‘Market mirroring real activity in economy’

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Mumbai: The stock markets are reflecting the rising heft of small and mid-sized companies as the benefits of 7.0-7.5% annual GDP growth percolate to them. That's why the market construct has changed—the Nifty 50 companies which accounted for 80% of the total market cap 15 years ago have seen their share drop to 50-55%, especially after the pandemic. That share has been taken up by the market cap of the rest of the companies rising, says A. Balasubramanian, MD & CEO, Aditya Birla Sun Life AMC. He adds that the initial results of leading companies are slightly better than analyst estimates and will keep the market upbeat. *Edited excerpts:*

Are there any more regulatory concerns around the small- and microcap segments?

The intention of regulation is to create checks and balances in the market where there is a significant rise, driven either by flows or by a huge participation coming from high networth individuals (HNIs) and retail. Some elements of checks and balances need to be created. Whatever the noise emanating from the regulation is more intended towards that (checks and balances) so that people don't assume that the market will continue to rise. Secondly, they (participants) also ignore any investment that is being made at obnoxious valuations and so on. Therefore, the intervention that came was more intended towards this end. Otherwise the intention is to allow the market to find its own path, the free market.

It's not just today. Historically I've seen that regulatory interventions always help the market to stabilise.

So how is the sentiment now?

The buoyancy continues to remain high, and that optimism and buoyancy is coming on the back of expected GDP growth being close to about 7.5-8.0%. I often say that all cylinders are firing in the Indian economy, which is driven by broadening of the economic growth across the wider segment of India. Therefore, we are finding more and more companies are benefiting out of the increase—increase in revenue, increase in order book, increase in revenue and increase in profit. We are seeing this across the board. That's why we see the market construct having changed from high concentration coming from Nifty 50 companies about 15 years back in the overall dominance of market cap from 80% to around 50-55% now. That decrease has been taken up by the market cap of the rest of the companies (midcap and smallcap) rising, particularly, over the past four years. These companies could not have taken such a large component of the market cap without having any merit.

So they all have gone up on merit, purely on the base of earnings growth and on the base of revival of fortune.

Are you saying that the high valuations are justified?

Whether you like it or not , the market is reflecting the real activity that is happening in the Indian economy across all segments of economic growth. The government's focus is on building public infrastructure. Now that's not just restricted only to roads. It actually is covering multiple segments of the economy, including railways, so the whole ecosystem will get the benefit. In the ecosystem are many small companies who have been playing a role in the making of India. But they did not get recognised in the past. Now they are. That's why I think the whole shift has happened—Nifty 50 from 80% of market cap to 50-55%.

So could the real concern of the regulator have been for froth in the SME segment?

In every market, you'll always find some abnormal movements. Like the SME issues getting priced very aggressively. In a smaller issue size, people also participate big time and we see huge oversubscription coming from a smaller issue size. Generally, this is a sign of euphoria. But that euphoria is only in a certain segment of the market. There has been euphoria in the SME segment, which is visible in oversubscription in retail investor portions.

Is such euphoria present in pockets of small- and midcaps?

I think the fundamentally sound companies don't have any problem. There are genuinely sound companies in the small- and midcap space—both from a business model point of view as well as from future growth point. And third is because of the way the balance sheets construct has happened, because they have been large beneficiaries of low interest rates and of the spending that comes from both the private and public sector. Like, the automobile ancillary companies have been large beneficiaries of the significant investment that has gone into the EV (electric vehicle) making. EV is not just only about making a new vehicle, it's a whole ecosystem that has been built around the electric vehicles movement, including creating a station for charging, etc. Similarly, with renewable energy, the whole ecosystem gets developed.

Probably, we'll only see more momentum coming post-elections. Say, when the government goes about implementing a vision that 10 million houses must have solar power generation capability. Now, once they meet their own requirement, if these houses start supplying power to the grid, which would become a public infrastructure being built by individuals which is what the government is actually trying. If 10 million households set up solar panels on each of their rooftops and whatever excess power they generate gets actually connected to the grid, power available in the country goes up significantly. Plus the consumer, the owner of the house, can make some income out of it. That's a beautiful model which the government has announced recently.

This pie cannot be underestimated. This pie actually can be very, very big and as we move forward, the seepage of power itself drops. There is going to be 300 million meter installation—one for each house. Assam is a large beneficiary of the implementation of metering. Therefore, the theft has gone down and the consumer has started getting the benefit of 100% power availability. At the same time, they're able to pay reasonably good price for the power consumption as they can subsidise their cost by what they earn in supplying to the grid. In this process, electricity boards are becoming more efficient.

Do you see this lowering our imported energy bill?

Exactly! When the oil price goes above $100 a barrel are we in a position of heavy dependence only on oil? Or do you have enough alternates to overcome the oil price pressure that could come and hit the economy and still continue to pursue the growth path?

I think the way I see it is despite the oil price going up this time around, the impact of that, in general, on the broader economic growth should not cause a shock as it has in the past. That's courtesy of the whole alternate energy system improving quite significantly.

But, this will take time to come on stream, given the size of our country…

Even if it takes time, as long as there is a direction, that's what the market and the world is looking at. In my view, the direction India is moving in, is clearly one towards making India achieve new milestones across the economic spectrum. Towards becoming the world's third-largest economy.

That's the first big component. The second is saving up on forex through such initiatives. Generally, we pay attention to forex only when there is volatility in the dollar-rupee pair. The dollar being saved in the country is far higher by not importing certain items.

The number of items which get imported in the country now has actually reduced and local production has started. Like, if EV manufacturing happens in India then I don't need to import electric cars. Or, when mobile manufacturing happens in India then I don't import mobiles. Going forward , laptops and other electronic manufacturing here will become very large. So, you probably will see in 2025 we'll have more laptops being made in India by Dell and others, and being exported from India.

All these initiatives will converge and if you look at them from the buoyancy point of view for the small- and midcap space, that will continue to remain from the India point of view.

So, this outperformance of and flows into smalls and mids will continue?

I think we'll see a shift. If you look at 2014 to 2018 there was a complete midcap rally and then after the IL&FS crisis, when there was uncertainty in the broader economy, we saw a significant dip in smallcap and midcaps.

And then we saw once again a rise after the pandemic when interest rates were cut, and SMEs and MSMEs were getting money at a relatively good cost and significant government spending pushed loans toward mid and small companies. This is a cycle we go through. The only the advantage that I see now compared to the previous period (post 2018 to pandemic) the probability of the drawdown period (in smalls and mids) will not be too long because they are not that bad for the drawdown to be significantly higher or significantly the same as what you have seen in the past. The fundamentals today are more in favour of more companies to benefit. Secondly, whenever significant movement happens in one segment of the market, let's say the broader market, we always see some catch up game coming from the large caps. Ultimately valuations have to move in tandem.

Wherever significant overvaluation happens, the market gives room for them (the segment) to do a time correction. So we don't see a fall, but we see the time corrections, as seen in many company stocks, and we will probably have to be prepared for that in the small and mids.

If you come to the large cap and, say, your nominal GDP growth is 12.0-12.5% that limits earnings growth for large caps, to the benefit of smalls and mids, isn't it?

The breadth in the economy is improving. Therefore, more and more companies able to participate in economic growth. The smaller size companies generally enjoy a higher rate of growth than the larger ones.

As they start growing bigger, they will also face the same challenge, which bigger companies will face and bigger companies will have a larger dominance given the role they play in building the economy. Like in renewables, huge investments will come from the top but execution will come from small companies. Therefore, the benefit for them will be significantly higher than the large names.

But ultimately, the market rewards size... as the company becomes bigger, it becomes part of the index. Therefore, they get the merit of being part of the index. Therefore, they get the benefit of inflows, whereas the small and midsized companies' rate of growth generally is two times the GDP growth. The large cap earnings tend to grow at 1.2 times GDP growth. So, as long as the small and mid-sized companies maintain two times the nominal GDP growth then there is no reason why one should be concerned that something is fishy. I think small- and mid-cap generally gets impacted if there's an accident in the economy. If huge uncertainty sets in on the broader economic parameters, macro variables, or if business suffers because global market exports get cut or imports become way cheaper and so on. That is the time they get impacted.

The earnings cycle is underway. What's your feeling?

The earnings cycle is going to be mixed, but more in favour of marginal positive than being bad. Most sectors, like capital goods, autos and public sector undertakings (PSUs) should report good numbers. Banking will also report good numbers but we might see slight pressure on margins because borrowing costs (deposit rates) have gone up, liquidity has been tight albeit pressure has eased in the past one and a half months and lending rates haven't gone up significantly. Pharma will see improvement after two-three years of consolidation and consumer durable players will see a pick up in volumes (AC sales and home appliances) because of a significant pick up in the realty sector. We continue to maintain 14-15% growth for large cap and 20-22% for Smids for the next two years (FY26). Initial corporate results of some of the leading companies and their guidance are a little better than analyst estimates which should keep the buoyancy in the market intact.

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