Where is our stock market headed?

Himanshu Kaji
Group Chief Operating Officer & Executive Director
Edelweiss Financial Services Ltd.

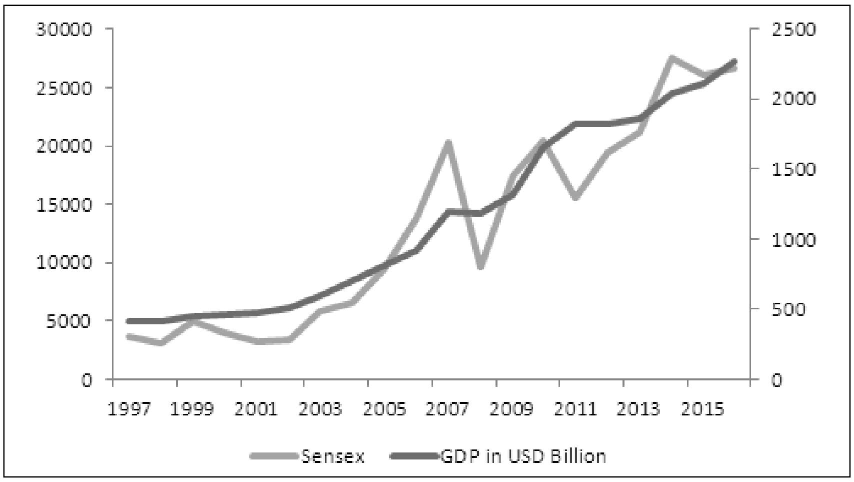
Indian stock markets have had a phenomenal run in last few months and making new all time highs. This led to a question for most of us that "where is our market headed?" We have come a long way from where we had started in 1875. Post liberalization in 90s' the stock markets growth has been exponential with the introduction of the Securities and Exchange Board of India (SEBI) which created a regulatory and governance architecture around securities market, dematerialization of stocks, online trading through emergence of internet and technology, significant liberalization in the foreign capital flows and other regulatory changes. We have moved from an information scarce world we have an information overload today. I anticipate interesting times ahead for Indian stock markets as India is one of the fastest growing countries in the world. In this article, I have discussed some of the important factors impacting stock market.

Factors impacting our stock markets:
Stock prices are majorly driven by fundamentals of the listed stock, demand for those stocks, accessibility for foreign investors, regulation with regards to investment, primary market development in the country and macro economic factors. We can look at some of them in detail.

Corporate earnings:
Corporate earnings are fundamental driver the stock markets prices. Investors need the companies to provide steady revenue and profit growth leading to increase value of the stock which in turn would reflect in stock prices. As per analysis by ET intelligence group, India Inc has shown a good growth in revenue and profits in FY 17 with marginal pressure on operating profitability[1]. With good monsoon in sight, stable and reformist government, favorable macroeconomic conditions and stable rural demand, we can expect the corporate earnings to show higher growth in next year. This would lead to higher stock market prices. Also Post recent rally to new highs, earnings growth would be important factor to drive markets further.

Macroeconomic factors impacting stock market:
For corporate earnings to show consistent growth, it is also important that India's financial strength remain intact. Hence it is important to look at some of the key macroeconomic indicators which impact the earnings and stock prices as well.

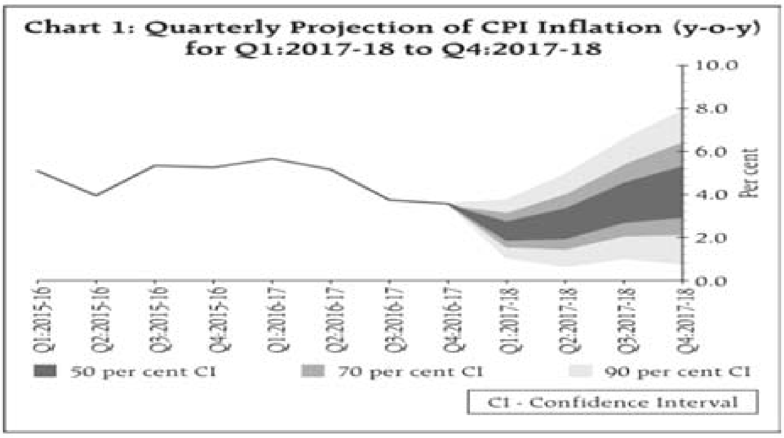
- *GDP growth*: One of the biggest factor in favor of Indian stock market is that India has been one of the fastest growing economies in the world and there are high expectations that the similar growth will be sustained in near future. We had plotted our GDP and sensex over last 30 years.



Source: Bloomberg database

We can see a good correlation between the GDP and Stock index. Hence as we are anticipating good GDP growth in next few years, we can anticipate stock market prices to head northwards from here.

- *Inflation and interest rates*: RBI has been very proactive in taming inflation in last few years. RBI has stated its objective is to achieve the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth[2]. In the same report, RBI has projected CPI inflation to be in range of 2 to 6% over next one year.



RBI is well respected institution across the world and this kind of focused approach to tame down inflation has further helped investor confidence to invest in India. Low interest rate periods are beneficial for growth of Indian corporate as well.

- *Fiscal deficit*: For international investors, it is very important that emerging countries like India keep fiscal deficit (the gap between expenditure and revenue) under control. India has been reducing its fiscal deficit from as high as 8% in FY09 to 3.5% in FY17. Further, for 2017-18, the government aims to further bring down the fiscal deficit to 3.2 per cent[3].

Hence improvement in domestic macros such as higher GDP growth, lower-than-expected inflation, a downward revision in interest rates and lower fiscal deficit due to a drop in crude oil import bill and improved fiscal discipline, stable currency, improved commodity prices make India an attractive investment destination.

Foreign investment in India:
Government of India foreseeing the potential for growth, has allowed more foreign direct investment (FDI) in core sectors like retail, defense and civil aviation etc. in recent times.

Many other sectors have been allowed 100% or near 100% FDI with government approval or through the automatic route. The objective of 100% FDI and other relaxations is to promote employment and improve infrastructure, along with greater FDI inflows and the ease of doing business in India. With positive improvements in Macro indicators, FDI investment in India has increased steadily in India, from USD 4 billion in FY 2001 to USD 60 billion in FY 2017[4] Also FPI in India over last 17 years has been USD 194 billion. This helps in improved liquidity and investor confidence in Indian stock markets, which further increases foreign investment in India.

Investor perception for India: Policy reforms
For continuous flow of foreign investment in India, it is important that India remains in top of the list for foreign investor. In this case, India has been in the sweet spot for last few years. We came a long way from being emerging market country of 1990 which was marred with stock market & banking scams in 1992 and 2004, or telecom or coal scams in 2009 to 2014 period, which has tarnished India's image in global world.

Our current government has been seen as a reformist government taking lots of initiative to improving India's competitiveness in emerging market spectrum. We have seen a lot of reforms in last three years under Mr.Modi's government. Some of the initiatives like improvement "Ease of doing business", "Make in India" program, Implementation of GST, digital India initiatives, " Direct benefit transfer", " Jan dhan yojna" has improved faith in India's image globally. Also fight against black money and changes in foreign treaties like Singapore and Mauritius has been taken positively by investors.

Regulations of India:
It was important that emerging country like India have a strong regulator and keeps tab of any changes in the environment. With this in mind, the overall responsibility of development, regulation and supervision of the stock market rests with the Securities & Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices.

In recent past, SEBI, Reserve Bank of India (RBI) and Government of India have been constantly coming up with various reforms / consultation papers to ensure continuous capital flow to the economy, create a strong governance structure and to ensure that the Indian capital market grows continuously to supplement the overall economic growth. Some of the important reforms in regulations recently concluded are bankruptcy code, implementation of GST etc. Also regulators have ensured that investors can further keep investing through primary markets as well.

Primary market development:

For stock markets to get continuous investment, it is important to have vibrant and liquid primary markets which would help further investment from investors. We have come a long way where even raising a few lakhs was a Herculean task because people did not understand shares as an asset class like we do today. We are looking at huge amount of IPO getting listed every year and many of them getting oversubscribed. In 2016, 26 companies raised over Rs 26,000 crore through the IPO route, which is more than double the Rs 13,564 crore grossed by 21 issuers in 2015[5] . Also many of these IPOs have provided double digit returns to investor. This has further improved investor sentiments leading to increased participation by retail investors. This kind of investment in IPO has happened due to changes in IPO process where listing timelines has been reduced significantly. SEBI has cut down time taken for listing of shares from date of close of IPO from 12 days to 6 days, thereby reducing investor funds getting locked for a lesser period of time. Retail investor has moved from filing individual physical forms for subscribing the shares to ASBA which has reduce the time for locking of funds. This has lead to increase in retail and HNI participation. SEBI is looking at reducing the listing process timeline to 3 days[6]. SEBI has further eased various requirements to help startup firms get listed and raise funds in the domestic market. The market regulator plans to set up alternative trading platforms for these early-stage companies. The move is aimed at attracting startups that could be considering overseas listing due to stringent regulatory requirements at home. It will also provide early-stage startup investors an easier exit route. Both BSE and NSE have separate SME platforms for SME listing. They have started gaining traction in last few years.

With primary and secondary markets showing good signs of growth and as most of the factors impacting stock markets are indicative positive momentum, we can expect stock markets to higher from current levels.

Factors to watch out for

While there are many positive domestic factors for Indian stock markets, there are many factors that can derail the upside momentum.

Factors like spike in oil prices can lead to spike in Inflation and interest rates, foreign exchange rates for India compared to other emerging economies, Global inflation, the global macroeconomic situation like American protectionalist policies and any bad news from China and event risks such as wars and so on — that could spoil the rise of stock markets. Domestically challenge for Indian government would be to quickly revive the private capex cycle. Big infrastructure projects need to be provided quick access to capital, speedy environmental and policy support. The good news is that infrastructure public investment had picked up in 2015. The government acted to clear 42 stalled projects worth Rs 1.15 lakh crore since February 2015, which activated the idle investments locked in the projects. This began yielding results in 2016-17. Further unlocking of stalled projects will accentuate the GDP and construction job growth[7]. Quick execution of such projects will provide massive employment, provide quick transportation for goods, lead to productivity gains and will have large trickle down effects on the adjoining towns and villages leading to increase in consumption demand. Another factor also would be to resolve the NPA situation for banks which can help them to improve their capital allocation. Another big factor would be implementation of GST. Any issues while implementing GST can lead to chaos in the system and would impact credibility of government and corporate earnings as well.

Conclusion:

As most of the factors are in India's favor for further rise in stock markets. In the next two years we are likely to see Indian equity markets cross many peaks as both the global economy and Indian economy are seeing signs of coming out of a long slump post 2008 financial crisis. India's long term story continues to be extremely bullish driven by structural drivers, including demographics, reforms, stable government, improving infrastructure, urbanization and rising middle class. These factors will drive growth across sectors. Currently, only a very low percentage of the household savings of Indians are invested in the domestic stock market, but with GDP growing at 7-8% annually and a stable financial market, we might see more money joining the race. Maybe it's the right time for investors to seriously think about joining Indian stock market growth story. Though valuation might be a little stretched but long term growth story still remains intact.

[1] ET ANALYSIS - India Inc's Revenue, Profit Grow, But Margins Slip http://epaperbeta.timesofindia.com/Article.aspx?eid=31818&articlexml=ET-ANALYSIS-India-Incs-Revenue-Profit-Grow-But-01062017015014

[2] RBI Policy: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=40685

[3] Source: Bloomberg database

[4] DIPP website.

[5] Packed schedule awaits IPO market in 2017: Investors to be spoilt for choice: http://economictimes.indiatimes.com/markets/stocks/news/packed-schedule-awaits-ipo-market-in-2017-investors-to-be-spoilt-for-choice/articleshow/56179510.cms

[6] Sebi plans shorter gap between IPO and listing http://www.livemint.com/Money/ocMOmlKCvlSHZ5GMLlk3eI/Sebi-plans-shorter-gap-between-IPO-and-listing.html

[7] Can Budgeted Infrastructure Investment Drive Growth and Job Creation? https://thewire.in/106895/budgeted-infrastructure-investment-job-growth/