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Investing at Market Peaks

This article is authored by MOI Global instructor Amey Kulkarni, founder of Candor Investing, based in Pune, India. Amey is an instructor at Asian Investing Summit 2018, the fully online conference featuring more than thirty expert instructors from the MOI Global membership community.

The Indian stock markets have been performing well in the recent past and the benchmark Sensex Index reached an all-time high of 36,443 on 29th Jan-18.

Though the consensus is that India is the economy and the stock market to invest in, for the next decade investors are also worried about the fact that the Sensex is trading at historical valuations. Trailing P/E ratio is around 25 and P/B ratio of the Sensex is more than 3.

Worse is the BSE SmallCap Index which is trading at a trailing P/E of a staggering 112.

So, most investors are excited to invest in the India story, but are either not finding compelling enough investible ideas or are scared that a quantitative tightening or a global trade war or rising inflation/interest rates in the developed world may result in a valuation melt-down in India.

In such a scenario, individual investors are typically faced with either of the following questions

a) I have investible savings and I want to invest more in stocks/equity But, is this the right time to put more money in stocks?
b) With stock markets at an all-time high, should I remove some of the money already invested in stocks?

I will try and attempt to provide some pointers which might help in making an informed decision

Differentiating Business Cycle with Stock Market Cycle

Though it is true that stock markets are at an all-time high, the business environment in India is also probably at its best.

Oil prices are low and with the electric car disruption, expected to stay low in the medium to long-term, Indian fiscal deficit is under control, reforms like GST (Goods & Services Tax), bankruptcy laws (Insolvency & Bankruptcy Code 2016) have been put in place, the median age of Indian population is around 27 years, monsoons have been good for 2 years in a row, inflation is at historical lows for more than a year and interest rates are falling.
Thus, if the economy does better in the next 3 years than in the previous 3 years, the stock markets will end up much higher than what they are today.

What is risk?

The financial world defines risk in terms of volatility ie price movements (up/down) However, in my opinion, risk is the chance that one will permanently lose money in the stock markets. When will this happen?

If one makes a mistake in buying ie the companies one bought go bankrupt. To avoid this, one should invest in highly profitable companies with a history of good performance of at least a decade. This results in a low downside risk.

Also, one may invest in about 8-10 such well-managed companies.

There is a nuclear war or government nationalises the entire industry and we are back to being a Socialist State; chances of this happening is remote and one will have to live with it.

Investment time horizon

Indian economy is growing by an average of 7% with average inflation of 5%. In 6 years, Indian economy will be 2 times its current size.

If one invests with a time horizon of at least 6 years, the chances of losing money in the stock markets dramatically reduces.

Investing in Individual Companies

The companies that one has invested into do not necessarily have a correlation with the benchmark Indices which comprise of only 30 companies (in case of Sensex) out of the more than 5000 listed companies.

As an illustration, take the case of Vinati Organics. The company has given phenomenal returns (250 times) over an 11 year period; the interesting part is that it has also given great returns if one had invested 4-5 years back (11 times).

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	57	82	146	191	232	323	447	553	696	772	631	666
PAT	2	4	15	25	40	52	55	69	86	116	132	140
Stock Price	4	13	17	41	82	66	105	94	419	456	618	1028

Between 2006 and 2017, the markets have crashed and gone up several times, however the company performance has sent the stock price higher and higher.

One should buy into such companies at as cheap a price as possible and then hold for as long as the company is delivering good business performance.

“Stock prices follow business performance – ie prices rise when profits rise and vice versa” If one stays true to the above philosophy, then a temporary downturn in the stock markets does not cause any problems to the investor

Is the market currently over-valued? – some companies are definitely expensive.

Will the market crash further? – Maybe yes, but when – 2 months from now, 6 months or 3 years is what nobody can predict. Maybe stock markets will fall by 20%, but how long will they remain there? Stock markets fell by 10% just after demonetisation in Nov-16, but ended up 30% above previous highs just 15 months after demonetisation.

The more relevant point is whether the companies one has invested in are increasing profits year after year.