India's Stock Market: Is a downturn overdue?*

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A longish bull-run that added to investor cheer over Christmas week 2023 took the most cited index of Indian stock market activity, the Sensex, to a record 77,240 level on the last trading day of the year. But the 18 per cent increase, over the nine months starting April, that explains that level only partly captures the frenzy in the market. What is more remarkable is that the share price spikes driving the market boom go well beyond the 30 stocks that enter into the computation of that index. Indices capturing stock price movements of a larger set of large-cap and mid-cap companies have risen by a much higher 34 and 36 per cent over this period. Even small-cap companies as a group delivered a return of more than 21 per cent. The broad base of the boom has meant that the S&P BSE 200 index, covering 200 selected companies, rose 23 per cent while the S&P BSE 500 recorded a 24 per cent rise over the first nine months of financial year 2023-24. This cross-cutting boom reflects the fact that the rush of investor capital into the market is of a magnitude where the demand for stocks cannot be accommodated by the traded, free-floating equity of just better known companies. In the event, market capitalisation at the Bombay Stock Exchange spiked 34 per cent from Rs. 271.8 trillion in April 2023 to Rs 364.3 trillion in December that year.

Though India's GDP growth has bounced back from the trough of 2020-21 and stayed at comfortable levels, that alone cannot explain this stock price spike. In fact, the evidence suggests that the boom has gone too far. Price-earnings ratios of leading companies have touched levels that cannot be justified by projections of likely trends in revenues and profits. Thus, the Economic Times reports that: "Kotak Institutional Equities' fair value estimates of 50 stocks of Nifty show only six stocks could return more than 10% from current levels." Moreover, fair value estimates for some stocks "such as UltraTech Cement, Eicher Motors, Divi's Labs, Bajaj Auto, Coal India and L&T are 23% to 31% below their current levels." These shares, the estimates suggest, are significantly overvalued.

But with speculative investors unsatiated, demand has continued to surge and spilt over into segments of the market that are normally nor favoured. What is particularly surprising was activity in the normally dull new issues market. SEBI statistics reveal that as many as 238 firms issued new capital and raised Rs. 63,730 crore between April and November 2023. The prices of these shares too soared. According to one analysis, there were 59 companies which raised Rs. 54,000 crore through share issues, for which the market prices turned out to be 45 per cent higher than the issue prices on average. Of them, nine delivered more than two-fold gains over the issue price. Not surprisingly, the media is filled with news of "multibagger" stocks (offering more than 100 per cent returns), the lure of which have dragged retail investors to the market in the hope of quick and high returns.

According to FYERS Research, a brokerage firm quoted by the Economic Times, in the IPO market, 166 Small and Medium Enterprises (SMEs) raised a record Rs. 4,472 crore during 2023 (till late December), as compared with 109 SMEs raising around Rs. 1,980 crore in 2022. Of these 166 companies, 136 closed higher when they reached the market and 24 companies recorded close to 100 per cent gains on listing day. There can be no better indicator of “irrational exuberance” that has in the past left investors badly bruised.

The search for explanations for this frenzy are on. As is to be expected, the first look has been on the role of foreign institutional investors (FIIs). They have shown much interest in the Indian market. Total net investment by foreign institutional investors in the equity market stood at Rs. 1.97 trillion over April to December 2023, as compared with a negative (net outflow) of Rs. 114.2 billion in the corresponding period of the previous year. This spike in FII investment has been attributed to India’s choice as an alternative to the Chinese market, from which India has retreated. Besides the growth slowdown in China, increased official scrutiny of foreign investors and asset managers is seen as having triggered that withdrawal. This occurs when fears of further rate hikes in the US have retreated, and expectations of rate cuts are rife. Investors are looking to return to global markets. To the extent that India is seen as an alternative to China in those circumstances, it is turning out to be a vent for surplus capital looking for quick and high returns.

It also helps that the government at the Centre is seen as “market friendly”. It is almost common knowledge in today’s financialised world that when a country is praised for its GDP growth performance, as has been the case with India in recent months, analysts have an eye to the quick returns that could be had from financial markets buoyed by those numbers. So, a government looking to exploit praise from international agencies in an election year, would stretch itself to keep markets buoyant. That attitude could delay the inevitable and feed exuberance.

However, this is not the first time that India’s markets have turned buoyant because of unusual FII interest. What seems different about the recent boom is that domestic players, tired perhaps of waiting out the Covid months, are seeking to ride on it. They are being goaded on and facilitated by the large number of intermediaries, investment managers who have launched small- and mid-cap funds. The net inflow of mutual fund capital into overprices equity markets was, at Rs. 1.2 trillion during April-December 2023, almost exactly equal to the 1.19 trillion channelled during the corresponding months of the previous year. It is this domestic boost to an external stimulus that underlies the broadbased boom that has sent money chasing unusual stocks. In the past, when that has happened, the consequences have not been palatable.

Predicting stock market trends is indeed a hazardous occupation. But too many indicators suggest that the ongoing boom is unsustainable. Even investment managers who survive on fuelling optimism have begun expressing caution about pouring more money into the market at this point in time. But for poorly informed investors, the lure of quick and high returns is difficult to resist. They are likely to risk more of their savings and refuse to pull out in time to keep their fingers from getting badly burned.

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