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Trust equities! Sensex delivers CAGR of about 10% over 10-year horizon

The Sensex CAGR of approximately 10 percent over a 10-year time horizon proves that equity as an asset class has the potential to deliver the best performance over the long term, Devang Kakkad – Head, Research & Advisory – Equirus Wealth, said in an interview with Moneycontrol’s Kshitij Anand.

Edited excerpt:

Q) Caronavirus has become a ‘worry’ from markets across the globe from a ‘concern’. What is the way ahead for Indian markets?

A) Both the global and the domestic environments are going through a phase of uncertainty and volatility. Over the last few days, we have witnessed a flight to safety amidst uncertainty surrounding coronavirus.

Global equity markets have seen sell-off on fears and panic that disruptions for the global economy could be far more severe than earlier estimated. Markets have been particularly concerned with the rapid spread of coronavirus outside China.

The latest update suggests that more than 100,000 people across 58 countries have now been diagnosed with the infection. Indian markets have corrected sharply in line with global equity markets:

Indian equity markets are expected to continue to perform in-line with global markets. Indian and global markets were already trading at historic and relatively-stretched valuations only a month ago before the onset of coronavirus.

Relatively-stretched equity valuation is another factor leading to the accentuated sell-off.

Q) FIIs have pulled out more than Rs 12,000 crore from Indian markets in February. What is leading to the selloff in Indian markets? Do you think the selloff could intensify if the situation with respect to coronavirus escalates?

A) FIIs have been negative on the Indian equity market for February with total outflows of approximately Rs 12,684 crores. In the same breadth, DII has been on a buying spree with a net additional purchase of approximately Rs 16,900 crores.

We have witnessed a global reallocation of capital with equity markets across the globe witnessing negative flows. India’s fundamental growth story and long-term attractiveness continue to remain intact. Once coronavirus is contained, we will see FII inflows turning positive again.

Q) It looks like money has started moving from equities to safe havens like Gold and other fixed-income products. Do you think the fixed-income space could outperform in 2020? What should be the strategy?

A) Portfolio allocation should be based more on risk profile and financial goals rather than various return scenarios especially one-year/near-term return scenarios.

While building a long-term portfolio, one should ensure a combination of multiple asset classes and product diversity for each asset class.The weight allocation for each asset class should be a function of your risk appetite, time horizon and long-term financial goals.

Equity as an asset class has significantly outperformed other asset classes over the medium to long-time horizon. Precious metals such as Gold or Silver have always been viewed as a safe asset class and are chased by investors in times of uncertainty/market turmoil.

The recent surge in prices is more driven by events in the global markets rather than demand/supply or any domestic triggers.

From an asset allocation perspective, it always helps to invest in the uncorrelated asset class and, hence, works as a good hedge/protection in one’s portfolio.

One could consider holding a 5-10 percent allocation in Gold as an asset class from a diversification point of view.

With reference to Fixed Income, our preference is the low duration and ultra-short-term bonds. This strategy minimizes interest rate risk and volatility.

We also recommend investors to be cautious of credit quality and always prefer high credit-quality portfolios.

Q) How should investors play the massive fall which we have seen in February? Is this time to create long-term wealth for investors? What does history suggest?

A) The ongoing uncertainty and fear remind one of Sir John Templeton’s quote - “The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell”.

Current challenges are surely concerning but not insurmountable. Such times provide the best investment opportunity. For long-term investors, there is certainly a bargain available to invest and create wealth.

History suggests that such steep correction is often a buying opportunity. In terms of valuation as well, owing to recent correction, valuations are in a reasonable zone as well.

The following table tracks the historical performance of the S&P 500 after the outbreak of deadly viruses in yesteryear:

Epidemic	Month end	6-month % change of S&P	12-month % change of S&P
SARS	April 2003	14.59	20.76
Swine flu	April 2009	18.72	35.96
Ebola	March 2014	5.34	10.44
Zika	January 2016	12.03	17.45

Source: Dow Jones Market Data

It is an opportune time for investors to evaluate increasing their equity exposure if the current equity allocation is less than the desired exposure.

Q) What should be the investment strategy of investors with respect to mutual funds? This is a time usually when investors stop their SIP as nervousness clouds investors’ minds.

A) Incorporating the recent sell-off, historical returns of Indian benchmark indices are as follows:

Incorporating the recent sell off, historical returns of Indian benchmark indices are as follows:

	1-year	3-year	5-year	10-year
Sensex TRI	6.9%	11.1%	6.7%	10.1%
Nifty TRI	3.7%	9.2%	5.8%	9.6%

Source: Bloomberg, data as on 2nd March, 2020

The Sensex CAGR of approximately 10 percent over a 10-year time horizon proves that equity as an asset class has the potential to deliver the best performance over the long term.

Returns analysis across various time horizons corroborates the age-old portfolio theory that spending more investment time in equity markets is far more important rather than trying to time the markets.

Historical returns not only prove the unravelling of India's long growth story but also provides ample evidence that irrespective of various uncertainties including geopolitical or domestic events, long term investors are expected to earn impressive returns.

SIP is the most time-tested and evergreen way of investing in the market. History has proved time & again that it is humanly impossible to time the market. SIP provides perhaps the most disciplined way of investing in equity markets.

SIP provides investors with dual benefits of the power of compounding and rupee cost averaging, both of which key ingredients for long-term wealth creation.

For investors with ongoing SIP investments, the ongoing crisis presents a compelling opportunity to not only continue their SIP investments but also tactically top up their existing investment if feasible.