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ISSN: 2348 - 5612 | Volume: 04 Issue: 02 | April – June 2017

IMPACT OF DEMONITIZATION ON STOCK MARKET

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ISSN : 2348-5612 © URR

ABSTRACT : If price and quantity are the fundamental building blocks of any theory of market interactions, the importance of trading volume in understanding the behavior of financial markets is clear. However, while many economic models of financial markets have been developed to explain the behavior of prices—predictability, variability, and information content—far less attention has been devoted to explaining the behavior of trading volume. In this article, we hope to expand our understanding of trading volume by developing well-articulated economic models of asset prices and volume and empirically estimating them using recently available daily volume data for individual securities from the University of Chicago's Center for Research in Securities Prices. Our theoretical contributions include: (1) an economic definition of volume that is most consistent with theoretical models of trading activity; (2) the derivation of volume implications of basic portfolio theory; and (3) the development of an intertemporal equilibrium model of asset market in which the trading process is determined endogenously by liquidity needs and risk-sharing motives. Our empirical contributions include: (1) the construction of a volume/returns database extract of the CRSP volume data; (2) comprehensive exploratory data analysis of both the time-series and cross-sectional properties of trading volume; (3) estimation and inference for price/volume relations implied by asset-pricing models; and (4) a new approach for empirically identifying factors to be included in a linear-factor model of asset returns using volume data.

KEYWORDS-stock market, demonetization, effect on market.

Definition of 'Stock Market'

Definition: It is a place where shares of pubic listed companies are traded. The primary market is where companies float shares to the general public

Description: Once new securities have been sold in the primary market, they are traded in the secondary market—where one investor buys shares from another investor at the prevailing market price or at whatever price both the buyer and seller agree upon. The secondary market or the stock exchanges are regulated by the regulatory authority. In India, the secondary and primary markets are governed by SEBI.

A stock exchange facilitates stock brokers to trade company stocks and other securities. A stock may be bought or sold only if it is listed on an exchange. Thus, it is the meeting place of the stock buyers and sellers. India's premier stock exchanges are the Bombay Stock Exchange and the National Stock Exchange.

EFFECT OF DEMONITIZATION ON STOCK MARKET-Rashesh Shah also believes that the move was just not an economic experiment but a social experiment. "It's an experiment that has a lot of benefits with an increased flow of informal funds into the formal system," he says. Bharat Shah, Executive Director, ASK Group, pointed out that there could be a shift from physical assets to financial assets because of demonetisation. Rashesh Shah says export-oriented companies will also be under a lot of pressure because of global slowdown. "There will be some earnings pressure on these companies."

But there are other dangers, too, for the broader market in 2017. Oil prices have shot up by 40 per cent from $36 a barrel a year ago to $52 a barrel. There is likely to be further increase in oil prices. This increase has the potential to fuel domestic inflation. In fact, the strengthening of the dollar coupled with higher rates in the US has the potential to weaken the rupee value further against the dollar. "The biggest economy in the world is exiting the easing monetary policy," says Desai .There is yet another unknown risk. President-elect Donald Trump has already labeled H1B Visa program as being 'unfair' and, if implemented, could impact Indian IT companies. Trump had also vowed to bring American jobs back from India. For a week now demonetization of high value notes has been polarizing the country between those who totally support the idea and those who are

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against it. The move has had a big impact on the stocks markets. A lot of investors are withdrawing capital from stocks. Some because they are out of funds (since the currency they had at home no longer works) and others because they expect a crash, perhaps an opportunity to buy at lower levels.

Between all of this, I've heard some intelligent and some not so intelligent theories about markets, stocks, sectors and the overall economy. Here's what's doing the rounds; I leave it for you to judge what makes sense:

1. Pharmaceutical stocks on a tear: 1 day after the announcement, pharma stocks zoomed in trade. Some analysts credited Trump's winning the U.S. Elections since Clinton would have created regulatory hurdles for the sector. The most interesting analysis however came from one of my clients who called in with this – 'Sir, chemists are accepting Rs. 500 and Rs. 1000 notes for a few days. People are buying 1 year medicines in advance. I think Pharma companies will present very healthy Q3 results. Should I buy this. Genius.
2. Housing finance: HDFC, LIC Housing, Can Fin Homes, Gruh Finance, Repco home – some of these stocks have been favourites for most fund managers (I included) over the last 1 year. The fear is that as realty prices fall, some of the loans extended by these companies could default. This happens when the value of the outstanding loan exceeds the market price of the property. Ideally, these companies should extend a loan which is not more than the registered value of the property. Of course, the limits are often pushed. Now if you ask me, if house prices fall, it would be the best thing to happen for housing finance. Housing finance thrives when house prices come in the reach of salaried people and first time home buyers, the biggest market for housing finance. I am not sure how falling house prices are negative for this sector.
3. Banking:This is one sector which will benefit for sure. However here to, the house seems divided between those wholike PSU bank vs. those who prefer pvt sector banks. No doubt that money will flow into all banks, may be a little more in public

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sector banks where all of the jandhan accounts were opened. That said, once the dust settles, pvt sector banks will continue to enjoy competitive advantages as before. My views on this have been clear for many quarters now.

4. Information Technology: In the rush for fast buying and selling, everybody missed on this sector. First, everything bad that could have happened for IT happened over the last 1 year. First, there was the Brexit, then U.S. elections RHETORIC – HIKE IN VISA FEES FOR H1B VISAS, TALK AGAINST OUTSOURCING AND FINALLY currency violatility. Now the U.S. elections are out of the way, and tremors of Brexit are beginning to subsid. Demonetization probably impacts the least on stocks in this sector. For one, they get most revenue in Forex and secondly, they get everything via banking channels. I expect this sector to do well going forward.
5. Infrastructure: If the government's deficit will go down, which seems to be the intention of this move, they government will have more money to pay for infra projects of which the direct beneficiary will be companies in this sector.
6. Consumer Discretionary stocks: Think of all companies where transactions happen in cash. Hotels, alcohol, restaurants, consumer electronics, cigarettes etc. Naturally, sales for these companies will come under pressure at least for this quarter. But how much should you worry or how much can they correct is anybody's guess. Usually, markets discount such one of events and if somebody sells these stocks for these reasons, somebody else will buy.
7. Impact on Gold: I have heard of people hoarding gold. In fact the tweet below sums up the situation perfectly. Thy person who narrated this story, told me that the tax officer bought gold at 2.5 times its market value. The thinking here is not the most novel. Buy gold today and in a year or so sell the gold for cash once new notes become available. If everyone starts doing this, gold prices could completely crash in future because of oversupply of gold. Further, many will be overpaying for gold today and will be selling it far cheaper in future. Of course, many would prefer to hold this gold for many years to come. For them, the analysis of gold (read here) becomes more relevant.

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ISSN: 2348 - 5612 | Volume: 04 Issue: 02 | April – June 2017

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