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WHAT STOCK MARKET TAUGHT US THIS WEEK - DON'T CHASE THE MOMENTUM

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Our benchmark indices this week have lost some blood as the bears seemed to be establishing their grip. Several stocks' valuations are skyrocketing, although fundamentals seem to be lagging behind. Interestingly, FIIs and DIIs have reduced their holdings in the majority of the companies that sharply corrected within the week despite no negative news.

This is consistent with the Dow Theory's final phase, in which institutional investors (considered smart money) gradually book profits during a steep rally, while retail investors absorb these volumes and keep the rally going. The conclusions of the Dow Theory do appear to be applicable as retail investors have been rapidly piling up shares over past couple of months.

This bull market began when markets fell to rock bottom valuations owing to fears of the pandemic. Institutional investors began buying stocks after the announcement of stimulus packages throughout the world, gushing liquidity, progressive opening of the economy and improved business sentiments. With such a rapid comeback in stock prices, enthralled retail investors entered the market.

FOMO spread like fire and record number of new investors joined the frenzy. In such situations, retail investors are likely to buy stocks absorbing any prospective drop in the market, without scrutinizing the fundamentals. As observed in the past, when valuations diverge from underlying fundamentals, hopes and expectations propel the markets upwards into the perilous zone of greed. This is typically followed by smart money pulling the plug, resulting in a sell-off or correction. Only time will tell whether we will see such intense sell offs in the future, but events of this week do signal that investors are should remain extremely cautious.

Event of the week

Whipsaw swings appear to be the new normal for markets, after a flurry of businesses announced their quarterly numbers this week. Several companies saw an abrupt slump in their stock prices despite posting good set of numbers. While such conflicting movements may appear puzzling, they are not unfathomable. It might be attributed to the fact that investors appear to be putting greater emphasis on results surpassing or struggling to meet expectations rather than considering a wider perspective. As a result, even slight variations of actual results from their estimates cause panicked reactions. Investors are advised to consider the long-term potential value of the companies rather than comparing performance to various estimates.

Technical Outlook

Nifty closed on a negative note after a volatile week and is still trading in overbought zones. Other emerging market indices are also finding resistance at current levels and therefore a further correction in the index cannot be ruled out. The benchmark index has strong support at the 18050 levels. Any break below this support level can trigger a bearish sentiment across the markets. Until the index makes a decisive directional move, we suggest traders to maintain a cautious outlook and not venture into any aggressive trades.

Expectations for the week

The market may struggle to hold its footing next week and is likely to stay range-bound. After exceeding the 40,000 mark for the first time this week, Bank Nifty is likely to be in the limelight in the next week as various banks announce their results. Given the improvement in economic activity, enhanced collection efficiency and stabilized asset quality, a favorable earnings outlook from this industry can be expected. Furthermore, with the monthly expiry coming up next week, market volatility may linger. Nifty closed the week at 18114.90, down by 1.22%.

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