# THE C3 EFFECT – CORONA, CREDIT & CRUDE

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http://blog.Intelsense.in

https://twitter.com/a_basumallick

https://www.linkedin.com/in/abhishek-basumallick-9826ab168/

https://www.facebook.com/Abhishek-Basumallick-344572583038440

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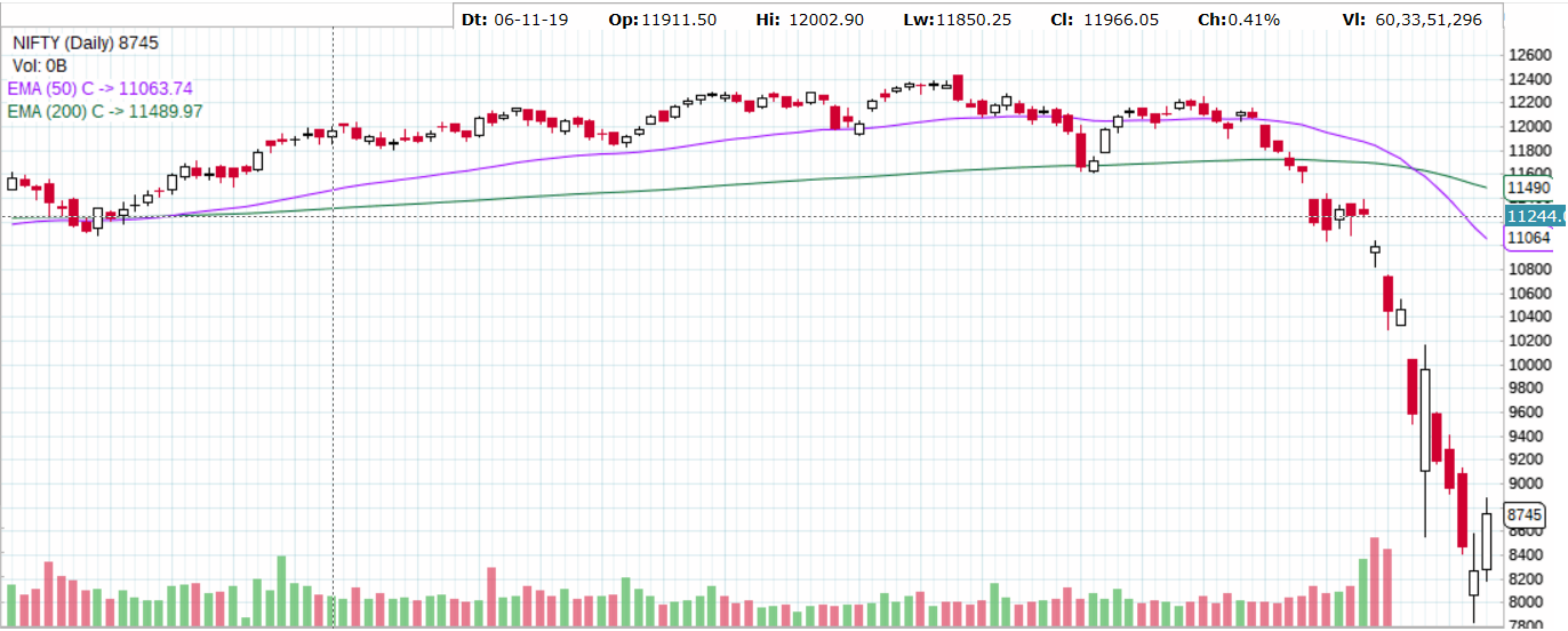
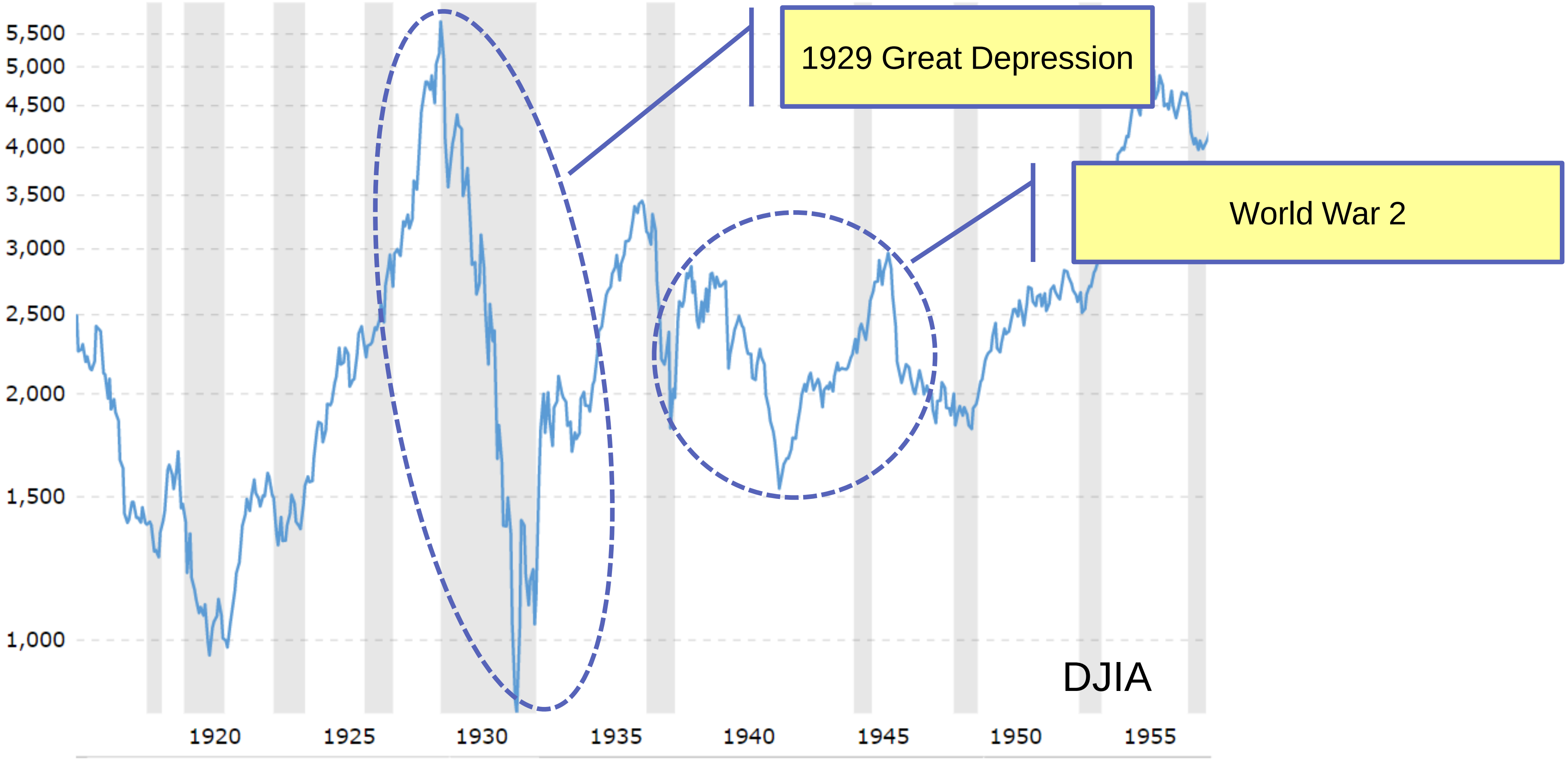
# The Indian markets have crashed precipitously over the last 1 month due to the 3C effect.

- This is one of the sharpest falls in Indian indices ever, including 2008.
- March 2020 could potentially see the worst monthly fall in Nifty. Worst is 28% in Oct 2008 and Mar 2020 is currently about 23%.



# First a look at Corona

- We are in a world war like situation. Completely unprecedented in scale and impact by anything anyone in our generation or previous generation has witnessed.
- Situation is likely to be worse than 2008 GFC as solution is unknown.




Source: [https://www.macrotrends.net/](https://www.macrotrends.net/)

# Index returns can be negative for consecutive years if conditions are strained

- Let us look at the Great Depression and WW2 for some reference.
- Under exceptional circumstances, negative index returns for consecutive years cannot be ruled out.

| | Year | Yearly Decline | Total Aggregate Move |
|---|---|---|---|
| Great Depression | 1929 | -17.17% | -80% |
| | 1930 | -33.77% | |
| | 1931 | -52.67% | |
| | 1932 | -23.07% | |
| WW 2 | 1939 | -2.92% | +25% |
| | 1940 | -12.72% | |
| | 1941 | -15.38% | |
| | 1942 | 7.61% | |
| | 1943 | 13.81% | |
| | 1944 | 12.09% | |
| | 1945 | 26.65% | |

| | Year | Open | Close | Annual Return |
|---|---|---|---|---|
| Nifty | 2011 | 6177.45 | 4624.3 | -25.14% |
| | 2012 | 4640.2 | 5905.1 | 27.26% |
| | 2013 | 5937.65 | 6304 | 6.17% |
| | 2014 | 6323.8 | 8282.7 | 30.98% |
| | 2015 | 8272.8 | 7946.35 | -3.95% |
| | 2016 | 7938.45 | 8185.8 | 3.12% |
| | 2017 | 8210.1 | 10530.7 | 28.27% |
| | 2018 | 10531.7 | 10862.55 | 3.14% |
| | 2019 | 10881.7 | 12168.45 | 11.82% |
| | 2020 | 12202.15 | 8745.45 | -28.33% |

Source: https://www.macrotrends.net/

# Global recession seems inevitable

- China's growth reduced from 4.8% to 2.9% by S&P
- Goldman Sachs has reduced US GDP growth rate down from 0.7% to 0% in Q1 and -5% in Q2FY21.
- JP Morgan believes US GDP will contract by 2% in Q1 and 3% by Q2. Eurozone GDP could contract by 1.8% and 3.3% over the same periods
- CRISIL has reduced Indian GDP growth rate from 5.7% to 5.2% with the risk of revision downwards.

- During the Global Financial Crisis (GFC), fiscal stimulus by the G20 amounted to about 2% of GDP, or over $900 billion in today's money, in just 2009 alone.
- Coordinated and synchronized global fiscal stimulus is likely from major countries and their central banks.

# Serious economic impact if lockdown or social distancing needs to persists for more than 1 -2 weeks

Big hit for travel & tourism, hotels, hospitals, manufacturing industries, construction, consumer discretionary spending, entertainment (cinema halls, malls, theme parks, restaurants etc).

Cancellation of weddings and other events leading to further pressure on entire value chain.

Oil sector under severe pressure. Huge remittance from Indians working in Middle East can be severely impacted.

IT industry can face major crisis as global recession hits US, Europe.

# Immediate economic fallout could also be substantial both at the individual firm level and the country level.

Reduced revenues & profits

Debt repayment issues – moratorium and debt restricting may be needed

Working capital availability

Ballooning of receivables

MSME sector may get impacted the most

March being FY ending, book closing and tax work to get impacted.

A major difference from 2008 GFC is:

- this impacts everyone
- People are dying
- No clear solution

# Governments are acting by taking monetary and fiscal measures. Outcome needs to be observed and monitored.

| Fiscal | Monetary | Regulatory |
| --- | --- | --- |
| • Adequate spending on disease spread prevention.<br>• Funding readiness of hospitals, healthcare workers, quarantine facilities, medicines etc. | • Reduction in interest rates<br>• Increase in liquidity in the system | • Central banks have to maintain the balance between preserving financial stability, maintaining banking system soundness and sustaining economic activity. |

Investors have removed nearly $42 billion from emerging markets since the beginning of the crisis.

**This is the largest outflow EMs have ever recorded.**

## Not everything is bleak. Crude price has given India some breathing space on the fiscal side.

- India imports about $110 billion worth of oil. FY21 import bill could be potentially cut in half with current depressed prices. India purchases between $10-15 billion worth of oil every month.
- The savings for Feb-Mar would be around USD 10-15 billion.
- In FY16 when crude fell to $26 / barrel, India's oil import bill was $64 billion.

## Yes Bank's problems, preceded by ILFS, DHFL, PMC Bank, raise serious questions on how well Indian banks & financial institutions are regulated and monitored.

- YB is India's 5th largest private bank and accounts for 2.3% of total loans and 1.6% of deposits.
- After Rana Kapoor's extension as MD was disallowed by RBI and new MD Ravnit Gill was brought in by the bank.
- The new MD kept assuring that the bank is turning around.
- YB's deposit base crashed from Rs 2.09 lakh crs in September 2019 to Rs 1.65 lakh crs in December 2019. It has now gone further down to Rs 1.37 lakh crs as on March 04, 2020.
- YB's gross NPA has been reported at 18.87% and absolute NPAs figure is Rs 40,709 crs.
- AT1 bonds have been completely devalued and this will have second order consequences on other banks who raise funds through this mode.

# The positives

- Getting a medicine or an antidote is just a matter of time.
- Scientists and pharma companies are focusing on releasing a cure.
- Coronavirus is not an unknown virus to the virologists. It is similar to SARS Coronavirus.
- Maximum period of stress could be 6 months, as per reports.
- Regulators are going to increasingly intervene with policy measures to relieve the challenges. This can prevent markets from correcting or actually aid in recovery.
- Once an antidote/medicine/vaccine is found, markets are likely to have a very sharp recovery.

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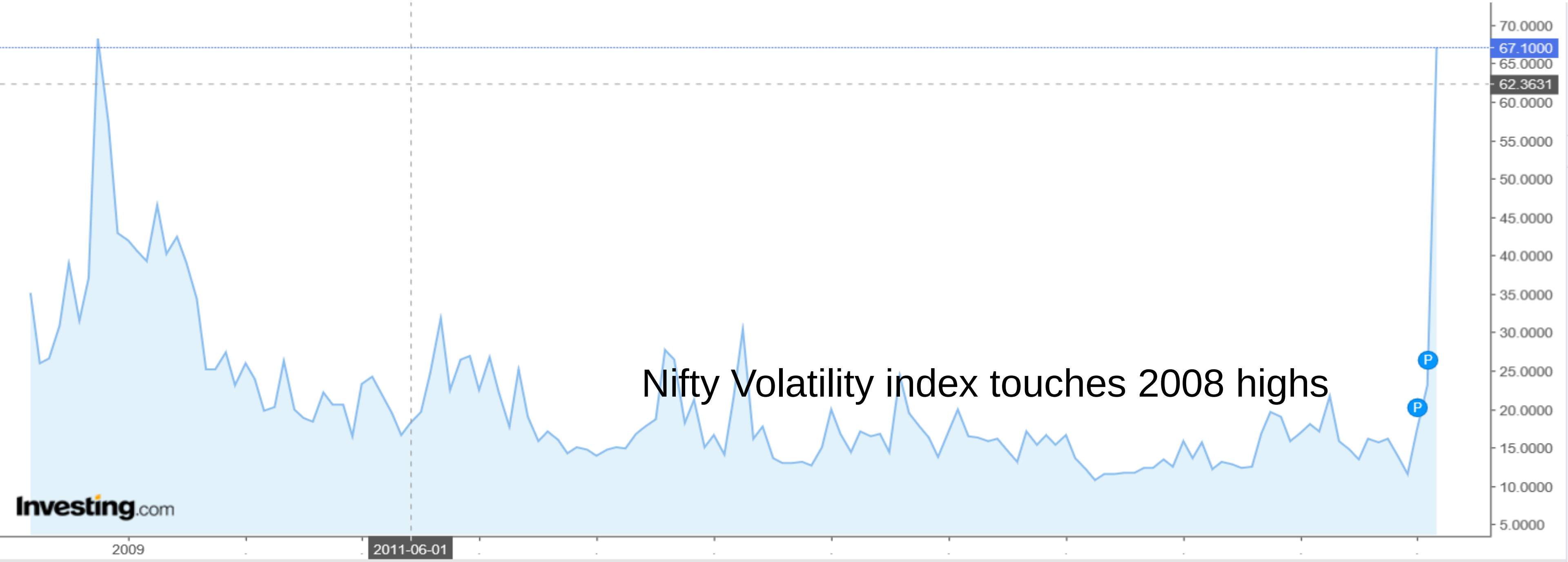
# There is extreme fear in the markets as evidenced by VIX



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# RSI (Relative Strength Index) is lower than 2008. The velocity of the fall is much higher than in 2008.

# How far can we fall?

- **I don’t know.**

- Technical View:
  - Possible lower levels: 7900-8000, 7500, 6500-6300

- Fundamental View (pessimistic view):
  - Current Nifty EPS = 439 (standalone)
  - Possible FY21 Nifty EPS ~ 350-400 (expecting a 20-30% decline in earnings)
  - At a PE of 15 (standalone) we get a price range between 5250-6000.

At 6000 levels, markets would have corrected 50% from top. This is NOT impossible, even though it sounds improbable.

These levels are NOT sacrosanct. For all I know, markets could have already made a bottom last week.

# What to do now?

- No one knows for sure. Be very sceptical of people who sound sure of themselves.
- Do not watch the market everyday unless you are a full time investor. Read some good books, watch movies on Netflix/Prime/Hotstar etc.
- For those who have cash to deploy in the portfolio:
  - Wait for markets to get some stability or valuations to become very lucrative.
  - Good quality companies are still not mouth wateringly cheap.
- If you are fully invested:
  - Selectively reduce positions and raise cash.
    - Do NOT consider buy price.
    - Do NOT think I don't want to book losses.
  - You can raise cash by selling proportional percentages in each stock holding. E.g. if you want to raise 20% cash, sell 20% each in all of your holdings. Or, sell all non-core holdings.
- **Do NOT be impatient. Do not have Fear-Of-Missing-Out (FOMO).**
- Most likely, in the coming 3 months, you will get a chance to load up on stocks.
- The stocks we buy in the next 3 months will define how we do in the next 3 years.
- You will remember 2020 for a long time. How you act in the next 3-4 months, will decide how you remember it.

STAY SAFE