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How to beat Market Volatility?

From The Editor's Desk

Dear Reader,

Equity markets and volatility always go hand in hand. While the intensity of the volatility can vary from time to time, there will be very few days where the stock markets will be flat. In these globally testing times with turmoil across economies and countries, volatility is logically high. Markets have swung upwards and downwards, creating fear in investors, especially the newer investors who have started their investing journey recently.

Experts say the first fundamental rule of beating volatility is to embrace it as a friend. To believe that volatility is a part of investing. And then proceed in a disciplined manner by keeping on investing through the lows so you can get the benefit when markets rise, having accumulated stocks or mutual fund units when their prices are low.

A good way to beat volatility is to do systematic investing through an SIP in mutual funds or stocks. In this edition, we bring you one such expert Mr. Aashish P Somaiyaa, (WhiteOak Capital Asset Management, Executive Director & CEO) who has seen several cycles of the stock market. We are sure the article will help understand the various aspects of market volatility.

Happy Reading,

How to beat Market Volatility?

When I started my career, a 100 points fall in the Sensex would be greeted with a "market has crashed" in the next morning's newspapers. While in percentage terms it would be the same as it is now, but given the surge in the Sensex, the number has gone from 100 to 1,000 points before it is termed as a "crash" or "sinks".

What has not changed is volatility. And it can't because it is inherent to equities. Equity markets never move in a single line. When markets decline the way, they did in early 2020 or more recently from October 2021 till June 2022, we can have lengthy discussions about how ugly the rear-view mirror (result on past investment) looks but the following rules about investing in equities are eternal.

1. When the rear-view mirror looks disastrous, that's when the windscreen starts to look bright and sunny albeit you may not be able to see it that way

2. People who invest when results on existing investments look great, and hold back when results on existing investments look bad never create wealth

3. Contrary to perception, wealth is not created in bull markets; wealth is created by investing in bear markets which shows up as appreciation in the investment reports when bears go into hibernation

4. Lastly, the last 30 year average of India's nominal GDP growth is about 12%, the 30 year average of corporate earnings growth of index companies is around the same and so is the growth in Sensex value. So if the last 30 years of compounded growth of the economy and markets is average 12%, how can you earn more than 12% on your investment if you were to buy just the index? Arithmetically, if you invest when the recent average is well below 12%, then you stand to gain because somewhere in the near future the average has to go above 12% to reconcile with the long term average of 12%!

But how do investors respond to volatility and decline in markets? Let me share that with my personal experience of dealing with an investor, take it as a case study.

There was an investor who invested somewhere in March 2015 when Nifty was close to 9,000 and by end February 2020 when five years were over, the investor had a return of about 12% CAGR[1] in a large and midcap mutual fund; about 4% CAGR ahead of the Nifty 500 TRI index like to like basis. When this investor spoke to me in early April 2020, obviously she did not care for the position in February 2020. She was quite upset because the five-year CAGR was 4%. After all, what is long term and what is the use of investing if return is less than FD rates after five years? She decided she wanted out. Insisting on determining the fate of an equity investment and seeking liquidity from it exactly after the market has nosedived is like your boss or the HR manager insisting on fixing your annual appraisal on your worst day at work. If the only intention is to catch you making a blunder and draw a conclusion then that's fine but if the intention is to treat an investment like an investment, may it be your employee or your mutual fund, then there's a different way to conduct affairs.

Anyway, coming back to our investor, we referred to historic portfolio values at various dates and explained as recently as February 2020, one saw about 12% compounded. By the end March 2020, it did not matter what one was holding, everything collapsed; there was a 35-40% decline. Arithmetically the entire five-year CAGR declined by 7-8%. She continued to be unhappy and over the next few months we had to stay connected and make efforts to avoid redemption at an inopportune juncture. Ultimately, the investor prevailed, and she redeemed in early November 2020 when Nifty crossed the Jan-Feb 2020 peak levels around 12,000. The return had improved from 4% to 10% CAGR. It is now well known that if the investor had waited for a few more weeks or even till the end of 2020, the then five and three fourths (instead of five years) of a year CAGR would have been more than the earlier 12% noted in February 2020. And if she had waited till date, she would have been a raging fan of investing in equities.

What are the learnings?

1. **Belief and conviction in the concept of equity needs to be demonstrated at the troughs and not just at the peaks.** One may or may not demonstrate faith when Nifty is at its peak, one does need to demonstrate faith in this concept of equity investing when Nifty falls 40% and hits 7,500 in flat 15 days as it did in March 2020. When money doubles in a year, everybody has faith and belief; what you do when it halves, is what will eventually count.

2. **Equity returns are non-linear and lumpy.** What was built over 5 years can be destroyed in a matter of weeks and that which can be destroyed in weeks can be regained in short periods too. Did a 3-6-9-month disruption call for companies to lose 50-60-70% of their market value? The wise investor is one who takes advantage of the irrational mood swings of the markets rather than become party to it. “Be greedy when others are fearful, be fearful when others are greedy”, is not just meant to be a soft board pin-up. And time horizons of investing cannot be cast in stone, a few days, weeks, and months ahead or behind can have disproportionate impact.

3. **Avoid jumping to conclusions.** Famous American novelist, F Scott Fitzgerald said, “the test of a first-rate intelligence is the ability to hold two opposing ideas in mind at the same time and still retain the ability to function”. Another famous American novelist Jack London said, “life is not always a matter of holding good cards, but sometimes, playing a poor hand well”. When things do not work out as expected, instead of re-visiting and re-calibrating, we human beings crave for closure and conclusion. In the equity investing journey there is nothing like black vs. white, right vs. wrong, good vs. bad; there is only context and perspective. One needs to stay away from drawing fateful definitive conclusions because what works is careful calibration and probabilities.

4. **Equities are for optimists.** Something that economic analysis will not be able to model; when humans experience threat to life and livelihood locked down for months; what does that prolonged fear and suppression eventually do to the human spirit to overcome fear, bounce back with vengeance, rebuild, and reclaim life? If one generally believes that humans, and corporations or businesses run by humans are the next dinosaur, then equity is not for you.

5. **Predicting macroeconomics is not only difficult, it is impossible.** Investing in equity while predicting macros is like ignoring the proverbial butterfly effect. It’s usually chaotic.

6. **Be countercyclical.** Never assume good times will last forev er but apply that same logic to the bad times also. When the going is good and you get way more than what you expected, do not extrapolate it into the future and take some money off the table. When things are going bad do not extrapolate that either and do some bottom fishing. In March 2020, investors’ actions were as if humans are the next

dinosaurs and then there are times when investors' actions seem like trees growing to the sky.

Let me share a few more learnings…

What windscreen wipers teach you about investing behaviour

It's quite pertinent to note that while the stock markets are based out of Mumbai, Mumbai is also endowed or cursed as the case may be with very heavy rainfall. As a result Mumbaikars are very clued into the wild gyrations of the stock market index and also used to sitting through hours in the traffic amidst heavy rainfall and water-logging.

Many years back, on one frustrating rainy evening journey circa 2002-03 from South Mumbai back home to the suburbs along with office colleagues the conversation veered towards the general apathy in the markets, the impact on investor sentiment and associated investor psychology.

Just a couple of years earlier there was a frenzy to buy equity funds in general and technology funds in particular. As a trainee in late 1999 early 2000 I had myself witnessed an event for the launch of a technology fund where the projector did not work for a product presentation (so much for the technology) and still pretty much everyone in attendance invested on the basis some half-baked communication and flyers circulated. At another city close to Mumbai, the fund had not opened local collection accounts and still investors decided to purchase demand drafts and anyway go with the investment at additional cost to their pocket. Such was the conviction level that selling effort was pretty much not required. Its well-known that technology investments took 10 years to produce returns eventually – and one can use that experience as a positive example of the "waqt har zakhm ko bhar deta hai" type or one can use that experience as a negative example of the "Aaj ek dua aur maang lo, aaj ek aansoon aur pee lo, aaj ek zindagi aur jee lo, kya pata, kal ho naa ho..." types…

And here we were in 2002-03, where the general belief appeared to be like the world was coming to an end and there was no "kal" (tomorrow). How can beliefs swing so wildly? We were just discussing the behaviour and a fresh downpour caused my friend at the wheel to turn on the windscreen wipers. Staring blankly at the screen amidst a gloomy mind frame further compounded by the external gloom, an unlikely analogy struck my mind.

Since then I have been telling investors not to behave like windscreen wipers. While the downpour wets the whole windscreen, the wipers oscillate left to right and back in their own kind of quarter circular cross breed elliptical kind of path. But what's obvious is that there's never a moment where the screen is wiped dry with the vision for the driver being completely clear. When the wiper is at one end of its trajectory, the water obviously wets the other end and by the time the wiper comes back there at that end of the trajectory, the former end is wet again. Net net, water keeps pouring and the wipers keep moving from one end to other, tirelessly; at the mercy of the water and the driver.

Market participants and investors' behaviour appears quite like this wiper each time I hear some of the recent commentary. Equity has given negative returns so let's put money into debt. Active funds have underperformed so let's buy index, small and midcaps have caused losses so let's buy large caps.

Don't be a wiper. Ascertain the causes of something going against you, how long has it been and is likely to work against you, understand the causes and then decide whether it's time to come back and double down or just stay at rest or not to come back, stay away and bail out.

Just like the wiper function has a cycle to it, the stock markets are also cyclical – asset classes, market caps, fund flows, investing styles like growth and value, philosophies et al. But your objective is to create wealth over the long term, not to wipe water over a windscreen, with great urgency; lest your master's vision be hampered.

What investing has to do with springs lifts and local trains ?

Talking of heuristics and short cuts for the brains to make quick inferences; I would like to present a few of my own observations and I dare call them inventions. I have seen that time and again; investors are long term investors while signing up, but if returns turn negative the long term goes out of the window. What causes this kind of reaction? It's obvious that as an investor (even I am one) none of us want to see a negative in our portfolio because negative returns give us a feeling of having lost and that's disappointing, a huge let down on our expectations.

Let me take a simple example. If someone has invested Rs.100/- and the value is down to Rs. 80/- they are 20% down. The feeling is that of having lost 20% and the fear is that it will never come back. This is akin to visualizing that there are say physical objects one owns and one of them is lost so its 20% gone and that 20% will never come back. Further, there are some arithmetically astute people who scare investors by throwing about numbers like;if 100 becomes 80, it's 20% down but for 80 to become 100 now you need 25% up!How will this happen?

This is where the right visualization is crucial. If you own an equity portfolio with underlying companies that are producing profits the correct visualisation is that of a spring.

If a spring is compressed 20%, it stores more energy than before. If a stock price declines even as it produces earnings, it becomes more valuable. Even as companies continue to produce profits, there is a limit to how much the spring can be compressed. Now let's say a spring is compressed 20% and then it's released! How much will it recoil? 20% from the 80 or or 25% from the 80 to come back to the original length of 100? Of course this logic doesn't work if you own a portfolio full of junk, but that's obviously not the case with us.

Imagine you are in an elevator looking to get up to the 20th storey of a building. As soon as you enter the elevator, you note that it was actually headed down from the ground floor where you entered so instead of taking you straight to the 20th storey, it makes a detour and takes you to Basement Level2 first. Unfortunately just as you hit B2, there's a power outage and you are stuck in the elevator for 20 mins.

Now, food for thought: after 20 mins if the power comes back and you find yourself at B1 or G, how many of you will rush out the moment the doors open and how many of you will calmly stand back and say, cool, I am headed to the 20th. Chances are, everyone will make a dash for the door and mind that 20th storey business some other day. Maybe that's the right response if you are stuck in an elevator unexpectedly, but no, that's not the right response if you are investing in equities. If you invest in equities and someone told you that you could double your money in 5-6 years, unfortunately which 2 years will be bad, which two years will be above average and which 2 years will make you a great deal of money is not easily predictable. So if you bolt out the moment the elevator door opens, let me tell you, you've lived the worst part and decided to bail out exactly before the good part starts playing out.

Similar analogy I remember from my early days working in Mumbai. I lived in the Mumbai suburb of Goregaon and I had to be in Churchgate before 9 am each morning.

Taking a train from Goregaon headed to Churchgate meant that the train would be coming from Borivali and lesser mortals from Goregaon had to stand or probably even hang outside. And if the train was a fast one coming from Virar, you'd be looking to get a foot in the door. Eventually I realised that if I went 20 mins early, and from Goregaon I took a train in the opposite direction that train, I would get to sit possibly at the window seat and the train would end up in Borivali and eventually return back to Churchgate! Voila!In equities, it's not always possible to time the entry. Sometimes the market makes you take a detour. If you try to time the entry chances are, you won't catch the bottom. And if you don't catch the bottom, i.e. you try to get a fast train from Goregaon, chances are you won't get a foot in the door.

Over a long period like 15-20 years, the Nifty MidCap 100 has delivered average 4% over and above the Nifty50 for any one year holding period. Currently, at the time of writing this, I can see that for the last one year the Nifty MidCap 100 has delivered, forget +4%, it's…. -16% as compared to Nifty 50. So what's with the pendulum? Imagine a pendulum swinging, where the midpoint is +4 and currently the pendulum is at position of -16, what would you expect the pendulum to do? Maybe swing further away a little bit? But eventually? Well, either the Nifty50 corrects downwards or the Nifty MidCap 100 corrects upward, the key is that both will be called "correction". Where would you like to be on the pendulum? You are better off with your small and midcap portfolios.

The most effective way to deal with volatility and build wealth through equities is investing through what is now a fairly popular route called Systematic Investment Plan or SIP. In fact, we at WhiteOak have decided to take only SIP based investments in our mid-cap fund. A research we did, from the period of April, 2005 to July, 2022, shows that SIP investments in the small and mid cap space, were able to deliver reasonable returns even during the painful periods, while lumpsum investments remained flat.

During this 17 year period, there were nine challenging years, where investors would have lost patience as their lumpsum investments would have remained flat. However, if they had chosen the SIP route, then even during these periods, they would have earned handsome returns.

Aashish P Somaiyaa, Executive Director & CEO, WhiteOak Capital Asset Management

MF CENTRAL – a harmonization process across the industry

SEBI vide its circular no. SEBI/HO/IMD/IMD-II DOF3/P/CIR/2021/604 dated July 26, 2021 issued guidelines in respect of RTA inter-operable Platform for enhancing investors' experience in Mutual Fund transactions / service requests. The aforesaid guidelines issued in order to make it more convenient to the existing and future investors to transact and avail services while invested in Mutual Funds.

Accordingly, NSDL and MF-RTAs completed the process of harmonization the processes across the industry to provide a single-window, integrated, simplified investment and service experience for the investors.

NSDL has implemented the PAN based API mechanism for providing the details for holding and transactions in respect of Mutual Funds held in NSDL Demat account based on consent from investors. MF-RTAs are providing the said information on MF Central portal (https://www.mfcentral.com/).

Simultaneously. NSDL has implemented the API mechanism between NSDL & MF-RTAs for fetching the details of holding and transaction in respect of Mutual Fund Folios held in SOA (Physical) form from MF-RTAs in respect of investors holding demat accounts with NSDL based on consent from investors.

Based on the aforesaid information being received from MF-RTAs (Mutual Fund Folios) and holdings in NSDL Demat account, NSDL has provided a facility to clients to generate Statement of Account (SoA) through NSDL IDeAS portal.

NSDL Demat account holder can login to NSDL IDeAS portal (https://eservices.nsdl.com/) and click on "Request Statement of Account" link and generate the SoA. The said SoA will contain the details for Holdings, Transactions and Demographic details of NSDL Demat account and Mutual Fund Folios.

BLOCK MECHANISM IN DEMAT ACCOUNTS

Recently, SEBI has issued guidelines in respect of Block Mechanism in demat account of clients for undertaking sale transactions and validation of Pay-in Instructions.

In this regard, you are requested to take note of the below mentioned points:

1. In case you are submitting delivery instructions to your Depository Participants (DP) for sale transaction executed through broker, you will be required to submit additional details viz., Client UCC, Trading Member ID & Stock Exchange ID.

2. The aforesaid UCC details will be validated with the UCC details available in UCC master as provided by Stock Exchanges to NSDL. In case the UCC details do not match, then the instructions will get rejected.

3. In case the UCC matches, the securities will be blocked in client's demat account till Pay-in date provided it also matches with obligation details received from Clearing Corporations of the Stock Exchanges.

Investors are requested to take note the aforesaid changes in pay-in process so as to avoid any inconvenience.

Join our Investor Awareness Programs

NSDL conducts Investor Awareness Programs (IAPs) to help investors to be aware of different aspects of investing. These programs are conducted on different topics of interest to investors and in different languages. The schedule of the forthcoming programs/webinars is published online at https://nsdl.co.in/Investor-Awareness-Programmes.php. We invite you to participate in these programs. We shall be happy to conduct an awareness program for your employees, staff, students, or members. Please write to us at info@nsdl.co.in if you want any such program to be conducted.

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