Twitter Thread by Devina Mehra

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I tweeted that an indicator that had historically forecast a US recession is now on

Q I get: Should I now steer clear of US markets?

In India the story is that the economy is booming & hence the mkts look great

But the economy & markets are different animals

A thread ■ (1/n)

There is no one to one correlation between the economy of a country and its stock market - more so not in the same time frame.

At the minimum,there are leads and lags.

Plus there are many other adjustments to be made.

Simplistic predictions don't work. Neither do stories(2/n)

The S&P 500 is down for all 3 quarters in 2022- this has happened only 4 times in the last 50 yrs

Both US stocks & bonds are down substantially in 9 mths which has happened only 3x in 100 years

So the question for US is how much of the bad news is already in the price? (3/n)

Probabilistically speaking, it appears more than likely that most of the bad news is already in the price especially for stable,traditional businesses
The impact of the interest rate rise will, of course, be higher for companies where profits & cash flows are still far away (4/n)

Therefore one can say in a sense that in the US, the stock markets have been a leading indicator of the bad news that is still unfolding in the real economy.

Go back to March 2020: If someone had told you that this would be the impact of the pandemic (5/n)

- About 7 million people would lose their lives
- There would be extreme uncertainties throughout the world
- Industries like Airlines, hotels, cruises would have zero business
- There would be little shopping or eating out

What would you've predicted about the markets? (6/n)

I'm guessing many would have said there is no chance of the market going up - yet the stock market zoomed in the US, in India and in many other parts of the world

In real time, there was a clear disconnect between what was happening in the economy and the stock markets (7/n)

In India, the narrative is that India is on some new growth path & the markets can only go up.

I've been saying clearly & unambiguously for over a year that India will outperform in 2022
But one shouldn't extrapolate this to mean that there are no issues with the economy (8/n)

The narrative that India is becoming an asset class in itself is just #storification

As is the assertion that the US is yesterday's story

Similar stories were heard in 2003-07 when US underperformed hugely while emerging markets went up 3.5 times & India went up 6 times (9/n)

Remember that whether it is stocks or markets, we look for stories but most stories are just explanations in hindsight on the lines of, 'This happened, so therefore it's logical that this should have happened because of....',even though it wasn't the only possible outcome (10/n)

If the stock markets and the economy had a one on one correlation then the Chinese stock market would not still be at the levels it first crossed in 2007 and be at about half its all-time high set in that year when its GDP has gone up 6.5 times during that period! (11/n)

Coming back to the Indian stock market, I expect it to outperform partly because it had underperformaned hugely relative to the rest of the world, as well as relative to its own history, for the entire 2010-20 decade.

Doesn't mean that there're no issues with the economy (12/n)

As against the long term equity compounding of 15-16%, the CAGR was only 8.5% for the decade 2010-20, which was less than the fixed deposit returns for that period.

In the world ranking of 42 countries, it ranked 20 to 25 for most of the years. It was like a coiled spring (13/n)

THEN, when the outperformance started around 2021, I knew it would last for a while

Fundamentally speaking too, while there is still widespread distress in the economy which shows up in the demand for free rations, MNERGA jobs etc there is also another side to the picture (14/n)

The organised sector employees and the so called creamy layer are doing well. Apparent in data like 2wheelers, or entry level cars, not selling as well as the higher end cars & SUVs

As far the listed space is concerned, the companies have benefited from two broad trends (15/n)

One, post the demonetisation and the GST implementation, the economy has become more formalised and the share of the organised sector, which obviously includes listed companies, has generally increased

Two, the listed companies tend to cater more to the mid to creamy layer(16/n)

Eg, the listed real estate companies don't build rural houses
Even in FMCG, footwear or apparel, lower-end consumers buy from by the informal or regional level unlisted players

Therefore with a K-shaped recovery, listed players are relatively insulated from the distress (17/n)

Hence, if you're looking for a story for market outperformance, there are two points

a) The listed space is doing better than the overall economy(The share of corporate profits relative to GDP is another topic altogether)

b) The market performance relative to its history(18/n)

The bottom line: A country's economy and stock market can go in different directions, sometimes for extended periods - whether it is the US,China or India

The moves depend on a whole host of factors
There is no 1 to 1 correlation, especially in exactly the same timeframe
(19/19)