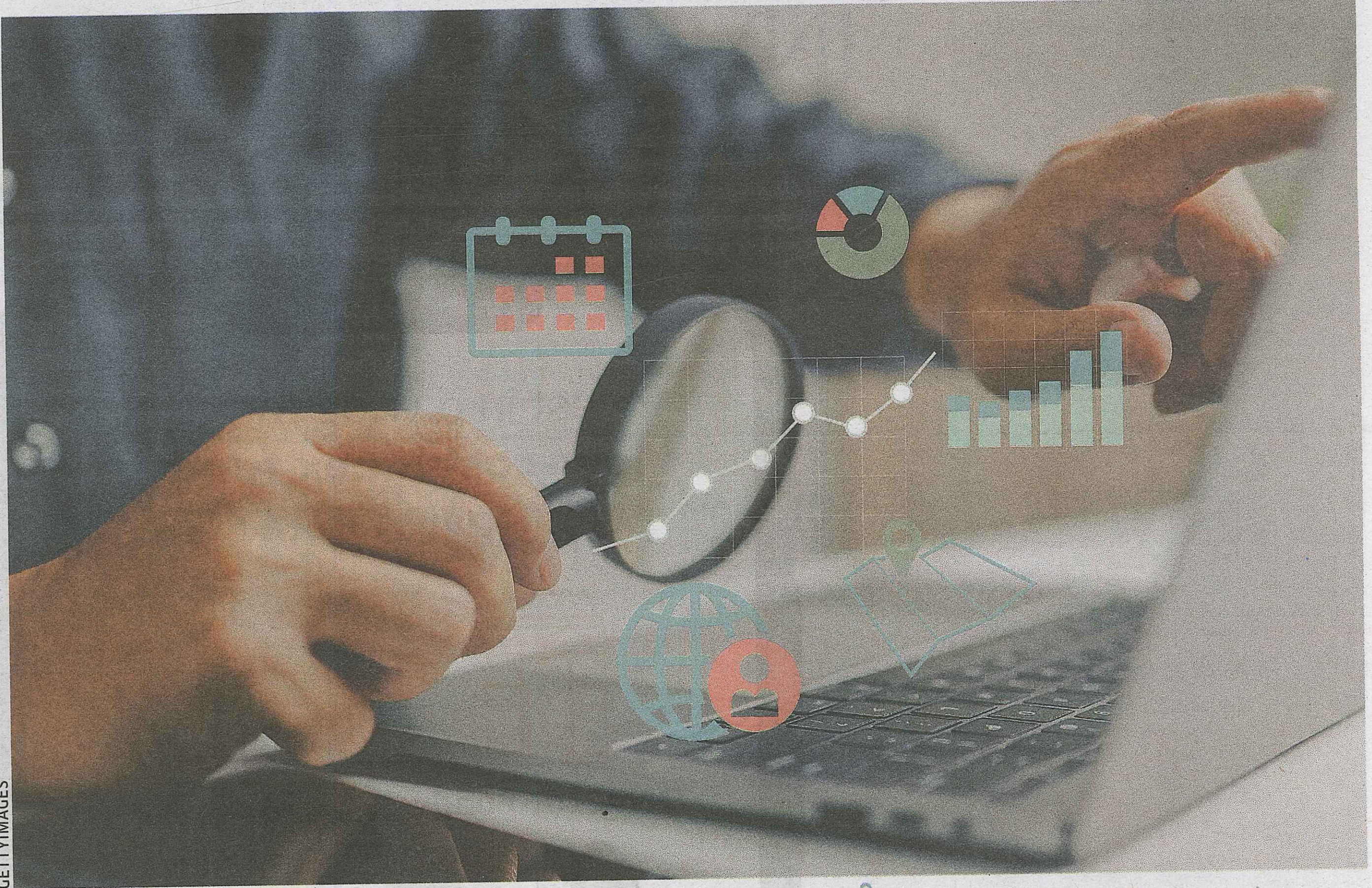
There is no need to panic during market corrections

Investors should consider practical and actionable aspects during this phase, says **Harshad Patwardhan.**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In theory, most investors know that volatility and corrections are a part of the game in equities. When a meaningful correction strikes, however, many of them tend to forget this wisdom. They become nervous, anxious and even panicky. In that state of mind investors tend to worry about the unknowable rather than focus on useful and profitable aspects. In this brief note we explain the key lessons learnt from past market corrections and subsequent recoveries.

Corrections are normal

It is important to keep in mind that meaningful corrections are fairly normal in equity markets. Over the past 15 years or so we have seen six instances of the Nifty correcting by at least 15%. The steepest correction was from January 2008 to October 2008 when Nifty dropped 60%. The shallowest was from August 2018 to October 2018, when Nifty declined by 15%. The longest correction lasted from November 2010 to December 2011. The shortest correction was from February 2020 to March 2020.

While normal, these corrections were different from each other in terms of duration, extent and causal factors. It is almost impossible to predict the exact start and end of a correction phase. Unfortunately, many investors expend considerable time and energy trying to figure out when the correction phase will end. This often leads to frustration and anxiety.

Dispersion of stock returns

Most discussions about stock markets are predominantly focused on the behavior of indices such as the Sensex or Nifty. While this fascination about indices is understandable, the real drama in the market is about dispersion of stocks and sector returns. If you were to analyse past data for any year, you will find that there was a meaningful gap in performance of top performing stocks and bottom performing stocks. This is true irrespective of whether it was a positive, negative or a flat year for indices. In 2021, NSE500 was up 30.2%, but the average return of top 25 stocks was positive 244% while average return of bottom 25 stocks was negative 33%. In 2018, NSE500 was down 3.4%, but the average return of top 25 stocks was positive 49% and the average return of bottom 25 stocks was negative 68%.

The most important learning

Instead of worrying about the unknowable factors, we strongly advocate that investors think about more practical and actionable aspects during the correction phase. An important learning is that after the market bottoms out at the end of the correction phase, the next 12-month returns in the index tend to be very healthy. Moreover, there is a leadership change in sectoral performance before and after the correction phase. Sectors that tend to outperform the broader market after the market bottoms out are often very different from the sectors that outperformed before that correction phase began. The table shows how the leadership tends to change.

Sectoral leadership changes through correction phase

Period	Extent	Leading sectors and returns 1 year before correction	Leading sectors and returns 1 year after correction
Jan 2008-Oct 2008	Nifty down by **60%**	Utilities: **177%**, Energy: **123%**, Nifty 50: **60%**	Metal: **236%**, Auto: **172%**, Nifty 50: **92%**
Nov 2010-Dec 2011	Nifty down by **28%**	Consumer Durables: **109%**, Auto: **58%**, Nifty 50: **32%**	Realty: **55%**, Finance: **54%**, Nifty 50: **30%**
Mar 2015-Feb 2016	Nifty down by **23%**	Finance: **83%**, Capital Goods: **80%**, Nifty 50: **45%**	Metal: **79%**, Basic Materials: **74%**, Nifty 50: **28%**
Aug 2018-Oct 2018	Nifty down by **15%**	IT: **51%**, Energy: **29%**, Nifty 50: **18%**	Consumber Durables: **47%**, Realty: **28%**, Nifty 50: **15%**
Feb 2020-Mar 2020	Nifty down by **37%**	Consumer Durables: **30%**, Realty: **30%**, Nifty 50: **13%**	Metal: **157%**, Basic Materials: **147%**, Nifty 50: **95%**
Oct 2021-Present	**NA**	Metal: **173%**, Realty: **154%**, Nifty 50: **57%**	**Yet to be identified**

What investors should do

As corrections are an inherent part of the equity market, we urge investors not to get perturbed. Also, as it is impossible to predict the duration and extent of the correction phase, it is best to use a systematic investment approach. In fact, as the 12-month returns post the end of correction tend to be very healthy, investors should think about increasing equity allocation during the correction phase. Also, as new sectors emerge as leaders in the post correction phase, investors should make sure that they are positioned right by investing in strategies that capitalise on leadership changes to outperform the broader market.

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