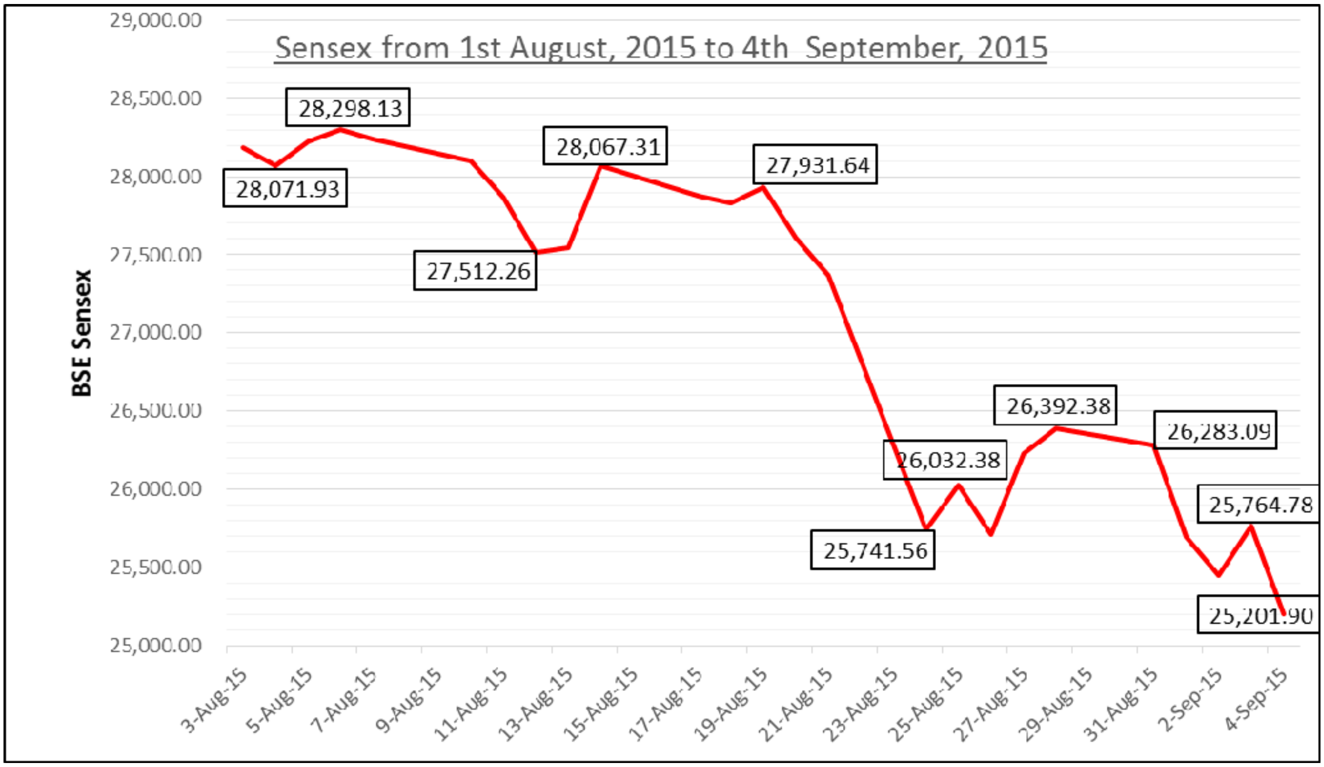
AXIS Equities Pvt. Ltd.
58, Mittal Chambers, 228, Nariman Point, Mumbai - 400 021
Tel. : 6115 1919 Fax : 6115 1999 Email : dipanmehta@vsnl.com

Markets get Mauled in August



Stocks tumble on Chinese economic woes

The Sensex declined by 6.51 % in August; its worst monthly performance since November 2011, 45 months ago. At the present level of 25,201.90 (04-09-2015), the benchmark index is up just 4.48 % from its 16th May, 2014 close of 24,121.74, when the Lok Sabha election results were released. Gains of the past 15 months have been nearly wiped out due to a confluence of domestic and global factors.

FIIs sold a massive 17,209 crores during the month as a *risk off trade* in global markets unfolded on fears of a hard landing in China. There were other concerns as well such as hike in US interest rates, deflation and slowdown in the world economy which rankled investors across geographies. Indian equites lost value in line with fall in global markets and but for support from local institutions, who pumped in a record 16,248 crores, the decline in Sensex would have been even higher.

Over the past few weeks, the media has covered the slump in global stock markets fairly well and many explanations have been offered; but for the average Indian investor, the key question which remains unanswered is: *Is it a Bull Market Correction or Beginning of a Bear Market?* This month's newsletter is an attempt to answer this question which is of paramount interest to investors.

Is it a Bull Market Correction or Beginning of a Bear Market ?

Investors need to distinguish between a bull market correction and a bear market

This is the big question on every investor's mind.

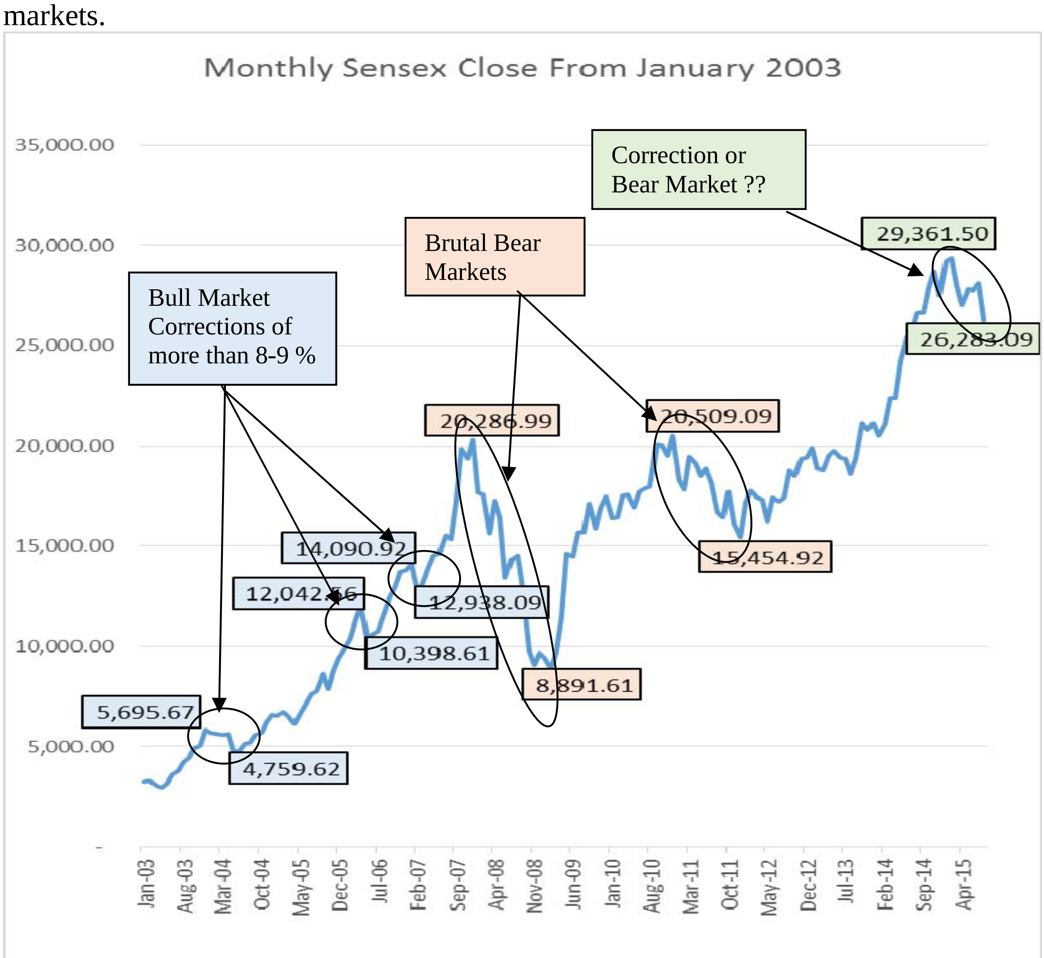
Bull Market corrections are manageable and in fact opportunities to increase exposure to equities. Bear markets on the other hand are tough and test the resolve and skill of even the most astute players. Therefore, at this stage of the market, where a correction has already set in, it is important to assess if this recent bout of selling is a *Bull Market Correction or Beginning of a Bear Market ?*

As expected, there is no easy answer.

When stock prices are collapsing all around, it is difficult to figure out if the fall is a temporary blip in a rising market or the turning point of a bull market and the beginning of a bear market. It is only in hindsight that investors can conclude that the fall in stock prices was just a bull market correction or that the bear market has begun. Since the last bull market, which began in 2003, there have been 5 instances when the Sensex declined by more than 8 %. In three of these instances, the prices recovered lost ground and in other two scenarios, the selloff deepened and initial declines turned out to be the beginning of a bear market.

Past decline in the Sensex

The Monthly close of the Sensex from January 2003 below depicts the corrections which were bull market corrections and those which turned out to be gruesome bear markets.



In the Sensex graph above, it is clear that in the bull market from January 2003 to December 2007, there were three meaningful corrections.

- December 2003 to May 2004, when the Sensex on a month end basis declined from 5,695.67 to 4759.62, a fall of 18.49 %.
- April to May 2006, when the Sensex fell by 13.65 % from 12,042.56 to 10,398.62.
- January – February 2007, when there was a mild correction of 8.18 %.

After these three bull market corrections, the Sensex peaked in December 2007 and a brutal bear market set in which lasted for 14 months and knocked off 56.17 % of the value of the Sensex from a then all-time month end high of 20,286.99.

Finally, the last recorded bear market started in December 2010 and ended a year later with a fall of 24.64 % (December 2010 to December 2011).

At this stage, it important to reiterate that the two bear markets mentioned above, originally started as bull market corrections and it was only after the fall was substantial and relentless that investors realized that a bear market was under way. This brings us to the key question of what was different from the last two corrections, which turned out to be bear markets, from the previous three which were minor reversals in an otherwise strong bull market.

The answer to this question may perhaps help us determine if the recent fall of 16.34 % in the Sensex, from its 4th March, 2015 high of 30.024.74, *is a bull market correction or the beginning of a bear market ?*

Analysis of past corrections in the Sensex

In our analysis of the five corrections listed above, we have ignored the qualitative factors such as the reason for the fall in stock prices. Instead, focus has been on quantitative aspects such as the length of the correction and the growth in corporate profits in the following two quarters. Just a simple analysis of these two factors throws up amazing results which can enable us to have a fair judgement of whether the present bout of selling in equity values is temporary or whether we are in for another bear market.

Beginning and Ending Months of the Correction	Time Period	Decline in Sensex (%)	Growth / Decline in Corporate Profits (all NSE listed Cos)		Observations / Outcome
			First Full Qtr after a 8 % fall in Sensex	Second Full Qtr after a 8 % fall in Sensex	
December 2003 to May 2004	5 months	-18.49%	38.11%	28.32%	Bull Market Correction
April to May 2006	1 month	-13.65%	58.94%	89.05%	Bull Market Correction
January to February 2007	1 month	-8.18%	41.87%	16.50%	Bull Market Correction
December 2003 to Feb 2009	14 months	-56.17%	12.34%	-10.11%	Bear Market
December 2010 to December 2011	12 months	-24.64%	0.20%	-34.19%	Bear Market

From the table above, it is very clear that if

- The time period of correction is less than 6 months; and
- There is no perceptible slowdown in corporate profits in the second full quarter after a 8-9 % correction,

then a fall in stock prices should not lead to a full blown bear market.

Application of this Analysis

The problem with this co-relation / connection is that months pass by before we can conclude if the initial 8-9 % fall in equites will lead to a change in the primary trend from a bullish one to a bearish one. Therefore, investors must keep an eye on the time lapse since the last top was created, in this case it is 5 months, and the news flow from the corporate world.

Are managements turning cautious ? Are profit warnings being issued ? Is there a general slowdown in demand ? These are the signs which investors should look out for. Analysts downgrades of earnings is another data point which can provide an insight into how profitability may shape up a couple of quarters down the line.

The last earnings season for the June quarter did not show any indication of profit slowdown. Since then, very few companies have come out with any negative announcements. The mood remains optimistic with an interest rate cut in September being a highly probable event. This would augur well for the bottom-line for several sectors which are sensitive to interest rates. The monsoon although subpar is not a threat to economic growth.

Investment Strategy

Keeping these trends in mind, we are inclined to term this fall equities as a healthy bull market correction. Our view would change if the time and depth of this correction intensifies and profits from India Inc. come under stress.

We advise investors to gradually buy into good quality stocks. Focus should be on companies which have good corporate governance standards and steady performance over the past few quarters.

The average returns of the portfolios managed by us are as follows :

	1MONTH	3 MONTH	6 MONTHS	1 YEAR	3 YEAR	5 YEAR
Axis Equities Portfolio Performance	-8.70%	1.55%	-1.95%	18.54%	31.57%	15.06%
SENSEX	-10.23%	-6.66%	-14.70%	-9.09%	9.89%	4.02%
NIFTY	-10.13%	-6.45%	-14.60%	-7.58%	10.12%	4.27%
Out - Performance (higher of Sensex or Nifty)	1.43%	8.00%	12.65%	26.12%	21.45%	10.79%

Dipan Mehta