Analysis of Sensex Returns in Different Political Regimes

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Abstract

The stock market performance is said to be governed by two important factors that is fundamental and technical. The fundamental answer which sector/company to invest and technical gives reply when to invest and when to divest. The fundamental performance of a sector improves according to the stable economic/ monetary policies of the government and technical are governed by the flow of liquidity which again is a imperative of internal and external factors. The present study is modest attempt to understand as to how political stability and ideology affect's the stock market index Sensex's performance in different regimes of Indian politics.

Key Words: *Sensex, Politics.*

Introduction

India's parliamentary system is based on the Westminster model of constitutional democracy, a legacy of British colonial rule. The Parliament is comprised of a bicameral legislature: the Rajya Sabha, the 250-member upper house, where members are elected by state legislative assemblies (12 members are nominated by the president), and the Lok Sabha, the 543-member lower house directly elected by the people **.**In the Lok Sabha, voters elect candidates based on the electoral system where the person securing the largest number of votes in each district wins.

The government's performance on economic issues, especially reform, since India moved toward economic liberalization in 1991, has become important to electoral politics. The economic reforms undertaken thus far have not been those that would directly affect the lives of India's poor masses, and this has fed their resentment against the reforms. As this Backgrounder points out, despite India's 7.5 percent average annual growth rate since 1991, there is increasing rural-urban, sector-based, and income inequalities, and benefits from growth have failed to trickle down to significant segments of the population. Political leaders will continue to find it extremely difficult to stake their political fortunes on economic reforms that are expected to cause substantial short-term dislocations and are likely to produce rewards only in the long term.

S&P BSE SENSEX, first compiled in 1986, was calculated on a 'Market Capitalization-Weighted' methodology of 30 component stocks representing large, well-established and financially sound companies across key sectors. The base year of S&P BSE SENSEX was taken as 1978-79. S&P BSE SENSEX today is widely reported in both domestic and international markets through print as well as electronic media. It is scientifically designed and is based on globally accepted construction and review methodology. Since September 1, 2003, S&P BSE SENSEX is being calculated on a free-float market capitalization methodology. The 'free-float market capitalization-weighted' methodology is a widely followed index construction methodology on which majority of global equity indices are based; all major index providers like MSCI, FTSE, STOXX, and Dow Jones use the free-float methodology. The growth of the equity market in India has been phenomenal in the present decade. Right from early nineties, the stock market witnessed heightened activity in terms of various bull and bear runs. In the late nineties, the Indian market witnessed a huge frenzy in the 'TMT' sectors. More recently, real estate caught the fancy of the investors. S&P BSE SENSEX has captured all these happenings in the most judicious manner. One can identify the booms and busts of the Indian equity market through

S&P BSE SENSEX. As the oldest index in the country, it provides the time series data over a fairly long period of time (from 1979 onwards). Small wonder, the S&P BSE SENSEX has become one of the most prominent brands in the country.

A variety of factors affects the stock market performance when it comes to politics like the ideological mindset of the party whether it is capitalist or socialist or takes a mid-way of the same. Another factor is the quantum of integration that a government is ready to take with the outside world is important. Economic reforms are another agenda which may or may not be in the political interest. The most important point is the stability of government and its policies because a business can take long term decisions in good visibility and ultimately it is reflected on its profits and thereby the stock performance. Movement of the foreign institutional investment is also governed by the same aspects.An election year is usually perceived to be a year of enhanced volatility for equity markets. Investors may get swayed by projections of possible election outcomes and may also be tempted to time the market.

Prime Minister	Party	Tenure		Sensex		*Returns*	*CAGR*
PV Narsimha Rao	INC	21-Jun-91	16-May-96	1,337	3,823	*186%*	*23.9%*
AB Vajpayee	BJP	16-May-96	01-Jun-96	3,823	3,725	*-3%*	*-44.7%*
HD Deve Gowda	JD	01-Jun-96	21-Apr-97	3,725	3,800	*2%*	*2.3%*
IK Gujral	JD	21-Apr-97	19-Mar-98	3,800	3,821	*1%*	*0.6%*
AB Vajpayee	BJP	19-Mar-98	10-Oct-99	3,821	4,982	*30%*	*18.5%*
AB Vajpayee	BJP	10-Oct-99	22-May-04	4,982	4,962	*0%*	*-0.1%*
Manmohan Singh	INC	22-May-04	22-May-09	4,962	13,887	*180%*	*22.8%*
Manmohan Singh	INC	22-May-09	26-May-14	13,887	24,717	*78%*	*12.2%*
Narendra Modi	BJP	26-May-14	08-Mar-19	24,717	38,607	*56%*	*9.6%*

Source: Bloomberg, data of 2019

As is evident, equity returns do not show any significant divergence from the long-term positive trend of wealth creation across different prime ministers. Let us now evaluate the impact general elections based on returns during pre- and post-election periods. Sensex CAGR return of 16 per cent over a 10-year time horizon proves that equity as an asset class has the potential to deliver best performance in the long term. A return analysis across various time horizons and market capitalizations corroborates the age-old portfolio theory that spending more time in equity market is far more important rather than trying to time the market. Historical returns not only prove the unraveling of India's long-term growth story, but also provide ample evidence

that irrespective of geopolitical or domestic events, long-term investors are expected to earn impressive returns. As for potential investment avenues in 2019, it is an opportune time for investors to evaluate increasing their equity exposure if current equity allocation is less than the desired exposure. In most cases, stock valuations are reasonable even though the indices have scaled peak valuations in recent weeks. Specific to 2019 investment avenues, it is an opportune time for investors to evaluate increasing equity exposure if the current equity allocation is less than the desired level. In view of the recent correction from historic highs, valuations are reasonable. BSE Sensex now trades at a forward P/E of 18.6 vis-à-vis a five-year average of 16.7 and BSE Midcap trades at a forward P/E of 19.1 vis-à-vis a five-year average of 19.0. Retail investors should adopt a staggered approach (spread over next six months) to increase equity exposure. Given the risk profile and the steep correction, one may find pockets of opportunity in midcaps and small caps.

Given the recent volatility, investors may prefer low duration and ultra-short-term bonds. This strategy can help minimize interest rate risk and volatility. We also urge investors to be cautious about credit quality and always prefer high credit quality portfolios. Hence, chasing returns across asset classes always pays off. While building a long-term portfolio, one should ensure a combination of multiple asset classes and product diversity within each asset class. The allocation of weightage for each asset class should be a function of one's risk appetite, time horizon and long-term financial goals. India's key stock market indices, the Nifty and Sensex, showed a rise six months after all the four Lok Sabha elections between 1999 and 2014, compared to the previous six months.

We analysed Nifty and Sensex levels on three key dates—six months before the first day of polling (pre-election), the first day of polling (during the election) and six months after the first day of polling (post-election), over the last four Lok Sabha elections. The Nifty and Sensex showed an average rise of 40.8% six months after each of these general elections, as compared to the previous six months. The Nifty, short for the National Stock Exchange (NSE) Fifty, was launched on April 1, 1996, and represents the weighted average of 50 major Indian companies across 12 sectors that are listed on the NSE. The Sensex, short for the S&P Bombay Stock Exchange (BSE) Sensitive Index, which is an index of 30 major Indian companies listed on the BSE, was established in 1986.

Of the four Lok Sabha elections held after the establishment of the Nifty, two (2004 and 2009) saw the election of an Indian National Congress-led United Progressive Alliance (UPA) government. In 1999, the Bhartiya Janata Party (BJP)-

led National Democratic Alliance (NDA) formed the government, despite falling short of a majority. In 2014, the BJP won a simple majority and formed an NDA government along with allies. In all four cases, both the Nifty and the Sensex rose. The Nifty saw the highest rise after the 2009 elections, when the UPA government was re-elected. The index was at 5,142 on October 16, 2009, compared to 3,269 on the same day a year before—a 57.3% increase. The Sensex, too, saw its highest post-election rise after the 2009 elections, going from 10,581 on October 16, 2008, to 17,323 on October 16, 2009—a 63.7% increase.

A stable government is desirable, which means that a political party or its alliance needs to win majority for the markets to respond favorably, says the report. “People want a stable government, so if any political party or alliance crosses 272 [halfway mark in the 543-seat Lok Sabha], irrespective of who it is, then we will have a stable government. It is not about UPA or NDA winning a majority. If the market sees a stable government, it will build expectations of stable policies and the market will start rising.”

“Over every five-year period, you will find that the Nifty has actually delivered 100% returns from election years. Hence if there are stable five-year governments and stable policies, markets will rise,” a source at. Another reason for markets rising, irrespective of who wins, is that the election is a very big economic event in India’s consumption-driven economy, the source said. A lot of the money spent by political parties and governments around elections eventually goes to people in both rural and urban India. People will eventually spend this money and this drives consumption. Therefore, the earnings of listed companies are likely to go up, which is nothing but the mirror of their returns. “So, who is elected doesn’t really matter. This has happened historically and we believe strongly that this will continue to happen.”

“There is also [a positive sentiment of] hope [around elections] that something different is going to happen in the next five years,” said the source. “[There is an expectation that] the new elected government is going to come up with new policies and therefore you find that markets start going up,” he added.

The report, which also analysed 48 state assembly elections that took place between 2011 and 2018, found that the outcome of 43—or 90%—indicated that voters followed logical reasoning before voting for a party. Voters in India reward or punish incumbent governments by logically assessing the government’s report card, it says.

“We saw that people are ready to elect strong leaders. For instance, in Punjab, we found that despite winning several other states at the time, the BJP lost

here [in 2017] because there was a strong leader in [now Congress chief minister] Captain Amarinder Singh. So, people did not vote only for a particular party. People wanted someone who can take on this leadership role and deliver," the source said.

The election results are more significant for markets if there is a "logical" or "favorable" outcome, according to the report. "There are three possible outcomes in the [current Lok Sabha] election. One is the same [BJP-led NDA] government returning, second is a Congress-led UPA and then a third-front government, with no single party winning a majority. We logically think that the BJP will win re-election," explained the source. "We found that out of these three [options], the first one is the most logical for people. There is hope and expectation of having a strong leader."

Should an alliance headed by either of the two key political parties, the BJP or the Congress, come to power, the markets will rise significantly, the source said, adding, "However, if a third front [mahagathbandhan] comes to power, then it will be a disaster [for the markets] because then you will not have strong leadership and there will be no stable policies as well. We have seen this historically."

In the past, stock markets have rallied significantly six months before elections, and post a "favorable" result, the rally has continued further. For instance, in 2009 for a 12-month period during the election (six months before and six months after the start of polling), the market delivered almost 57% absolute returns. However, after the 2004 general elections, where the outcome was not as expected—the Congress party emerged as the single largest party and formed a UPA government, amid widespread expectations of another NDA government—for a 12-month period around the election, the market delivered 16% absolute return, the report says.

Conclusion

It can be concluded from the above analysis that whenever a strong government has delivered for full five years without compromising on its reform agenda and sticking to the fiscal and monetary discipline it has been able to generate positive sentiment in the business world. Further bold politics also has the courage to take reforms internal and external both that can give a long-term impetus to the investment climate in the country which not only brings FDI money but also the hot money FII. With all positives the economy grows and when the private capital gets its due share the profitability of companies increases and so does the EPS of the companies and good economic climate also get higher P/E multiple there by higher equity market and indices. This is evident from the table that the periods 91-96, 04-14 and 14-19 were all the periods of stable economic policies and government and thus have yielded the above average returns.

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