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Samvat 2077 to be the year of stock-specific opportunities; expect sideways consolidation in H12021: Mazhar Mohammad

The year 2020 surprised both the bulls and the bears equally.

In the initial part of the year, the bulls were caught off-guard as the bears were on the prowl due to the coronavirus outbreak. In the later part, the bulls unleashed their animal spirits as the bears were caught on the wrong foot with a surprise rally that led indices across the globe to new highs.

In the early part of 2020, the Nifty and other global indices sank around 40 percent in a three-month period, a first in recent memory.

A similar fall was witnessed during the great depression of 1929 when Dow Jones Industrial Average was down by 43 percent in the December quarter from the highs of 352 to 198 after topping out in September with a high of 381.

Subsequently, a much bigger fall was registered as Dow Jones collapsed like a house of cards between 1929–1932 before bottoming out at a low of 41 in July 1932.

Fortunately, COVID crisis, at least for stock market investors, appears to have lasted only three months as indices bottomed out and made new highs.

Is this rally sustainable?

This surprising up-move across the world has left investors wondering.

Rightly so, as economic indicators were pointing to a slowdown in the global economy even before the COVID pandemic hit. Recovery should have been delayed and theeconomy should have deteriorated at a much faster pace during such a crisis.

But, my friends from Fundamental Fraternity may pull a rabbit out of their hat and make a case justifying the rally by hinting that Mr Market is a forward-looking animal and trying to factor in future growth prospects.

However, such forecasts have gone thoroughly wrong since 2015 and it is better to look at historical earnings multiples rather than forward PEs.

To unravel this mystery we analysed historical earnings multiples and their behaviour since 1991.

Before the global financial crisis hit, the Sensex registered a higher PE multiple of 28 in the year 2008. In the year 2001 also, before the market collapsed, the highest PE was 25.

In 1992 when the famous tech bubble busted, the bulls were on steroids as the market consistently traded with 30–55 earnings multiple between February–June 1992.

So in normal conditions, a PE of around 28 is something to worry about.

The current earnings multiple of the Sensex is 31 when the economy is still grappling with multiple problems.

The crisis in the banking sector which was brought into light with the collapse of IL&FS still seems to be unabating as the list is growing with DHFL, PMC, Yes Bank and now Lakshmi Vilas Bank.

In the broader markets, too, 72 stocks with a market cap of more than Rs 10,000 crore are trading above 50 plus earnings multiple and few stocks are at ridiculous four-digit earnings multiple.

Are the markets mimicking the 2003–07 phase?

Mark Twain famously said, “History doesn’t repeat but often rhymes”.

These days commentators and analysts are tempted to draw comparisons between the current rally to the one witnessed between 2003 and 2007.

By no means the current rally can be compared with that of 2003, which occurred after a huge bear market of almost 10 years. Between 1992 and 1998, upsides for the index were capped at around 4,650.

In fact, between 1994 and 1998, the Sensex remained in a tight range of 4,650–2,700 before witnessing a false breakout, which though took indices towards 6,150 in 2000 but correction again brought the index down towards 2,600 levels by September 2001.

This kind of underperformance for 10 years will obviously bring in a lot of pessimism, frustration and a sense of disbelief, which eventually led to one of the most memorable rallies in the Indian markets between 2003 and 2007.

Obviously, such times will also suppress valuations. Contrary to this, the current bull market is neither backed by valuation comfort nor followed by a prolonged bear market.

The current phase can be compared to the spike that was seen during 1998–2000 in a prolonged bear market from 1992–2003 or the rally witnessed after the global financial crisis from the low of 2008 to 2010 after which the Nifty slipped into a prolonged multi-quarter corrective and consolidation phase.

Long-term technical trends

Post-COVID induced sharp correction, the Nifty took support on long-term charts that were in the 8,000–7,500 zone.

Since then, for the last eight months, the Nifty witnessed a relentless rally from the lows of 7,500 to 12,963.

In this process, from the long-term support levels, it approached the long-term resistance point placed around 13,000 levels.

Hence in the near-term, it needs to sustain above 13k. In that scenario, the rally may temporarily extend towards 13,200–500 but for a breakout and bigger up move after December 31, the index needs to consistently remain above 13k levels.

Failure to do so shall invite a bigger correction of a minimum of 10–15 percent, the signs of which are yet to emerge.

At this juncture, it will be prudent on the part of traders as well as medium-term investors to take some money off the table as the medium-term top may be nearing for the markets.

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