments are influenced by the market and thus carry an element of uncertainty, investors shouldn't adopt a lackadaisical approach in selecting and maintain their portfolio. To make the right investment choice, consult a financial advisor who will take you through the process and ultimately help you zero in on the right schemes ■

RERA

A blessing for the buyer

The real estate sector in India (particularly residential) has, for a long time, favoured developers. Despite investing their hard-earned money, buyers in the market have always been at the receiving end, be it in the form of project delays, poor construction or hidden information. In order to create a level playing field in the hitherto unregulated and unorganised sector, the Government of India implemented the Real Estate (Regulation & Development) Act, 2016 also known as RERA.

The Act seeks to protect the interests of home buyers and also spur demand for property, which has witnessed a great slump ever since demonetisation. By putting in place rules and regulations, the Act aims to not only ensure accountability and transparency in real estate transactions in the country but also penalise sellers for any deviation. By setting up a forum to address buyer grievances, it seeks to hold developers responsible for their projects, a welcome move for disgruntled buyers.

Let's look at 10 reasons why RERA is good for buyers.

1 Timely Delivery

Builders need to specify a date of possession in the sale agreement and the rate of interest in case of a default. Also, the buyer can seek withdrawal of booking amount along with the interest. If the buyer decides to go ahead with the project, the developer would be bound to pay interest for every month of the delay till possession by the buyer. In case of a delay, both the buyer and the seller would be charged the same rate of interest which was earlier higher for the buyer.

2 Decreased Booking Amount

Developers can only take up to 10% of total property cost as booking amount. Accepting a higher amount will be seen in violation of RERA and can attract a severe penalty for the developer.

3 Prevents Diversion of Funds

RERA requires the developers to deposit at least 70% of the buyer's money received for a particular project into an escrow account. Withdrawal from this account can only take place on the basis of project completion certified by engineers, architects, and a chartered accountant.

4 Mandatory Registration

RERA has mandated setting up of a regulatory authority in each state and union territory. As per the Act, developers and agents need to register themselves with these State Regulatory Authorities and obtain a registration number. All details regarding project including construction progress, occupation, sales details have to be updated with the RERA state authorities.

5 Broker Registration Mandatory

Brokers too need to be registered under RERA and will be liable for all the deliverables committed by the developer they represent.

6 Pay Only for Carpet Area

The price quoted by the developers will be based only on the carpet area (area within the walls). Unlike earlier, the developers can't charge for the super built-up area (including balcony and common area), which essentially means that buyers get what they pay for. In case of default, the developer is entitled to imprisonment for three years.

7 Approval for Changes

Approval of at least 2/3rd of the buyers is required for the developer to change or modify the building, layout plans, etc.

8 Liability of Structural Defects

The developers are liable for repairing any structural defects (such as cracks, plumbing or electrical issues) that appear in the first five years. These repairs need to take place within 30 days or buyers need to be compensated for the same.

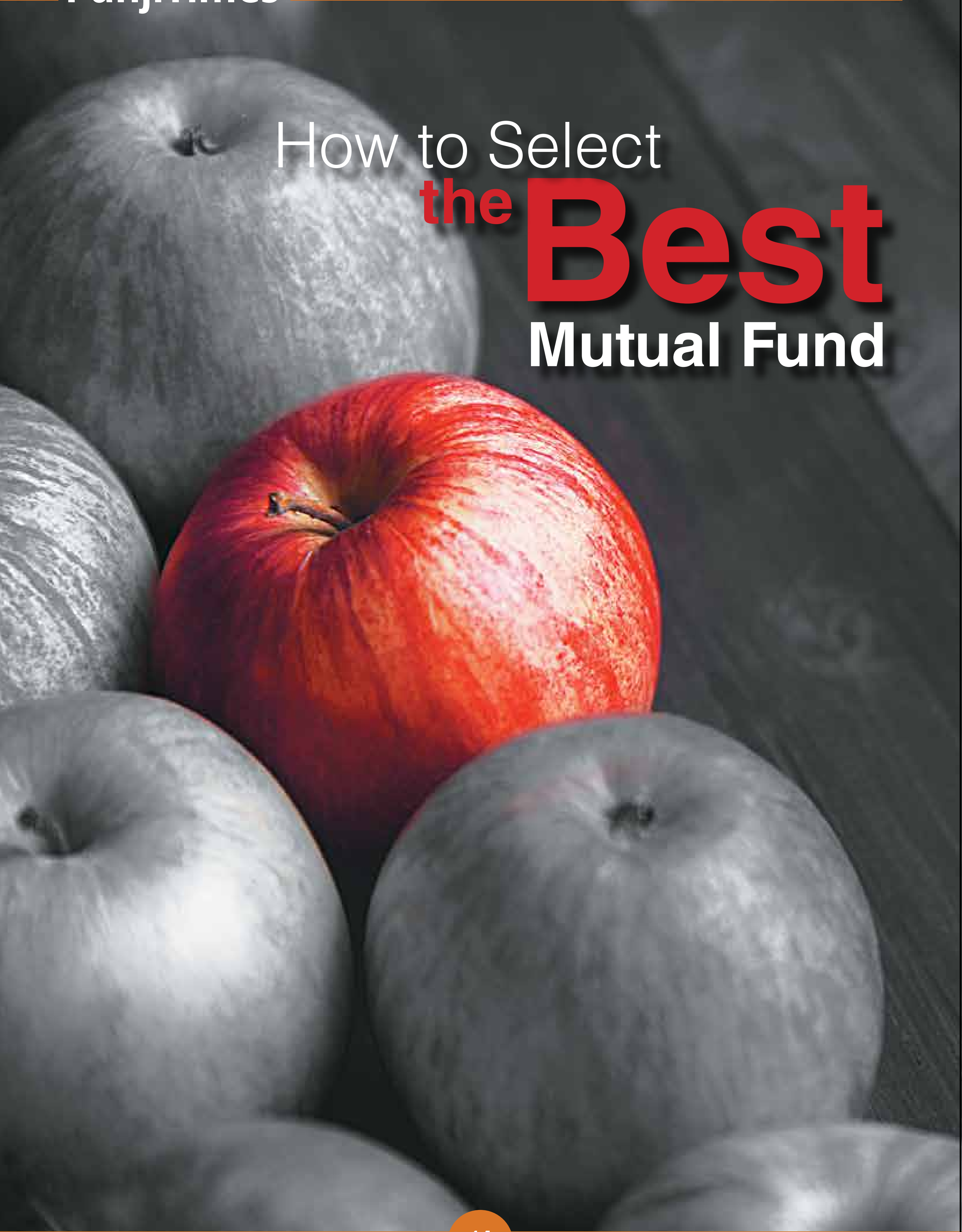
9 Land Title Documents

written affidavit needs to be provided by the promoter indicating the property is free from encumbrances. Such encumbrances previously prevented delays in case of title transfer.

10 Grievance Redressal

A dissatisfied buyer can file an appeal in the Appellate Tribunal which will be addressed by the State Regulatory Authority within 60 days.

Thus, the Real Estate Act, 2016 creates a level playing field by protecting buyers. In essence, it has brought about a change in the sector for the better. Developers can no longer take advantage of unsuspecting buyers without having to bear consequences. It ensures accountability and transparency to transactions in a sector which for a long time thrived without any. For now, the ball has shifted to the buyers' court ■



How to Select the Best Mutual Fund

When selecting the right mutual fund, a number of considerations such as investor profile, risk appetite, financial goals etc. must be taken into account. Equally important to choosing the best fund is a quantitative analysis of different schemes. However, looking at several different parameters can be time consuming and confuse you more than conferring clarity. Let's look at the two most important analytical tools for selecting the right debt and equity schemes.

EQUITY FUNDS

Simply focusing on returns can be misleading. For instance, an equity fund offering a 10% return can be both exceptional and poor, depending on market conditions. Other risk and performance measures like Sharpe Ratio, Standard Deviation, R-Squared are often difficult to interpret. Instead, alpha and beta are the two most effective measures of a fund's performance.

BETA

This metric indicates the risk underlying a fund relative to the market benchmark. Before looking at the beta of a fund, it is important you know your risk profile. Within a particular risk segment, characteristics of a scheme can differ based on the fund manager's strategy.

The beta of a fund is defined as the excess return over the risk-free rate relative to that of the benchmark index. For instance, you invested in a fund with a benchmark index of BSE-100 and a beta of 2. For risk-free rate, we consider a fixed deposit offering 7% interest (schemes typically use interbank rates as risk-free rates). If the benchmark rises by 15%, the expected returns can be determined with the Capital Asset Pricing Model (CAPM), according to which:

Fund Return = Risk-free Rate + Beta (Benchmark Return – Risk-free Rate)

Thus, expected return of the fund is 23% (7% + 2 X (15% - 7%)). If the benchmark falls, expected return is -27%.

We see that higher the beta, higher the potential return in a bull market but with the risk of higher losses during a bear market. A fund with a beta of <1 is a low beta fund while that with >1 is a high beta fund. However, a high beta fund is not necessarily worse. Investors must select funds with higher or lower beta based on their risk appetite. If you have a high risk appetite, opt for a high beta fund and vice versa.

ALPHA

This is one of the most important parameters of a mutual fund scheme. Alpha is defined as the excess returns generated over expected returns. It is mathematically denoted as:

Fund return = Risk-free rate + Beta (Benchmark Return – Risk-free Rate) + Alpha

Thus, alpha is the value added by the fund manager for the same amount of risk. Taking the above example where the benchmark rises by 15%, the expected return is 23% according to CAPM. Assuming you get a return of 25%, the extra 2% return is a result of the value created by the fund manager, the alpha of the fund. If the benchmark fell by 10%, expected return according to CAPM would be -27%. However, if the fund manager were able to generate a 2% alpha, actual return would be -25%.

Thus, alpha can be understood as the excess return generated by the fund manager compared to what CAPM predicts. Top performing funds that have sustained their performance over a long period of time have high alphas, an indication of the fund manager's ability to pick the right stocks for an optimal portfolio construction. Thus, look for high alpha funds when selecting equity funds for your mutual fund portfolio.

DEBT FUNDS

In India, debt funds aren't as popular as equity funds. What can seem particularly complicated is the analysis of debt funds, given a range of categories and quantitative investment strategies. However, debt funds are excellent for a range of investment needs, risk appetites, and tenures compared to traditional fixed income schemes.

Debt fund investments are typically for shorter tenures compared to equity funds. For longer tenure investments, income is the most important consideration. This means that risk is a prime consideration here, chief among which are interest rate risk and credit risk. To meet your specific investment needs, you should be able to select the right schemes based on these two risk factors. Let's take a look at modified duration and credit quality, the most important analytical tools for selecting debt funds.

MODIFIED DURATION

Bond prices and interest rate are inversely proportional. Some bonds and debt funds are more sensitive to interest rate fluctuations than the others i.e. when interest rates fall, they rise faster and when interest rates rise, they fall faster. Modified duration is the interest rate sensitivity of a bond or debt fund i.e. the price sensitivity of a bond to changes in interest rate or yield. If a bond has a modified duration of 10 years and interest rates go down by 1%, the bond price will increase by 10%.

The modified duration is closely related to the bond maturity profile of a debt fund. To achieve higher returns by taking more risk, select a fund with high modified duration. If you're looking for stability, select a fund with moderate to low modified duration – less than 2 years. Debt funds with a higher modified duration offer significantly higher returns than traditional fixed income schemes in favorable (declining) interest rate scenarios. Even moderate modified duration debt funds (1 – 2 years) offer higher returns in stable interest rate scenarios. Schemes with a modified duration of less than 1 year are part of the money market category – they are low-risk schemes with low returns.

For most investors, the primary importance of the bond's duration is its ability to predict how sharply the price of a bond will change due to an interest rate fluctuation. For instance, if a 10-year government bond has a duration of 6 years and interest rates increase by 1%, the bond's price will fall by ~6%. If interest rates fell by 1%, the bond's price would increase by ~6%.

Long term Instruments (Maturity > 1 year)		Short Term Instruments (Maturity < 1 year)	
Rating	Risk	Rating	Risk
AAA	Highest Safety	A1	Lowest Risk
AA	High Safety	A2	Low Risk
A	Adequate Safety	A3	Moderate Risk
BBB	Moderate Safety	A4	High Risk
BB	Moderate Risk	D	Expected to default
B	High Risk	*CRISIL may apply '+' (plus) sign for ratings from 'CRISIL A1' to 'CRISIL A4' to reflect comparative standing within the category.*	
C	Very High Risk		
B	Expected to default		

Key points about modified duration:

- A lower modified duration implies that returns result more from accrual income than capital gains
- A higher modified duration implies that returns result more from capital gains than accrual income
- Lower a bond's coupon, the longer its duration. Higher a bond's coupon, shorter its duration

CREDIT QUALITY

Higher the credit quality of a fund, lower is the risk of price (NAV) declining as a result of credit rating downgrade or default. Thus, the risk of an AA rated bond defaulting is much less than that of a BB rated bond. So if you're looking to reduce your investment's credit risk, opt for a debt fund with a high proportion of AA or higher rated bonds in its portfolio. Among the most commonly used credit rating scales is the one CRISIL uses to rate debt securities (shown in the above chart):

The credit risk profile of a debt fund can be found in its factsheet or on a mutual fund research website. Investors must select funds based on credit quality according to their risk appetite. Those with a low risk appetite should ideally select funds with more than 80% or portfolio invested in AA or higher rated securities. However, lower rated bonds give higher yields, even though not all of them are downgraded.

To capture an extra few percentages of yield, investors can also look at credit opportunities funds that have a higher proportion invested in lower rated papers. Sometimes, even a highly rated bond can suddenly be downgraded, impacting the returns of those funds that hold a high percentage of such bonds in their portfolios. Thus, be cognizant of the risk of an unexpected rating downgrade.

SELECTING THE RIGHT MUTUAL FUND

While investors today have plenty of information at their disposal, not all of it is relevant to making an investment decision. A discerning attitude is required for a thorough analysis. Ultimately, your financial advisor is the best person to help you make the right mutual fund choice

SYSTEMATIC TRANSFER PLAN

Killing Two Birds With A Stone

For mutual fund investors, the top two concerns are the volatility of their investments and asset allocation. For instance, investing in equity is lucrative given the high upside it promises. However, its volatile nature can have investors losing sleep. Another quandary most investors face is an optimal allocation of capital between debt and equity to strike the right balance between achieving long-term and short-term objectives, in keeping with their risk appetite. A Systematic Transfer Plan (STP) is ideal for combating volatility as well as effectively managing one's portfolio.

WHAT IS AN STP?

A Systematic Transfer Plan is an instrument that allows an investor to transfer a fixed or variable amount from one scheme to the other, primarily used by investors to transfer capital between debt and equity funds. When investing with a long-term view but with short-term volatility in mind, one can invest their capital in a low-risk debt or money market fund and use the STP route to transfer fixed amounts to equity funds over several months. If you've almost met your financial goals and are wary of a market correction, you can leverage an STP to transfer money from your equity fund to your debt fund. The two types of STPs are:

- **Fixed STP:** Here, investors can transfer a fixed amount from one scheme to the other at regular intervals
- **Capital Appreciation STP:** Here, investors can withdraw the profits of a scheme and transfer them to another one

Let's look at how STPs help address an investor's prime concerns.

A SHIELD AGAINST VOLATILITY

Much like SIPs, STPs help tackle volatility through the various benefits they offer such as rupee-cost averaging, disciplined investing, and freedom from continuously timing the market. Investors can use rupee-cost averaging to shield themselves against volatility by parking a lump sum in a fixed income scheme such as a liquid fund (Transferor Fund). This amount can then be transferred to an equity fund (Transferee Fund) at regular intervals. Thus, more units are bought when the market is down and fewer units when prices are high. This allows for a lower average cost per unit over a period of time.

For example, an investor with a lump sum amount of Rs. 10 lakhs can invest it in a debt fund. With the STP route, he can transfer say Rs. 1 lakh to an equity fund every month. While this would allow him to take advantage of upswings in equity, it would also protect them during a downswing. Investors thus do not need to time the market and can play on the volatile nature of equities worrying about the consequences. Since the amount is transferred in a phased manner every month, it prevents any rash decision making on the investor's part. Thus, an STP can be immensely useful in combating market volatility.

A TOOL FOR PORTFOLIO MANAGEMENT

Asset allocation demands a careful juggling between one's risk appetite and investment objectives. This becomes even more daunting as the investment period draws to a close. Imagine a scenario where an investor is invested in equity for 10 years. Towards the end of this period, they would want to shift from equity to debt to secure the returns earned over time. A delay in re-allocation could mean market volatility impacting the corpus. An early exit could cause the investor to lose out on the returns too. In such cases, emotions often take over rational decision making. For instance, in case of bullish tendencies, greed prevents investors from reallocating while in case of bearish tendencies, investors make decisions in haste and take an early exit. By using an STP when nearing the investment horizon (say, the 8th year), rash decisions can be avoided. It could also protect the investor from the exit load and short-term capital gains tax, if timed correctly.

SUMMING IT UP

An STP proves to be an effective tool for mutual fund investors looking to invest a lump sum amount. Its greatest advantage lies in the fact that it helps address an investor's major concerns viz. managing volatility and asset allocation by offering a slew of benefits to investors ■

Currency and Equity Markets

The US dollar in 2018 emerged extremely strong against most currencies. The Indian Rupee (INR) too weakened by about 10% in 2018 with market participants worried that it could hit new lows in the coming weeks/months.

We studied trends in currency markets (INR-USD) and Indian equity markets across business cycles over the past 10-12 years, taking Nifty as a proxy for the equity markets. Note that the trends for Sensex, Nifty 500, BSE 500 etc. would not be very different.

The weakness of the INR can be attributed to the fiscal and current account deficits and high inflation on account of supply-side factors. As a result, interest rates too needed to be higher than in developed economies. Current account deficits for the past 20-25 years have been more than made up by capital/investment flows and remittances, which ensured relative macroeconomic stability. This is the reason that India has never plunged into economic chaos like some European and South American nations have in the past and Turkey has lately (July-August 2018) been facing.

TRENDS IN CURRENCY MARKETS

When we look at the trends in currency markets (INR-USD) over the past 20 years, we observe:

1. The INR's weakness is not perennial but in spurts
2. INR has alternated between periods of sharp volatility (INR weakness/depreciation) and periods of calm for a few weeks/ months, every few years
3. While INR has depreciated against USD over a 20-year period, much of the depreciation has occurred in sharp spurts over short periods of time, on a few occasions
4. To a large extent, these spurts can be retraced to INR strength during the period of calm in the currency markets
5. Some of the weakness in INR can also be attributed to the strong USD against almost every other currency, especially emerging market ones that depreciated much more than the INR

TRENDS IN CURRENCY AND EQUITY MARKETS

Indian equity markets (Nifty) have been on a steady uptrend over the past 20 years, making higher tops and higher bottoms through the cycles. This has been driven, to large extent, by the steady, sustainable and consistent earnings growth of Indian companies. When we juxtapose the INR-USD cycle with Indian Nifty cycles, following are the observations:

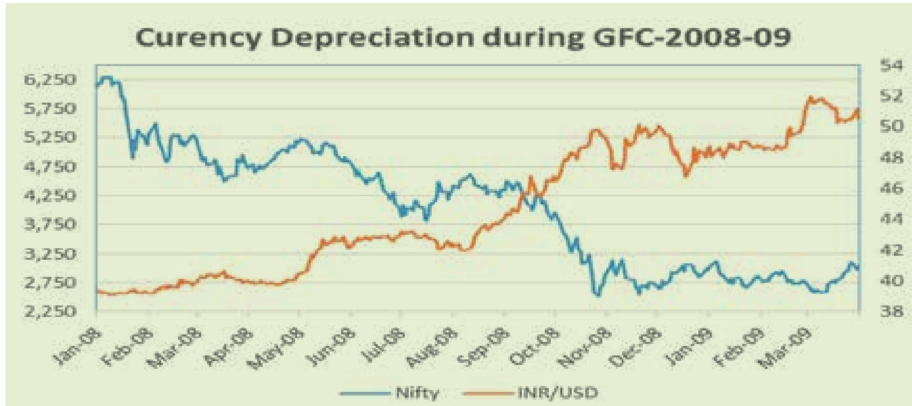
1. Periods when INR has been weak invariably resulted in a period of volatile and down-trending Nifty (sharp corrections)
2. When currency markets stabilize (after over-shooting on INR weakness), Nifty has resumed its uptrend
3. Periods of calm/stability in currency markets have witnessed moderately up-trending Nifty
4. Periods of strong INR has seen very strong Nifty gains

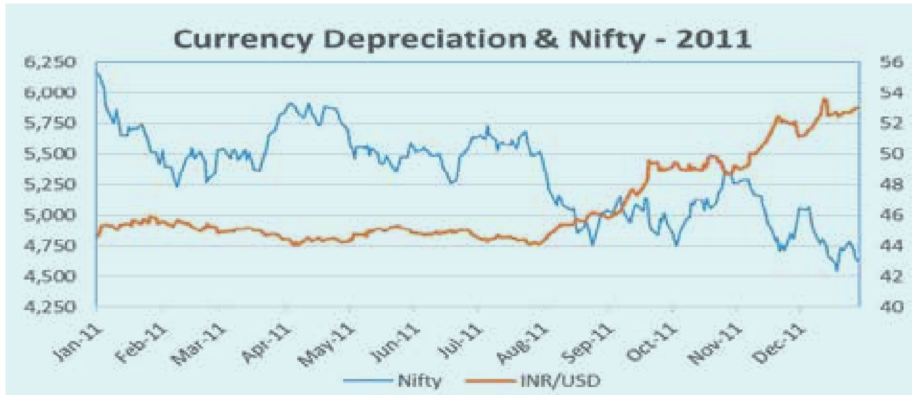
The observations provide significant opportunities in the equity markets from a cyclical point of view. The good part is these cycles have been repeating regularly, every couple of years, offering ample opportunities for:

- Trading (both long and short), including hedging opportunities
- Investments by aggressive buying during periods of weak INR and holding through the cycle

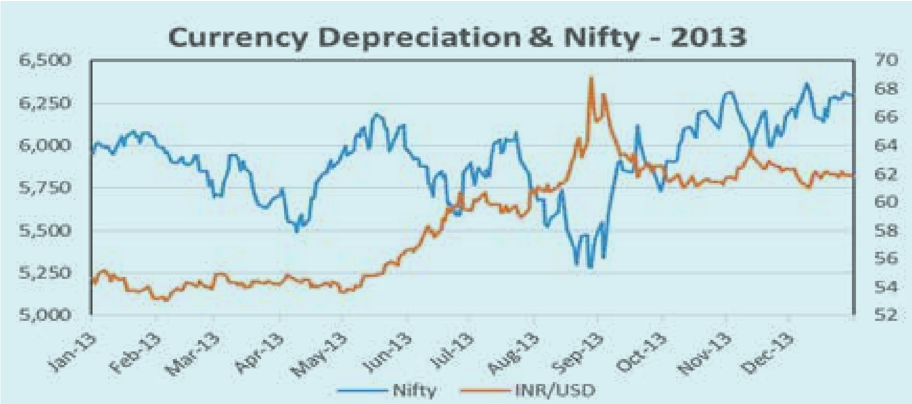
We look at the past cycles to substantiate the correlation between currency markets (INR-USD) and equity markets (Nifty).

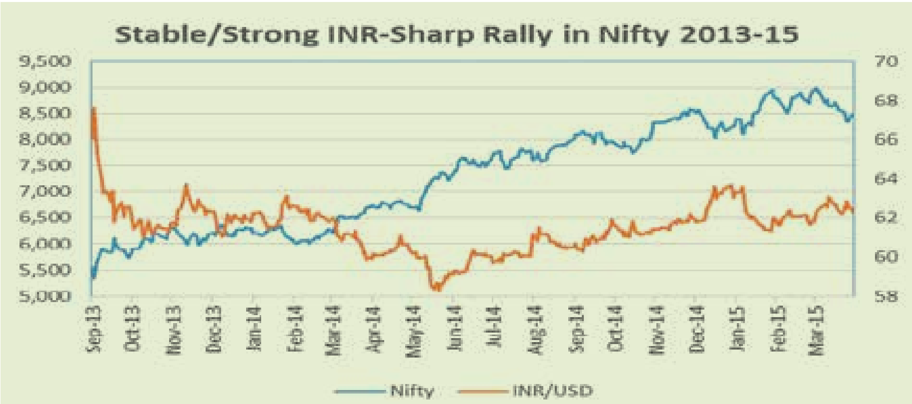
- During the Global Financial crisis (2008-09), INR depreciated by ~28% from Rs. 39/USD to Rs. 51/USD between January 2008 and March 2009





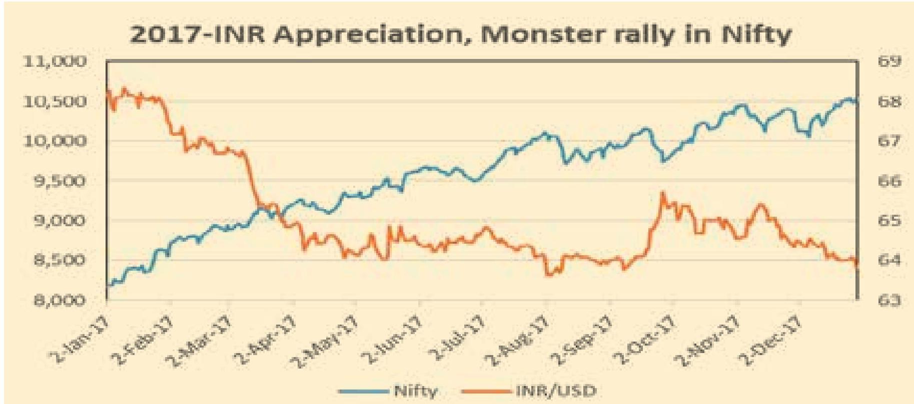
- Nifty fell by 55% from ~6250 levels to ~2800 levels during the same period
- 2009-11 was a period of INR strength with low volatility in currency markets. INR appreciated by ~15%, from Rs. 51/USD to Rs. 44.50/USD between April 2009 and January 2011
- Nifty rose by ~100% from ~3000 levels to ~6000 levels during the period
- The correlation has been strong - a decline of INR from ~Rs. 44.50 to Rs. 46/USD during December 2010-January 2011 saw Nifty correcting from ~6000 levels to ~5600 levels (right side of the chart)
- 2011 was a period of INR volatility. INR depreciated from ~Rs. 44.50/USD to ~Rs. 53/ USD, a depreciation of 19%
- Correspondingly, Nifty corrected by ~25% from ~6000 levels to ~4500 levels
- The correlation can be observed visually
- The 18 month period of 2012-13 was one of relative calm and stability in currency markets with INR staying in the range of Rs. 52-56 for the most part. Initially, there was a sharp appreciation from Rs. 54 to Rs. 49 between January-February 2012, leading to a sharp rally in Nifty
- During this 18-month period, Nifty witnessed a rally of ~30% from ~4600 levels to ~6000 levels
- August-September 2013 witnessed one of the worst bouts of currency volatility overshooting massively leading to a near meltdown in Nifty. As soon as currency markets calmed down, equity markets stabilized immediately. Nifty resumed the uptrend as can be seen towards the latter part of 2013

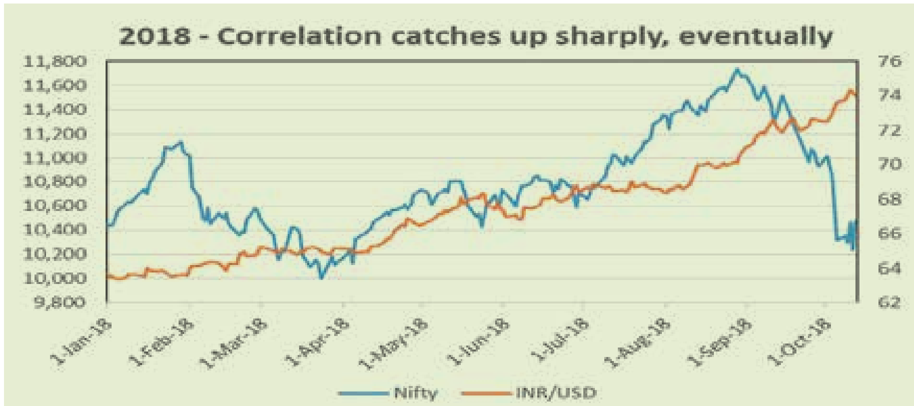




- For the year CY 2013, based on opening and closing INR, there was a depreciation of 13% from Rs. 54.50/USD to Rs. 61/USD. Nifty gained moderate 6% during the year, with a period of sharp volatility
- Post the volatile period of August-September 2013, INR weakness retraced substantially. From ~Rs. 69/USD on 28 August 2013, (overshooting, panic in currency markets), within 9 months, INR was at levels less than Rs. 60
- With currency stable in the Rs. 59-62 range, Nifty saw a monster rally from lows of ~5300 to ~9000 levels, a rise of ~70% in just about 18 months
- CY 2015 and CY 2016 was a period of relative stability with INR in the range of Rs. 63-68
- Weakening INR from Rs. 63 to Rs. 68 between April 2015 and March 2016 resulted in Nifty correcting by ~20% from 8700 levels to ~7000 levels

- The relative stability of INR during March-November 2016 (Rs. 66-68/USD) witnessed the resumption of the up-trend in Nifty with a rally of ~25%, rising from ~7000 to 8500 levels
- The little weakness resulted in a small correction towards the end of CY 2016
- Again, the correlation is visual
- CY 2017 saw one of the sharpest appreciations of the INR and the rally in equity was also the sharpest
- INR appreciated by almost 10% ~Rs. 68/USD to ~Rs. 63/USD. Nifty witnessed a monster rally in Nifty of ~38%, from ~8,000 levels to ~11,000 levels in CY 2017-end
- Here again, the correlation is visual
- The strength of CY 2017 in Nifty continues in CY 2018, but correction sets in. INR weakness also gradually lifts its head
- For a while, INR weakness and strength in Nifty is simultaneous, but the rally was extremely narrow led by just a few stocks, while the broader markets had continued to correct





- The depreciation of INR by ~16% from Rs. 63/USD to ~Rs. 74/USD resulted in Nifty correcting by ~12% from the highs of ~11,700 to ~10,300. Weakness in both currency and equity markets continues

CONCLUSION:

1. Currency markets usually give lead indicators, followed by commodities, debt and finally equity markets, driven by global fund flows
2. The ~16% weakness of INR in 2018 should be seen in the light of a strong Dollar against all global currencies that have also weakened. Relative to other emerging markets, India is slightly better off
3. Compared to other emerging market currencies and (Euro, Pound, Canadian Dollar etc.), INR has been relatively stronger
4. For any Government (or Central Bank), it is always a challenge to keep the currency strong and inflation and interest rates low amidst high current account and fiscal deficits. It is invariably the currency that adjusts over a period of time with periodic spurts (overshooting, panic-driven) movements in the short term
5. This is where the opportunities lie for equity investors to accumulate for the long term and ride the wave
6. For traders, the opportunity is both on the short side to hedge positions/speculate and riding the trend

Vivek Mavani
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Expert Speak

The market heaved a sigh of relief as September came to an end. Nifty 50 in the last month fell by 6.8%. The decline in the Nifty Midcap 100 was 12.10% and the Nifty Small Cap was down by 19.65%. On a year-to-date basis, the Nifty Small Cap index is down by around 34%. In the same period, the Midcap index was down by 20%. Much of the Small Cap index gains over the last three years have been wiped out. Hope our call for caution while investing in equities came in handy for our investors.

The default by a mega infra-finance company triggered this phase of decline. The market was already concerned by the ripples of the default and got frightened even further when rumour-led selling caused a 60% (intra-day) fall in the price of a major HFC. The equity market crash can be attributed to movements in the debt market, currency market, and credit market along with tight liquidity.

The uncertainty regarding NBFCs has created anxiety amongst investors of a possible contagion effect. Lending activity has dropped drastically. Not many want to go out on the wicket and play anymore. If this is the way, the game may stop even before the referee comes in.

The good news is that policymakers have sprung into action. But market nerves remain jittery and debt-holders have their risk sensors on high alert. The market needs to regain its confidence and nerves need to be soothed. For that reason, regulators must begin to allay fears and demonstrate eagerness in resolving the problem.

On a larger note, the NPAs in PSU banks and the current infra-finance issue has two things in common – a lack of transparency and accountability. Resultantly, corporate governance and capital allocation have suffered, putting the whole system at risk.

This episode may have some lessons for us. There is a cycle in play. At first, there is an over-optimistic lending for hyper-inflated projects, unviable businesses, and unscrupulous promoters. Then these investments go bust and the lending institutions themselves need rescue.

Regulators need to play an important role at the time of lending itself. There is enough competence within the nation to bring in effectiveness and efficiency in publicly-held lending institutions. Promoters, rating agencies, regulations, capital, and technology must be brought together to create transparency and open access to information. The market must be enabled to efficiently discover lending costs.

Oil and elections are expected to be drive market sentiment in the near future. Markets have a downside if oil goes to three digits and/or if the election fails to produce a stable government. Markets have an upside if oil corrects from here and the election produces a reform-oriented government.

For now, we must continue to remain cautious. Currently, markets have few reasons to go up and many potential causes to remain down. However, islands of opportunity have emerged. Especially in the small-cap segment, investors with a long-term view may look at allocating in a staggered manner – either through SIPs or STPs. Investors may also look at allocating in avenues like offshore equity funds to diversify, allowing the domestic situation to get back on track ■

Nilesh Shah,
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