The Only Game In Town

22 April 2019

A question has been bugging me for a long time. Market valuations are not cheap. Earnings growth of most companies is in the single digits and yet the market (at least the Nifty) keeps going up. Earnings growth in the last 5 years has been anaemic and yet most mutual fund schemes have given double digit compounded annual returns in the same period of time.

The lack of earnings growth coupled with growth in asset prices have combined to make market valuations steep. For example, the Nifty 12 month trailing PE is about 2-standard deviation above its long term average. This kind of steep valuation is almost always a recipe for either, a largish correction or an extended period of sub optimal returns. Surely no investor will be happy with both these outcomes.

And yet, whenever a potential investor asks me whether to invest money now or whether there is a need for caution, I suggest that the investor should bite the bullet and actually go ahead and invest. I have also been suggesting a move from conservative equity funds like Equity Saving Funds etc to a 100% Equity fund. I have been explaining my reasoning for such an advice on an individual basis. Today, I thought, why restrict my incredible wisdom to only those who talk to me? Why not send it out to everyone who cares to read my note? (and spread the misery J)

My understanding of the current situation is that Central Bankers have been compromised (okay co-opted if you don't like the implications of the word compromised) by the politicians of the world. The politicians have finally learnt that it is in their interest to keep the asset prices inflated irrespective of the underlying economic growth. We are thus having a surfeit of low interest rates policies, Quantitative Easing, expansion of Central Bank balance sheets and large budget deficits being run by the powers that be. What started out as an emergency measure 10 years ago is now the norm.

The Fed made a pretense of trying to normalize the situation by reducing QE but a barrage of tweets by The Donald was sufficient for the Fed to change his mind. No one expects the Fed to increase rates anymore. There is in fact a great chance that the rates will be cut in the coming months. The low interest rate policies and the large liquidity surplus are here to stay.

In the past, when Central Bankers would increase rates whenever the economy heated up, companies had to work hard to increase earnings. Now all that the companies have to do is to borrow at cheap rates to buy-back shares and reward shareholders. This availability of easy money is resulting in inflated asset prices irrespective of underlying earnings growth and the only question an investor has to ask is whether the easy money policies can continue into the future.

Anyone who reads the financial papers will know that the Govts are trapped in a vicious cycle of their own making. They are riding a tiger or if you prefer, holding a tiger by its tail. There is no way, they are going to be able to reverse their low interest policy without crushing the asset prices and no politician worth his salt is going to let it happen in his watch. The policies are being made in such a way that investors have no choice but to invest in financial assets.

All this talk about politicians getting involved does not mean that this rally can continue forever. But until such a time, we as investors cannot sit out of the market just because we are uncomfortable with the current valuations. We have to be involved in this messy rally because, willy-nilly, there is no other place to invest in other than financial assets. I other words, this is the only game in town.

P.S I am putting my money in Equity Mutual Funds, especially multi-cap funds and Contra Funds. For my SIPs, I am investing in midcap and small cap funds. Finally, I have also bet 10% of my money now on Kotak World Gold Fund which is a bet on Gold mining stocks. I do think that Gold as an asset will also inflate as a reaction to the continuous printing of currency by the Govts.

Do get in touch with me for any help in portfolio restructuring or allocation or financial planning.