Watch out for US tapering, economic growth as triggers for markets; largecap stocks preferred | INTERVIEW

By: Kshitij Bhargava | September 05, 2021 9:07 AM

Deep corrections will provide an opportunity to buy deep cyclical stocks.

"We are not expecting a sharp correction. " (Image: REUTERS)

US tapering of quantitative easing, India's growth outlook, corporate capex, and revival of the banking sector are among the key triggers for domestic stock markets, according to **Dhananjay Sinha, MD & Chief – Strategist, JM Financial Institutional Securities**. In an interview with Kshitij Bhargava of Financial Express, Dhananjay Sinha said that he does not expect a sharp correction while adding that any correction would only provide an opportunity to buy deep cyclical stocks. Further, Dhananjay Sinha discussed what IPO investors should do to avoid listing losses.

What are the major triggers for domestic stock markets in the next few quarters?

Major factors pertinent for India's market outlook are a) the trajectory of US tapering of quantitative easing (QE), b) India's outlook on growth in the context of a potential slowdown in China and peak out of the stimulus led rebound in developed markets, especially in the US, c) decline in global commodity prices, d) potential revival in corporate capex and e) growth revival in the banking sector. Expectations of earnings growth of 25-30% are fairly aggressive and there are pockets of over-valuation enabled low interest rates and surplus liquidity. The key question will be whether the markets will continue scaling up as it did since Mar'20 amid the above factors or will it be a gradual path going forward.

In the event of a heavy correction, where should investors go to find a safe haven?

We are not expecting a sharp correction. However, our sector preferences (given below)should be good enough to withstand volatility. Deep corrections will provide an opportunity to buy deep cyclical stocks.

We saw many people promote the hypothesis that India will benefit from the China+1 strategy, is that taking shape in any form right now?

Over the past 4-5 years several Asian countries like Cambodia, Philippines, Vietnam, and Bangladesh have been benefiting from de-industrialisation and structural shift of China into services and domestic consumption led economy, which is a departure from its earlier predominantly investment and exports strategy. Trade conflict between US and China, including relating to US sanction and Chinese counter sanctioning measures and tech fragmentation are leading to some diversion of FDI flows into other countries. The pandemic impact has also resulted in reconfiguration of supply sourcing from other countries. And the newly formed trade bloc RCEP has stimulated FDI investments in other countries, even while China continues to garner large FDIs. Under the theme of China plus one, India has gain in areas of chemicals and pharmaceuticals exports. However, there has not been any perceptible rise in FDI into the manufacturing sector as yet with an average inflow of USD1-1.4bn per month, a third of total FDI. Like India, several countries are offering policy support to attract FDI to tap the opportunity under China plus one. We will also need to investments in industrial infrastructure to realise the full potential

Foreign investor flows made a u-turn recently, what is the primary reason behind that and could it change in the near future?

Portfolio flows into cash equities have been negative since April 2021 but on overall basis it is positive. However, there has been a significant moderation since 4Q 2020 and 1Q 2021. The reason for the moderation is strengthening in US dollar with rising evidence of strong growth and speedy progress in vaccination process in the US. In addition, rising inflation feeding is feeding into expectations of QE tapering sooner than expected. We think QE tapering will begin in the next in a month of two with a monthly reduction of around USD15-20bn in US Fed purchases. Over the longer term as the Fed continues on its normalization process, US money supply to GDP ratio can decline from the peak current peak of 90% to 80% by end of 2024. This would imply that the portfolio flows into Emerging Markets would also normalize. However, since this is going to be a predictable smooth glide path, market impact will remain fairly predictable.

We saw recent IPOs list at a discount, is it a sign of worry for IPO investors, or only a short term trend?

The strong interest in the IPO segment has been in response to the strong run we have seen in the small and mid-cap space on the back of large retail investor participation. The recent listing discounts are due to some correction in the small and mid-cap stocks. Here, our suggestion remains to be careful about the valuations and market strength of the companies.

What pockets do you believe are the most attractive right now?

We are positive about consumer sectors including stables, consumer discretionary, technology, and select pharma and industrial stocks. Based in comparison of relative valuations, we think the large cap segment should perform relatively better than mid and small caps. Autos will continue to see stress in the near term, but given the valuation comfort there can be good opportunities over the next 6-12 months horizon.