Benchmark indices are scaling new highs. What should investors do?

Sundeep Sikka
Executive Director & CEO
Nippon Life India Asset Management Ltd.

Unchartered territories make many nervous and confused. And stock markets are not an exception. There has emerged a situation in the stock market which contains elements of circumspection and elation. For instance, after a long period of sideways movement, Indian equity markets are showing a bullish undertone. Amid volatility, the benchmark equity indices - the Sensex & Nifty - are flirting with new highs every other day.

The topmost questions which many retail investors — existing and potential — face now is: Does it make sense to stay invested? Given the sentiment, should I up my investments in the markets at this point in time? Importantly, they may also want to know which investment vehicle is best suited to increase returns and minimize the risk factor.

Before these questions get answered, it's important to highlight upfront that investors should have a long-term orientation for equity investments. Investors need to learn to live with volatility irrespective of index levels. Equity indices will scale new peaks or stay volatile on global uncertainties, upcoming elections, and weather, among other reasons. Sticking to one's investment goals and risk appetite is sacrosanct in investing.

Equally important is to understand that sitting on the sidelines never aids sustained wealth creation in the stock markets. Many investors who sat on cash post the pandemic anticipating a recession and sell-off in the Indian markets could not re-enter into the market at lower levels. These investors have been contemplating re-investing now. Surely a lesson is well learnt that timing the market seldom works.

India is expected to continue to be one of the world's fastest growing economies over the next decade. This will make India one of the most important long-term growth markets for wealth creation via stock markets. Here is the low-down on the factors that favor fresh and incremental investments in the Indian markets:

Economy – An attractive story

From among the top 10 economies in 2010, India is likely to be the third-largest economy by the end of 2030. Its GDP is likely to cross US $ 6 trillion by 2030 from around US $3.5 trillion now. The country's per capita income is likely to jump from around US $ 2,500 currently to more than US $ 4000 by 2030. Long-standing macro trends like young demography, formalization of the economy, urbanization, and aspirational middle-income population will ensure that the Indian economy stays well anchored.

An interesting report released by economists of the Reserve Bank of India (RBI) have forecasted that India could become a developed country by 2047 by growing by around 7.5% every year over the next 25 years. To achieve this feat India will have to give due emphasis on aspects like structural reforms, investments, digitalization, upskilling of labor force, and sectoral policy initiatives.

Change is visible on the ground level. Post pandemic, capex has been holding up well, government-led manufacturing push has remained robust and there are signs of increasing participation by the private sector. Reform push, political stability, a healthy external sector, and robust banking sector (with decade-low bad debt levels) will act as solid foundation for India's macro stability in the future.

Corporate India – from strength to strength

Given India's long term growth outlook there are incentives for Corporate India to expand. A stable inflation and interest rate scenario - a pre-condition for corporations looking to undertake capital expenditure - ensures sustainable economic growth. It's worth highlighting that while world over, people are fighting high inflation, in India, thanks to all out efforts by the Reserve Bank of India, price pressure are under control. Sooner or later interest rates will start coming down in India fueling so called animal spirits in Indian Corporates.

Most importantly, over the last decade, Corporate India has traversed a difficult path of deleveraging. Now with healthy balance sheets, spending on capital expenditure by corporates will lead to significant growth going forward. Most high frequency macro indicators like Purchasing Managers' Index (PMI), capacity utilization levels and most importantly rising corporate earnings to GDP are already pointing towards revival in Corporate sentiment.

Valuations & Flows

A combination of long-term fundamentals of the Indian economy and flows are driving the stock markets higher. So, are markets expensive after hovering around their peaks, one may ask. Valuations – a function of stock price and corporate earnings – are nowhere near to the October 2021 levels. In the next two to three years, corporate earnings' growth is expected to be in a decent range of 15-16%. Financial Year 2023-2024 may see corporate earnings grow faster than the rate of India's economic growth. Thus, Corporates' earnings momentum will continue to support valuations.

While domestic flows – retail and institutional – into the markets have been strong over the last few years, foreign players have missed out on the opportunity. Domestic investors bought heavily into Indian markets even when foreign players sold during critical months post Covid breakout.

Although foreign portfolio investors have been buying Indian equities in the last few months, their ownership is still low as compared to historic highs. For foreign investors it's always about relativeness. With peer-group economies struggling, they are expected to not only cover the lost ground but also scoop up investments in the Indian markets. The return of sustained foreign flows could support the market levels in future.

The Key Question: What now for investors?

Though the stage appears to be set for strong earnings' growth and flows into the markets, what should investors do now? Despite strong earnings' growth, investors need to understand risks do not disappear in the world of equities. Direct investors should avoid chasing momentum and under-researched stocks.

Investors should look at Mutual Funds as vehicles for wealth creation. Being well regulated, Mutual funds not only protect investors' interest but also offer low-cost, simple to understand and tax-efficient means to invest in equities.

The only way to reduce the risk of near-term volatility is to stay invested for longer duration. This feat can be achieved by taking a staggered approach to investment through Systematic Investment Plans (SIPs) and Systematic Transfer Plans (STPs). A staggered approach is best suited if one wants to invest lumpsum money or if someone wants to increase the exposure to stock markets from here on.

Sticking to one's asset allocation and investment roadmap is in the best interest of investors. A new index high or a rally in the stock markets should not be the reason to invest more in equities or to switch to another asset class. They should stick to their asset allocation strategy.

Investors who have moderate risk appetite are better off investing in asset allocation-based hybrid mutual fund products including multi-asset funds and balanced advantage funds. For long-term investors, diversified equity mutual funds such as flexi-cap schemes and multi-cap schemes are best placed to build a large corpus.

Can investors book profits at these levels? It's important to stay invested for a longer duration to realize higher returns. However, if a goal fixed by the investor is nearing, one may book profits; but it's important to shift that money immediately to some instrument like a debt mutual fund till the goal is met.

In the near term, equity as an asset class can be riddled with volatility; but in the long term, stock markets always accurately reflect the state of the economy. Currently, both developed, and peer-group economies are under stress. India today stands out as one big shining star in the world. Indian economy is well charged-up from a medium to long term perspective. Investors should not miss out on the opportunity to build long term wealth.