SEBI-NISM conference

“Behavior of Securities Market- Sighting of Black Swan”

February 25, 2021

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1. Ladies and gentlemen, it is my pleasure to be speaking to you today on this interesting topic. I will try to put forth some securities market related perspectives on this subject, more so in the context of developments and trends post the onset of the ongoing pandemic.

2. Nassim Nicholas Taleb coined the term ‘Black swan’ to refer to an event which has three particular features- it is unpredictable, rare and catastrophic. There are debates on both sides on the predictability aspect of the ongoing pandemic with some like Taleb himself arguing that it was not unpredictable and hence, not a black swan and others arguing otherwise. Whether it was predictable or not, one can definitely say the pandemic has been rare and catastrophic. Considering the unprecedented impact that the pandemic has had on almost all aspects of our lives, the changes it has brought about, especially in the context of the securities market, are definitely worth analysing.

Securities market in pandemic times

3. A lot has already been said about how the Government and Regulators including SEBI have responded to the pandemic, including by me in my previous speeches. Further, what SEBI has done is already there in the public domain. I will not be repeating the same.

4. Today, I would like to rather focus on how the securities market and various actors in the securities market behaved after the onset of the pandemic. In this context, I will cover trends in four broad areas - market movements, investor behavior, corporate behavior and other unique trends that have emerged in these pandemic times.

Market movements

5. As is expected during any crisis, especially ones which are expected to have a serious impact on economy, the equity markets began falling around mid-February 2020 when it started becoming amply evident that the infection was going to spread globally and will not be restricted to a certain region.

6. The first steep fall was witnessed on March 13, 2020 in Indian stock markets when the 10% circuit filter was hit in early trades leading to a market-wide halt for 45 minutes within an hour of market opening. By then, WHO had declared COVID-19 to be a global pandemic, India had already reported its first COVID related fatality and many States had started reporting increasing numbers of affected persons.

7. Over the next few days, as the situation started to look gloomier, the markets kept falling and then the second steep fall was witnessed on March 23, 2020 hitting the 10% circuit filter once again. Since that date and over the course of the next few months, the markets significantly recovered. The flagship indices Sensex and Nifty crossed the then January 2020 all-time high in November 2020

and since then have largely been on the rise. Several scrips and indices have hit all-time highs since then.

8. If we see the fall, recovery and the overall market movement during this period, they are significant & unprecedented for a variety of reasons:

   a. On 23rd March 2020, Sensex witnessed its largest single-day fall of more than 13 % close-on-close. In the last three decades, only thrice earlier- in 1992, 2004 and 2008, Sensex had single-day falls of more than 10% close-on-close. However, before 23rd March, it had never crossed the 13% barrier.

   b. Significant price movements causing market-wide halts are rare occurrences. Before the halts in March 2020, the last one was in October 2012. In March 2020, it was the first time ever that there were market-wide halts on two separate days in the same calendar year and that too within a span of just two weeks.

   c. Another major trend witnessed was with respect to the market volatility. The volatility witnessed during March 2020 was the highest ever since the 2008 crisis. The volatility index India VIX touched as high as 86.63 on 24th March and stayed above 70 till end of March. It fell below 50 around mid-April, broadly moved between 25-30 in June-July and has been hovering around 20-25 since then. Even the current volatility above 20 is high compared to say, last 5 years, where it was largely below 20 with a few exceptional instances.

d. Not only have the two major falls resulted in probably what may have been the steepest fall over the last 30 years, the recovery has been quite fast as well. If we plot the graph of flagship indices Sensex/ Nifty over the last 30 years, we can see that the steep fall and the quick recovery have created the steepest ‘V’ shape ever during the said period.

e. Typically, stock markets have been barometers of the economy and move in the direction the economy moves or is expected to move. However, after the onset of the pandemic, several institutions including Financial Stability Board and the RBI have raised concerns of an increasing disconnect of the financial markets with the real economy and a possible risk it may pose to systemic stability. This increasing disconnect is another occurrence witnessed in today’s times which possibly has no precedent before.

9. It is not just India which has been witnessing such unprecedented market movements but similar trends have been seen across many global markets- movements one can very clearly attribute to effects arising out of the pandemic & the efforts to tackle the pandemic.

Investor behavior

10. Apart from the movement of the market itself, there are two main actors in the securities market whose changing behaviors in these times are important to

assess- the investors and the corporate. Let me first begin with behavior of individual investors.

11. Individual investors:

a. A defining trend of FY 2020-21 has been increasing direct participation of individuals in the equity markets. If we compare the average daily turnover in NSE in the cash segment in current financial year as compared to the last financial year – broad approximations for the post and pre-pandemic periods - we find that the share of institutional investors, corporate and partnership firms in the total turnover in this financial year has gone down by around 8.3% and correspondingly, shares of individuals & proprietary trading have gone up by 8.3% - around 6.6% increase in share of individuals and around 1.7% increase in share of prop trading. In case of equity derivatives, the same figure stands at 7.2% increase – shares of individuals and prop traders being 3.2% and 4% respectively during the same period.

b. Increased participation of individuals can also be seen from the sheer increase in number of demat accounts opened during FY2020-21. As on 31st Mar, 2020, there were around 4 crore demat accounts. As on 31st Jan, 2021, the number of total demat accounts had already crossed 5 crore i.e. there has been an addition of more than 1 crore demat accounts in just a span of around 10 months. While the increase in demat accounts from 3 crore to 4 crore took around 28 months, increase from 4 crore to 5 crore took only around 10 months.

c. Further, there has been an increasing trend in opening of new demat accounts even within current financial year. While we saw around 7 lakh demat accounts opened each month in the months of April- May 2020, it increased to around 11 lakhs monthly average between June-Nov 2020 & rose even more substantially to around 15.4 lakhs and 18 lakhs in the months of December 2020 and January 2021 respectively.

d. On the other hand, monthly SIP inflows into growth/equity schemes of Mutual Funds averaging around INR 5600 crore in FY 2019-20, initially increased to around INR 6200-6400 crore in April-May 2020 but since then has been almost consistently falling every month. In the last 3 months i.e. Nov 2020-Jan 2021, monthly SIP inflows have been less than INR 3000 crore. This reducing trend could be indicative of a trend of individual investors using funds previously being dedicated for SIPs to invest directly into the market or in other assets such as debt / real estate or even possibly holding out in cash waiting for market corrections.

12.<u>Mutual Funds</u>:

a. Mutual Funds are pooling vehicles for investor funds into the securities market. Therefore, the behavior of Mutual Funds as institutional investors is often linked to the inflows and outflows in their various schemes. It is important to analyse the trends of such inflows/ outflows to understand behavior of Mutual Funds as institutional investors.

b. If we first take equity/growth schemes, the trend in SIP inflows as I outlined earlier is replicated in such schemes. With the exception of just one month, every single month in each of the last 3 financial years from FY 2017-18 to FY 2019-20 had seen a net inflow in such schemes. In this financial year, however, while the months of April and May saw positive inflows, every month since then has witnessed net outflows.

c. In the last three months alone i.e. Nov 2020 to Jan 2021, the monthly net outflows averaged around INR 12,700 crore with December month having the highest ever monthly net outflows in equity/ growth schemes amounting to around INR 14,400 crore. The gross outflow in the December month was also highest ever at around INR 42,000 crore reflecting heavy redemptions during the month. The reasons for the trend in such outflows could be the same as I already outlined earlier in the context of SIPs.

d. We can now link the trend of inflows & outflows in equity / growth schemes to the participation of Mutual Funds as institutional investors in the cash and equity derivatives segment. If we see trends in the net delivery based turnover in the cash segment of NSE, we can see increasing outflows by Mutual Funds from June onwards with exceptionally high figures in the months in November and December 2020 reflecting the overall trends of outflows from their equity/ growth schemes.

e. Further, if we see the overall share of MFs in the total daily turnover in the NSE cash segment, it fell significantly due to relatively lower participation by Mutual Funds and relatively higher participation by others especially individuals and prop traders. The overall share of MFs as a percentage of total average daily turnover in the NSE cash segment reduced from around 7.5% to 5% in this financial year compared to the previous financial year. Similarly, in the NSE equity derivatives segment, the percentage fell from around 4.3% to 3% for the same period.

f. If we now consider the trends in the debt/income oriented schemes, initially we saw massive redemptions in the month of March 2020 resulting in total net outflows of around INR 1.95 lakh crore. Since then however, we have witnessed a total net inflow of around INR 2.46 lakh crore in such schemes during this financial year till January 2021.

g. As is typical for debt/ income oriented schemes, the month-on-month net inflows in such schemes do not show a clear trend of outflow/ inflow like equity schemes since fund flows in the largest category of liquid/ overnight and other short duration schemes typically follow yield movements and quarter-end obligations.

h. The credit risk schemes, however, saw a clear trend. The initial risk aversion following the pandemic and the closure of certain schemes led to a significant net outflow of more than INR 19,000 crore in credit risk schemes in the month of April 2020, with the AUM of such schemes falling around 35% compared to the previous month. Since then, the credit risk schemes continued witnessing outflows every month till December, though the outflow amount has been reducing over time. The month of January 2021 however saw a reversal with a net inflow of more than INR 350 crore into such schemes.

i. Despite the outflows in equity schemes during the current financial year, there is an overall increase in the AUM of the Mutual Funds industry, crossing INR 31 lakh crore in December 2020 on account of mark-to-market gains in equity market and net inflows in debt schemes. This reflects continued importance of Mutual Funds as a significant institutional player in the equity and debt markets in India.

13. FPIs:

a. If there is one institutional investor whose behavior towards Indian securities market drastically changed post onset of the pandemic, it is the FPIs. This financial year has been unprecedented in respect of FPI inflows into India's equity markets. FPIs have already made a net investment of more than $35 billion in this financial year in the Indian equity markets which is the highest in any financial year till date.

b. If we see the data on a month-on-month basis, initially in the months of March and April 2020 and later in the month of September, we saw FPI outflows from the Indian equity markets. Apart from these months, every month in this financial year has seen a net FPI inflow. The months of November and December saw substantial inflows of more than $8 bn each, with December accounting for the highest ever net FPI inflow in equity markets in a month amounting to around $8.4 bn.

c. India is the highest recipient of FPI inflows in equity market during this financial year compared to other major emerging markets, several of whom have seen outflows during the period. This signals the confidence of global investors in the Indian economy and markets as a whole.

Corporate behavior

14. While investors play an important role on the demand side on the markets, the supply side is equally important. Therefore, it is relevant to analyse as to how the behavior of corporate changed during the pandemic. Overall, the pandemic induced major unprecedented changes in corporate behavior. I will place certain points on this aspect on two counts - first, functioning of the corporate as a whole and second, on fund-raising.

15. With respect to corporate functioning, technology played the most important role in facilitating relatively smooth operation of their activities. The lockdown and social distancing requirement led to most corporate permitting their employees to work from home. Physical meetings got replaced by video conferences. The conferences became e-conferences and webinars just like this one. HR policies including employee compensation policies were restructured to suit the new way

of working. It is more than likely that many of these trends which were induced by the pandemic might stay even after the pandemic dissipates.

16. With Ministry of Corporate Affairs permitting AGMs through VC/ other audio-visual means, virtual AGMs became the norm since last year. Companies accustomed to holding large physical AGMs had to change their settings and the way they interacted with their investors. On the other hand, investors accustomed to attending physical meetings had to learn how to be tech savvy, attend and ask questions during virtual AGMs. Apart from virtual shareholder meetings, virtual Board meetings also became the norm since last year.

17. However, virtual meetings have given rise to new concerns which were earlier not there in physical meetings. For instance, whether investor voices are adequately heard during virtual shareholder meetings, whether shareholders have sufficient opportunity to pose questions to the management, whether confidentiality & security concerns are adequately addressed in virtual Board meetings, etc. These issues need greater study if such virtual meetings are to become regular feature in the future.

18. We can see changes in corporate behavior in fund raising as well. The gush of liquidity through central banking measures across the globe including in India post the onset of the pandemic facilitated significant bond raisings by the corporates. In this financial year till January, companies in India raised around INR 6.5 lakh crore from bond markets compared to around INR 5.3 lakh crore during the same period in the last financial year, an increase of more than 22%.

19. On the equity side, there was very little fund raising immediately after onset of the pandemic, especially public issues till end of May. But, it picked up June onwards. Since then, equity fund raising, especially through public issues, has increased quite well. Except for preferential issue, every single mode of fund raising, be it IPO, FPO, rights issue or QIP saw an increase in this financial year till January 2021 vis-à-vis corresponding period last financial year. While public offerings through IPOs and FPOs together more than tripled, rights issue and QIPs increased by 18% and 33% respectively. There is also a healthy pipeline of public issues lined up which are expected to come out in the coming months.

20. If we analyse the 18 IPOs that have come out in this financial year on the main Board till January 2021, certain trends can be seen in respect of four particular aspects-

   a. <u>Types of companies</u>- IPOs largely appear to be by the companies which are either in sectors resilient to the pandemic or those which are recovering well e.g. technology, specialty chemicals, healthcare, certain financial sub-sectors, etc. Of course well-established market leaders have been able to raise funds through IPOs as well.

   b. <u>Increased fresh issues</u>- In this financial year till January, the amount raised through fresh issue has gone up to 29% of the total IPO size from 19% in the corresponding period in the last financial year. This indicates increasing use of IPOs by companies this financial year for fund infusion compared to last year.

c. Participation by investors- Every IPO saw a good amount of subscription with every issue being oversubscribed by at least more than 2 times. 6 of the total 18 IPOs i.e. 1/3rd of the total number of IPOs were oversubscribed more than 100 times. Of these 6 IPOs, 5 were oversubscribed around or over 150 times. If we compare this to the last financial year during the same period, only 2 out of 13 IPOs were oversubscribed over 100 times, of which only one was above 150 times. One of the IPOs in this financial year was oversubscribed as high as 196 times, highest ever for an IPO of over INR 200 crores in the last decade or so. This reflects a healthy investor interest in the IPOs in this financial year.

d. Performance post-listing

IPOs performed quite well post-listing in this financial year. 14 of the 18 IPOs listed at a premium to the issue price. Out of these 14, 3 listed at a premium of more than 100%. With the exception of 2 IPOs listed in January this year, the other 16 IPOs are all trading today above the issue price.

21. Overall, till January 2021 in this financial year, corporate have already raised more than INR 8.4 lakh crore through equity and bond markets, around INR 40,000 crore more than the corresponding period in the last financial year. Funds raised from corporate bonds last financial year till January was almost double of the funds raised through equity. This year, the proportion is almost 3.3 times.

Certain unique trends

22. Apart from general trends in market movements, investor and corporate behavior, there are certain interesting unique trends which have emerged.

   a. ESG issues:

      i. Initially, at the beginning of the pandemic, there was a concern that climate change and environmental issues may be relegated to the background as the fund raising in itself was perceived as a challenge in these difficult times. However, we can see that focus on ESG issues globally and in India has only increased in this financial year.

      ii. In line with the general global trend of ESG becoming more and more prominent for investors, Indian investors also showed increased interest in ESG investment.

      iii. This can be seen clearly in the increasing number of ESG schemes by Mutual Funds and investment in such schemes. From 3 ESG schemes of Mutual Funds as at the end of FY 2019-20, today we have a total of 9 ESG schemes i.e. 6 schemes have been added only in the last 10 months. From around INR 2100 crore invested in such schemes in the whole of last financial year, the amount has increased to around INR 3800 crore in FY 2020-21 till 31st Jan, 2021. While the trend appears to be on the rise, we still have a long way to go compared to global levels.

iv. With a view to meeting the increasing investor demand for ESG related information, SEBI is in active discussions with various stakeholders to bring in greater granularity in disclosures by listed companies in the ESG space so that investors can make well informed investment decisions. We are expecting to issue the relevant guidelines soon. The proposed guidelines are aimed at achieving much higher level of transparency and accountability from listed entities in the ESG arena.

b. Diversification through investment abroad:

i. Another trend witnessed in this financial year is diversification through investment abroad. The net inflows in dedicated overseas schemes of Mutual Funds in this financial year till January is 9 times that of the corresponding period in last financial year and 3 times if we consider the entire last financial year.

ii. The interest appears to be only increasing over time, with around INR 5000 crore of net inflows in such schemes in just last two months- December and January. This appears to indicate increased appetite for diversification by investors through investment abroad or a general increased interest in more global exposure.

c. <u>Role played by technology</u>

i. Investors, intermediaries and companies- everyone saw increased adoption of technology in their activities post start of the pandemic. Intermediaries started offering more online services and replaced physical interactions with customers with virtual interactions. SEBI facilitated e-KYC for customers which enabled easier onboarding access for new investors by intermediaries. I have already mentioned about increasing trend of virtual meetings, including e-AGMs & e-Board meetings by companies.

ii. On the other side, more and more investors also moved from physical dealings to online dealings with the pandemic making physical interactions difficult. While a lot of these trends were thrust upon people due to the pandemic, many are likely to stay.

Conclusion

23. Overall, in conclusion, there have been several perceptible changes that the pandemic has brought into the securities market in various aspects. Some of them particularly those relating to technology changes are likely to continue even post pandemic as well.

24. I have tried to touch upon the broad trends in the post pandemic era. I am sure the other participants will add on a lot of insights, especially on the more technical aspects. We would welcome any useful policy suggestions that may

emerge out of deliberations over the course of the two days. I wish the conference a great success. Thank you.