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Brexit – Fear of the unknown

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As this article is being written (3.30 pm on 24th June 2016), the stock market has witnessed a very sharp fall for the day (the BSE Sensitive Index has fallen by 604 points or 2.24%, and the Nifty 50 Index has fallen 182 points, or 2.2%). The market had actually fallen more than 4% from its previous close during the day, but recovered from the mid-session.

The results of the British referendum on whether to remain or exit from the EU (Britain voted in favour of an exit) was behind this panic. The currency markets were also in turmoil, with the British Pound falling more than 9% in a day.

While being overwhelmed with the fact that something momentous has occurred, we also have to remember that the exact impact that such a move will have on the fundamentals of the companies that we have invested in is, at best, a surmise at this stage. It is likely that the exact financial implications of Britain's exit from the EU, and the impact on the financials of the companies that do business in the EU region, will take at least a year to get clearer.

However, from our point of view, companies with substantial business interest in the EU region, such as Tata Steel, Tata Motors, TCS, Infosys, Tech Mahindra, HCL Technologies, Bharat Forge, Tata Global Beverages (to name just a few) will be affected by this move. New tariffs, more bureaucratic hurdles in travel within EU countries, currency changes, the cost of setting up new offices, will most likely affect the bottom-lines of such companies.

We are still unclear how the Central Banks of these countries, and those of Japan and the US will respond to the situation. Some of them might resort to more stimuli. The hike in US interest rates, therefore seem less imminent.

As far as our portfolios are concerned, our funds are exposed to the companies mentioned above only to the extent of their weight in the benchmark indices, and therefore our funds are likely to be affected only to the extent the index would be affected.

For friends who are concerned about a 2.24% fall in the stock market index today, we have to remind them that the market falling sharply is as natural as the market rising sharply:

Some memorable market falls (BSE Sensex)

Date	% fall
24th October 2008	10.96 %
21st January 2008	7.41%
7th January 2009	7.24%
17th March 2008	6.03%
24th August 2015	5.94%

Source: www.bseindia.com

— This is not the first time a panic has hit the Indian market – nor will it be the last. Just a few months ago, the market fell 14% in a space of 2 months. In 2013, there was a very sharp fall. About a year ago, there was a fear of a Chinese meltdown and a showdown between North and South Korea.

There are several reasons to feel bullish about India's economy over the next several years

— The earnings revival is expected to happen from 2016-17 onwards. Bloomberg has predicted a 19% CAGR for Nifty earnings over the next two years, and this is well above long term average rates of about 13%.

— India's economy depends only 23% upon exports. This is predominantly a domestic demand-led economy.

— The monsoon promises to be good, leading to a revival in rural incomes and demand

— Significant investments are happening in roads, railways, power T&D and in non-conventional energy.

Whenever something unexpected happens, the tendency of the financial market is to talk of “flight to safety”. We might see increased investment in gold, or we may see some FIIs pulling out money from equity altogether and moving to more mature markets.

As an asset management company, we cannot second-guess the trader. But for an investor, investment prospect for Indian equities has not altered significantly. As long as we invest in companies with a sound competitive position, a strong balance sheet, and at valuations that are not extravagantly expensive, there is reason to feel bullish in an economy that is expected to grow.

By the way, that is just what we try to do.

After today's fall of 2.24%, the prospects for Indian equities just got 2.24% better.

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