Top five factors which are making Indian stock market volatile

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NEW DELHI: After staging a strong rally in the previous session, benchmark indices failed to build on the momentum and came under pressure on Thursday, which pushed both the Sensex and the Nifty below their respective key support levels in trade.

The benchmark S&P BSE Sensex has corrected about 8.5 per cent over the past one month, but prior to that the markets had rallied 42 per cent from February to November last year.

Both global as well as domestic factors are equally responsible for wild swings in the market, say experts, adding that the volatility is pretty much here to say. However, long-term investors should use the opportunity to enter the markets on every decline.

"I guess the volatility is here to stay. It is not going to go away very easily," says Deven Choksey, MD, K R Choksey Securities.

"This could be a good opportunity in the market because this kind of volatility or this kind of fall in the market particularly gives an opportunity to investors to buy quality stocks at lower prices," he adds.

We have collated a list of top five factors which could be fuelling volatility in the stock market:

Rising bond yields in the US, Europe:

US bond yield and premium is quite low and is expected to rise when the Federal Reserve announces or hikes rates. It could also be a reason for shift of funds, say experts. Apart from that, the rupee depreciation is causing the market to push into negative.

The primary reason is that people realize eventually all the QE of last several years will result in eventual currency debasement, resulting in inflation. So the long-term 10-year inflation outlook is 2% or more.

"The US 10 year sovereign bond yields were in -0.5% to 0.5% territory. So there was a clear mismatch between inflation expectations and bond yields. In the last few days there is realization that an average of 0 yield is not sustainable and hence yields have to increase," says Dr. Vikas Gupta, EVP & Fund Manager, Arthveda Fund Management Pvt. Ltd.

Just to understand, an increase in the bond yields relates to an increase in discount rates for all asset classes, and hence stocks also fell. Similarly, emerging market stocks and debt also fell.

"They fall more since a higher discount rate makes some of the emerging market stocks and bonds not worth as much. In addition, their currencies suffer, and further, the carry traders exit in a herd, trying to be the one ahead of all the others," he adds.

Gupta is of the view that a sudden drop like that triggers margin traders, algo-traders and F&O speculators' 'stop-losses'. All of this then spirals into panic-news grabbing onto any explanation, including that there is something wrong with the Indian economy or government etc. "Let's be clear. There is nothing wrong with the Indian economy," clarifies Gupta.

The US Fed is also giving enough notice to the market to absorb the news. But deferment of inevitable is not the solution to this problem.

"Besides, it is not only the US rate hike, but the dollar strengthening is also doing damage. As a result, we are already witnessing yield hardening in some of the emerging market bond yields," says Saibal Ghosh, Chief of Investments & Business Development at AEGON Religare Life Insurance.

"However, our bond market is insulated beyond a point as FII holding in Indian bond is capped well within an acceptable limit," he adds.

FIIs cutting India weightage

After outperforming its global peers over most part of 2014, India has underperformed the same pack on a year-till-date basis, led by the prevailing global and domestic issues.

One notable factor has been an increase in the fund allocation towards the other emerging markets (EMs) such as China, Taiwan and South Korea due to valuation comfort, taxation issues (MAT notice to FIIs with a retrospective effect) etc.

HSBC on Wednesday slashed India ratings to underweight from overweight earlier on concerns over slowing earnings growth, and said that they would only re-enter the markets if they fall by another 10% from the current levels.

Speaking to ET Now, HSBC's Herald Van der Linde said that India remained one of the most over-owned markets in Asia. Linde listed out delay in capex recovery as a reason for downgrading Indian to underweight.

Hence, HSBC has slashed India to underweight from overweight earlier and has raised the Philippines to overweight and Hong Kong to neutral. India's PE valuations therefore remain elevated. India is currently the second most expensive market in Asia in terms of 12-month forward PE.

Tax issues come to haunt investors again:

Notwithstanding the slower-than-expected recovery in the economy and corporate earnings, some unnecessary and avoidable issues -- like the demand notices issued to foreign institutional investors (FII) levying the minimum alternate tax (MAT) with a retrospective effect -- have caused more damage to investor sentiment.

"The FII inflows have turned negative and are finding their way to the other emerging markets," said a Sharekhan report.

Thus, the tables have turned with the Indian market underperforming its emerging market peers in the calendar year 2015, contrary to a strong outperformance in 2014.

"We have been monitoring the MAT issue for a while now. It is an industry-wide issue. Recent news flow has not been that clear in terms of its implementation," says Medha Samant of Fidelity Worldwide Investment.

"So, any further clarity on this front is always welcome, but at this point, we think it is still too early to tell whether it is a step in the right direction or not," she adds.

Volatility in global markets:

Global markets too have become volatile largely on concerns over 'Grexit', ie Greece's exit from the euro zone, China slowdown and uncertainty over the US interest rate hikes did cause anxiety in the market.

The rise in volatility in local markets is, to a large extent, due to a spill-over effect of volatility in global markets, Manpreet Gill of Standard Chartered bank said.

This spill-over effect is more pronounced, because investors had built long positions since the general election results last May, and in the event of global volatility, investors tend to sell in markets where they have a sizeable holding, he explained.

Hence, the current volatility is not surprising, coming as it does on the back of a long and large run-up after the new government took charge at the Centre last May, he said.

Delay in key reforms adding to uncertainty:

The Indian stocks corrected sharply earlier this week on worries the government has agreed to review the Land Acquisition Bill and the Good and Services Tax Amendment, unnerving foreign investors about likely delays.

"The logjam in the land acquisition bill situation has made matters more complicated. I do not think it will go through even in the monsoon session with Bihar elections around the corner. In the face of such agrarian distress, I can't see the government pushing the bill hard," says Saurabh Mukherjea, CEO, Institutional Equities, Ambit Capital.

"It means we are not going to get important structural reforms - which the FIIs were expecting - any time soon. On top of this all, MAT has further queered the pitch. So for a lot of both domestic and foreign investors, this is a whole new world," he adds.