

Where are the markets headed?

The phenomenal run of the Sensex over the last 1.5 months from a level of 14,000 to almost 18,000 now has led to a lot of people asking me the above question and as usual my problem is that I don't have an answer. Having said this, the question is valid from an investor's angle who wants me to add value and help in their decision making process of booking profits, making fresh investments etc. Now, before I respond to the above question let us look at what some fund managers and other experts are saying about what has fuelled the current rally

1. **Interest rate cut by Fed reserve** – For anyone who watches the markets closely, 18Sep07 was an important date as US Federal Reserve (equivalent to RBI in India) lowered its benchmark Fed Funds rate by 0.5% to 4.75%. This cut marked a change in stance of Federal Reserve after a long time, and it is largely being attributed to the following:

To address Sub-prime – The increase in interest rates over the last 3 years was causing borrowers to default as they could not afford higher EMIs. This was affecting the banking and financial system at large. A cut in rates should help both the borrowers and the lenders

To address a potential US Slowdown – Various figures in public domain seem to suggest that the US economy's growth is moderating faster than expected and it may move into a recessionary phase. A cut in rates will help in boosting the economy as cheap money would fuel growth

In the short term the above cut in rates has released lots of liquidity (cash) in the system and a large chunk of it has come to developing markets like ours. As a result, the Sensex jumped by 600+ points on 19th Sep following the news of this rate cut and has not looked back since. In the medium term, this rate cut is expected to save the US economy from going into a recession as cheap funds would encourage spending.

Now, I'm not an economist to be able to interpret the above like a 'cause – outcome' scenario and I believe that in an economy there are so many variables at any point of time which are tough to address by one stroke of pen. What I definitely see is that despite all the talk of a US slowdown, the Dow Jones (index for New York Stock Exchange) is trading at near all time highs. This is like a paradox, an economy heading towards recession whereas the stock markets continue to move higher!!! I could not understand this so I moved to the next argument being quoted

2. **India in a long term structural bull-run** - This is where foreigners (read FIIs) are more convinced about India than Indians themselves. Corporate results quarter on quarter have been supporting this and the recent advance tax numbers which show a 41% increase in gross collections are an indication of sustained growth. This growth is also largely driven by domestic consumption rather than exports. In the midst of a talk of slowdown in the US, investors continue to invest in emerging markets like India which are less affected by a slowdown in the US. Corporate growth has also been able to catch up with the growth of the index as evidenced below:

Date	BSE Sensex	Trailing PE
20-Apr-06	12039.55	21.82
30-Oct-06	13024.26	21.48
03-Jan-07	14014.92	23.14
09-Jul-07	15045.73	21.86
19-Sep-07	16322.75	22.04
27-Sep-07	17150.56	23.17
05-Oct-07	17773.36	24.01

This week, as we head into half-yearly results season, corporate earnings and projections would guide the market direction.

OK. Where does all this lead us to? Well.....it depends on where you stand

If you do not see yourself invested in the markets for very long i.e., you see yourself withdrawing money from equities for some other purpose anytime soon then maybe it is time to take profits off the table and not wait for the markets to go higher. As they say, a bird in hand is better than two in the bush

Otherwise, if you are a long-term investor and this recent spurt has simply aroused your curiosity then just sit tight and enjoy the run, who knows India may actually be getting re-rated and moving in a higher orbit, in which case you don't want to miss the rally even for a day. There would be a correction for sure and it would be sharp just like the run-up, but just tighten your seat belts and don't lose grip as it would eventually move higher.

While taking any of the above steps, just stay within your acceptable asset allocation to avoid any agonies due to sharp moves in the market.

Happy Investing!!!