



WALL OF WORRIES; HALL OF MIRRORS

There has not been a more eventful month in years than April 2025 for investors across the world. In many ways, it was an ominous month with signals that may have the most far-reaching implications for all those around the world with surplus capital. Indians included. There was relative calm in the world of Indian equities. The IT services folks came out with some shockers and that is not for the first time. The banks made some dull progress but that was progress after all. The SIP brigade reiterated their optimism on Indian equities and that is nothing different. FPIs turned buyers in mid-April and that may have been a bit of a positive surprise. Indian market did way better than the US and many other markets. Even the perennially weak INR strengthened against the USD.

What are we complaining about? Are we not supposed to declare the bear market in India as a still born that never was? Are we not supposed to revert to our mechanical refrain that India is the hottest growth market of this decade? Are we not supposed to get back to the business of cheering up our mid & small caps as they always seem to give higher returns if you cling on? In short, investors with capital should now supposedly go back to their siesta as fund managers will continue to sweat their capital and manufacture magic.

Unfortunately, the proximate market movements do not constitute lead indicators. The gravity of the upheaval brought by the US will play out over many months and years. To be sure, we are not bearish on Indian equities. Not anymore. But the whole challenge lies in the no man's land between mindless optimism and doomsday mongering. Investors cannot take anything for granted. Beware of sales pitches. There is a severe over-capacity of opinion-makers and hence the conflict of interest may itself dilute the quality of inputs. The fact is that the outlook is incredibly confusing, and the range of probabilities has never been so diffuse. Forecasting is fraught with difficulties but forecast we must. We believe we should do so with humility and with an open mind. We should not hesitate to question what usually supports the well-directed but misplaced expectation that all will live happily hereafter. We are at the juncture where rigid long-term thinking has limited value. Long term may be after lunch or in the long term, many may not survive. We are not advocating a trading mindset. We believe it is necessary to pivot as and when called for. Given how the macro is poised, it is not prudent to bank on ideas that seemingly promise high or lazy returns. The risk may wipe out any upside and much more. Now is the time to climb the wall of worries one careful step at a time.

Here is why the world is left between many rocks and several hard places in the wake of a seismic shift that was initiated by the US.

Macro Matters

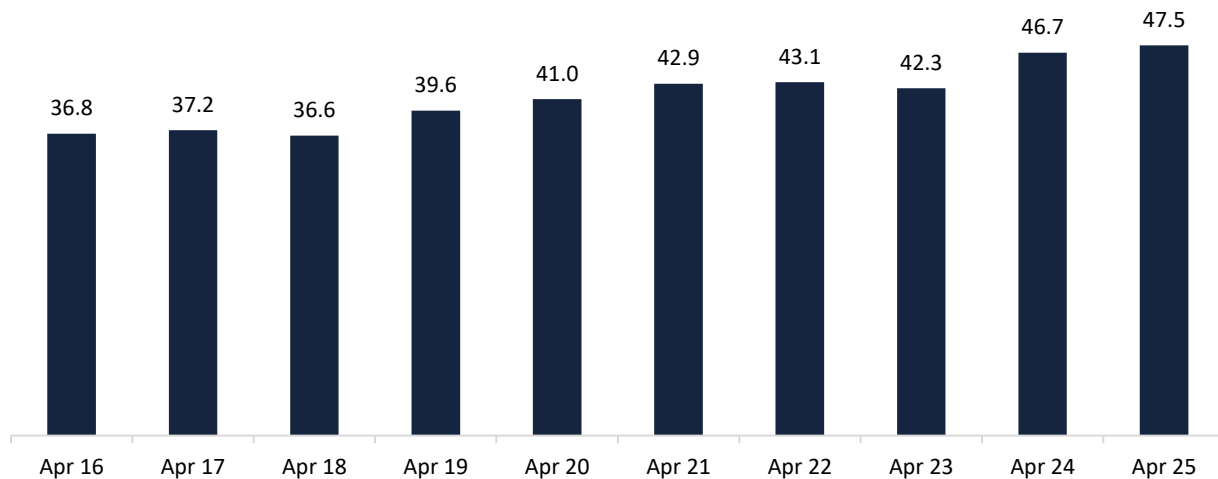
We have said so more than a few times in the last few months. We invite attention to our first newsletter of 2025. The focus was on US bond yields. About 90 days on, Mr. Trump pulled back from the brink as the bond markets forced his hand. Several other macro trends have since come to the fore. When uncertainties go up, as they have, valuations need to come down. The Indian sales pitch that our stocks can buck the trends that may affect global valuations is so naive that it should be called out as a fast one on unsuspecting investors. China is a cheaper market and that shall not be denied. If the US market can look heavy at 19 times earnings, Indian stocks cannot look attractive at 40/50/100 times earnings based on arguments like the presence of marquee fund managers, 10-year average multiples, self-certification on quality and perceived TINA theories. Companies losing money and merely signalling the path to profitability ought to find the going tough. If such stocks are rallying, beware of the metaphor on what dead cats supposedly do. Beware of the hall of mirrors in which we have stood for a while. Break a few to perceive the reality outside.

Here are some big macro-shifts of a tectonic order that convince us that India cannot stand alone and aloof.



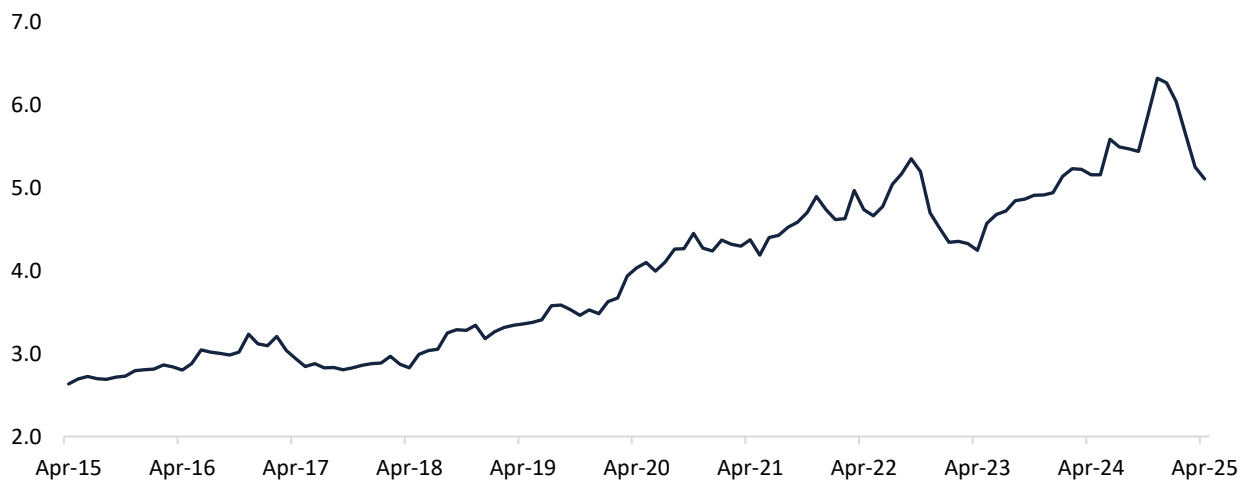
Too much of a good thing

US Market Cap share to World Market Cap (%)



Source: Bloomberg, Spark Fund Research

Combined Market Cap of Select European Countries vs US Market Cap



Note: Select European countries include Germany, France, Italy, Spain and United Kingdom.

Source: Bloomberg, Spark Fund Research

The US has dominated the asset markets like no one has. In this journey, the US per capita income left Europe behind by country miles. While innovation and productivity gains were certainly causative factors, the role of debt and the willingness of the rest of the world to finance US debt are forgotten easily. All bubbles burst at some time and maybe the US is finding that out. The world is feeling the tremors from the shock of investor revolt against the biggest and most successful economy in all of history.



USD – Flight to new havens

Something strange happened in April. When the US equities sold off in response to the tariff tantrums, the US bonds sold off and the US Dollar retreated. They should have diverged directionally at the least.

Date	Dollar Index	US 10 yr G-sec (%)	S&P 500 Index
09-12-2008	86	2.6	8691
23-12-2008	81 ↓	2.2* ↑	8419 ↓

Date	Dollar Index	US 10 yr G-sec (%)	S&P 500 Index
01-04-2025	104	4.2	5633
15-04-2025	100 ↓	4.3** ↓	5397 ↓

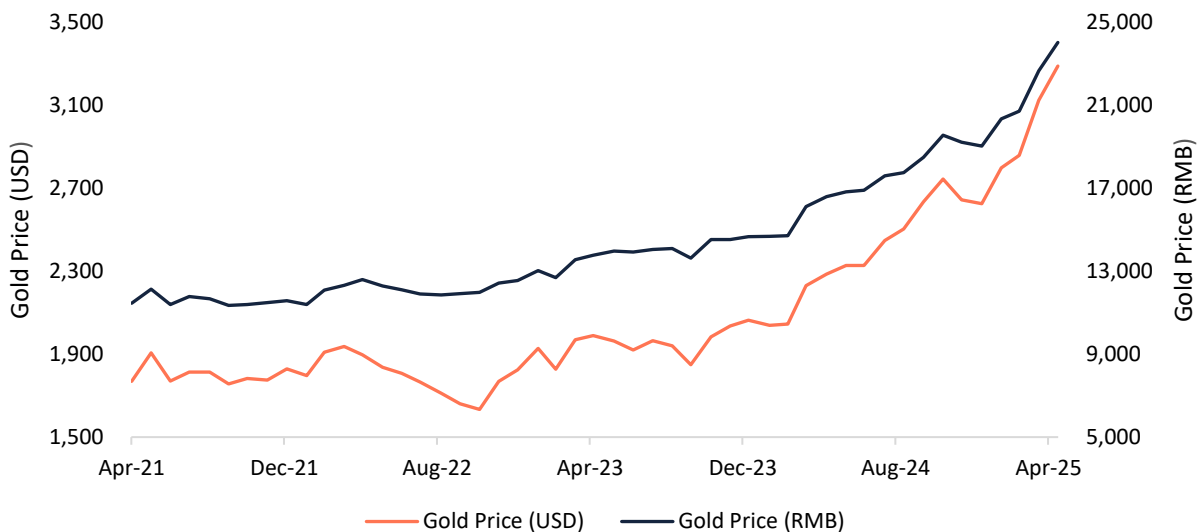
Note: * Bond prices are up, ** Bond prices are down.

Source: Bloomberg, Spark Fund Research

The US may be slipping in its status as the default safe haven for global capital. While it is premature to write any epitaphs. This may have heralded a trend of capital flight away from US assets, something unthinkable only a few months back.

Japan, China and hedge funds with arbitrage positions are all supposedly behind the sell-off in US bonds. For China, one of the telltale signs that they are diversifying out of USD/related assets is reflected in the price of gold in the Shanghai market,

Gold Price (RMB vs USD)

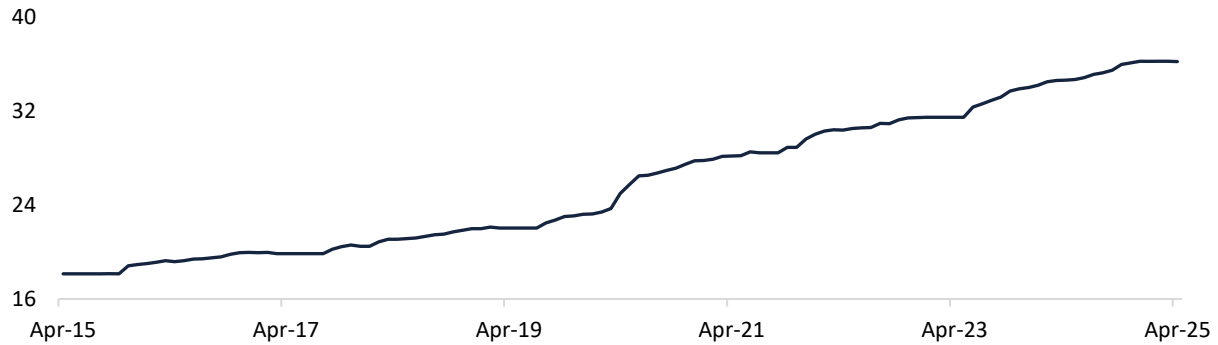


Source: Bloomberg, Spark Fund Research

Gold expressed in Yuan equivalent has done markedly better. China may well have moved towards Gold and a bit away from USD. China has been preparing for a possible showdown with the US on trade right from 2018 when Mr. Trump made his intentions clear. Other countries are evidently behind the curve. By now, the notion that US cannot be trusted has gained currency except among the uninitiated. The USD may have lost its impregnable position. USD may see further weakness even though there is no imminent risk of the dollar being replaced et al. What does this mean for the USA?



US Total Public Debt Outstanding (USD Trillion)



Source: Bloomberg, Spark Fund Research

What makes the situation complicated is that about USD 10 trillion of US debt is set to mature in the coming twelve months or so. The average interest rate at which the US Treasury bonds have been financed stands at about 3% on the current mix. The US 10-year bond trades closer to 4.3% now. US is staring at a much higher debt servicing cost and beyond the optics, this has ominous implications. The newfound US position has been that all governments have been ripping off the US because they run a trade surplus against the US. These assertions betray some level of desperation, and the markets cannot ignore this. The USD may be in for a long winter. Given the size and significance of the US market and its lead in technology and standout military strength, the situation is pregnant with so many possibilities. Most of these are unappealing. Now let us look at some seemingly random titbits that give the plot away

When the leader betrays desperation.....

1. The US President called out for the ousting of the Fed Chair before pulling back for now when the market showed visible discomfiture. The ostensible reason was that the Fed Chair is not lowering interest rates to counter the ill-effects of tariffs. There is a near universal consensus, which is also rooted in unassailable common sense that tariffs disrupt supply chains that have been functional for decades. Such disruption cannot but be inflationary. The mandate of the Fed has something to do with inflation. The point to be noted is that even before it is ascertained whether the US President can sack the Fed Chair (other than for cause – which means clear and sound reasons), the market is giving hints that it might sell off if he is sacked. And it is not the equity market but the bond market – which can cause lasting damage.
2. The most powerful policy-making establishment in the world is calling the tariffs that the US imposed a burden on the rest of the world. The simple fact is that the tariff is a tax on the US importers. What are we hearing from some of the supposedly smartest people with huge clout?
3. A senior US trade official suggested that the 10-year bond could be rolled over to perpetuity. In other words, is the US threatening a default?

Many believe these are negotiating tactics. If so, at what cost? How will the CEOs of some of the biggest enterprises in the world (most are American) take any decisions if the goalposts are meant to be shifted every few days (or even months) based on games of brinksmanship.

..... Welcome to the chaos

The inescapable conclusion is that the ground has shifted from under our feet. The air will not clear up for weeks or months. The effect will be felt for years. In such a scenario, our investor interests are well-served if we keep a flexible approach to capital allocation. On one side, there are visible tailwinds emerging for Indian equities. These include

1. A clear possibility of renewed foreign investor interest in India. This is a shift from the data we saw last month, and we need to acknowledge this. This time, it is not India vs China. It is all about India getting some part of the flows that are reversing from the US. China may have its own drivers at work.



2. A drop in commodity prices, most notably crude oil. Though this is because of the risk of US/Global recession shooting up, this in itself is positive for India. INR is clearly discounting this for now.
3. A high possibility for a trade deal with the US. We made this point last month that such a deal will be positive for the part of the listed universe that we care about – which are the companies that know how to compete and those that believe in a cash flow-based business model.
4. Enhanced prospects with other emerging trade blocks. We will get to hear a lot more on this space.
5. The presence of a large domestic market in India and autonomous growth drivers.
6. A correction in stock prices in many segments which gives a chance for the rubber to meet the road on valuations. Time correction also plays a role here.

These are unquestionably positive for Indian equities. There is one more important point to note. There is a certain postulation that goes on to aver that if equity markets can generate only high single digit returns at the index level, that is not exciting enough. It is not about excitement but about risk. With deposit rates being driven down, the fixed income returns should taper down along the risk curve. Investors will come around to respect risk-adjusted returns based on where the risk-free rates go. Equities will hold their own when there is a realisation that easy returns are a thing of the past and no one has an entitlement in free markets. All the above should keep Indian equities well-supported on any correction.

On the other hand, we need to stress on the point we started with. Which is that there are many things that will worry investors. April was an eventful month in turning the spotlight on the lead indicators that signal trouble – including

1. A possibility of US recession or serious slowdown – impacting global demand and growth.
2. A washout year for Indian IT services – which can delay and derail consumer demand in India.
3. An unstable US bond market that can upend capital flows and bring about problems which we cannot model today.
4. A retreating US dollar that can have winners & losers. We will know better as we feel the road ahead.
5. A weakened US. Which spells trouble for all.
6. Even if the tariff standoff eases off considerably, this could be of small solace. Average tariffs should settle way above previous levels and there will be a heavy price that the global economic system will pay. We believe this has not been fully appreciated by the equity market.
7. Uncertainty which is never good for equity valuations. India is unequivocally expensive. Let us not fool ourselves by sugar-coating the counter to this.
8. We have the risk of a conflict in our sub-continent which is a very recent and unexpected development. Prudence demands that we hold our horses on this one. This further stretches the envelope on the level of uncertainty that we need to contend with.

The import of all these is the following. Should stocks which we believe to be reasonably valued at one time get expensive or if something else shifts, we need to act. We may book profits. When the dust finally settles, only a few may be left standing. May we repeat what we said last month – Between risk & returns, the role of risk has never been more important.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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