Reasoning the Indian Stock Market Trends

What is the issue?

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- While stock prices are believed to be largely a factor of real earnings, recent trends in the Indian stock market have been in contradiction.
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- Economic Survey has come up with an explanation for this, but this is filled with flawed assumptions and conclusions.
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What is happening in the Indian stock market?

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- Despite the faltering growth story over the past four years, the Indian stocks markets have been in high spirits.
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- The BSE Sensex has vaulted by over 70% in this period despite just a 14% absolute expansion in its constituent companies' earnings.
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- Multiple agencies have tried to reason with the high valuation of Indian stocks and the Economic survey has also come up with an interesting explanation.
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What is the "Economic Survey's" explanation?

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- **The US Comparison -** Sensex and the US S&P 500 have shown identical gains in 2 years, with about 26 convergent trends, despite the underlying economies being quite dissimilar.
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- Notably, Indian stock market surge has coincided with a decelerating

economy, falling corporate profits-to-GDP ratio (3.5%) and high interest rates.
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- US markets have been backed by an improving economy, stable corporate profits-to-GDP ratio (9%) and negative interest rates.
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- While the Survey is hinting that the US market gains thus have far better fundamental moorings than India, it doesn't persist with it.
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- **The Hypothesis -** While warning of a "sudden stall" in global asset prices, the Survey stops short of extending this dire warning to Indian markets.
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- Instead, it surprisingly speculates that the higher valuation may represent a "new normal" where investors have shrunk their demanded for equity capital.
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- As a fivefold expansion in mutual fund inflows were seen in FY17, it argues that there has been a structural shift in investments.
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- This, it reasons, is due to anti-black money campaign of the government, which has nudged investors away from gold and property.
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What are the flaws?

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- The world over, retail investors chase high returns and the Indian investors have been upping their equity bets due to double-digit market gains.
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- The tax-free status for equity returns, on top of plummeting debt returns, may have driven this investing behaviour rather than any government campaign.
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- Notably, there is a call for a policy-level rethink on the exceptional tax breaks on equities, which may be necessary to quell the euphoria.
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- Notably, "foreign portfolio investors" still control over 25% of stocks.
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- Hence, the survey's assumption that the new domestic enthusiasm will offset global tightening doesn't stand merit.
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- Therefore, apart from waiting anxiously for the resurgence in corporate

earnings, Indian markets needs to pay close heed to global trends.
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Source: Business Line

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