Trading Strategies of Institutional Investors during COVID 19: Some observations from Indian Stock Market

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Abstract

Pandemic of COVID 19 has affected the global financial markets in an extraordinary way. The pandemic is viewed not only as global health emergency but also as a significant sign of world economic recession too. Most of the countries adopted lockdown and quarantine policies to alleviate its health impact. As a result, economic activities came down, consumption demand shrunk and businesses were in a bad shape. Due to pandemic formed uncertainty and risks, stocks markets of both advanced and emerging economies reacted differently. In this context, an attempt has been made to examine the trading behavior of institutional investors vis-à-vis Foreign Portfolio investors (FPIs) and Domestic institutional investors (DIIs) during first phase of COVID 19 in the Indian stock market. We found that both these institutional investors adopted the same strategy i.e. both buy and sell during first quarter of year 2020 (Q1: April-June). But, from July onwards, dichotomy started reflecting in their trading behavior. Correlation analysis evidenced that instead of focusing more on Nifty 50 index movement they adopted each other’s trading strategies to synthesize more gain from uncertainties caused by spread of COVID 19 across the world.

Key words; Foreign Institutional Investors, Domestic Institutional Investors, COVID 19, stock market, Nifty 50

1. Introduction:

Pandemic of Novel corona virus that appeared first in China, gradually spreading globally has affected and continues to threaten millions of people across the world in different ways. The pandemic has emerged as a key risk to human health and is causing significant damages all around in different sectors be it health or economy and has created an atmosphere of economic turmoil through supply chain disruption, drop in
economic and external demand, lower tourism and business travel and loss of consumer and investor’s confidence. As per IMF’s World Economic Outlook (April 2020), global growth is expected to contract sharply by -3 per cent in 2020-21, much worse than during the global financial crisis of 2008-09²

Since 1991 one of the prominent feature of the Indian stock markets has been the dominance of the institutional investors, particularly domestic institutional investors (DIIs) and foreign portfolio investors (FPIs). DIIs primarily comprise of domestic mutual funds, financial institutions and banks, insurance and pension funds whereas FPIs are dominated by foreign institutional investors. These institutional investors could not remain aloof & protected from the harrowing Covid 19 crisis which has inflicted a shadow of gloom across world financial markets. With increasing number of Covid cases across the world financial global markets started facing the heat under the pressure of economic contagion. In India too, fears of upcoming recession are being felt & experienced. During this difficult time, it is necessary to understand the trading behavior of Institutional investors as DIIs and FPIs flows are crucial to channelize scarce foreign exchange reserves to support economic growth, enhance liquidity in the stock markets, broadening investor’s base and confidence. In this paper an attempt has been made to examine trading behavior of Foreign Portfolio Investors & Domestic Institutional Investors in the Indian stock market during first phase of Covid period i.e. April 2020 to August 2020.

2. Objectives;

➢ To examine trading strategies of FPIs during first phase of COVID 19 in Indian context.
➢ To analyze trading strategies of DIIs during first phase of COVID 19 in Indian context.

3. Data Sources and Methodology;

In this study we have used secondary data to analyze the trading behavior of institutional investors. Data of Monthly FPIs and DIIs has been taken from website of moneycontrol.com. In addition, we have used monthly data of Nifty 50.

“The NIFTY 50 is a diversified 50 stock index accounting for 13 sectors of the economy. It is used for a variety of purposes such as benchmarking fund portfolios, index based derivatives and index funds. It represents about 66.8% of the free float market capitalization of the stocks listed on NSE as on March 29, 2019. The total traded value of NIFTY 50 index constituents for the last six months ending March 2019 is approximately 53.4% of the traded value of all stocks on the NSE”³. The study spans from April 2020-August 2020 and employs correlation coefficient technique to analyze the data.

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² Monthly Economic Review April 2020, Ministry of Finance
³ www.nseindia.com
4. Trading Strategies of Institutional Investor’s in Indian Context: Overview

Most of the research scholars propounded that institutional investors are neither rational negative feedback investors nor blind herders. Rather, they are heterogeneous in nature and hence their trading behavior or strategies followed are heterogeneous. So it is quite obvious that at one point of time one group of institutional investors follow positive feed-back strategy (herding) and other one’s negative feed-back (contrarian). Therefore, their trading strategy does not destabilize asset prices, as the heterogeneity of trading strategies is fair enough that the aggregate excess demand is approximately zero, which indicates that there are enough negative feedback traders to offset the positive feedback traders. For instance, the positive feedback trading strategy of FIIs would be offset by negative feedback trading strategy being followed by DIIs. Hence, trading strategies being followed by various classes of institutional investors would have a neutral impact on the equity market despite generating a substantial trading volume in the market (Lakonishok et al., 1992).

On the basis of these facts one can deduce that institutional investors broadly follow two types of strategies viz. positive feedback (herding) and negative feedback (contrarian) or combination of both depending on the global controlled and uncontrolled events. The role of stock market is also important. When market participants assume position that are in tandem with the market movement ,it is generally known as “Positive feed-back strategy” i.e. when market moves upward positive feed-back investors buy stocks and in case of reversal they sell stocks. On the other hand, contrarian or negative feed-back investors buy stock when market is moving down ward and sell shares when market is booming and tend to book profits by selling stocks. There is a general assumption that both FPIs and DIIs adopt opposite trading strategies i.e. FPIs follow positive feedback strategies while DIIs are negative feed-back traders. Therefore, in the current global scenario there is a need to understand in which direction these institutional investors are doing their business particularly in the Indian context.

5. Empirical Analysis and Discussion:

During April 2020, when nationwide lockdown was imposed, both DIIs and FIIs withdrew their investments from the equity markets. This resulted in a net outflow of approximately Rs.5208 crores and Rs 117 crores respectively. However, after steep lows in March- April 2020, institutional investors moved again to stock markets by buying large numbers of shares. And, net inflows from both these categories of investors increased. From Table 1, we can conclude that for the months April, May, June 2020 both DIIs and FIIs seemed to be investing in the same direction. Surprisingly, subsequent months (July and August) shows a different picture altogether, they moved in different directions. The FIIs parked their money into Indian stock market whereas DIIs withdrew from the markets.
Table 1: FPIs, DIIs and Nifty 50 (April 2020-August 2020)

<table>
<thead>
<tr>
<th>Months</th>
<th>Nifty 50</th>
<th>FPIs Gross Purchases</th>
<th>FPIs Gross Sales</th>
<th>Net FPIs Flows</th>
<th>DIIs Gross Purchase</th>
<th>DIIs Gross Sales</th>
<th>Net DIIs Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>April</td>
<td>9859</td>
<td>122,483.01</td>
<td>127,691.51</td>
<td>-5,208</td>
<td>75,066.03</td>
<td>75,183.03</td>
<td>-117</td>
</tr>
<tr>
<td>May</td>
<td>9580</td>
<td>155,977.41</td>
<td>142,062.92</td>
<td>13,914</td>
<td>87,531.66</td>
<td>75,238.4</td>
<td>12,293</td>
</tr>
<tr>
<td>June</td>
<td>10302</td>
<td>155,215.80</td>
<td>149,722.85</td>
<td>5,492</td>
<td>100,174.07</td>
<td>97,739.67</td>
<td>2434</td>
</tr>
<tr>
<td>July</td>
<td>11073</td>
<td>113,501.55</td>
<td>111,011.36</td>
<td>2,490</td>
<td>89,373.83</td>
<td>99,381.71</td>
<td>-10,007</td>
</tr>
<tr>
<td>August</td>
<td>11387</td>
<td>131,434.85</td>
<td>115,684.99</td>
<td>15,749</td>
<td>77,599.64</td>
<td>88,646.42</td>
<td>-11,046</td>
</tr>
</tbody>
</table>

Source: www.moneycontrol.com

It is evident from the Table 1 that during the months of April, May and June, both FPIs and DIIs behaved in tandem i.e. both withdrew their investment from the Indian stock market in April and invested in May and June. One can say that the reasons for this behavior could be that FPIs flows are closely associated with monetary policy of central banks; the liquidity infused by them through low interest rates and stimulus funding fuel these funds. In addition, in India FPI flows are more receptive to conditions in the US because investors from the US have the largest share of FPIs investments. They are also more inclined by conditions in the global financial markets and due to that press the selling bells when global risk off sentiment is high as evident in April 2020. But as soon as recovery period starts, they fly towards countries with better economic conditions and accordingly they have driven market recovery in India.

According to Macro Economic Report (May 2020) “Global financial markets dramatically sold equity and debt in March 2020 which led to crashing of benchmark equity indices and tightening of bond yields before a modest recovery in April 2020. Governments and Central Banks have responded by announcing stimulus packages and liquidity injections. On 12th May, 2020, the Prime Minister of India announced a package of Rs. 20 lakh crore for the country, amounting to 10 per cent of GDP, inclusive of all previous liquidity support by RBI and fiscal stimulus by the government. Nifty 50 and Sensex recorded large gains in April 2020, helping them recoup losses driven by the Covid-19 outbreak. Nifty 50 and BSE Sensex rose by 14.7 per cent and 14.4 per cent (MoM) respectively in April 2020 after a sharp decline of 23 per cent (MoM) in March 2020. The surge in equity market indices in April 2020 happened as equity markets tracked gains in global peers on optimism about a COVID-19 drug to treat the pandemic that has brought the world to a standstill. Stimulus packages by Central Banks and governments across the globe and the US Federal Reserve’s commitment to aggressive monetary policy to revive the economy also boosted global market
sentiment*. With net inflows both the category of institutional Investor’s in the months of May and June (See Table -1) reflects strong belief of these investors in macroeconomic fundamentals, reform measures and policies and growth prospects of India even during pandemic time.

From July onwards, difference in the activities of FPIs and DIIs are stark, while former went on a buying spree adopting positive feed-back strategy, the latter continued to sell following negative feed-back strategy. From the Table -1 we can sum up that when in the months of July and August market recovered FPIs with their positive feed-back strategy started lapping up the shares of various companies and thereby creating a net inflows of Rs. 2,490 Crores and Rs . 15,750crores respectively. At the same time, DIIs with their conservative and contrarian perception and negative feed-back trading strategy begun to book profits by selling their holdings and increased their liquidity buffer which resulted in creation of net outflows of Rs.10,007 Crores and Rs.11,046 Crores respectively.

After analyzing the data, we calculate correlation coefficients between FPIs flows, DIIs flows and Nifty 50(Table -2). We found that both FPIs gross purchases and DIIs gross purchases were negatively correlated (-0.51 and -0.08 respectively) with Nifty 50. So, we can say that during the study period they were not paying more attention to Nifty 50. Further, FPIs gross sales and Nifty 50 is strongly negatively correlated (-0.72). It is interesting to note that DIIs gross sales and Nifty 50 exhibited a strong positive relationship (0.68).

As far as correlation between FPIs and DIIs are concerned we found that both moved in the same direction (0.53 and 0.61 respectively) as far as gross purchases and gross sales are concerned. We can say that during the study period they followed each other’s trading strategies to combat the mitigation of COVID 19.

Table-2

<table>
<thead>
<tr>
<th>Correlation between FPIs flows ,DIIs flows and NIFTY</th>
<th>Correlation values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Correlation b/w FPI GP and NIFTY</td>
<td>-0.513559853</td>
</tr>
<tr>
<td>Correlation b/w DIIs GP and NIFTY</td>
<td>-0.088031767</td>
</tr>
<tr>
<td>Correlation b/w FPI GS and NIFTY</td>
<td>-0.726698722</td>
</tr>
<tr>
<td>Correlation b/w DIIs GS and NIFTY</td>
<td>0.68670857</td>
</tr>
<tr>
<td>Correlation b/w FPI GP and DIIs GP</td>
<td>0.534207259</td>
</tr>
<tr>
<td>Correlation b/w FPI GS and DIIs GS</td>
<td>0.618196566</td>
</tr>
</tbody>
</table>

GP ; Gross Purchase ,GS; Gross Sales
On the basis of this analysis one can infer that, institutional investors may be pursuing positive feedback and herding trade strategies or negative feedback trading strategy or both positive feedback and negative feedback strategies and herding. Accordingly, the impact on the stock market is also conflicting.

6. Major Conclusions;

Institutional investors, foreign or domestic play a significant role in providing direction to stock markets. They have framed different trading strategies, taking clues from each other’s action and deeply analyzed performance of global markets, state of the economy before parking their funds. Literature supports that most of the time FPIs and DIIs adopt positive feedback and negative feed-back strategies. In this paper an attempt has been made to examine FPIs and DIIs trading strategy relative to NIFTY 50 during initial stage of COVID 19 in India. We found that both these institutional investors adopted the same strategy i.e. both buy and sell during first quarter of year 2020 (Q1: April-June). But, from July onwards, dichotomy started reflecting in their trading behavior. Correlation analysis evidenced that instead of focusing more on Nifty 50 index movement they adopted each other trading strategies to synthesize more gain from uncertainties caused by spread of COVID 19 across the world.

References;