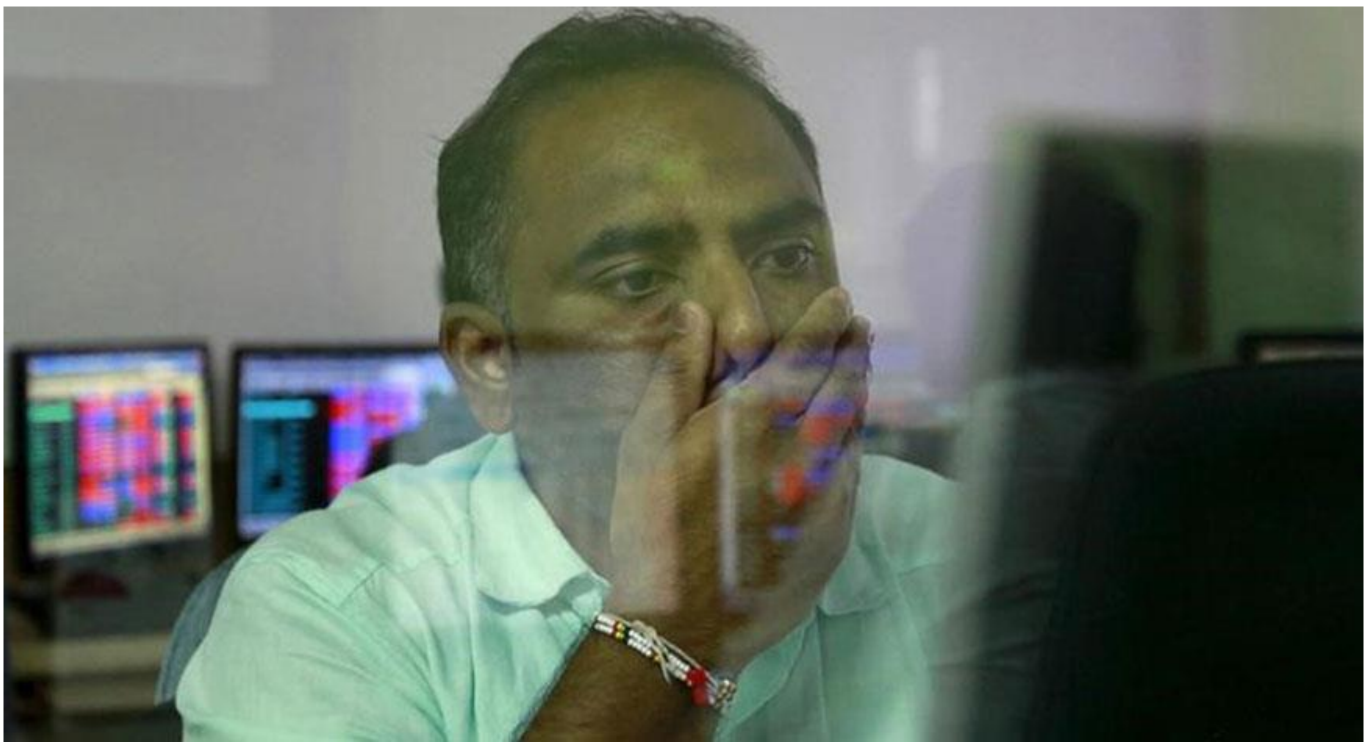
Stocks Crash As Global Sell-off Spooks Indian Markets

Investors should wait for the correction to get over before buying. However, a quick rebound cannot be ruled out



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Indian stock markets tumbled over 1000 points on the Sensex during the day on the back of a global sell-off. The massive sell-off has wiped out over Rs 4.5 lakh crore in the Indian equity markets. Stocks took a beating across the board.

All of Nifty's constituents were in the red during the mid-session showing that the sell-off is widespread and deep. Tata Motors plunged the most losing 6.3 percent followed by Axis Bank (5.12 percent) and IndiaBulls Housing (3.98%).

Earlier, the Down Jones fell 1175 points as bond yields surged repricing the riskier equity assets on the lower side. The 10-year bond yields in the US surged close to 2.8 percent mark briefly roiling the global equity markets. Rising bond yields will result in analysts repricing their risk of equity assets. The result is that the PE multiple of equity assets will start to shrink and reflect the cost of capital.

For some time now, the equity markets have been hovering over the 25 PE mark. In India, the Sensex PE climbed over the 27 PE mark on January 23. These peak valuations were seen back in 2008 when the markets went into a capitulation following the Lehman-crisis.

To be sure, experts don't expect a similar fate for the markets as the credit markets are still going strong. However, rising bond yields does have a bearing on short-term equity asset prices. The US Fed has signalled that there will be a further three rate hikes this year. If that happens, equity prices are more likely to remain range-bound with a downward bias than go running away higher.

The sharp drop in the US markets has become the reason of down fall in the global market. "At the same time, the rise we have witnessed in the Indian markets in the last few months has not been supported by any fundamentals so, a correction was imminent. So, for India there has been a double whammy - the global carnage has been coupled with the market correction that was looming. The negative sentiment from the LTCG tax decision is unlikely to have had a role in today's slide", said Preeti Goyal, Professor, Finance & Accounting, Great Lakes Institute of Management – Gurgaon

In the Indian markets, earnings growth has been tepid. Signs of a revival in earnings growth of around 9 percent has not expanded to the rest of the sectors. Hence, markets will remain on the back foot in the coming months.

Mid- and small-cap stocks were the bigger losers. The Nifty Mid100 and the Nifty Small 100 lost 3.1 percent and 4.1 percent respectively during mid-session. Over the last few months, excessive speculation in the mid-cap counters drove stocks of mid- and small-caps into the stratosphere. Investors who have entered late into the party are now left holding the bag.

Will it hold on the downside? The market could see a bit more turmoil as foreign investors and speculators unwind their positions. However, given that the domestic liquidity situation is strong as there have been inflows into domestic mutual funds through SIPs of over Rs 6200 crore per month, the downside is likely to be capped.

On the positive side, markets will once again be fairly valued making them attractive again."

Going by historical PE yardsticks, at a PE of 27+ equity prices are quite overvalued and in the zone where markets have always reversed. Over the longer run, earnings growth will ultimately dictate the course of the market. So far the earnings growth has at best been marginal. If the earnings growth picks up, and the lofty PE ratios shrink to more reasonable levels of around 20 times earnings, stocks will begin to look cheaper.

However, if you have a risk-taking streak in you and can grab a few heavily beaten down stocks, you could even snag yourself a few bargains in this turmoil.

The article can be read online here.