When traders sell, look for opportunities

Use corrections, as can be seen now, as a chance to buy quality stocks for your long-term portfolio

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After the market corrected nearly 7.5% in the past two months, Monday's 150-point or 2% jump in the CNX Nifty and a similar rise in the S&P BSE Sensex might seem exciting. But the market still remains, to use a common term from traders, "bearish" or in a downward trend.

For those who weren't able to buy the stocks they wanted last year due to a steep one-way move, such interim corrections are worth exploring. The open interest data combined with the stock and index price movement (see graph) clearly shows that market participants are bearish. When traders turn bearish, it's time for long-term investors to look for opportunities to buy.

Despite the bounce, in the absence of any positive news flow, the correction is likely to continue. This gives investors room to look for good quality, fair to undervalued stocks to add to one's long-term portfolio.

Falling short on expectations

In January, when the CNX Nifty reached a peak of 9,000 (intraday), *Mint* reported (*http://mintne.ws/1BjA1TL*) that the euphoria could be overdone and risks needed to be watched out for. So, the correction isn't all that unexpected. "The very reasons for which the market rallied last year are now working against it. Crude oil (prices) are higher, putting inflationary pressure; quarterly earnings aren't improving; and liquidity from global investors is not easy to come by as other markets are looking more attractive," said Siddharth Bhamre, head-equity derivatives, Angel Broking Ltd.

Moreover, it was an expectations-led rally, which pulled up valuations way above fundamentals. There was hope that a new government would make the economy vibrant once again, combined with the prospect that interest rates would lower at a similar pace. But both these events haven't happened.

Gaurav Mehta, vice president, Ambit Capital Pvt. Ltd, said, "There was a lot of hope built into the markets. But, as yet, neither has economic data improved, nor have corporate earnings bottomed out."

While long-term investors— both domestic and foreign—are likely to stay put, short-term traders are booking profit and looking elsewhere.

What to look for?

Foreign investors can book profits in Indian equities and invest in other geographies. For existing domestic investors, the choice is to either consider other assets or reinvest in equities itself. While it is always prudent to follow an asset allocation according to your financial goals, given that other asset classes such as real estate, fixed income and gold are not doing too well, increasing your tactical allocation to equity by reinvesting profits can be considered.

If you missed the bus last time, the current slide is an to start building that long-term portfolio.

Bhamre said, "For traders it may not yet be time to switch from short to long, but this isn't a bear market; the market is consolidating with a downward slope and we remain in a multi-year bull market." This pause is likely to give more investors the opportunity to buy, and Bhamre feels that contrary to typical behaviour, this correction could see an increase in participation from investors looking for good stocks.

So, what is a good stock? The consensus view is once again moving to quality stocks. And if you get them at a relatively lower price, then don't hold back. "In the last month, even good quality stocks have corrected and that's where the opportunity has opened up," said Mehta.

Healthy and relatively debt-free, cash-full balance sheets, strong management and high earnings growth can identify "good quality'' stocks. Experts pin this down to stocks in three or four sectors, which include information technology (IT), healthcare, private sector banks and consumer discretionary sectors including automobiles.

Dhananjay Sinha, head-research, Emkay Global Financial Services, said, “IT stocks have corrected from the peak, and in the next year or so, we expect 12-15% returns, given that prospects for this sector remain positive and valuations are lower.”

The argument is supported by others. “Mid-cap IT stocks were undervalued even when the benchmark was at a peak. Large-cap IT, too, is mildly undervalued, and none of these companies have a bad balance sheet. Moreover, directionally, in the long run, Indian rupee is expected to remain weaker than the dollar,” said Vikas Gupta, executive vice-president, traded markets and investment research, ArthVeda Fund Management Pvt. Ltd.

A similar logic can be applied to increasing investments in healthcare companies, which are growing, and whose stocks are now available at relatively lower valuations post the correction.

While experts unanimously advise staying away from public sector banks as this sector is seeing structural weakness, select private sector banks look promising.

“A couple of private sector banks have surprised positively on earnings and others have seen a price correction. There is good opportunity in this segment,” said Ritesh Jain, chief investment officer, Tata Asset Management Ltd.

Look for companies where the earnings outcome has been positive and which show a continuation of growth momentum. Stay away from stocks that rallied too much on hope and expectation without fundamental support.

“What was overvalued when the benchmark reached a peak is what has corrected the most now. Companies with bad balance sheets weren’t worth buying then and aren’t worth buying now,” said Gupta. This essentially includes companies in sectors where operational activity has slowed and debt has piled up. This includes some infrastructure companies and capital goods manufacturers.

No need to rush

The underlying panic that begins to show in daily selling shouldn’t affect long-term investors. But, at the same time, there is no rush to pile up stocks because prices have fallen 10-20% or more from the peak. “The correction in valuations can continue for a while longer as markets were considerably out of sync with earnings. There is merit in utilizing these dips to buy stocks you want to own,” said Sinha.

It’s hard to tell whether the correction will be steep or sideways but experts say that in the absence of any positive news flow, any sharp and sustained upward move is ruled out. Next quarter earnings, monsoons, US Federal Reserve action and domestic interest rate news are some of the factors that may dictate market direction. A reduction of another 5-10% in index levels in the next 2-3 months can’t be ruled out.

“Some time correction is needed; despite euphoria around the new government, investment cycle hasn’t yet restarted. But now that the ‘froth’ is out, we are utilizing this opportunity to add to holdings,” said Jain.

Given the lower levels, it is easier to buy stocks with more conviction towards building your long-term portfolio, which wasn’t the case when the Nifty touched 9,000. But be selective; the rules of investing remain unchanged. Look for companies with resilient earnings, healthy balance sheets and capable management.

The good news is that there is no hurry to buy; you have a few weeks at least. Do the homework and find that good quality stock.