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Bear phase has ended

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2011 was a year best forgotten. The fall of our markets from the high of 6338, nifty levels on Diwali day, 5 November, 2010, to the low of 4531 on 20 December 2011, may have been one of the most painful bear markets that I have ever seen. The markets grinding down lower and lower for 14 months to fall by 1807 points or just 28% was more painful than the swift crash of 2008, when it took only 11 months to fall a whopping 4100 points or 65%.

For all of us involved in the Indian stock markets, the year gone by is best forgotten. Not only had our markets given the second worst negative returns in the last 30 years, but also was one of the worst performing markets in the world in calendar 2011. The Nifty and Sensex fell by 25% (in dollar terms it was 37%), compared with a rise in US markets, where the Dow Jones went up by 6%.

Signs of markets bottoming out

Unlike previous bear markets, where retail participation became a trickle, sentiment was so bad this time that even seasoned and professional traders (those rare species who trade and make a living out of it) completely stopped trading. Many sub brokers shut shop and there were reports in the media of several smaller broking houses surrendered their stock exchange memberships, a phenomenon last seen in early 2000, after the Ketan Parekh fiasco. Typically, all these were signs of markets bottoming out which were seen from November onwards.

Market valuations were at historical lows

The market valuations were also nearing historical lows. If you see the historical PEs of the Sensex, the PE at the beginning of the current long term bull phase which started in April 2003 at Sensex levels of 3000 was 13.5,

while the stand alone PE of the markets were at 17 at Sensex levels of 15100 in December last year. The consolidated PE, (the PE if you consider the consolidated profits of Sensex shares) was at 14 levels, which meant that even if the markets were to go down further if could have hardly fallen down by another 5 to 10%.

The recovery in the markets

The markets have already recovered by around 900 points or 20% in a short period of less than two months, from a low of 4550 recorded on 20 December. The recovery can be attributed to several factors, the main being of course the FII fund flow which is already around Rs 20,000 crore in around 45 days in the New Year, compared to nil last year. The second of course is the softening and bottoming out of inflation, which also signalled the end of the interest rate hike by the RBI. The heavy FII inflow further reversed the trend of the depreciating rupee that touched an all-time low of INR 54.26 and appreciated by 10 % in a jiffy.

The midcap stocks usually bottom out before the peaking the interest rate cycle. They had and still provide the best buying opportunities with even short term investment horizons. And with the rupee appreciating fast their fortunes changed many fold with their ECB loan burdens diminishing on top of that, the expectations of domestic interest rate softening. In fact positive developments are heaping up so fast that we are unable to comprehend the compounding effect of all these which ultimately saw the stock markets spiralling up and up beyond anyone's wildest imagination.

Bullish breakout from a downward sloping channel

Technically, we have been moving in a downward channel from November 2010 onwards. A break out from such a long term channel in either direction signifies a substantial movement in the direction of the breakout. From the chart shown here, it is clear that we have made an upward breakout at 5200 levels, which is a very bullish signal. If one has to go by proven technical theory, the upward movement should be equal to the width of this channel, which is around 850 points, that translates to Nifty levels of over 6000 and Sensex levels of over 20000, very near to their historical highs.

To substantiate this we can see an upward sloping channel which preceded the current downward sloping channel. It started in June 2009 and the breakout occurred in September 2010. The width of that channel was 650 points and the markets went up by 650 points from the breakout point of 5650 to touch 6300 points.

Markets to see new highs

Besides, a close above 5650 will signal a 61.8% retracement of the fall from November 2010 to December 2011. On the Fibonacci retracement scale, this implies that a new high is on the cards.

So, it seems that, not only have we seen the bottom of a very painful bear market, but are also likely to see an all-time high in our indices in the near future. The markets have already run up almost 20% at the time of going to press a correction is imminent. But remember that from now onwards all corrections are buying opportunities!

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