

Volatility in stock markets

At first volatility may appear like a soft word and maybe chaos is more appropriate word to use to describe stock market behaviour especially yesterday which *is expected to follow today*.

For the sake of academic interest let us first look at what *supposedly* is the cause for the recent sharp fall, the 'sub-prime' meltdown on the global economy.

'Sub-prime'

In U.S. many lenders have lent to debtors with a below 'investment grade' credit-worthiness (sub-prime) at a higher interest rates. Many of these loans were taken with an intention to participate in the then on-going housing boom. With rising interest rates and declining property prices, these borrowers are finding it increasingly difficult to services their loans. This has led to rise in defaults /delinquencies.

The lenders have therefore, been forced to distress-sell the collateral, in most cases the mortgaged real estate. However, since the housing market is already going through a slump, the lenders, in most cases, have not been able to realize much value. Many funds that had invested in these sub-prime papers, have therefore declared losses. Since sub-prime is only 2% of the housing market, many thought that the risk would be 'contained'. However, the recent woes of a large hedge fund have stoked concerns that the problem could have a cascading effect on the overall U.S. economy. As one of the engines of the world economy, any slowdown in the U.S. could also impact other economies. Due to these heightened concerns, there is a fear that investors will shift from risky assets (equities, commodities etc) to safer assets (Sovereign bonds, gold etc). This has set off a violent correction in global equities.

What does the future has in store?

Global investor sentiment is currently cautious as markets await further news flow on the sub-prime issue. As long as global investor *sentiment* remains weak, markets could potentially continue to be volatile. However as witnessed in the past, global investor sentiment can prove to be fickle. A sudden turn in investor sentiment could lead to a sharp bounce-back in the markets. It is however very difficult to predict the timing of the same. The fundamentals of the Indian economy remain unchanged. The Q1FY08 results were much better than expected and serve as a testimony to the economy's robust fundamentals. There is no reason to doubt the long-term success of corporate India.

While markets have now corrected approximately 9% since the peak made in the last week of July, it is important to keep in mind that this is on the back of a strong rally in the recent times. The correction is thus not that significant in relation to the market rally, and *further downside is possible* which may reverse soon or *may last for a slightly longish time period*.

What should you do?

While further downside in the markets cannot be ruled out, it is important to keep in mind that the markets can bounce back equally sharply and suddenly. We would recommend that investors should *stay invested*, and make *fresh investments in equities at every fall* without compromising on the overall asset allocation.

In this chaos like any other in the past, it is ***how you react*** which ***will determine whether you profit*** from it or otherwise.