

Takeaways from the Sub Prime Crisis

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The financial markets across the world are on the job of safeguarding themselves from the ongoing Sub Prime Crisis. The news from the media is giving shock after shock by revealing the names of the Hedge Funds and Mortgage firms which had lost huge amount on this default. The victims include well known Financial czars in the likes of Bear sterns, countrywide mortgage, BNP Paribas and other leading Financial behemoths. The crisis had hit SENSEX in such a way that the Index had come down by more than 1000 points. Nifty had seen a loss of 500 points.

The Central Banks throughout the world have reacted to the Sub Prime Crisis by pumping in huge amount of local currency in to the economy. The ECB had injected about 140 billion \$ and The Federal Reserve led by Mr. Ben Bernanke had executed the Green span put on the line of the US market Expectations .The Federal Reserve had also slashed its Fed discount rate to 5.75% from the previous 6.25%. The Fed discount rate is the rate of interest charged by the central bank for lending \$ to the commercial banks in US.

The above remedial measures taken by The Federal Reserve and the ECB have made the markets to end the last week's trading in Green. However experts are of the view that the Sub Prime Crisis is yet to reveal the full picture. The peculiarity of the problem is expressed as below;

1. The financial Institutions do not know the exact amount of the default of their NINJA borrowers and the portion of CDOs for which there is no asset backing.
2. The market value for the CDOs [collateralized Debt Obligations] is not known, as there is no one in the market who is interested in buying these mortgage backed securities.

A Hypothetical portfolio

We can better understand the impact of sub crisis on the Indian Market with the help of a Hypothetical portfolio consisting of 12 scripts taken out from the NIFTY stocks.

The stocks; Tata Steel, Suzlon Energy, L&T, Reliance Industries, Hero Honda, Aumbuja cement, CIPLA, BHEL, Bharati Airtel, ONGC, TCS and SBI.

Period of study

This study compares the Market prices of the above mentioned stocks on 17 th July 2007 with that of 20 th august 2007.

Table-1: Impact of SPC on a hypothetical NSE portfolio

Script	17 TH JULY 2007 In Rs	20 TH AUGUST 2007 [in Rs]	CHANGE In Rs
Tata Steel	681.05	569.30	-111.75
Suzlon Energy	1469.85	1300.80	-169.05
L&T	2392.25	2349.75	-42.50
Reliance	1827.85	1798	-29.85
Hero Honda	700.05	642.55	-57.50
Ambuja cement	137.45	127.80	-9.65
CIPLA	217.15	184.85	-32.30
BHEL	1618.40	1609.80	-8.60
Bharti Airtel	864.65	827.90	-36.75
ONGC	913.75	818.60	-95.15
TCS	1155.75	1055.55	-100.20
SBI	1583.10	1549.65	-33.45
TOTAL	13561.30	12834.55	-726.75[- 5.35 %]

Source: www.nse-india.com

We can infer from the above table that all the stocks taken for the study have declined deeply over the Base figure. This indicates the severe impact of SPC on Indian Bourses. The impact would have created greater damage, had the fundamentals of the market been weaker.

Takeaways

The following are the takeaways for a typical Indian Investor:

1. **Well integrated markets:** The stock markets across the world are highly connected in such a way that, small triggers in one part of the world, creates a great impact over the other parts of the globe. Hence, for the formulation of a Good portfolio the fund manager/Investor should not just stop with a thorough Economic analysis of the operating country. He should also foresee the global market trends at the time of portfolio construction. Further he has to reconstruct the portfolio at the occurrence of riskier events on the likes of SPC.

2. Long term view:

Crashes may come and go, but the long term view produces higher returns on a regular basis. We can better appreciate this statement by Comparing, the 20th august 2007 prices of the selected stocks with that of the 18th august 2006 prices.

Table-2: Appreciation of the hypothetical portfolio on a one year Investment horizon

stock	20-08-2006 [in Rs]	28-08-2007 [in Rs]	Change [in Rs]
Tata Steel	518.65	605.80	87.15
Suzlon Energy	1194.10	1239.45	45.35
L&T	2363.90	2553.10	189.20
Reliance	1055.90	1882.50	826.60
Hero Honda	706.20	631.25	-74.95
Ambuja cement	134.10	134.05	-0.05
CIPLA	249.65	170.65	-79.00
BHEL	2283.30	1812.60	-470.70
Bharti Airtel	409.65	875.30	465.65
ONGC	1210.25	809.25	-401
TCS	969.70	1028.75	59.05
SBI	879.10	1550.60	671.50
Total	11974.50	13293.30	1318.80[11.01%]

Source: www.nse-india.com

The hypothetical portfolio had appreciated by 11.01% in the 1 year investment horizon. From this, we can make out the fact that long term holding yields superior returns compared to speculative short term investments[-5.35% in the 1 month period].

3.Regulator for credit rating agencies:

The Leading credit rating agencies such as Moodys and S&P had offered " A "rating even for the defaulted CDOs . The SPC crisis ,had imparted a significant learning to the government authorities about the need to establish a regulator for monitoring credit rating agencies.

4.FIIs-The Change Agents:

Foreign institutional investors [FIIs] have once again proven their ability to change the direction of the markets by their net selling Position.

Table-3: Market Trend for the month of August

Category	Net buy/ sell -in Rs cr
FII-Cash	-8558.1
FII- F& O	3197.61
MFs	1823.5
DII's	7427.97
Retail investors	1808.38
Proprietary	-298.91

Source- The Hindu Business Line, 23-08-2007

The above table indicates the extent to which our markets are dependent on FIIs.

5. Opportunity for Value Buying;

Investors waiting to enter the equity market can get into the Bourses after a week/fortnight by which the SPC is expected to reveal the full picture of it's impact on global markets.

Conclusion;

Though Indian markets have managed to protect themselves from a greater damage, the SPC is to be viewed as a wake up call for the Indian regulatory authorities about the need for persuading the retail investors to increase their participation in capital markets so that the economy can withstand the highly unpredictable FII moves. .This can be done by creating awareness among the retail segments about the superiority of returns generated by Indian capital markets over the past decade. **“There is never a wrong time for doing the right thing.”**