July 1st, 2021

A Glimpse into the Financial World

Edition 5

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Kautilya

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SEBI plans to come out with regulations for SPACs

Securities Exchange Board of India is planning to come up with the regulation for the SPACs which will enable the listing of startups on the domestic stock exchange. Special Purpose Acquisition Companies (SPAC) are the companies that are formed to raise capital in an Initial Public Offering with the purpose of using the proceeds to identify and merge with a targeted company. SPACs are usually formed by private equity funds or financial institutions, with expertise in a particular industry or business sector, with investment for initial working capital and issue related expenses. The capital market regulator is said to release guidelines for SPACs in the week starting 28th July 2021.

(**Source: Financial Express**)

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Infosys share price surges as 9,200 crore buy-back opens.

On Friday, 25th June 2021, the share price of Infosys surged 1.68 per cent making a new high of Rs 1,575 per share. This happened as the IT firm began its buyback of Rs 9,200 Crore. Upon completion of buyback at the maximum price, Infosys will have bought back 5.25 Crore equity shares. This is the third buyback done by the IT firm in the span of 5 years. The stock has surged 127.25 per cent in the last 1 year, more than doubling the investors' money. In terms of traded volume, a total of 2.5 lakh shares have been exchanged on Sensex (BSE) and 86.82 lakhs on Nifty 50 (NSE).

(Source: Financial Expess)

Wipro IT services raised $750 million from overseas bond sale

On Thursday, 24th June 2021, the IT major Wipro announced that its subsidiary, Wipro IT services has raised a sum of $750 million from an overseas bond sale. Last week Wipro had announced that Wipro IT services will issue U.S. dollar-denominated notes worth $750 million to Qualified Institutional Buyers (QIB). The date of issue stated was 23rd June 2021, with maturity being 23rd of June 2026. The net proceeds of the notes are intended to be utilized for refinancing existing debt and general corporate purposes.

(**Source: Financial Express)**

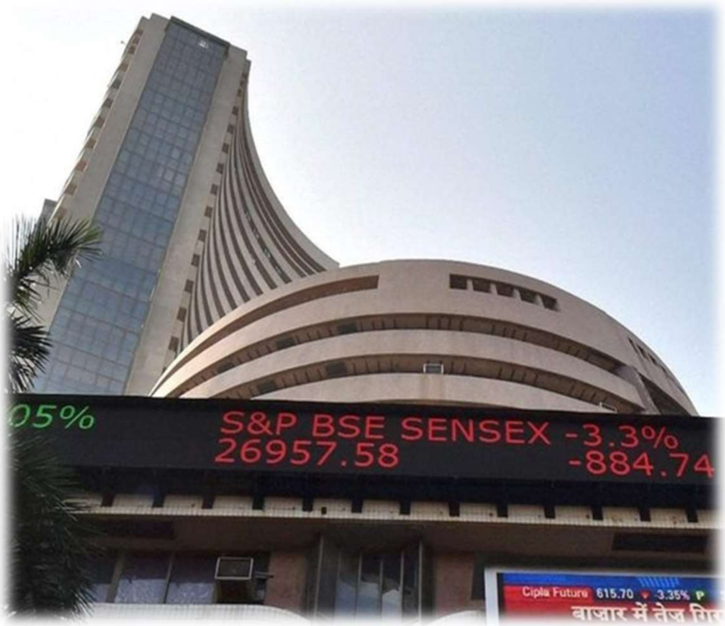
SEBI bans Equity Mania and its proprietor from market for 2 years

Security Exchange Board of India has banned Equity Mania Financial Advisory and its proprietor Ankit Goel from the market for 2 years as they carried out investment advisory activities without obtaining a certificate of the registrar from the regulator. SEBI has also asked them to refund the money collected from unauthorized investment tips to the investors. In view of the exceptional circumstances due to the breakout of the second wave of the COVID-19 and the lockdowns imposed the direction related to the refund will be effective from the 1st of July 2021.

(Source: Financial Express)

(Raj Gudhka – Newsletter Head)

Importance of Financial Market in an economy



"An Economy is the large set of inter-related production and consumption activities that aid in determining how scarce resources are allocated. This is also known as an economic system."

Efficient stock market is said to have a positive relationship with economic growth.

Increase in GDP – GDP refers to all the goods and services produced in an economy. An increase in a real GDP signals that the economy is heading in a right direction as it reveals strong economic performance. To state the relation between Economic growth and stock market we focus on two major components of GDP that is investment and spending. Investment fuels economic development and growth, stock market encourages the mobilization of domestic savings through issuance of equity shares and allocation of collected funds to productive sector. On one hand, investors can enjoy capital gain and dividend payments on the other hand corporate can use this fund for their operations.

Source of Business Capital – Without stock markets, businesses would largely resort to borrowing huge loans - which must be repaid with interest- from banks. Fortunately, businesses in both the developed and developing world can issue share to the public, raising vast amounts of cash that doesn't come along with a repayment burden (public companies are under no obligation to pay dividends, especially when they incur losses). When they have access to this capital, they can easily expand their business and in turn create employment which from Economy perspective will lower the unemployment rates and enable the government to earn more through business taxes.

Promotes Investment – Investments, whether in the financial markets or Commodities markets (agriculture, real estate, manufacturing etc.), are a key driver for economic trade, growth and prosperity. The stock market has opened a new world of investment options for common people. Mostly used investment options are Mutual Funds, Systematic Investment Plan. The benefits of investing in these options are that they would provide higher return as compared to conventional savings option like Fixed Deposits, Bank Savings account etc.

Source of Government Funds – Stock markets provide a trading platform for governments too. Sometimes a local, state or national government may need more money to develop a community housing estate, build a water treatment plant or initiate any other public projects. Instead of increasing taxes to raise the required revenue, it can issue bonds through the stock market. When investors buy these bonds, the government is able to raise the money it needs to launch various projects that can ease the cost of living or even create jobs for locals. In the long run, this improves the economy.

Influences Economic Perception – The stock market of a country is seen as one of the economic barometers. Usually, indices of a leading stock exchange are considered for the same. A continuous healthy condition attracts more investment from local and foreign investors. This, in turn, increases the economic health of a country.

(Raj Gudhka - Newsletter Team Head)

The Disconnect between Economy & Stock Market

The stock market and the economy have been moving in opposite directions. While the stock market is at its peak, the economic outlook remains gloomy. Looking at India's economy, when the COVID-19 crisis had just begun, GDP dropped by 23.1% during Q1 of 2020-21. The slowdown continued in the next quarter, with a negative growth rate of - 7.5%. According to the data released by CMIE, urban unemployment in India soared to 9.83 % in August 2020.

And yet investors continue to eagerly buy Indian assets, fuelling a 65% rally in the Nifty 50 Index over the past 12 months. Indian companies have taken advantage of the eagerness in markets to raise about $4 billion via public offerings since the start of 2021, according to Bloomberg.

Another reason for the disconnect could be that the stock markets are forward-looking in nature and are expressing optimism that the pandemic would end with a vaccine. However, the economy is backwards-looking. Moreover, a few stocks dominate the market. This means that some companies may be benefiting from the current scenario, while others might not. However, the benefitting companies outshine the impact of the non-benefiting companies. Also, liquidity in the system is ample and the interest rates have been cut. It means that consumers and corporates will benefit from low interest rates. This can lead to demand stimulation as borrowers can buy more with the same EMI.

While it appears that there is a disconnect between the economy and the stock markets, it is only the difference between the current reality and the expected future.

(Rhea Pinto – Newsletter Team Member)

Speculative Bubble and its effect on Market

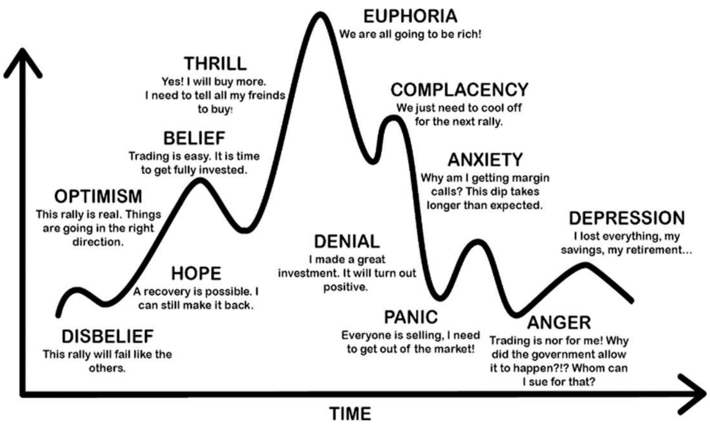
A speculative bubble occurs when there is an unexpected increase in the prices of assets such as currency, gold, commodities or real estate because of some random speculations. Such speculations are not backed by any fundamentals.

The speculative bubble leads the stock market to soar and more investors are attracted to the market. This leads to an increase in the number of buyers and eventually prices of the securities hike beyond their values.

This cycle ends when the prices are back to normal. This period is referred to as "pop." At this moment investors want to sell their stocks because of the fear of losses.

Following signs will be noticed during the rise of a speculative bubble:

- The rise in the prices of assets
- Unfound enthusiasm in the market
- Ignorance of traditional rules of the market
- Excessive use of debt for purchasing securities
- High publicity for a particular asset/ excessive media coverage
- Entry of speculators in the market
- A lower interest rate to encourage borrowings and fuel speculations
- Increase in higher-risk lending (lending to borrowers with lower credit scores)



Impact of Speculative Bubbles

There is no direct impact of speculative bubbles on the Gross Domestic Product (GDP) of an economy but there are huge changes in the prices of assets. When the bubble bursts demand falls rapidly and the outcome is reduced business or illiquidity or even insolvency. Studies find that the bubbles may lead to the misallocation of resources which will eventually lead to the inefficiency in the economy.

(Raveena Batreja – Newsletter Team Member)

Are Financial crisis becoming more often?

A financial crisis is described as a situation in which one or more large financial assets, such as stocks, real estate, or oil lose a considerable portion of their nominal value abruptly (and generally unexpectedly). Economic crises of one kind or another have occurred around every 25-30 years in the United States over a previous couple of centuries. The Global Financial Crisis of 2008 and the dot-com speculative bubble that burst around the turn of the century are recent instances.

Financial crises are frequently preceded by, accompanied by, or followed by periods of widespread credit difficulties. The Global Financial Crisis of 2008 was no different. It was partly caused by a tremendous rise in subprime mortgage lending, which resulted in a large stack of mortgage loans that were virtually doomed to collapse from the start. Subprime mortgage loans are big loans offered to those who are expected to have trouble repaying the loan. They are issued to people who have relatively low credit scores. Financial crises are almost often followed by a period of significant credit tightening, in which lenders try to limit their risk exposure by only lending to borrowers with excellent credit scores.

Financial crises are notoriously tricky to predict, in part because the triggering event or combination of events might be relatively minor. The dot-com boom of 2000-2002, for example, was devastating for many investors in the quickly developing IT industry. Still, it only affected a small percentage of the entire stock market at the time. Despite the demise of many enterprises, other dot-com companies, such as Amazon and Google, multiplied in the years that followed. Asian Financial Crisis was triggered by the devaluation of the yen and the bursting of a hot money bubble. It began in Thailand in July 1997 and quickly spread throughout East and Southeast Asia. In several East and Southeast Asian countries, the financial crisis wreaked havoc on currency values, stock markets, and other asset prices.

Following the Covid-19 pandemic, the world may be on the cusp of another substantial global financial disaster (assuming we aren't already in one). However, as of mid-2021, it's difficult to predict what the virus's long-term economic effects and widespread quarantine lockdowns would be.

(Jattin Jacob – Newsletter Team Member)

Techno-Funda Analysis for stock picking

For long, an idea that has gained some acceptance is that by picking stocks using a mixture of Technical and Fundamental Analysis, an investor might be able to get healthier returns compared to using either of them on a separate basis.

Technical Analysis is the art of inspecting the previous price movement of stock to estimate future price movements. It aids to recognize trading prospects by analysing statistical trends.

Fundamental Analysis is a technique of evaluating the intrinsic value of a stock or security to find continuing investing opportunities. This is done by examining related economic, financial and other qualitative and quantitative aspects of that stock.

Techno-Funda investing is a mix of technical and fundamental analysis. The experts of techno-funda investing generally approach it in one of the two ways - i) look for robust fundamental stocks and then look for respectable technical patterns in them or ii) look for chart patterns and then apply the fundamentals of the stocks. The techno-fundamental method helps an investor sail through all stages of the market. It makes sure that an investor does not sit with stocks that have lost buying interest. At the same time, it ensures that he is not entering 'junk stocks' in the excuse of racing momentum.

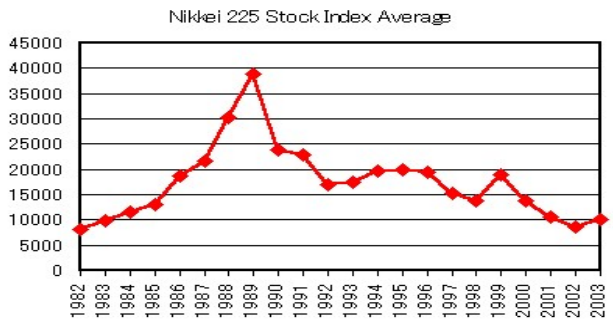
Techno-Funda is a report created on a mixture of Fundamental research and Technical Analysis. A fundamentally sturdy company in a Technically weak position is usually a good time to purchase while a Fundamentally weak company in a technically strong position is usually a good time to sell. This report delivers the clients with such openings.

(Khuzaima M Banatwala– Newsletter Team Member)

Do You Know about The Japan Asset Bubble?

The Japanese Asset Bubble Crisis also known as **Baburu Keiki** in the country's financial history refers to a period of exaggerated stagnation in the economy that caused the prices of the held assets as well as the stocks to elevate to an unprecedented level with abnormally fast growth.

The Japanese stock price index, Nikkei, began to rise in the early 1980s, which continued to rise and was more than 5 times in the year 1980 from when it started rising. Alongside the rise of the stock index, the land prices also started to rise and it rose to the extent that it was more than doubled. When the bubble burst in 1990, both of these started falling, it plummeted so hard that till today Japan hasn't recovered.



So, what was the reason behind this?

There are 2 views to this crisis,

The first one states that the bubble was caused by bank deregulation. Prior to the crisis, Japan's banks were tightly regulated by the Ministry of Finance. There was very little room for innovation, as long as the banks were under these guidelines, they were assured adequate profits which protected them from bankruptcy. This tradition changed in the early 1980s as the corporate moved to alternate sources of finance like accessing the International financial market, corporate bond issuance etc. Banks lost their franchise value & had to approach new clients. These new clients were SME, investment in land and property etc. But Banks lacked the experience of evaluating these new clients and as a result, they over lent the money when the economy was booming. When the bubble ended the prices came tumbling down and there was a huge burden of bad loans.

The second view states that the bubble was mainly because of monetary expansion. In 1985, there was sharp appreciation in Yen, and the Bank of Japan lowered short term interest rates and hence the money was easily available in the market. Since the price inflation at that time was close to zero, the Bank of Japan thought that it was a good move for the monetary expansion of the economy. Here comes the problem, when the asset prices are rising but the prices of the goods are stable, is liquidity excessive or not? The data showed that the broad money (M2 + CD) accelerated to more than 10% during 1987-89. Isn't this too high for an economy growing at about 4%? And because of this, the new governor of the Bank of Japan sharply increased the interest rate which resulted in the bursting of the bubble.

And this explains that these two reasons are not unlinked, bank deregulation explains the finance of many projects during that period and monetary expansion explains why the bubble carried on for a longer period.

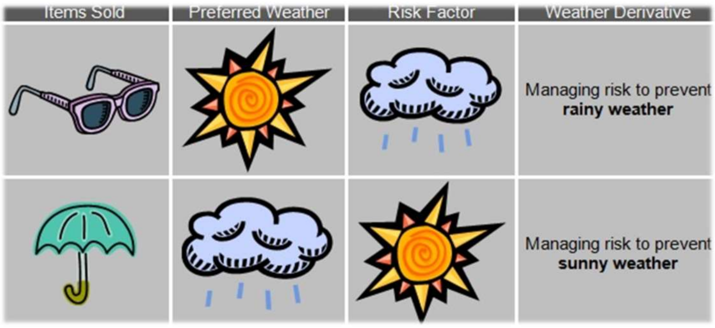
Although asset prices had already started to decline by 1992, the country witnessed a 10-year stagnation journey post the burst which later came to be known as **The Lost Decade.**

The effects of this crisis were so hard that the Japanese economy is still suffering from what is called **"The Lost Decade"**

(Snehal Wagh– Kautilya Co-Head)

Financial Product

Weather Derivatives



A weather derivative is a financial instrument utilized by companies or individuals to hedge against the risk of loss due to weather conditions. The seller undertakes to bear the catastrophe risk in return for the premium. If no comp ensation is made before the contract expires, the seller will make a profit. In the event of unforeseen or adverse weather conditions, the derivative buyer requests the agreed amount.

The first derivative (based on average temperature) by a trading mechanism was introduced in 1999 to the Chicago Board of Trade, and within a few years, it grew into an $ 8 billion industry. Investors interested in weather derivatives appreciate their low correlation with traditional markets. Weather derivatives can be used by companies whose business depends on weather conditions such as hydropower and sports management as part of their risk management strategy. Weather derivatives generally have an index base that measures a specific aspect of weather. For example, the index can be the total amount of precipitation over a certain period of time at a given location or the number of times the temperature drops below 0. Heating Degree Day or Cooling Degree Day are the most popular types of weather derivatives offered by banks such as ABN AMRO and Rabobank. These banks study the impact of monsoons on the performance of businesses in various sectors.

Since developed markets have enjoyed smooth trading over the past three decades, India also needs these products as investors are now more mature given their experience in agricultural trade. Farmers can use weather derivatives to protect against crop failure caused by heavy rainfall, drought or damaging winds reducing the intimidating role of moneylenders. In addition, it will have significant direct and indirect economic implications for various sectors such as tourism, travel, hospitality, sports, event management, energy, agriculture and consumer goods. India already offers subsidized public insurance programs, but derivatives could fill in the gaps or expand coverage. However, the Indian government has yet to introduce or promulgate regulations allowing the use of options on commodities and derivatives.

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