So long as the music is playing, investors must get up and dance

What Citigroup's Chuck Prince said is worth recalling as our stock market boom continues apace

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In September 2023, stock brokerage Kotak Institutional Equities (KIE) issued a research note saying, "The steep increase in stock prices simply reflects the irrational exuberance of investors in the mid-cap and small-cap parts of the market." Also that "there is no meaningful change in the fundamentals of most companies; in fact, they have worsened in many cases."

In a recent research note written in a tongue-and-cheek manner, the brokerage reiterated what it said in September: "The pond [that is the stock market] seems to have overheated of late, visible in the bubbles in the water." However, many investors remained oblivious to these bubbles in the stock market, KIE said. Some of this overheating was because of "a monthly plan". This is in reference to systematic investment plans (SIPs) which are used by many retail investors to invest regularly and largely in equity mutual funds (MFs), which invest mostly in stocks. Monthly flows into SIPs have been growing every month, with close to ₹21,000 crore invested in May.

All this money, the brokerage said, has led to the "water in the pond... reaching higher and higher levels." This refers to all the new money driving stock prices to newer highs. KIE analysts further said that "the pond's water could be at risk of turning into steam and disappearing altogether," but investors are busy "rolling in the lucre."

So, is this an escalation of commitment on KIE's part in order to defend what it said in September? Or is it just unhappy about how stock prices have continued to rise fast after its bearish call that month? Or is the stock market 'really' irrationally exuberant?

Any stock brokerage that makes a bold call against the prevailing trend needs to keep defending what it has said. Now, given that the BSE 500 index, a very broad representation of the overall stock market, has risen by more than 27% from 11 September, when KIE made its call, till last Friday, its recent writings might seem like an escalation of commitment.

Nonetheless, the stock market is clearly overvalued. The prices of many stocks are significantly higher than what their current earnings and prospects of future earnings justify. As this writer has mentioned in the past, in 2024-25, the price-to-book ratio (a valuation measure) of BSE 500 stocks has so far been the highest since 2007-08.

Further, a recent news report in *Mint* quoting data from Prime Database points out that in the first six months of 2024, promoters or owners of businesses have sold stocks worth ₹62,000 crore. This is the highest in the last six years, for which the report shared data, and only half the year has gone by.

Promoters are the ultimate insiders. The kind of information access they have about their own companies, no one else does. And when so many of them sell at the same time, what it basically tells us is that they feel their share prices are overvalued, and that they don't expect the future earnings of their companies to rise at a pace that justifies the rise in share prices, and so there is money to be taken off the table, and this is why they are selling. They may have reckoned they could buy back their holdings later, at a lower price.

In fact, this is a point that economic historian Charles Kindleberger made in his all-time classic *Manias, Panics and Crashes: A History of Financial Crises*, which was first published in 1978: "As the boom continues... the purchases of securities... by 'outsiders' [read retail investors] mean that the 'insiders' [read promoters]—those who own these assets—sell them and realize profits; if the outsiders are buyers, then the sellers must be insiders."

If we look at a specific example, a loss-making and over-leveraged company, Vodafone Idea, recently decided to raise ₹2,458 crore via a preferential issue of shares to its vendors in order to clear a portion of what the company owes them. Analysts feel that the company could use this modus operandi in the future as well.

It is able to do this simply because its stock prices have rallied by 140% in the last one year—despite a lack of earnings. This is again a great example of insiders using outsiders to take some money off the table.

So, where does that leave KIE or everyone else who believes that the stock market is overvalued? It's worth remembering a line often attributed to economist John Maynard Keynes, but actually said by another economist Gary Shilling: "Markets can remain irrational a lot longer than you and I can remain solvent."

Indeed, it's also worth remembering something that Chuck Prince, the then chief executive of Citigroup, told the *Financial Times* in July 2007: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." Which is why when it comes to institutional investors—be it stock brokerages, mutual funds, private equity firms or insurance companies—those who run them are always bullish. In public, they always believe that markets can only go up. They just can't stop dancing.

KIE has stopped dancing. This brokerage might eventually turn out to be right. But right now, it is looking wrong. Indeed, terribly wrong.