On a roll, virtually - Arun Kejriwal (Founder, Kejriwal Research & Investment Services)

The current year has been a great year for stock markets in India and the world. Dow Jones gained over 4,700 points (24.41 per cent) to be at 24,585. In India the BSE Sensex gained over 6,400 points (24.14 per cent) to close at 33,000, while the Nifty gained 2,000 points (24.52 per cent) to close at 10,200. Interestingly, our benchmark indices have matched Dow and registered similar gains of just fewer than 25 per cent. These are excellent returns by all standards and beat the often-mentioned 13-15 per cent as long-term returns in the stock market.

The broader markets saw BSE100, BSE200 and BSE500 gain 27.03 per cent, 28.28 per cent and 30.47 per cent, respectively. While the BSE midcap gained 39.56 per cent, BSE smallcap 49.27 per cent. The best performing sectoral index was BSE consumer durable, which almost doubled gaining 93.90 per cent.

After demonetisation the real estate has undergone lot of pain and transformation and has emerged significantly stronger. This led the BSE realty index gaining 84.64 per cent. The only index in the red was BSE healthcare, down 5.69 per cent. The other sector, which was in the news for poor performance, was BSE IT, which gained only 6.72 per cent.

The year saw the ruling party (BJP) make a big dent and score a landslide victory in the largest state, Uttar Pradesh, and upstage the ruling Samajwadi Party. The SP had tied up with the Congress for the polls this year. The UP election results, declared in March, saw the markets make a decisive move and gain sharply. The markets have been on a roll virtually since then.

There were some headwinds as well. The first was demonetisation, which happened in November 2016. Effect of this was felt in the quarterly results ending December 2016 and the 2017 April-June quarter as well. GST introduction was an issue and there was considerable debate about the launch date. It was finally rolled out on July 1. This led to most industries seeing a virtual stoppage of deliveries in the last week or fortnight of June. This impacted quarterly results for the April-June quarter.

In the rollout month of July one saw some strikes, protests and then normalcy after a couple of months. Rates of many products were also changed, which saw muted sales in the July-September quarter.

While GST is now there to stay, the impact of its introduction did affect the corporate India and cause obstruction to the expected growth. Despite these headwinds, this does not give reason for the poor showing of companies as expected growth is elusive for three years now.

Fund raising has been at its best in 2017. The last time that one saw the highest collection was in 2010 when 64 companies raised Rs 37,535 crore. This time in the eleven months of 2017, 33 companies have raised Rs 65,923 crore. Significantly, of this Rs 65,923 crore, around Rs 54,793 crore (83.11 per cent) was by way of offer for sale by private equity (PE) investors and promoters. Only 16.89 per cent (Rs 11,130 crore) is by way of fresh issue by companies going public. This amount does not include the sum of Rs 55,000 crore (approx), which has been raised by way of QIPs (qualified institutional placements) in the period under discussion.

Some of the key factors that have helped this huge fund raising began with demonetisation in November 2016. That single incident brought many investors from tier 2 and 3 towns to the capital

market by way of investments in mutual funds. SIP (systematic investment plan) is seeing inflows of over Rs 6,000 crore a month for the past 12 months and is inching upwards.

The strength of this number is borne out when one looks at institutional business in the secondary markets. Even when foreign portfolio investors (FPIs) sold, domestic institutions have been net buyers. This augurs well for the capital markets and indirectly helps in forming an unofficial sovereign fund. There could be pressure on this inflow once markets correct say around 10 per cent in the coming year. It would be interesting to watch how many of SIPs then get stopped, discontinued or put on hold.

On the divestment front, the investment committee called 'Dipam' has done a great job so far. Against a target of Rs 72,500 crore for FY18, they have done Rs 52,389 crore with a clear 3 months to go. Two of the railway companies, namely IRCTC and IRFC, are on the list and could happen sooner than later. IRCTC, the railway portal, is the cash cow in the group and has a business that is probably one of its kind globally. This company is bound to demand a steep valuation due to its unique business model. It sells tickets for railways and pays on journey happening as theoretically the ticket could also be cancelled.

What would be fund-raising like in 2018? I asked Pranav Haldea, managing director of Prime Database Group, for his views. He said: "The fund raising in 2017 is a record by itself. The fact that almost 83 per cent is by way of offer for sale by private equity and promoters is not necessarily a bad thing that PE's have sold. The funds realised would bring about redeployment of resources into new companies needing capital. There is a healthy pipeline of primary issues and fund raising would continue".

On over-subscription by leveraged HNIs where issues were getting unrealistically subscribed, Pranav said, "That till listing gains happen this would continue even though it is not a healthy phenomenon."

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During the year gone by it was a common thing to see on television and read in print that every correction was an opportunity to buy and by and large almost everybody was proved correct. 2018 is another year, and it would be difficult to replicate the year gone by.

On the political front, while Karnataka will go to polls in April-May, Madhya Pradesh, Rajasthan and Chhattisgarh would see elections in November. Elections in some of the northeast states like Tripura, Meghalaya and Nagaland are also to be held around that time. While these states election results would cause some movement to the markets, they would not change the trajectory completely.

On the global front, Dow Jones and the US economy would have a great impact on our markets. Currently, they are at a lifetime high like our markets. While the US Fed raised rates by 25 basis points on Wednesday, it also suggested/hinted of three such hikes in 2018. This would have an effect of squeezing liquidity and making money available for markets that much more expensive. With valuations being a concern and expected returns because of higher cost of money being the norm, asset allocation would become that much choosier.

Besides this, geo-political concern would have a big impact on global markets and could derail any positive trend in the short to medium term. Further the rise in crude oil prices could hit India in an adverse manner. The rupee has been steady and has helped in keeping our imports particularly that of crude oil under control. With the increased use of natural gas and higher standard of living,

demand for petroleum products would be continuously rising making our imports that much more. In such a scenario crude rising above $60-65 would have a double whammy effect as rising crude would also weaken the currency.

In such a scenario how do equity markets or other asset classes look in the New Year? The issue with last year has been that for the third year in a row company results failed to deliver the expected growth that markets expected from them. It means valuations moved up significantly, even as earnings lagged. The price earnings ratio for the BSE Sensex is currently at 24.60 times while that for the Nifty 26.25 times. The Nifty PE has moved from 21.41 at the beginning of the year to the current level of 26.25 times.

On 2018, said Nilesh Shah, managing director of Kotak Asset Management, “This year people would have to moderate their returns expectation from the markets. While there would be a recovery in earnings, there would be no expansion of valuations”.

On probing further whether the returns of 25 per cent made in 2017 could be matched or not, he was categorical and said: “110 per cent returns of 2017 would not be matched. You should expect high single digit returns.”

Raamdeo Agarwal, co-founder and joint managing director of Motilal Oswal, had similar views. “Earnings must come in FY19. Structural flow of liquidity should continue,” Agarwal said. On possible returns even though he is bullish on India and stock markets, he believes “next year one should look at returns of between 10-15 per cent.”

On the road ahead, Navneet Munot, CIO of SBI Mutual Fund, said: “The most important driver for FY19 would be the growth trajectory. Pushing valuations higher will be tough. It has to be backed by earnings growth. Bond yields have bottomed out. Rates are likely to move up.” He also cautioned, “Returns will have to be moderate and any expectation with last year’s performance would be incorrect”.

Moving on to sectors to look to make money in 2018, one logical call would be to invest in the most beaten down sectors like healthcare and IT. Said Nilesh Shah of Kotak: “look at the disruptor versus the disrupted. Artificial intelligence, data analytics are sectors where money would be made. Look at companies in these sectors not the ones in products and the run-of-the-mill services. In case of pharma or healthcare, look for companies with fundamental research capabilities”. He also cautioned investors. “Do not buy simply because the share price had fallen and the sector had done badly. Second, even if there was value in the sector it would be in individual companies and not the sector as a whole,” he said.

Nilesh made a very valid point when he said, “IT and pharma need catalyst for returns. The rupee depreciation needs to happen for IT and also pharma. Second catalyst could be the US FDA approval for new products and for IT sector it could be bigger spends.”

Echoing the view, Navneet Munot said, “Individual stocks could merit attention not necessarily the whole sector.” He warns about the “huge run-up that has happened in the NBFC sector and would like investors to be cautious about the same.” He is optimistic about primary market fund raising and trusts that would continue. More importantly, he believes “the capex cycle has bottomed out and there would be private investment and fundraising for the same. Maintenance capex has begun everywhere and that itself would be a sizeable amount”.

“Returns will moderate to single digit to low teens,” he said.

I believe that the returns moderating was across the board with everyone I spoke to and the underlying thought was that 2017 was too good. A repeat of that in 2018 is impossible and should not even be thought of.

Agarwal likes private insurance companies, diagnostic labs and part of the BFSI space. He believes 2018 could be the year of AMCs (asset management companies), where one finds many such companies being listed. While Reliance Nippon has listed, HDFC, ICICI and UTI are in the process of doing so. Once we have 3-4 companies in this space, it will throw up an opportunity to evaluate and invest in this sector. The way SIPs are increasing, it seems these companies would attract lot of attention and investment.

Insurance saw just one company listing in 2016 and suddenly in 2017, in less than six weeks we saw a re-insurer, a government general insurance company, two life insurance firms and one private general insurance entity listing. Couple of more companies is on the way. Thus suddenly you would have the listed insurance companies having raised close to Rs 45,000 crore from the market. We have many more to follow and the sector was the sunrise sector in 2016 with people wanting more and more exposure.

A PMS fund manager who didn’t want to be identified due to compliance issues, said, “Easy money making is over. Expect and target only single digit returns. While the IT and pharma space look exciting as contra bets, place them carefully”. He likes the diagnostic labs part of the healthcare business. Yet another theme based investment for him is the “rural” theme, which includes affordable housing and FMCG.

Under affordable housing one gets a wider spectrum of companies and sectors like infrastructure with steel and cement, road developers, entities doing work for NHAI and, of course, housing finance companies catering to bottom of the pyramid and associated with the government housing scheme where there is a subsidy on interest payment. He made an interesting quote, “later the correction, more the pain”.

Markets would be driven by local and global factors as well. Geopolitical tensions, crude oil, the US economy besides local factors like economic data points and political developments would all influence and affect our markets.

Having interacted with some thought leaders and learning from their valuable insights, a couple of points emerge.

First, returns in the New Year will be lower than the ones earned last year. The going will be tough and one would have to be selective in what they invest in.

Second, the real estate looks like an interesting proposition considering the measures introduced and the thrust on ‘housing for all’ and affordable housing.

Third, pharma and healthcare can be looked at but only company wise not the entire sector.

Fourth, fundraising will continue and could surpass last year’s number with government and private companies raising capital.

Finally, one has to keep his cool, patience and invest with clear thought, before one can beat the fixed deposit returns and make money.