

Sensex, Music & Headphones

Dr Sanjiv Mehta | June 27, 2008 | Sensex@ 13922

With Indian inflation at more than 11%, oil at \$135 a barrel, weak global cues, political uncertainty, rising interest rates and emerging signs of a slowdown in the economy, Sensex has taken a major nose dive to levels around 14000 and is expected to be under pressure for more time. Investors justifiably are worried about future prospects.

What should an investor do about Indian equity component of his portfolio? Should he just remain there, increase or flee? What should be the percentage allocated? In the earlier articles I emphasized appropriate asset allocation as the most important factor for impressive portfolio returns and harnessing the power of passive income.

Jeremy Seigel, one of the most renowned American professors and who was also my teacher at the Wharton School, wrote a highly acclaimed and deeply researched book 'Stocks for the Long Run'. He analyzed in detail more than 200-year history of USA stock market and markets of numerous other countries. The conclusion was unmistakable that stocks held for a reasonable time horizon produce much higher returns as compared to other asset classes. It is true that stocks move with lots of fluctuations and volatility but in the long run reflect economic fundamentals.

This is borne out by my own experience. In my column exactly 5 years back, in the Deccan Chronicle on June 27, 2003, I wrote an article titled 'Now you can invest in India' –Sensex was then at 3583, accompanied by poor investor sentiment. Good economic fundamentals were just emerging at that time. We have come a long way marked by usual volatility of a stock market- the index reached heady levels of almost 21000 before dropping to current levels. In between there were many moments of uncertainty and amidst all these fluctuations, investors who heeded the advice of following good economic fundamentals and stayed put are the ones who gained the most, with original investment multiplying six times.

The crux, the central issue with market under intense pressure, at this juncture is that whether economic fundamentals are still intact and their impact over the next 5 years. Where would Indian economy be in the year 2013? Factors in BRIC Report by Goldman Sachs that predicted India to be the 3rd largest economy in the world in the year 2050 are still valid. These include favourable demographics, economy driven by local consumption, less dependent on global factors and stability of macro economic environment.

Moreover, Indian economic growth on a comparative basis should continue to do well. Looking at different components of GDP, Services accounting for 60% is growing at 10% and therefore should contribute 5-6% to GDP. Industry, which is 25% of GDP and growing at 10%, will contribute 2.5%. Agriculture growing at 2-3% should also contribute 0.5%. Capital expenditure to the tune of Rs. 34000 crores is expected to be commissioned during FY 2008-09 and it will have a huge multiplier effect. Overall, GDP growth rate is expected to grow at 7.5-8%. This is the most likely consensus view emerging from multiple forecasts including RBI and Economic Advisory Council to the Prime Minister. Indian banking system is also sound with limited exposure to real estate lending or share financing.

With this kind of growth establishing at least a degree of economic decoupling with USA and other developed markets, a strategic shift in global asset allocation may gradually gain momentum. Presently we are in a transitional stage of this global shift of multiple dimensions and transitions could be slow and painful. There has been a lot of debate about economic decoupling and while it will be fallacious to expect a complete decoupling, Indian growth at 7.5-8% in the face of USA sub par growth will be noticed. George Soros, one of the greatest hedge fund managers, in his latest book states that he protected his fund returns by recognizing such an impending shift and investing more in India and China. Combine this with a greater percentage of Indian savings coming into equities, and a scenario of at least partial market decoupling is highly probable.

Recommendation – With a 5 year time horizon, Indian equities should continue to be a significant part of total asset allocation. Existing investors should continue to stay invested. Since short-term pressures are likely to remain for some time, for new investors, a sensible strategy will be to invest systematically in various tranches rather than in one lump sum. Investing should be smart with selection of good funds excelling in picking fundamentally sound stocks at good valuation. Indian rupee again is on a long-term appreciation trend albeit with corrections like the present one that has taken it to Rs. 43 and therefore NRIs should gain from this factor too.

Three principles of appropriate time horizon, valuation and diversification remain sacrosanct.

Conclusion - I listen intently to music while being driven in Hyderabad but gradually the joy was decreasing. Noise levels in the city were picking up with rapid growth inevitably accompanied by increasing traffic. Utilizing ‘Acoustic Noise Cancelling High Quality Headphones’ has restored that happiness. Original music is as melodious as ever though the noise is also real and almost led to the false perception as if music itself was distorted. As Shakespeare would say, play on.

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