BONDS VS STOCKS PREFERENCE IN PORTFOLIODURING COVID 19 PANDEMIC

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ABSTRACT:

This research explores investor preferences for bonds and stocks during the COVID-19 pandemic, a period marked by significant financial market disruptions. Bonds, considered safer with fixed income, were favoured for stability, while stocks, representing higher risk and potential returns, saw varied responses. The study employs market data from HDFC Bank, Bank of Baroda, Muthoot Finance, and India Bulls Housing Finance. Findings indicate a general inclination towards bonds, with specific recommendations for investors based onrisk tolerance.

INTRODUCTION:

The COVID-19 pandemic, caused by the novel coronavirus SARS-CoV-2, emerged in late 2019 and quickly escalated into a global health crisis. Beyond its devastating impact on public health and human lives, the pandemic triggered unprecedented disruptions across various sectors, including profound consequences for financial markets worldwide. The introduction of the pandemic into the global landscape brought forth a unique set of challenges that significantly influenced the dynamics of financial markets.

Stocks represent ownership in a company and offer potential for capital appreciation. However, they also involve higher risks, volatility, and uncertainty. During periods of economic instability, such as the pandemic, stock prices can significantly decline, resulting in financial losses for investors. On the other hand,stocks can also rebound and provide substantial returns when the economy recovers.

Bonds, on the other hand, are debt instruments issued by governments or corporations. They offer fixed interest payments and return of principal at maturity. Bonds tend to be less volatile and provide a regular income stream, making them generally a safer investment option during times of crisis. During the pandemic, bond prices increased due to investors seeking more stable assets, leading to potential capital gains for bondholders.

Investors' preferences for bonds or stocks in their portfolios during the pandemic can vary based on their risk tolerance, investment goals, and time horizon. Those who are more risk-averse might prioritize bonds to provide stability and income, while others may see the stock market downturn as an opportunity to invest in undervalued companies and potentially gain higher returns in the long run.

Understanding the multifaceted impact of the COVID-19 pandemic on financial markets is crucial for investors, policymakers, and researchers seeking to navigate and comprehend the complexities of the evolving global economic landscape. The interplay of public health crises, economic challenges, and unprecedented policy responses has created a unique environment for studying the dynamics of financial markets during times of crisis.

- **Market Volatility:**

The onset of the COVID-19 pandemic was characterized by heightened uncertainty and fear. Markets experienced extreme volatility as investors grappled with the sudden and severe economic implications of widespread lockdowns, disruptions to supply chains, and the potential long-term impact on corporate earnings.

- **Economic Downturn:**

Governments around the world implemented stringent measures, including lockdowns and social distancing protocols, to curb the spread of the virus. These measures had an immediate impact on economic activity, leading to contractions in GDP, rising unemployment, and disruptions to global trade. Financial markets reacted to these economic challenges, with equity markets experiencing sharp declines.

- **Shifts in Investor Behavior:**

The pandemic also prompted shifts in investor behavior. Risk aversion increased, leading to a flight to safety. Investors re-evaluated their asset allocations, seeking refuge in traditionally safer assets such as government bonds, while reducing exposure to riskier assets like equities.

- **Policy Responses:**

Governments worldwide implemented fiscal stimulus packages to mitigate the economic impact of the pandemic. These policies, coupled with central bank interventions, shaped market expectations, and influenced the performance of various financial instruments.

Here's an overview of the COVID-19 pandemic and its impact on financial markets:

- Financial Market Volatility: Financial markets experienced extreme volatility in the early months of the pandemic. Stock markets witnessed sharp declines, with major indices experiencing some of the fastest and largest drops in history.
- Central Bank Responses: Central banks globally responded with monetary policy measures to stabilize financial markets and support economic recovery. Interest rates were lowered, and central banks engaged in asset purchase programs to inject liquidity into the financial system.
- Flight to Safety: Investors sought refuge in traditional safe-haven assets, such as U.S. Treasuries and gold, leading to a "flight to safety." Government bonds, particularly those issued by stable economies, becamesought-after assets.
- Sectoral Variances: The pandemic had varying effects on different sectors. Technology and e-commerce thrived, while traditional brick-and-mortar businesses struggled. Energy markets were particularly affected by a decline in demand and a price war between major oil-producing nations.

Significance:

- Risk and Return Dynamics: The pandemic underscored the importance of understanding risk and return dynamics in investment portfolios. Stocks, while historically associated with higher returns, also come with higher volatility. Bonds, on the other hand, are generally viewed as more stable but offer lower potential returns. Analysing how these dynamics played out during the pandemic provides valuable insights into investor behaviour andportfolio construction strategies.
- Monetary Policy Impact: Central banks responded to the economic fallout of the pandemic with unprecedented monetary policy measures, including interest rate cuts and large-scale asset purchases. These interventions had varying impacts on bonds and stocks. Understanding how monetary policy influenced the performance of these assets is crucial for investors trying to anticipate future market movements.
- Portfolio Diversification: The pandemic highlighted the importance of portfolio diversification as a risk management strategy. Investors sought to balance the risk exposure in their portfolios by holding a mix of assets, including both stocks and bonds. Analysing the effectiveness of this diversification strategy during the pandemic contributes to the broader understanding of portfolio management in times of crisis.
- Policy Responses and Fiscal Stimulus: Governments globally implemented fiscal stimulus measures to counter the economic impact of the pandemic. The interplay between these policy responses and the performance of bonds and stocks is a critical aspect of the analysis. It provides insights intohow market participants interpreted and reacted to government interventions.
- Long-Term Implications: The pandemic's financial market impacts extend beyond its immediate effects, influencing long-term investment strategies and shaping the future landscape of portfolio management. Researching the preferences for bonds versus stocks during this period contributes to our understanding of evolving investor attitudes and strategies.

Objectives of this research study:

- Understand whether investors favored bonds over stocks or vice versa and identify factors influencing these preferences.
- Analyze the effectiveness of portfolio diversification strategies during thepandemic.
- Investigate how combining bonds and stocks in a portfolio impactedoverall portfolio performance and risk mitigation.
- Explore the role of portfolio diversification during the pandemic, considering whether investors adjusted their asset allocations to achieve a balance between bonds and stocks.

Research question:

"How did the performance of bonds and stocks differ in investment portfolios during the COVID-19 pandemic?"

LITERATURE REVIEW:

- The pandemic's shock triggered a massive shift towards bonds, seeking their inherent safety and liquidity. Studies like Baker et al. (2020) document this dramatic movement, highlighting the unprecedented fear and uncertainty.
- Aggressive fiscal and monetary stimulus packages somewhat moderated the economic decline, boosting stock market recovery and dampening the bond rally. Research by Beirne et al. (2021) explores how government interventions influenced asset class preferences during this period.
- The pandemic's uneven economic impact led to varying performance within both bonds and stocks. For example, healthcare and technology sectors within equities, and government bonds, thrived while cyclical sectors suffered. Studies like Liu et al. (2022) analyse this phenomenon.
- While equities faced initial losses, the robust government response and subsequent economic recovery led to strong long-term stock returns. Bonds, initially in high demand, experienced price falls as interest rates rose later in the pandemic. Studies like Pastor and Vorsatz (2020) compare the performance of various asset classes during the pandemic.

Bonds vs. Stocks in Investment Portfolios during the COVID-19 Pandemic:

Risk-Return Trade-off:

The Risk-Return Trade-off principle suggests that investors are generally risk- averse and require compensation for taking on higher levels of risk.

Evaluate how the risk-return trade-off influenced investor decisions during the pandemic. Assess whether the perceived safety of bonds as lower-risk assets influenced their preference over stocks.

Diversification:

Modern Portfolio Theory (MPT) emphasizes the benefits of diversification to reduce portfolio risk. It suggests that combining assets with low or negative correlations can enhance overall portfolio stability.

Investigate how investors applied diversification principles during the pandemic. Explore whether the inclusion of both bonds and stocks in portfolios helped manage risk and achieve a balance between stability and potential returns.

Capital Asset Pricing Model (CAPM):

CAPM links the expected return of an asset to its systematic risk, as measured by beta, and the risk-free rate.

Assess how the CAPM framework could explain the relative performance of bonds and stocks during the pandemic. Examine whether investors adjusted their expectations of returns based on perceived systematic risk.

Behavioural Finance:

Behavioural finance explores how psychological factors and cognitive biases influence financial decision-making.

Investigate the role of behavioural finance in shaping preferences for bonds or stocks during a crisis. Analyse whether emotions, sentiment, or cognitive biases played a significant role in investor choices.

METHODOLOGY:

I used secondary data in the present research, which was collected from the official websites of the Yahoo finance. Scholarly publications on old research paper can be found in academic journals and research databases.

Here I used stock market companies, i.e., HDFC Bank and Bank of Baroda, Bonds are Muthoot finance and India bulls Housing Finance.

Stocks:

	HDFC BANK		BANK OF BARODA			
Date	Open	Close	Open	Close	HPR (HDFC)	HPR (BOB)
01-01-2020	63.860001	57.279999	102.25	92.699997	-10%	-9%
01-02-2020	57.209999	54.849998	92.699997	76.300003	-4%	-18%
01-03-2020	53.740002	38.459999	77.5	53.549999	-28%	-31%
01-04-2020	36.540001	43.349998	54	49.200001	19%	-9%
01-05-2020	42.25	41.830002	49.200001	38.950001	-1%	-21%
01-06-2020	42.459999	45.459999	39.700001	48.599998	7%	22%
01-07-2020	46.189999	46.75	48.650002	46.799999	1%	-4%
01-08-2020	45.709999	49.599998	46.450001	48.950001	9%	5%
01-09-2020	50.75	49.959999	49.5	41.049999	-2%	-17%
01-10-2020	51.049999	57.439999	41.349998	41.700001	13%	1%
01-11-2020	57.970001	69	42.099998	51.349998	19%	22%
01-12-2020	69.82	72.260002	51.549999	61.450001	3%	19%
01-01-2021	72.290001	72.099998	61.799999	68.050003	0%	10%
01-02-2021	75.809998	79.139999	68.949997	85.400002	4%	24%
01-03-2021	80.93	77.690002	85.400002	74.099998	-4%	-13%
01-04-2021	77.349998	70.279999	74.800003	66.75	-9%	-11%
01-05-2021	70.699997	76.529999	65.949997	80.699997	8%	22%
01-06-2021	76.709999	73.120003	81.050003	85.900002	-5%	6%
01-07-2021	73.25	70.57	86.349998	80.300003	-4%	-7%
01-08-2021	70.949997	78.309998	80.949997	77.349998	10%	-4%
01-09-2021	78.849998	73.089996	77.199997	81.75	-7%	6%
01-10-2021	73.089996	71.910004	81.449997	97.5	-2%	20%
01-11-2021	73.379997	65.470001	98.400002	85.75	-11%	-13%
01-12-2021	67.07	65.07	86.599998	81.949997	-3%	-5%

	HDFC	BOB	
Standard deviation	0.10	0.16	
correlation			0.559
beta			0.86
(or)			
beta scope			0.86

Volatility: HDFC has lower volatility (standard deviation of 0.10) compared to BOB (0.16), indicating its price tends to fluctuate less.

Correlation: The correlation between HDFC and BOB is 0.559, suggesting a moderate positive relationship. They tend to move somewhat in tandem, but not always perfectly aligned.

Beta: The beta of 0.86 (or beta scope, if that's the correct term in this context) indicates that HDFC stock is less volatile than the overall market. It tends to move 86% as much as the market in either direction.

- Risk Assessment: Lower volatility and beta suggest HDFC might be considered less risky than BOB for investors seeking more stability.
- Diversification Potential: The moderate correlation suggests that combining HDFC and BOB in a portfolio could offer some diversification benefits, as their movements aren't always perfectly correlated.
- Market Sensitivity: The beta of 0.86 implies that HDFC's price is somewhat sensitive to overall market movements, but not as reactive as a stock with a beta of 1.00.

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Bonds:

	Muthoot		IBHF			
Date	Open	Close	Open	Close	HPR(Muthoot)	HPR(IBHF)
01-01-2020	761	762.650024	315	306.39999	0%	-3%
01-02-2020	760	880.25	306.799988	279.85001	16%	-9%
01-03-2020	882.099976	613.150024	307.799988	96.75	-30%	-69%
01-04-2020	603.349976	862.700012	98.300003	132.7	43%	35%
01-05-2020	862.700012	862.650024	132.699997	122.15	0%	-8%
01-06-2020	865.049988	1086.050049	125	207.14999	26%	66%
01-07-2020	1099.900024	1273.800049	209	190	16%	-9%
01-08-2020	1278.349976	1146.75	188	208.2	-10%	11%
01-09-2020	1152.5	1132.099976	210.949997	157.14999	-2%	-26%
01-10-2020	1138	1230.800049	159	140	8%	-12%
01-11-2020	1239	1152	141.5	187.05	-7%	32%
01-12-2020	1171.949951	1210.550049	189	220.3	3%	17%
01-01-2021	1215	1105.849976	221	190.85001	-9%	-14%
01-02-2021	1110.550049	1299.699951	192.75	218.75	17%	13%
01-03-2021	1297.300049	1205.900024	222	196.5	-7%	-11%
01-04-2021	1222	1157.400024	200.050003	181.05	-5%	-9%
01-05-2021	1155	1311.599976	178.899994	223.95	14%	25%
01-06-2021	1318.199951	1481.650024	223.199997	261.04999	12%	17%
01-07-2021	1484.949951	1554.75	261.049988	275.45001	5%	6%
01-08-2021	1565.900024	1514	277.950012	224	-3%	-19%
01-09-2021	1527	1450.300049	224.600006	231.64999	-5%	3%
01-10-2021	1455	1467.75	230.949997	216.8	1%	-6%
01-11-2021	1483	1426.199951	218.199997	229	-4%	5%
01-12-2021	1449.25	1495.650024	231.449997	218	3%	-6%

	Muthoot	IBHF	
Standard deviation	0.14	0.25	
correlation			0.672
beta			1.18
(OR)			
beta slope			1.18

Standard Deviation: Muthoot has a lower standard deviation (0.14) compared to IBHF (0.25), suggesting it's less volatile and carries lower risk.

Correlation: The correlation between Muthoot and IBHF is 0.672, indicating a moderate positive relationship. They tend to move somewhat in the same direction, but not perfectly in sync.

Beta: The beta of 1.18 suggests both stocks are slightly more volatile than the overall market, which has a beta of 1. This means they tend to fluctuate more thanthe market.

- Risk-Return Trade-off: Investors might consider Muthoot as a relatively lower-risk option compared to IBHF, but it might also offer lower potentialreturns.
- Diversification Potential: The moderate correlation suggests that combining Muthoot and IBHF could offer some diversification benefits, but not as much as assets with a lower correlation.
- Market Sensitivity: The beta of 1.18 indicates that both stocks are somewhat sensitive to market movements. They could potentially experience larger price swings during market downturns or upswings.

Investors generally favoured bonds over stocks during the COVID-19 pandemic due to their lower risk profile. Bonds offered a fixed income stream and acted asa haven during the volatile market conditions.

Bonds:

Muthoot: Lower standard deviation (0.14) indicates lower volatility compared toIBHF.

Both: Betas slightly above 1 (1.18) suggest slight sensitivity to market movements compared to the overall market (beta of 1).

Stocks:

HDFC: Lower standard deviation (0.10) and beta less than 1 (0.86) indicate lower volatility compared to BOB and more in line with the market.

BOB: Higher standard deviation (0.16) and beta of 0.86 suggest higher volatility than HDFC but still less than the market.

Interpretation:

Bonds (Muthoot and IBHF): Preferred for investors seeking capital preservation and a steady income stream during uncertain times.

Stocks (HDFC and BOB): Could be considered by investors with a higher risk tolerance who want some potential for capital appreciation while still maintaining some protection from downside risk. HDFC might be preferable due to its lowervolatility.

Finding, Suggestion, and Conclusion:

Findings:

- During the COVID-19 pandemic, investors generally favoured bonds over stocks. The lower risk profile of bonds, with fixed income streams, made them a preferred choice for capital preservation and stability duringthe volatile market conditions.

- HDFC is lower volatility (0.10) and beta less than 1 (0.86) indicated lower risk compared to BOB and aligning more closely with the market.

- BOB is higher volatility (0.16) and beta of 0.86 suggested higher risk than HDFC but still less than the market.

- HDFC and BOB are moderate correlation (0.559) suggested combining these stocks in a portfolio could offer some diversification benefits, thoughnot perfectly aligned.

- Muthoot and IBHF are moderate correlation (0.672) indicated potential diversification benefits, but not as much as assets with lower correlation.

- Muthoot is lower standard deviation (0.14) and slightly above 1 beta (1.18) suggested relatively lower risk, but potentially lower returns compared to IBHF.

Suggestion:

- Bonds, particularly Muthoot, could be preferred for capital preservation and steady income.

- Moderate risk tolerance is a balanced portfolio with both bonds and stocks, like HDFC, could provide stability with some potential for capital appreciation.

- Higher risk tolerance in a Stocks, especially HDFC, might be considered for potential capital gains during market recovery.

- Moderate diversification of combining HDFC and BOB or Muthoot and IBHF in a portfolio could offer some diversification benefits due to their moderate correlations.

Conclusion:

The research findings highlight a clear preference for bonds over stocks during the COVID-19 pandemic, primarily driven by lower risk and the desire for a stable income stream. However, the choice between specific bonds and stocks depends on investors' risk tolerance and objectives. Diversification remains a crucial strategy, with moderate correlations providing potential risk mitigation. The pandemic has emphasized the significance of understanding risk-return dynamics, diversification benefits, and the role of different asset classes in a well- constructed investment portfolio during times of crisis.

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https://finance.yahoo.com/quote/IBULHSGFIN.NS/history?period1=1577836800&period2=1640908800&interval=1mo&filter=history&frequency=1mo&includeAdjustedClose=true

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