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## Indian shares at perilous levels

By Kunal Kumar Kundu

BANGALORE - India's benchmark stock index, the Bombay Stock Exchange Sensitivity Index, or Sensex, has surged a remarkable 11.4% this month to around the 20,000 mark - breaking through that during trading on Tuesday, September 21 - close to its historic high at 20,827 reached in January 2008. This should be enough to satisfy most investors - but it is making some jittery.

One notable feature is the question of where are the retail investors? Going by the response of Minister of State for Finance Namo Narain Meena in parliament last month, they are conspicuous by their absence. Meena made his point with reference to the National Stock Exchange, also based in Mumbai and whose S&P CNX Nifty Index has also surged to levels unseen since early 2008.

According to Meena, only 3.09 million investors traded in the cash equity market of the National Stock Exchange (NSE), also based in Mumbai, during the April to June period this year. Effectively, less than half of one percent of India's population were involved stock market activities in the NSE during that time.

Given that the NSE's turnover is more than that of the BSE and assuming a great deal of investor overlap between the two markets, it is clear that less than 1% of India's population is actively involved in the stock market.

But the situation became one of even greater concern when the minister gave further details. According to him, 90% of trading during that period came from just 192,200 investors and 80% of turnover came from just 41,654 investors.

Meena stated that just 8,727 investors accounted for 70% of turnover, among which 413 were proprietary traders, mainly brokerage houses, and 60% of trading came from a mere 1,563 traders. And then, hold your breath, 50% of turnover came from only 451 investors, of which 156 were proprietary traders. Effectively, this means that a mere 451 investors accounted for 50% of the volume. This means that only a miniscule number of investors account for a big chunk of market.

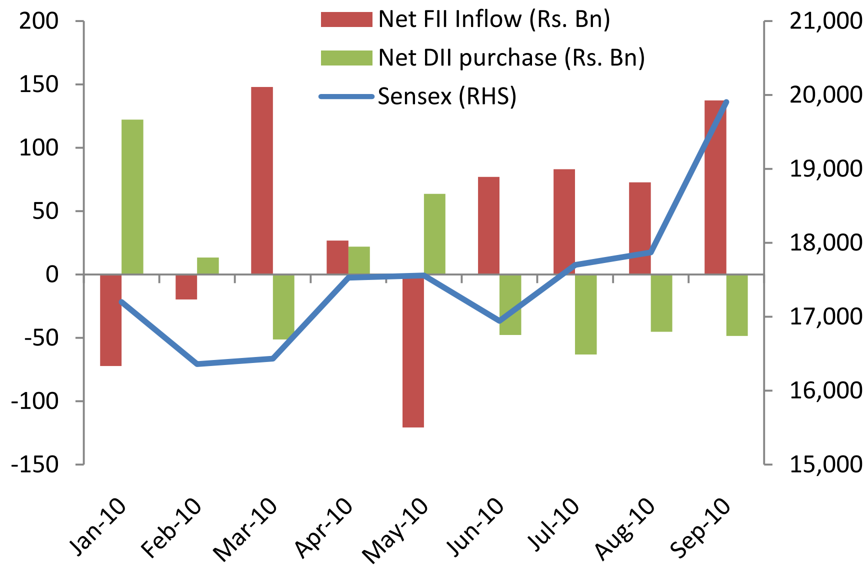
The situation is even gloomier in the derivatives segment. While the turnover of the NSE's derivative segment was nearly seven times that of the cash segment, only a little more than half a million clients traded in this segment during this period.

Of these, 90% of trading came from just 18,035 (including 520 proprietary traders). This means that 97% of the investors accounted for only 10% of total trading while only 3% of the investors accounted for 90% of the trading.

Clearly the Indian market is dominated by a very few investors.

But the story does not end here. It also seems that Indians have hardly any control of the market. Foreign institutional investors (FIIs) are moving to India in large numbers, attracted by the growing economy but also helping to drive up values.

Net FII investment in India stands at US$15 billion, with more than $3 billion coming in during September alone (as of the 20th). On the other hand, domestic institutional investors have been net sellers to the tune of 348 billion rupees (US$7 billion).




*Source: SEBI, BSE*

Clearly, the Indian market is becoming too risky for comfort. With a price to earnings (P/E) multiple of 23.6, the market concentrated in the hands of a few, and foreign investors calling the shots, makes it ripe for a big correction.

While corporate performance has been improving, sustaining P/E of this level requires the economy to record double-digit growth. During the current year, India's growth is likely to be about 8% - Finance Minister Pranab Mukherjee this week forecast 8.5% in the year to March 2011.

With private consumption yet to show signs of picking up and the global economy still reeling under pressure from severe recession, a fall in the market is only a few bad news events away. And, with the FIIs ruling the roost, a pull-back by them is a big possibility in response to global events in a repeat of the tank in Indian markets during the 2008 global meltdown.

No doubt the Indian economy is on a stronger footing than when the global crisis struck. But over-exuberance always calls for caution.

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