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Research
India

India Strategy

Sentiment Is Weak but Has Not Collapsed

MORGAN STANLEY RESEARCH

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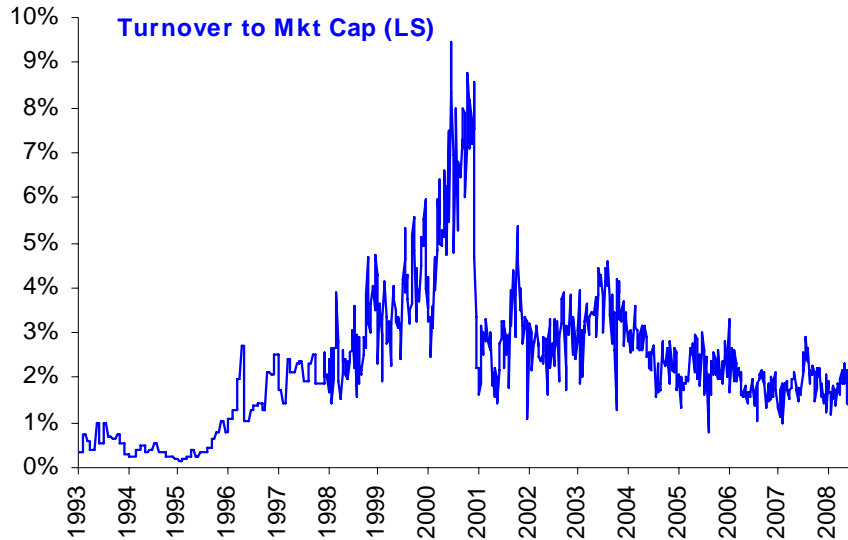
Sentiment Is Weak but Has Not Collapsed

- Several markets around the world suffered capitulation-like falls last week. What are the market internals in India suggesting? Did Indian equity markets suffer a similar fate that would have pushed technical/sentiment indicators into fear zone? Here are our answers:
- India suffered its capitulation-like fall in June/July when the market fell 20% in a month. At that time, our composite sentiment indicator dipped into fear zone and was at its lowest point since the bear market low of the mid-1990s. Several components of the sentiment indicator collapsed. Since then, India has outperformed emerging markets by 24% in USD terms and risen 11% in absolute rupee terms. Even though sentiment remains fragile, it is currently outside what we define as fear territory.
- The components of the sentiment indicator that are particularly weak at this point in time appear to be value-at-risk, return tails, realized volatility, and price relative to 200 DMA. These metrics point to a bearish sentiment and that the market's low point is behind us.
- However, there are other metrics that are either mixed or that have recovered from lows. Thus, trading activity, price momentum, institutional flows, market breadth, and India's relative performance suggest that the market is not all that bearish yet.
- On its own, the sentiment indicator is in "buy" territory, although not in "strong buy" territory. However, when the sentiment indicator is combined with fundamentals and valuations, the downside risk to the market is fairly evident.
- Even if we assume that the market hit its bottom on 16 July (12,515 on the BSE Sensex), previous bear markets show that the market almost always tests the previous low before a new bull market gets under way. This process of retesting took between 15 and 24 months in the previous three bear markets of the past 18 years whereas this market is only two months from its July low. That said, it is quite possible that the pace of the price fall to the end of this bear market could be significantly slower than what we have witnessed thus far.

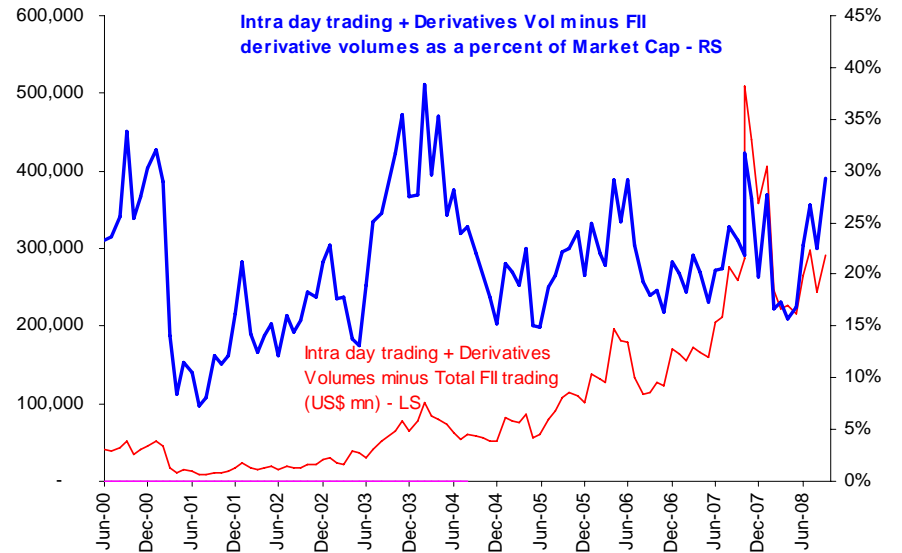
Trading Activity Is a Mixed Bag

While trading volumes are weak, speculative activity is as high as it has been in recent years. Thus, data on trading activity is inconclusive.

Turnover Volumes Suggest Sentiment Is Depressed



But Speculative Activity Is Buoyant

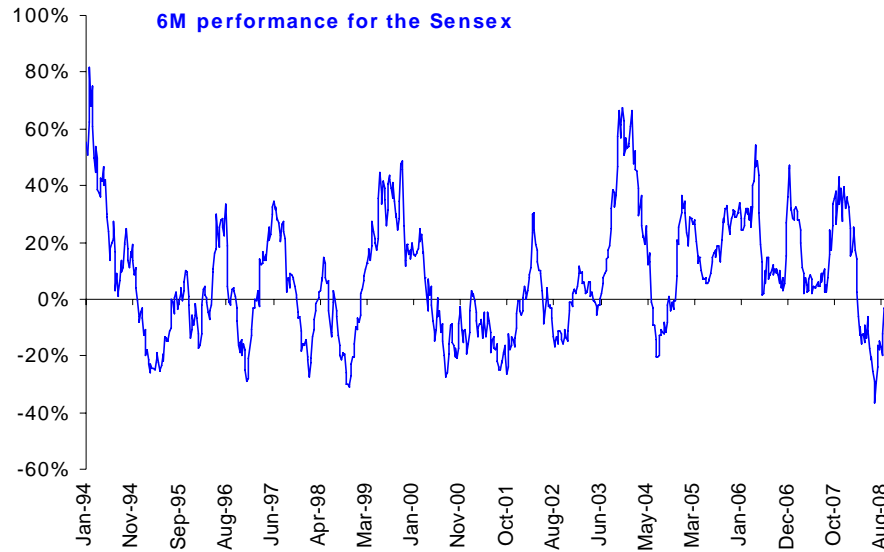


Source: NSE, BSE, Bloomberg, Morgan Stanley Research

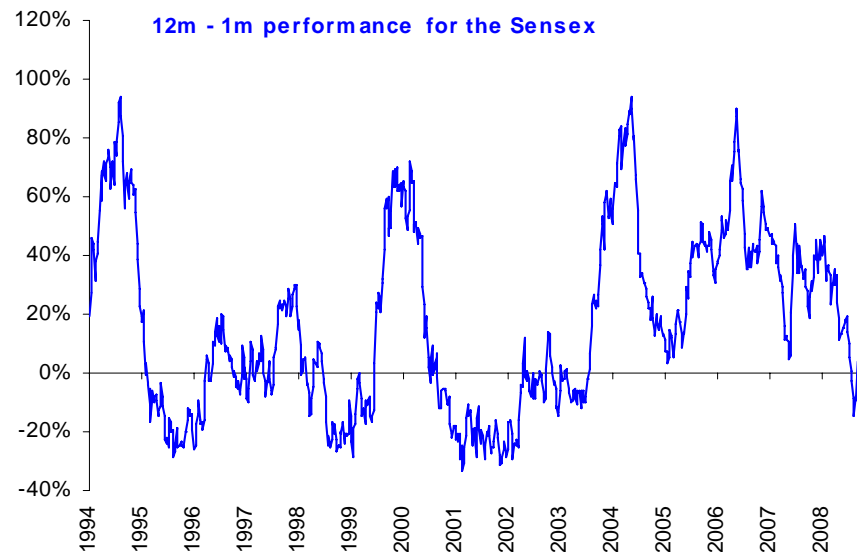
Price Momentum Is Weak but Has Recovered

Momentum turned very weak in July, but has recovered since then. Our favorite momentum indicator (12-month minus one-month returns) did not hit capitulation levels in July 2008 and is now in positive territory.

6M Performance: Recovered From Its Worst Level Ever



12M-1M Performance: Could Go Lower

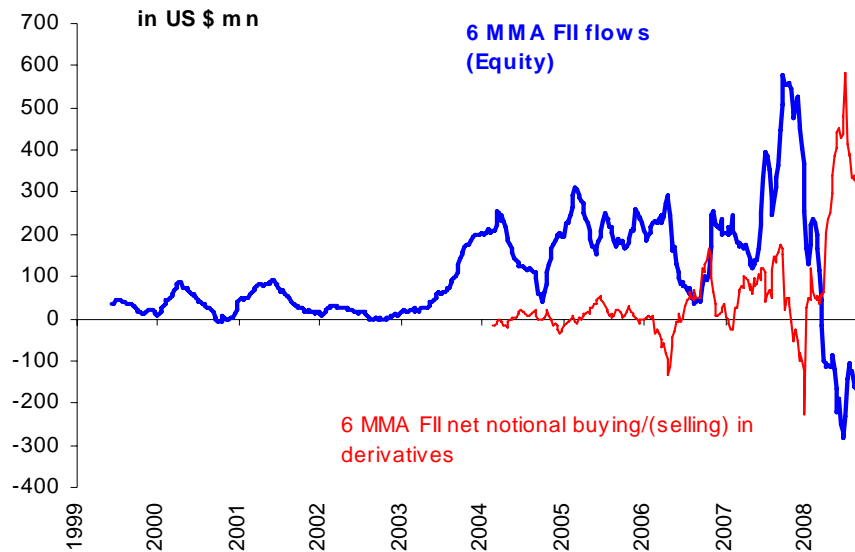


Source: Bloomberg, Morgan Stanley Research

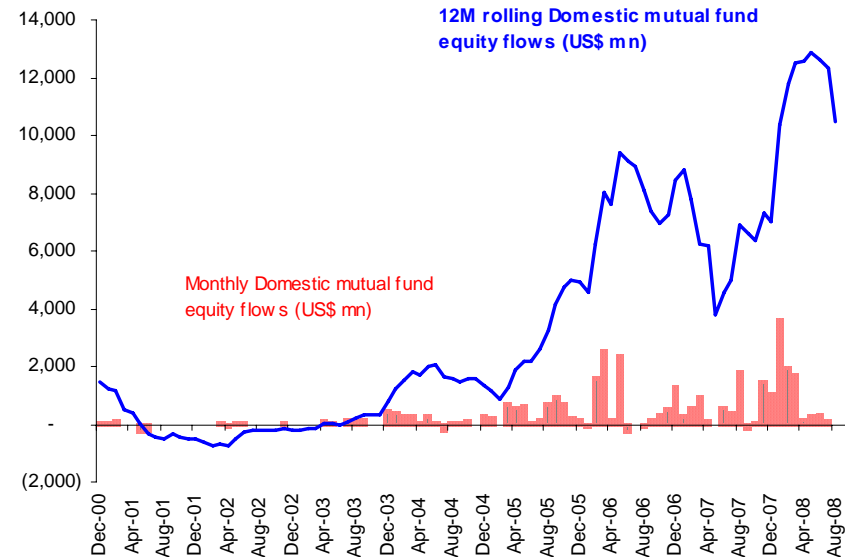
Flows Are Weak but Not Across the Board

FII flows are just off their weakest levels in history, which goes back 15 years. Domestic flows appear resilient although slowing at the margin.

FII Flows: At Their Worst Ever



Domestic Mutual Fund Flows: Resilience on Test

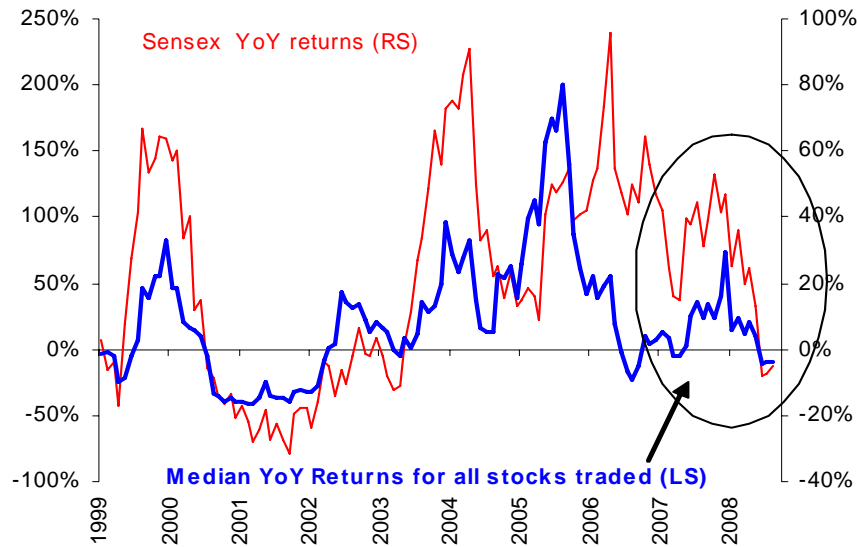


Source: SEBI, AMFI, Morgan Stanley Research

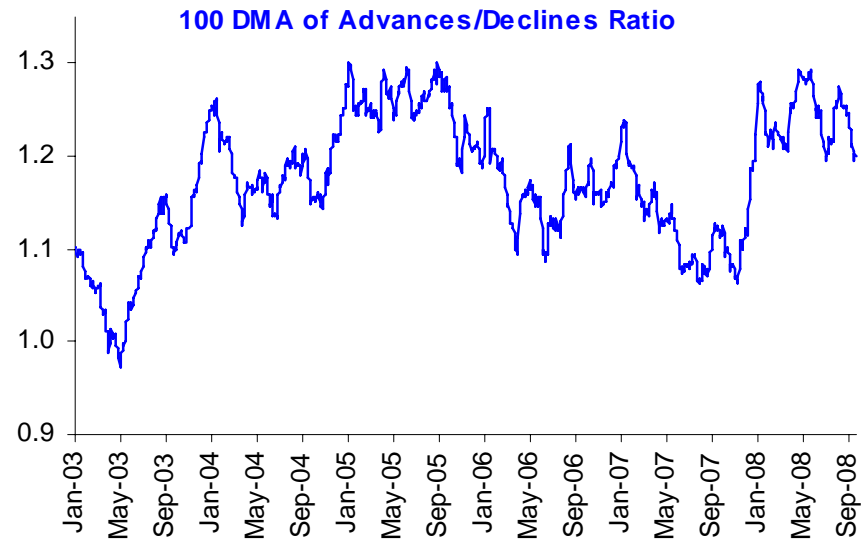
Returns Are Negative but Breadth Is Still Relatively Strong

Market breadth is relatively strong, especially in the context of what the market is returning. The market needs a much weaker breadth for us to turn more positive.

Broad and Narrow Market Returns Are Negative



Market Breadth Is Still too High

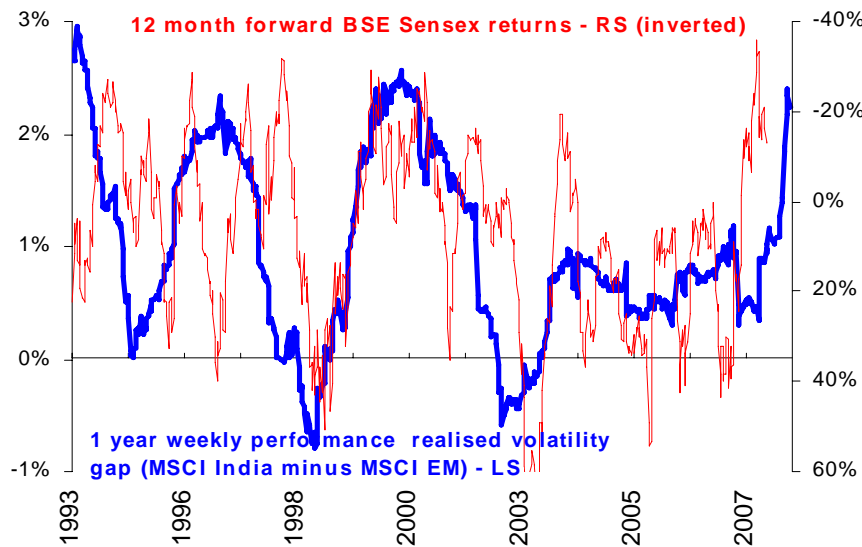


Source: Bloomberg, Capitaline, ASA, Morgan Stanley Research

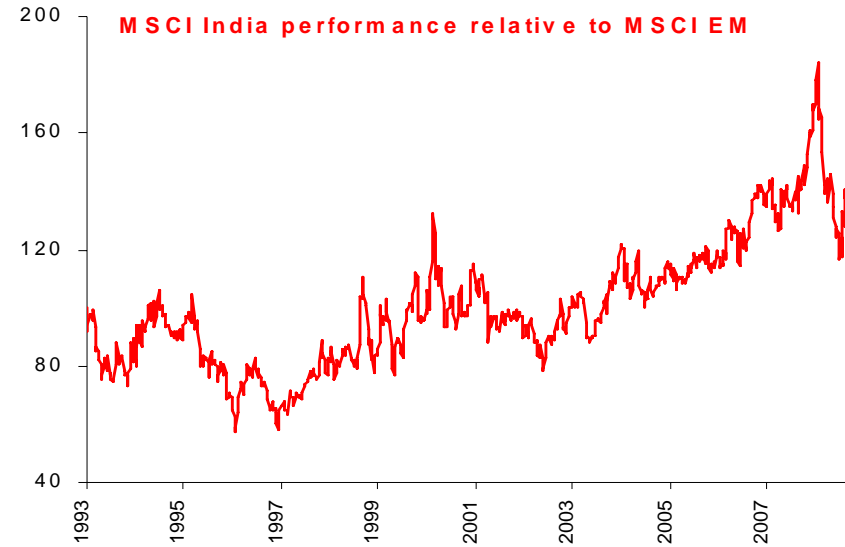
India's Recent Relative Performance Suggests Downside Risk

India has outperformed the emerging markets by 24% since its mid-July low. Its relative volatility has returned to the tech bubble peak and suggests that India could underperform in the coming months.

India's High Relative Volatility to EM



India Outperforms EM

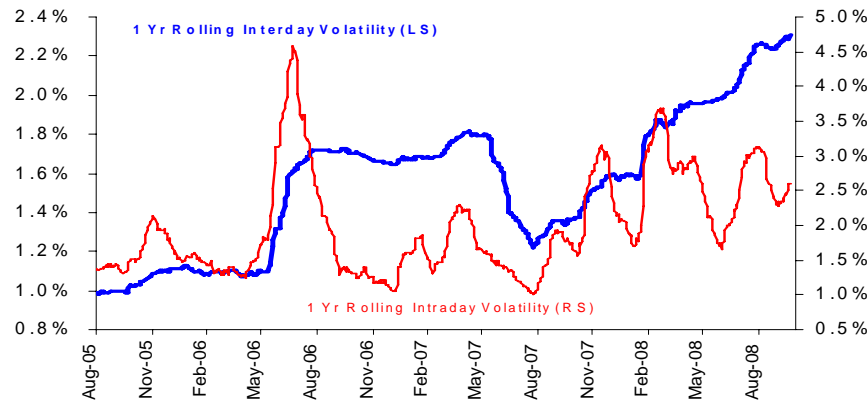


Source: FactSet, MSCI, Bloomberg, Morgan Stanley Research

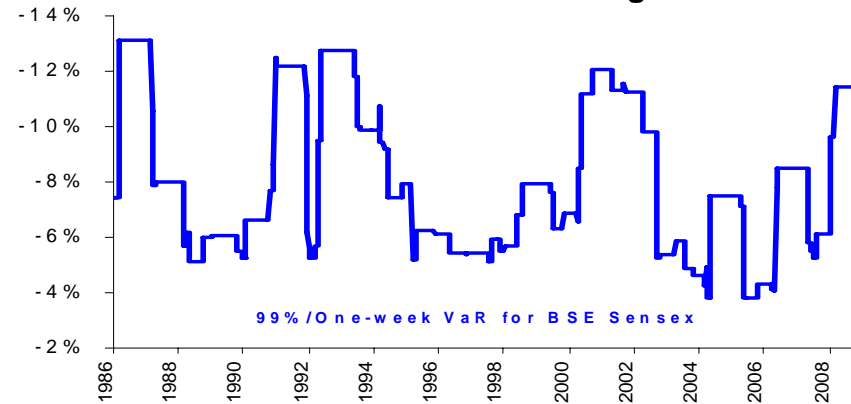
The Most Bearish Indicators and Hence Those Suggesting Capitulation

The market's performance relative to its 200-day moving average, the market's return tails, value-at-risk, and realized volatility are suggesting some sort of capitulation.

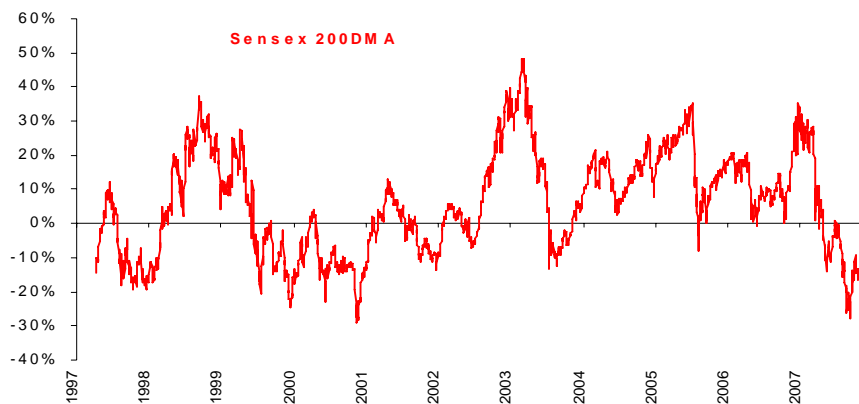
Interday Volatility at Multi-Year High



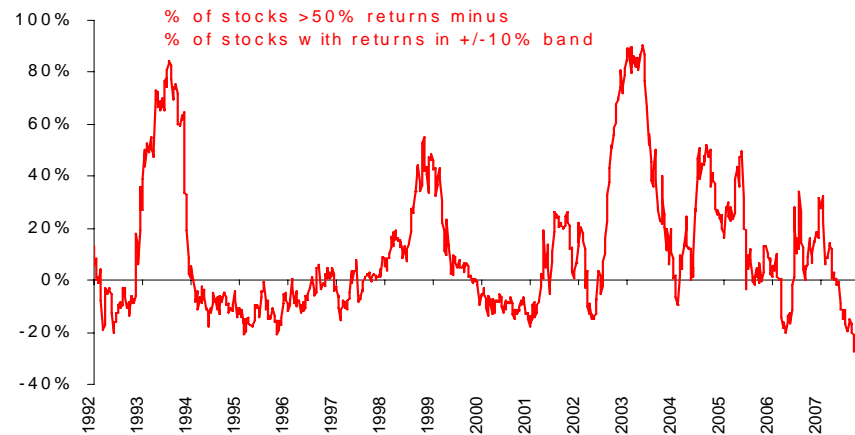
VAR – Close to Historical Highs



BSE Sensex vs. 200DMA



Return Tails Heading in Buy Territory

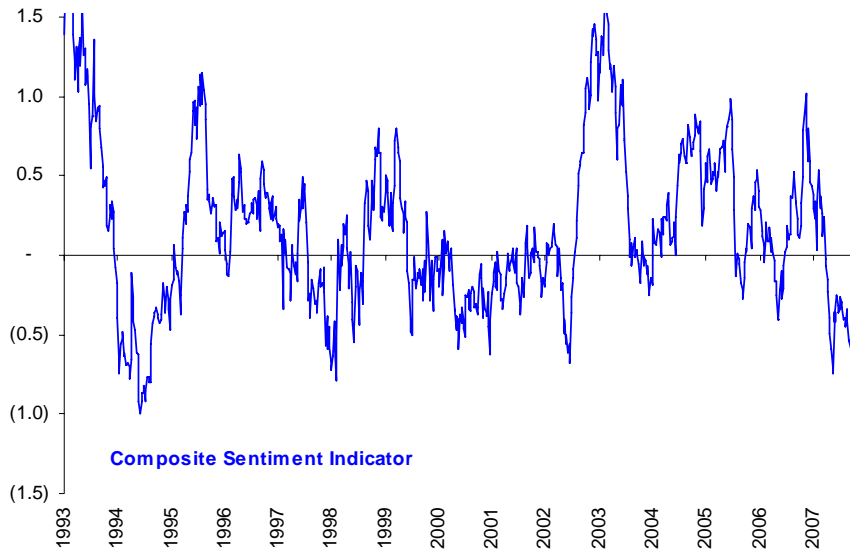


Source: Bloomberg, FactSet, MSCI, Morgan Stanley Research

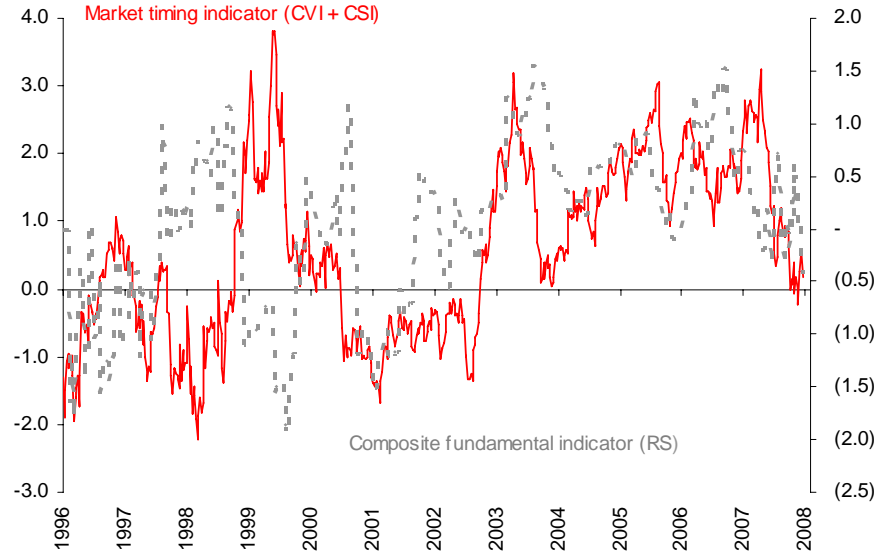
Composite Sentiment Indicator Off Lows

Sentiment is still fragile and is in what we could call “buy” territory but not in “screaming buy” territory. However, when combined with fundamentals and valuations, the sentiment indicator suggests that markets could fall further.

Sentiment Is Fragile

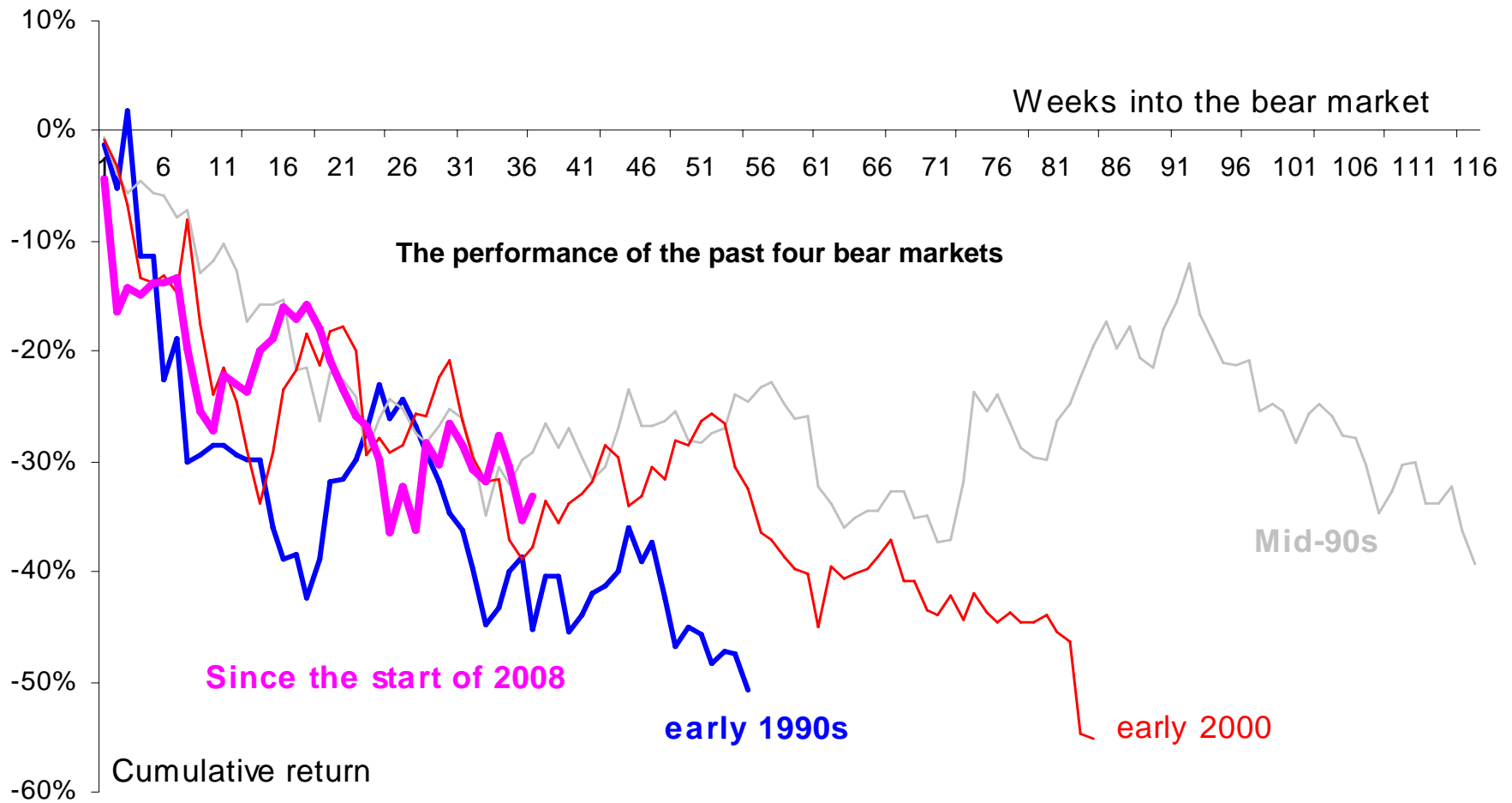


Market Timing Indicator vs. Fundamentals: More Downside



Source: SEBI, BSE, NSE, AMFI, ASA, FactSet, MSCI, Bloomberg, Morgan Stanley Research

Pace of Price Fall Is Slowing but the Bear Market Still Has More Time & Price Fall to Go

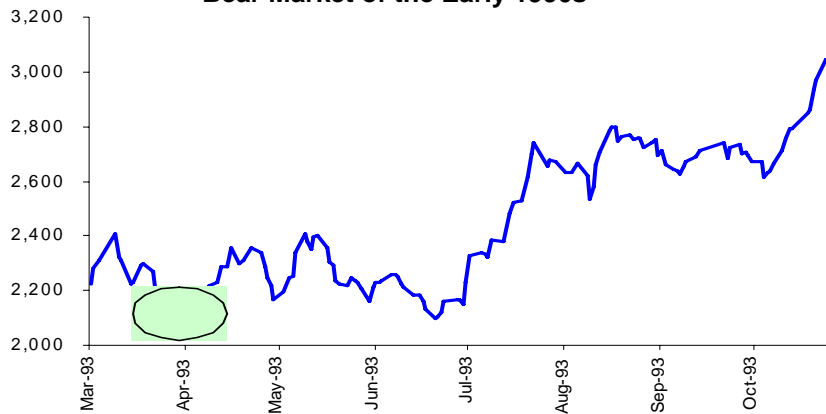


Source: FactSet, Morgan Stanley Research

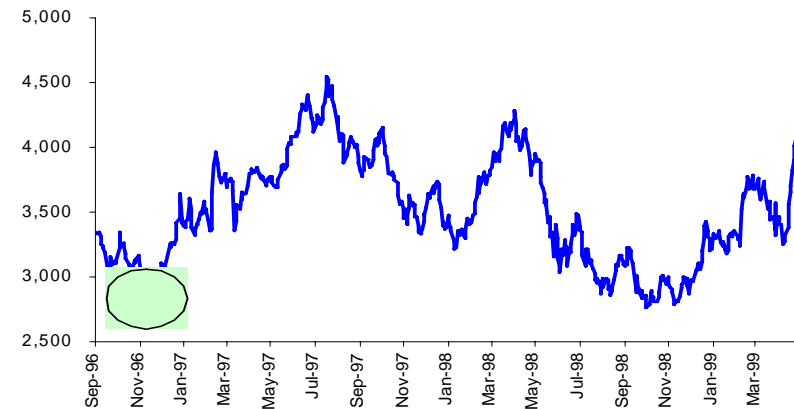
Bear Markets Do Not End with V-shape Recoveries

A look at market behavior of the past three bear markets shows that bear-market lows are almost always tested before a new bull market is formed. Even if the mid-July level was the low of this bear market (which we do not think is the case), there is a long way to go before a new bull market starts.

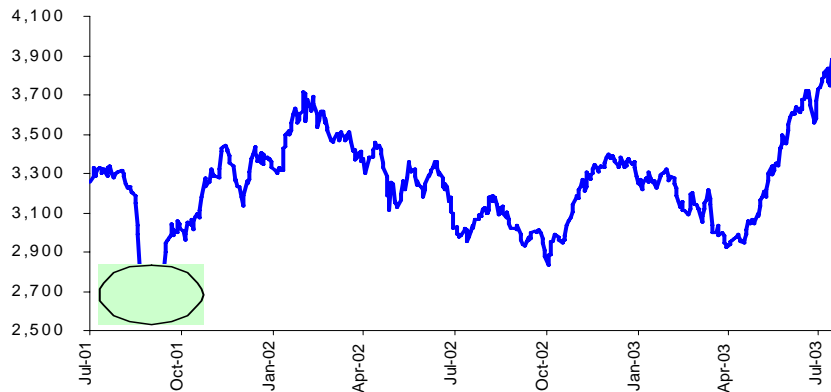
Bear Market of the Early 1990s



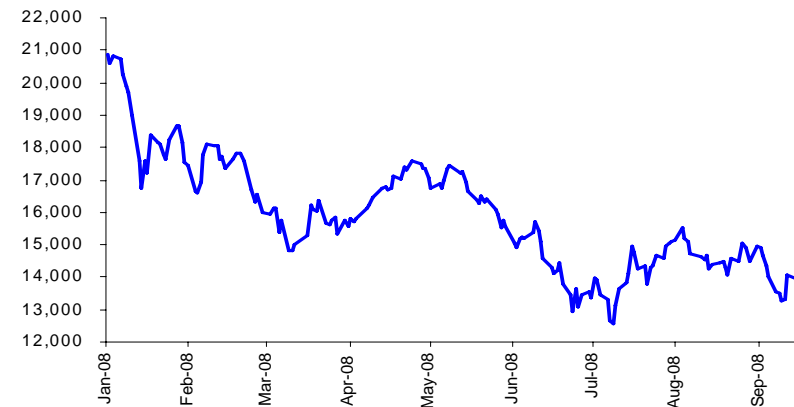
The Mid-90s Bear Market



The Post-tech Bubble Bear Market



The Ongoing Bear Market



Source: Bloomberg, Morgan Stanley Research



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