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Where & how to invest now

A stable government has been elected. Find out what this means for your equity investments

BY NARENDRA NATHAN AND SANKET DHANORKAR

he return of Narendra Modi as Prime Minister has pumped adrenaline into the stock markets. Markets prefer a strong, stable regime because it ensures continuity in economic policies 'Investors now have political stability and predictability of economic policies,," says Dhiraj Relli, MD & CEO, HDFC Se curities. "The mandate removes the overhang of uncertainty. This is a significant positive for market sentiment," says Mihir Vora, Director & Chief Investment Officer, Max Life Insurance.

The Sensex had breached the 40,000 mark last week, but experts say investors should not base their decisions on milestones in an index's trajectory. "Sensex at 40,000 or Nifty at 12,000 are just numbers. Investors should look at the long-term prospects," says G. Pradeep Kumar, CEO, Union Mutual Fund.

Volatility is part and parcel of stock markets, though it does not last forever. The markets factor in major events like the Lok Sabha elections but eventually go back to their normal functioning, ET Wealth looked at how markets performed after the formation of the past four governments. Though the short-term performance (1-6 months after election) was inconsistent, the long-term performance of 3-5 years produced good results.

Growing global tensions

Modi's second term has infused a lot of optimism but investors should tread with caution, "Global volatility will continue and allocation to emerging markets like India will move accordingly. However, India allocation from global funds will increase now because of stability and more ETF flows are likely over the short term," says B. Gopkumar, CEO, Reliance Securities, FII inflows had turned negative last year. But they started looking up a few months ago (see chart).

Tasks for new govt

With a clear mandate, the government is expected to implement pending schemes. Continued action is expected on infra-structure and agriculture related schemes. With numbers tilted in its favour, the ruling dispensation can also look to push through its reforms agenda.

But it will be an uphill task. Garima Kapoor, Economist, Elara Capital, points out the Modi government's second term in office is likely to be challenging. "Reeling under consumption slowdown and lower terms of trade in the agriculture sector, optimism around India's economic growth has come to a halt," she says.

Weak earnings growth

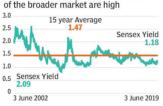
Even though FII inflows have improved in recent months, analysts say there is a storm brewing—corporate earnings growth remains elusive. Except a few pockets, there are no discernible signs



Mid-cap valuations are down Mid-caps were trading at a hefty premium

to large-caps till a few months ago. 40 35 26.21 Nifty Midcap PE 12.75

Don't go overweight on equity Based on dividend yield, the valuations



of an uptick in earnings growth. The consumption engine has started sputtering. Passenger vehicle and two-wheeler sales are down. Offtake of consumer durables has moderated. There is muted demand even in small-ticket consumer items such as shampoos, detergents and soaps. With NBFCs facing a liquidity crisis, a key factor fuelling consumption is no longer in a position to lend to con-

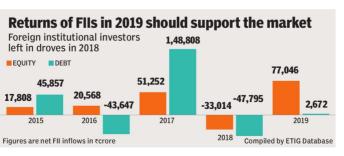
The rural economy is also in distress If the monsoon plays truant, it is likely to further affect rural consumption.

High valuations

Adding to challenges are the high stock valuations. The Sensex PE is now close to 29, significantly higher than its average. Some experts say this is not an area of worry, since the valuation has spiked due to big losses of a few companie

A more stable ratio is the dividend yield. The dividend yield of the Sensex is also very low now, suggesting that the index is overvalued.

While markets may power ahead in



the near term, analysts expect markets to come to terms with ground realities soon. "After the euphoria, the focus would shift to hardcore economic decisions," asserts Amnish Aggarwal, Head Research, Prabhudas Lilladher.

Trim your expectations

Investors who have adequate exposure to equities are likely to benefit in the coming months. However, this is not the time to increase your equity allocation. What if the short-term rally in stocks takes your equity allocation even higher? Vijay Kuppa, Co-founder, Orowealth reckons this expected short-term rally should be used to cut equity exposure.

Even investors who have remained on the sidelines waiting for a clear direction should refrain from jumping headlong into the market. Jimmy Patel, MD and CEO, Quantum Mutual Fund, suggests investors remain calm, "Rising markets make the stocks expensive, and hence it would be not the right time to jump in.' It would be prudent to build exposure gradually, and selectively. The market is at high levels and investors who get in now should rein in return expectations.

Sectors to bet now

The new government is expected to continue with its infrastructure thrust. All strong stocks from this segment should do well in the coming years. The action on agriculture is expected to put more money in the rural economy, which could revive consumption growth. Some fundamentally strong consumer discretionary stocks should do well over the next 3-4 years. Increased consumption should result in better capacity utilisation, which will trigger revival of capital expenditure by companies. Though this is expected to happen only after 2-3 years, banks and capital goods companies will be the main beneficiary.

Increase mid-cap exposure

Though benchmark indices are at alltime highs, the broader market, particularly the mid- and small-cap segment. has been battered over the past one and half years. The valuation gap between mid-caps and large-caps is down (see chart). This is why experts are recommending an increase in one's mid-cap exposure now. Instead of taking a broader call on the mid-cap space, the strategy should be to go sector wise. Another strategy is to use the corrections in this space to build the mid-cap portfolio and being very selective, particularly while investing in themes like infrastructure. However, experts say it is still not time to go bottom fishing in the small-cap universe. "Do not jump into small-cap stocks now. Stay with relatively larger names with known brands and strong balance sheets," says Vikas Gupta, CEO and Chief Investment Strategist, OmniS-

with data inputs from Sameer Bhardwai and Shailesh Kadam