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Market rally: Have we squashed the lemon or is there still some juice left?

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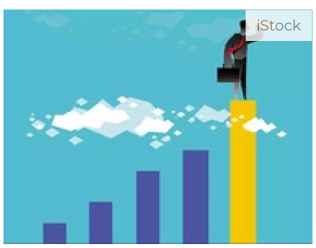
Synopsis
If history must give us any indication, the second year of a bull market historically performs well. So, is it fair to assume that 2022 will see similar extension in rally?



The market experienced one of the strongest recoveries in 2021 from the pandemic led crash of 2020. The S&P 500 Index's gave stunning 68% return from the March 2020 low to the end of the year. This may give us deja vu moment and take us back to 2008. Immediately after the global financial crisis (GFC), we saw similar recovery in the **stock market** where S&P 500 posted around 30% return in 2009. And the markets continued its rally in 2010 as well. If history must give us any indication, the second year of a bull market historically performs well. So, is it fair to assume that 2022 will see similar extension in rally?

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We need to get into little deeper as things are a bit different this time around.

Corporates have used low interest regime to get in shape: Corporate India has used the low interest regime to refinance its debt at a cheaper rate thereby saving on the interest costs. With growing demand as the economy reopens halve by FY2023 to Rs.5674bn as compared to Rs.12622bn in FY2020.

No dearth of flow from FII: Rising supply of money and slowing demand in the US has led FIIs to look for alpha elsewhere. Meanwhile, macroeconomics of EMs has been showing promising results. India continues to benefit from being best of the rest in the EM. In my view demand scenario in India is only going to improve going ahead. Macro indicators for India remains strong with record high GST collections and falling Current account deficit to name a few. Hence, I believe FII flow will continue to find its way in Indian stock market in the near term. Additionally, with rising inflation in US, FII expectation of return will also increase which may not be met by US economy compelling FIIs to invest in EMs. This might precisely be the reason for Indian stock market to outperform its peers in first half of 2021.

Mutual fund potential remains robust: MF industry is still at the nascent stage despite the industry managing ~Rs. 33trn of AuM. The world average of MF AUM to GDP is 63%, whereas India is only 12%. US is highest at 120%. Also, in terms of Equity AUM as a % of GDP, the world average is 36%, India is at mere 5% (Source: IMF, CRISIL Research). Additionally, India population as compared to the world is a younger lot. The fact that India is placed better than other emerging markets on economic growth front, we may also see more FII money flowing into our economy.

Passive fund – a sleeping giant: The rising popularity of passive funds will be one of the reasons that will bring stability to the markets. Share of passive funds to overall MF AUM have risen from less than 1% in 2010 to over 10% in 2021 (Source: AMFI). This is only going to increase going forward. In the US the continues.

Another way to look at the rising market is what are the factors that triggers a correction.

Correction is nothing but a sudden movement of capital from one asset to another. Generally, it has been Gold and real estate which has strong co-relation with equity markets. In all the previous corrections money has moved out of equity market to being parked in real estate for its potential appreciation or in gold on rising geopolitical risks. Indian real estate has been sitting on high inventory, for quite some time, which fails to show any indication of meaningful reduction any time soon. On the other hand, Mr. Joe Biden as newly elected President of the US (who has been perceived as a global peace lover), the geopolitical concerns have been parked at the bay. Thereby impacting the prices of gold. Even on the domestic front consumption of gold has been declining as share of financial to physical asset is gradually increasing. We have recently come out of an unprecedented crash and the likelihood of another wave of pandemic remains low as availability of vaccines and inoculation rates increases. Hence there is limited avenues for capital to find a space anywhere other than equity markets.

Thus, on a long run the story for Indian equity market remains robust. So, whether you are an FII or retail, a mid-aged professional or a millennial, an HNI or a blue-collar worker, the long term optimism of Indian equities remain intact, good enough to make lemonade out of the lemons.

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