Close Window

THE FINANCIAL EXPRESS

Print Story

'We have paid for the damages but don't know the price of a panic crisis'

Posted online: Oct 10, 2008 at 2303 hrs

Ajit Dayal is director, Quantum Asset Management Company, and founder director, Quantum Advisors. He has over 20 years experience in asset management and financial research and analysis. He has worked with leading US and UK financial advisory and asset management firms either as a key member of the executive management team or through the Advisors as a joint venture partner. In a free-wheeling discussion with Akash Joshi and Sai Prasan of The Financial Express, Dayal spoke on the equity market crisis and what impact it could have.

What do you make of this huge global equity markets crash and the Indian scenario?

At the beginning of the year, we believed that the market would come down. Not looking at oscillators and other technical analysis tools but purely from a fundamental view, we thought that the market at 20,000 level was certainly not cheap. We had a view that the markets would come down to 15,000 levels and this is much more that expected. The crisis in the global market is much deeper than was expected and the fear factor is a lot higher than what people expected initially. At the beginning of the year, the Indian markets were set to come down. This was because oil prices were high, commodity prices were rising, the US dollar was weak and we had elections coming around. Now, nine months down the line, oil and commodity prices have come down and the dollar is stronger.

So, three out of the four negatives have reversed and the markets have fallen even further. It's such a changing environment that people don't know what to do and they are selling. One of the things that has exaggerated the fall in India is the kind of investors we had from the foreign community. In 1992, we created rules for the FIIs and now we have p-notes in place. Now, since data is not available on this p-note issue, we are guessing that much of the p-note money that flowed into India from 2004 onwards was probably short-term hedge funds. And now, the bets are being unwinding. India is part of the asset class that is being sold out by short-term owners of capital. P-note is something that has exaggerated the fall. Yes, the Indian market required to fall, especially in the global crisis. The slide was almost 50%, especially when India's economy is not so much dependent on the US economy as much as China or Indonesia.

Now that the p-note regulation has changed, what more should the government do to strengthen the market?

In my view, closing the p-note route in October 2007 was a wonderful move. Reopening this was not a very wonderful view. Policy should be decided by the objectives we need to meet.

What we have done is we want to build a long-term economy based on short-term money. And now, the short-term money holders are taking back capital to their country irrespective of the value. So, we have exposed the long term growth of India to short term capital.

How could the policy makers now create a balance between inflation and growth, especially with a weak rupee?

Inflation is based on prices. There are reports suggesting that inflation really does not exist if seen from the corporate sales point of view, especially in the June quarter. There is a wholesale price inflation but that will come down sharply as prices ease. Countries with trade deficits will fundamentally have weak currencies.

The US had a trade deficit but there were people willing to buy bonds. So, they had a stronger dollar in 2004 and 2005. In India too, you had the hedge-fund monies wanting to buy Indian stocks. Therefore, you had a stronger rupee in 2006-07. The nakedness of the rupee is exposed as the hedge-fund guys are pulling out. So, the Indian rupee will remain weak until the day FDI monies pour in and create a base here and Indian exports will rise. And much of this is happening. So, in the next two to three years when India's exports strengthen, we will have a strong rupee.

What measures should the government take to strengthen the equity markets?

The ratio of foreign buying in Indian stocks and the domestic buying in the equity markets is 5:1. The FIIs have been buying around $10 billion a year and the domestic investors have bringing in around $2 billion. This ratio should be strengthened in favour of the domestic investor.

There is a tool in the finance minister's hand, the Section 80c, which allows equity investors to get benefit for up to a limit of Rs 1 lakh. Change that limit to Rs 5 lakh and reserve Rs 3 lakh for mutual funds. Then there are pension reforms that are yet to come across. All around the world, pension funds invest in equity because it has been proven that over the long-run, equity is one of the best performing asset classes. So it's better for the pensioner to get better returns.

Do you see value emerging at the moment? What would you advise investors in such a market?

Like I said, we thought the market was attractive at 15,000 levels and now obviously they would look even better. Now, we are taking a 'Barbell' approach. So, we will invest in two ends of the risk spectrum. On one end is the high-risk high reward, which is the equity markets and on the other is the low-risk gold and liquid funds – so 80% in equities, 15% in gold and 5% in safe and liquid funds.

Now, if the global crisis would continue, then stocks would fall. The 80% or say the Rs 80 in your Rs 100 portfolio would come down. But at the same time the value of the Rs 15 worth of gold would rise three times. As you have seen, gold has risen by 30% this year. So, your portfolio will still have some gain. And if the situation improves, equities would rise dramatically and the extent of gains will be much more.

When do you see the global crisis ending?

If we look at it broadly, the estimated loss on account of the credit crisis is around $1 trillion. Of this, $550 billion has been announced. Of these losses, some, say $500 billion would be eroded from the net worth and the rest would have to be from earnings. Suppose, we assign a price-earnings (PE) of ten times, which is the same as a developed market ratio, to these losses. Now, we have $5 trillion.

At the beginning of the year, global equity markets had $35 trillion. Say, $5 trillion, or 15% got wiped out due to the banking crisis. Then lets say another 15% was also sucked out due to other adverse factors, like a slowdown in real estate or other losses. So, it would roughly mean that this is the damage we have paid for the global crisis.

In other words, the indices should have lost 30% from the beginning of the year. And this is very close to what we are at the moment in most of the markets and fundamentally we have paid the price for the crisis. Again, this is assuming that the losses mentioned were around $1 trillion. But then, there is a crisis of panic and we don't know the price of that.