# Making Hay in the Markets*

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India's stock markets seem to be riding one more bubble. Between 19th February and 29th March, the Sensex rose by 9.3 per cent. The trend has not been restricted to a few stocks. The S&P BSE 100, which tracks 100 and not just 30 stocks, also rose by 9.8 per cent between those dates. In fact, financial year 2018-19 as a whole seems to have been a good period for punters, with the Sensex outperforming many global markets. Among the explanations doing the rounds is that confident of a return of a market-friendly, Modi-led government, investors are making hay in the hope that the sun would keep shining.

Market performance in the month and half ending March 31 was in part understandable. Principally, with the Fed announcing that it would hold back on interest rate hikes since growth in the US seemed to be slowing, financial investors engaged in the "carry trade", involving borrowing cheap in dollar markets and investing for favourable returns in emerging markets have chosen to return to India. Earlier they were pulling out, discouraged by policy driven interest rate increases at home. But, net foreign capital flows into India in March alone amounted to Rs 45,981 crore, of which Rs 33,980 crore came into equity markets and Rs 12,001 crore into debt. This clearly proved adequate to neutralise the effects of sluggish demand trends in automobile and other markets, the evidence of a persisting deficit in the external account with oil prices remaining high, and the uncertainties created by an impending parliamentary election. Though market players preferring the BJP have assumed that the return of the NDA is a done deal, many others must have been less definitive and should have preferred to stay out of the markets till the political air clears.

That having been said, developments over financial year 2018-19, when many of the "favourable" external factors noted above had not come into play, are also surprising. Globally 2018-19 was not the best year from an economic viewpoint, despite some limited signs of revival in the US market. Oil prices had been on the rise. Having risen from around $50 a barrel in early March 2017 to around $65 a barrel a year later, Brent Crude spot prices touched $80 a barrel mid-October 2018. Though they have declined from that level, they are still at $67 a barrel. Meanwhile, trade tensions between the US and China increased uncertainty, with many speculating that they will hurt global growth. And, encouraged by the US recovery, the US Fed and other developed country central banks began unwinding their unconventional easy money policies and raising interest rates and stuck with that policy till recently. That provide a compelling case for developed country investors invested abroad to book profits and return home. In fact, responding to these global developments investors had started pulling out of emerging markets, and India was one of them. Net foreign inflows into equity markets that stood at Rs. 25,634 crore in 2017-18 turned negative in 2018-19 with portfolio investors withdrawing a net sum of Rs. 1,629 crore. Carry trade deals that had brought Rs 1,19,035 crore into the debt market in 2017-18 also froze up, resulting in a net outflow of Rs 42,951 crore from bonds. This weakened the rupee, providing an added incentive for withdrawing from Indian markets, since rupee depreciation would reduce returns in foreign currency terms.

Domestically too there was little reason to be upbeat. Growth showed signs of slowing, corporate profits were subdued, the oil bill was rising and putting strains on the balance of payments, and receipts from the newly introduced Goods and Services Tax regime were far short of an expected Rs 1,30,000 crore a month, standing at less than Rs 1,00,000 crore in most months.

In sum, investor actions in 2018-19 seem to have ignored both economic trends and political uncertainty to plough in funds that drove markets up. Moreover, as trends over February and March show, any positive indicator seems enough to set off a sharp revival in stock market sentiment. It is true that markets are whimsical and seeking clear explanations for investor behaviour in financial markets is akin to looking for the Holy Grail. Yet since making sense of markets and predicting how they would behave is a lucrative industry, investment advisors and financial "pundits" of various kinds, including in the media, have to provide explanations and forecasts.

However, their task is rendered easy because a variety of factors varying from climate change to the political environment and expectations of possible government action are seen as combining with economic performance to determine market trends. And since each investor's decisions tend to be affected to different degrees by this variety of influences, what the net effect on market behaviour would be is difficult to predict. This implies that anyone providing explanations for past market trends and predicting future trends can never be wrong. If the market moves contrary to the prediction, it is argued that this occurred not because the influence on which the prediction was based was not operative. It could only be that, in the helter-skelter of an atomistic market with independent investment decision makers, the intensity of that influence was less than expected and the influence of some other factor was strong enough to neutralise the effects of the former. The market it can also be argued, had already foreseen and "discounted" for these adverse trends. Armed with this immunity from error, a "market analyst" can say anything and not be held responsible. In any case, given market volatility and the cacophony of multiple voices, who would remember what one analyst had said even after a relatively short time span? Moreover, the play of forces can be presented as making prediction near impossible. After all, after the Global Financial Crisis of 2008 that took the world to the closest it has been to the Great Depression, the rhetorical question doing the rounds was: Who could have predicted such a crisis?

It is in this light that we need to examine the claim that Indian markets have not been spooked by all the bad news at home and flowing in from abroad because of the "evidence" that breeds confidence that the NDA led by Narendra Modi would return to power, prolonging the good times. There are many assumptions here, besides the presumption that the NDA would return. First, even ignoring those who do not matter for "markets", such as peasants trapped in increasingly unviable agricultural production or the youth languishing without employment, it is an assumption that the majority see the Modi regime that is ending as being one of good times. After all, the well-documented damage inflicted by demonetisation and the failure of the GST, leading to a fall in revenues, must enter into the assessment of economic performance that influence investor decision. On the other hand, many promises, including that of beefing up the bank accounts of ordinary citizens or significantly enhancing peasant incomes, that Modi and the NDA had made while fighting the last election that brought it to power and during their tenure, have not been fulfilled. That the NDA and its leader recognise this is evident from the subordination, in NDA propaganda in this election, of all talk of economic performance and development to claims about military and strategic achievements and sermons on the neglect and insults suffered by the Hindus.

There is no denying the possibility that in the current fractured environment and with an opposition still divided this may work. But there are no grounds for widespread confidence in the assessment that the NDA would return. The attribution of the recent buoyancy in financial markets to such confidence amounts to propaganda that market performance is proof of successful economic performance of the Modi regime. And in the event that Modi and or the NDA don't return at the end of May these propagandists can rely on the shortness of the memory of market participants and expect that none would remember what they predicted or care to do so. In the interim, such "stories" can help drive markets further up, delivering profits to speculators who can invent sunshine in order to make hay.

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