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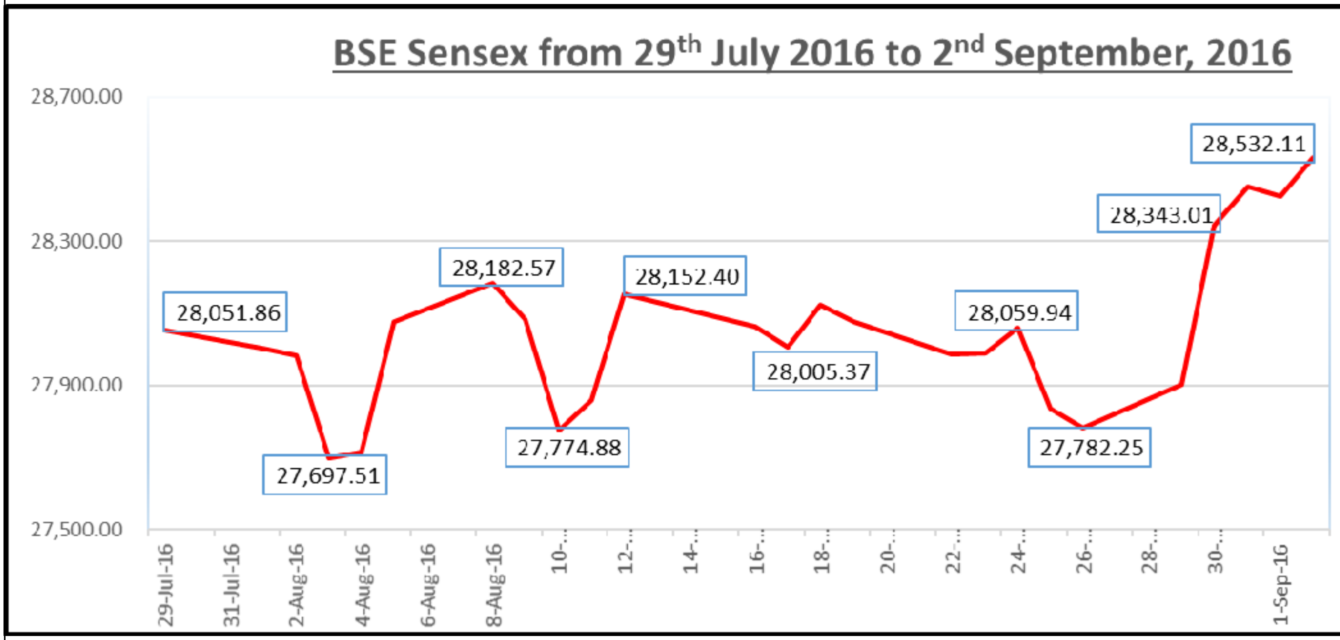
Sensex Consolidates in September



Sensex flat Mid Cap Index at New High

The Sensex traded in a narrow range in the month of July, with a marginal gain of 1.43%. The action was in the mid cap stocks, with the NSE Midcap Index scaling to a new life time high of 15,370.85 (31/08/16) a rise of 4.04 % for the month. Liquidity flows remained very strong with FII net purchases at Rs. 8,882.85 crores and domestic mutual funds (MF) buying at Rs. 3,609.31 crores. Major sellers were the state owned insurance companies, banks and other financial institutions (excluding MFs), who pressed sales to the tune of Rs. 8,015.62 crores during the month. This is a familiar trend, which reverses when corrections take place. In down markets, it is the same state owned insurance companies and financial institutions which buy when FIIs and / or MFs are selling. Nothing alarming, as the stock moves from one set of strong investors to another. What is different is their style of trading, while the FIIs and MFs are price makers, the state owned insurance companies are price takers.

Third Anniversary of this Bull Market

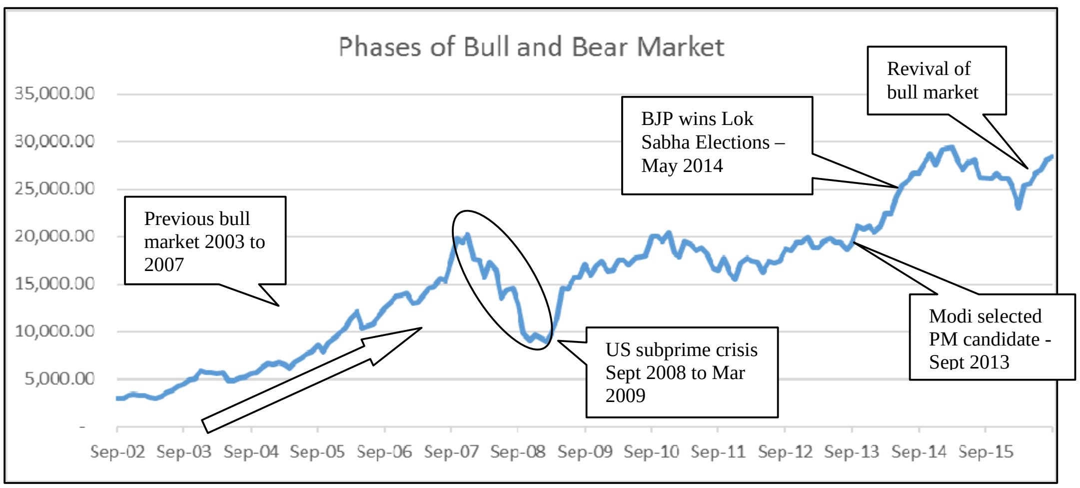
This see-saw between these two classes of investors is not new but what is interesting is that this bull market has now completed or nearing completion of 3 years; and that does merit a discussion; but first, an explanation of why 3 years. The underlying chart of the monthly close of the BSE Sensex clearly shows that from around August / September of 2013, the trend has been steadily positive. There have been corrections but the secular trend is upwards; which is what defines a bull market. As such bull markets do not have any specific starting or ending dates, however, from the point of time when new lows are not created and new intermittent highs are formed, becomes the starting point of a bull market. More often than not an event takes place, which in retrospect, appears to be the turning point and then that day may be termed as the birth day of that bull market by stock market historians.

We choose that day as the 13th September, 2013.

On that day, the BJP party choose Narendra Modi as its prime ministerial candidate. Many remember 16th May, 2014 as a red letter day as the Lok Sabha election verdict was announced on that day, but in our view, 13th September, 2013 is more important and it marked the turning point in India's political history.

Modi Wave Triggers a Bull Market

Narendra Modi's strong leadership and charisma led to a *Modi* wave and after decades of coalition governments, we had one single party with a majority in the lower house of parliament. Had the BJP, not taken such a decision, the outcome could have been vastly different, which is why we view 13th September, 2013 as more important than the day of the Lok Sabha results. Around the time it was clear, that Narendra Modi would lead the party, the street started building expectations of a BJP led right wing coalition government and from that point on, the bull market commenced. When actual victory was announced in May 2014, and Modi became PM, the bull market was well and truly on its way (as is visible on the graph). On 13th September, this year, this bull market will complete three years and is an important anniversary not only to celebrate but also deliberate and understand its form, structure and difference from earlier bull markets.



Differences with Earlier Bull Markets - Lower Returns

Firstly, this is a more sedate bull market. The three year returns are 46.81 % as against 281.11 % in the first three years of the previous bull market, which we reckon started in April 2003 and ended in December 2007. At this juncture it is important to note that preceding this bull market, we have witnessed 3 bull markets:

Earlier Bull Markets	Return	Period	Predominant Theme
Jan 1991 to March 1992	336.21%	15 months	Liberalisation, Harshad Mehta
November 1998 to January 2000	85.20%	15 months	Technology, Media and Telecom
April 2003 to December 2007	585.42%	4 years and 9 months	Global Liquidity, Economic Revival, Low Interest Rates

The best comparison of this bull market is with the April 2003 to December 2007 one as it was spread out over a reasonably long period of time and covered majority of the sectors unlike the earlier ones which although spectacular, were short lived.

Lesser Direct Retail Participation

Secondly, retail participation is through mutual funds and portfolio managers. Already we are in the third year and yet there are no visible signs of trading froth / leverage in the futures market or penny stocks sky rocketing. This is a clear indication that retail investors are not directly participating but leaving it to fund managers to get them the best returns.

This is a new and very powerful phenomena and makes this bull market very different from past bull markets. This trend reduces systemic risk and ensures better allocation of resources over the long term. Eventually it will lead to durability, consistency and steady returns - all the elements required to attract long term domestic household savings. What we are observing is that quality businesses, which are showing secular growth, are being chased by professional investors and are now trading at higher and higher price earnings (PE) multiples, unlike sub standard businesses hogging the limelight in earlier bull markets.

Enormous Challenges in Global Economy

Thirdly, there is stagnation in the world economy but our markets are thriving. We are in a '*new normal*' with central bankers trying to fight deflation and increase growth rates with monetary expansion. This is leading to negative interest rates and driving global investors to turn to even more riskier assets to derive meaningful yields. Sovereign balance sheets are stretched and threats of trade wars and protectionism may lead to lower trade flows. This may explain the dichotomy between large cap stocks and mid cap stocks here as many large index stocks (technology, commodities and pharma) are exposed to international down trends whereas midcaps are more domestically focused. This is different from earlier bull markets which were more synchronized with trends in overseas markets.

RBI Interest Rate Policy based on CPI

Lastly, there is a sea change in India's monetary policy with interest rates being based on consumer price inflation (CPI) and not wholesale price inflation (WPI). This is an important differentiator as interest rates in India would have been significantly lower had we determined them on the WPI; which is in flat to negative territory. By pegging our interest rates to the CPI, the scope to reduce interest rates to spur domestic growth is restricted and that has also impacted GDP growth rates and stock market returns which could have been higher, perhaps more in line with the previous bull market.

This Bull Market still has Distance to Cover

The objective of drawing investor attention to the third anniversary of this bull market and analyzing its differences with earlier ones is for us to use this insight to strategize and plan for the future. If the first difference is that returns are muted, then the logical inference is that investors must lower expectations or that this bull market may last longer as it strives to match the returns of the earlier bull markets.

Assuming that this bull market at least matches the lowest of the earlier 3 bull market returns of 85.20 % (November 1998 to January 2000), the Sensex would have to trade at 34,487. To keep pace with the second highest returns generated by a bull market (Jan 1991 to March 1992 – 336.21%), the Sensex would have to cross 81,221.50. (We are not even going to extrapolate the likely returns of this bull run with the preceding one of 2003 to 2007 as it may lead to unrealistic investor expectations).

The lesson in this is that investors need to be patient and invest for the long term. There may be periods of corrections and also times, such as the present, when valuations are expensive. By following a disciplined approach to stock selection and remaining invested in the downturns, exceptional returns can be generated. Another angle to consider is that the composition of the Sensex and Nifty may undergo a sea change over the next few years. Laggards such as refining, telecom and software companies may make way for new high growth companies and therein lies an opportunity for investors if they are able to identify such businesses.

Invest in Quality Stocks

The second difference is that quality stocks are leading this bull market and investing is such companies should be the mantra with investors. Avoid corporations with leverage, bad corporate governance and poor growth dynamics. There is greater risk in buying an ordinary business at cheap valuations than purchasing an extra-ordinary company at expensive PE multiples. Such phases of high valuation will subside through timewise or pricewise corrections and investors should not get carried away by chasing stocks.

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Volatility in Global Markets, Order of the Day

The learning from the third differences is that we are living in a dangerous world where upheavals can take place at any time. We are in unchartered territory and the global trends we are witnessing have no historical precedence. Should a crisis occur, traditional counter measures are not available to mitigate the impact. Investors are safer in companies which have a strong domestic footprint.

Interest Rates may not Trend much Lower

Lastly, we must not expect interest rates to trend much lower, a maximum of 1 % is all that should be factored in provided global commodity markets remain bearish. Even with the lowering of interest rates in the past two years, the GDP growth rate has not crossed 8 % and for June quarter it was a disappointing at 7.1%. The question we ask is that is 7.5 % to 8 % the real capacity for growth of our country? We may aspire for higher growth rates, but every individual, enterprise and nation has its limitations and the optimal growth rate, for us could be in the band of 7 % to 8 %. Investors must therefore be careful in investing in companies which are very closely linked to industrial activity as that may not expand as expected.

Wait and Watch Approach

Keeping all these nuances in mind, and the present valuations for blue chips, we maintain our wait and watch approach to equities. Existing investors should resist the temptation to book gains yet be prepared to weather a correction and perhaps deploy more cash to equities during such down market days. New investors or those with intent to increase equity exposure should invest very slowly and only when the opportunity presents itself in the form of a sell off either across the market or stock specific declines.

The portfolios under our management have delivered the following average returns:

Date From	**01/08/2016**	**01/06/2016**	**01/03/2016**	**01/09/2015**	**01/09/2014**	**01/09/2013**	**02/09/2011**
	1MONTH	**3 MONTH**	**6 MONTHS**	**1 YEAR**	**2 YEAR**	**3 YEAR**	**5 YEAR**
Elixir Equities Portfolio Performance	**2.18%**	**13.43%**	**31.88%**	**19.15%**	**21.32%**	**32.68%**	**22.63%**
SENSEX	**1.40%**	**6.69%**	**22.61%**	**10.31%**	**5.03%**	**12.97%**	**10.06%**
NIFTY	**1.69%**	**7.68%**	**24.62%**	**12.44%**	**6.89%**	**15.00%**	**10.96%**
Out Performance	**0.49%**	**5.75%**	**7.26%**	**6.71%**	**14.43%**	**17.68%**	**11.67%**

"*Strategy for Bull Markets*" is the topic of discussion in this month's Smart Investing Series. It is most appropriate as we are in the midst of multi-year bull market and this piece may answer many questions which are in the minds of investors.

Dipan Mehta

SMART INVESTING – X
- Strategy in Bull Markets

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Investors Harvest Gains in Bull Markets

After sowing the seeds in a bear market and tirelessly toiling in a grinding, rudderless sideways market, the bull market is when the investor reaps the harvest that equities as an asset class has to offer. It is when the fruits of patience and discipline are rewarded and the true wealth creation effect of the stock market is visible in full flow. It is often said that what you sow is what you reap and with that perspective, if the investors has managed the bear market and the subsequent range bound movement, well then the bull market will make it well worth the effort and fortitude of investing in equites. Negative to flat returns of the past are recuperated and the full benefits of compounding effect which the market has to offer are realized.

Common Mistakes to Avoid

Many have described bull markets as "*party time*" and they are not wrong as it is a time to rejoice and celebrate, but with all parties, it is important to ensure that the after party hangover is minimal and that can only be achieved if the party is enjoyed in a responsible manner and the animal spirits are not unleashed.

Selling Early is not Advisable

There are many common mistakes which investors make during a bull market and that does come around to haunt as all bull markets end and traders and senseless investors are left in ruins. In the beginning of a bull market, the investor tends to get fearful and sells early, only to see stocks soar thereafter, which is avoidable. Smart Investing has a simple dictum which can be followed to prevent this error: As long as the company is delivering on its financial parameters, do not sell, even if the stock price has soared and now trading at multiples you feel uncomfortable with, resist the temptation to sell. Bull markets do expand the PE multiples and investors will be surprised at the price their stocks will quote at during that period. The earnings trajectory may be as per expectations but the gains made may be well beyond expectations.

Changing Horses may not Always Yield Results

The urge to switch from one performing stock to another should also be avoided as it is better to remain seated in a running train than jump and catch another running train. Should there be minor (or major) jolt in a bull market, having the stock price trade at levels above your cost does help in remaining invested. On the other hand, notional losses on a newly created position may induce fear and drive the investor to sell early. Another aspect to consider is that the longer an investor is invested in a performing story, the more conviction he / she is likely to build and that does help in managing the daily / weekly gyrations in a stock. It is the best way to manage the natural volatility which plagues all shares.

Investors must not Dilute the Quality of their Portfolios

The other blunder which investors make is compromising on the quality of their portfolio. The characteristics of a bull market are that

- every day there are new stocks being discovered
- many counters touch new highs
- unscrupulous managements spin stories of how exciting their businesses are
- market operators create price volume action which suck innocent investor
- large dollops of capital are raised and diverted to uncertain ventures and acquisitions.

All of these are diversions which may lead the investor to invest in a poor quality business or become the victim of scams perpetrated by company managements or stock market operators. It is only by sticking to quality and ignoring the noise, that these threats in a bull market, can be successfully thwarted. There may be mistakes but by following the golden rule of diversification, the damage done by such mistakes may be limited. Investors must realize that just as the right stock can multiply tenfold in a bull market, a wrong one can lose 90% of its value in a bear market.

Chasing Blue Chips at Expensive Valuations is Detrimental

The final risk in a bull market is to pay too high a price for a superior business. It is very easy to get carried away and buy a blue chip company at an expensive valuation. The company has done well, the management is dynamic, the industry prospects are great, so what if we are paying a premium? This is the common logic which investor apply and perhaps justify buying a company at high PE multiples. However, this thinking is faulty and untenable. Its flaw is best explained in the words of the Oracle of Omaha, Warren Buffet when he says that:

> *"For the investor, a too-high purchase price for the stock of an excellent company can undo the effects of a subsequent decade of favorable business developments."*

The meaning of this is that all the positive upsides have been captured and discounted and even if the company were to do well in future, its stock price will not show a sizable appreciation.

So far in this discussion on strategy in a bull market, we have only highlighted mistakes which investors should avoid, but that in essence is the tactic which investors need to follow – AVOID ERRORS. Bull markets are magical moments and great wealth does get created during this period. It is the preservation of this wealth where there are maximum challenges. By avoiding these traps, investors will able to take full advantage of a bull market and prepare themselves for a bear market.

Signs that a Bull Market is Topping Out

Lastly, any discussion on this topic would not be complete without a few words of wisdom on signs to watch out for that a bull market is coming to an end.

1. Excessive leverage in the system, be it futures market or advances against shares. This becomes evident in the cost of carry between the cash and futures market.
2. Mega initial public offerings (IPO). In the 2003-2007 bull market, the Rs. 11,560 crores Reliance Power IPO marked beginning of the end of that bull market. At bull market highs, corporates indulge in fund raising and that is another sign to watch out for.
3. Spike in penny stocks. In stock market parlance 'cats *and dogs'* also begin to rally and that is never a good sign.
4. Heightened direct retail participation by novice / first time investors.
5. Surge in trading volumes in the cash and future market.
6. Stocks and markets become the talk of the party circuit and frequently make it to the front page of the non-business newspapers.

Investors must look out for these signs and attempt to book profits.

To conclude, strategy for bull markets is to avoid mistakes and watch out for signs of market topping.

Dipan Mehta