From the CIO's desk
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Spark Asia Impact
Equity Asset Management

What the Indian market knows that Indian investors do not (seem to acknowledge)

Indian market seems to present a seeming contradiction with purported fundamentals. Earnings growth has been beating expectations this year. This has come about at a time when there are global headwinds. In the small-midcap (SMID) space, revenue traction and earnings growth have been robust and even spectacular in stocks that are delivering. Even in the large cap space, the execution from companies has been noteworthy. Valuations at the headline level have moderated for large caps even though India is still trading at a premium to peers. Yet the market is unimpressed. In fact, it has been stubbornly resisting the high decibel optimistic narrative that has characterized a sizeable part of the spectrum on domestic discourse.

Look at the market returns

CAGR	Nifty 50	Nifty Midcap 100	Nifty Smallcap 100
1 year	*-10.4*	*-4.2*	*0.5*
2 year	*-2.4*	*1.1*	*-0.4*
3 year	*6.5*	*13.8*	*13.4*
5 year	*5.5*	*13.5*	*11.4*

Note: Returns as on 30-10-2026
Source: Bloomberg, Spark Fund Research

Nifty returns have fallen below the fixed deposit return in India over a five-year period. For the other indices, the returns show a serious deceleration.

The typical positioning from the experts on both the Buy side and the Sell side in India has been to buy all dips. This has been so for much of the last 2-3 years. The price action in much of the market has gone against that. Even when media reports talk about panic, we see that the retail flows into equities through MFs has remained resilient. In addition, there is no data suggesting that investors have been giving up on their equity exposure. When half a decade is lost doing that, questions are bound to come up.

It is often hard to determine what will be the tipping point in all this. Whether the market will call off its strike and start to deliver or whether the domestic investors will capitulate is a matter of interest to everyone tracking the market. It is a tough call. We fully agree with the optimistic assertion that a meaningful subset of Indian companies are delivering good numbers and are poised to continue their execution journey (save the macro). This could be a classic opportunity to deploy capital into equities. Yet there is something bothering the market and in several earlier editions, we had flagged many headwinds that India faced. At this juncture, we find it worthwhile delving into the possible factors weighing on the mind of the market. Before that, let us look at some data points to put matters into context.

Fundamentals

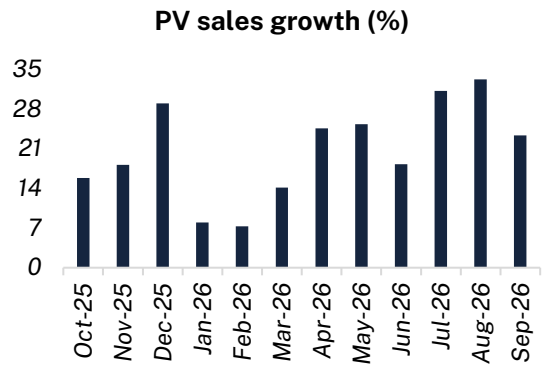
1. *Earnings growth is not the issue.*

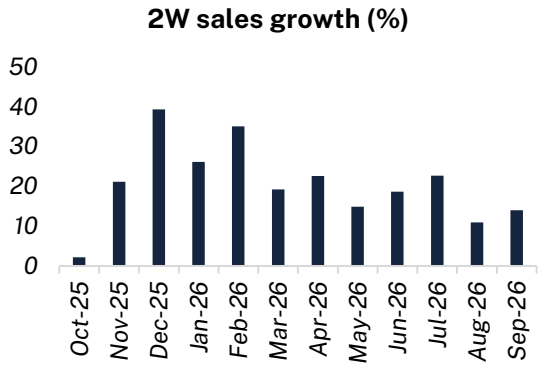
Nifty 50	Earnings Growth (%)
From 2011 to 2020	*4.2*
From 2021 to 2026	*14.6*

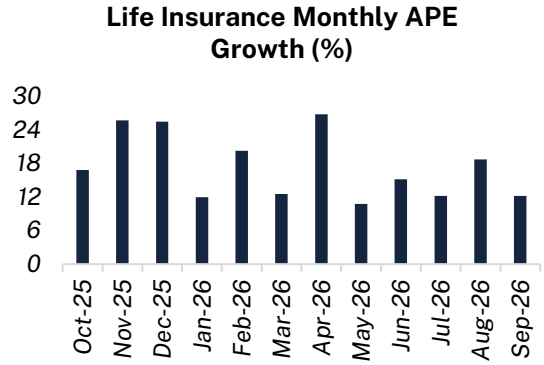
Source: IIFL Securities, Spark Fund Research

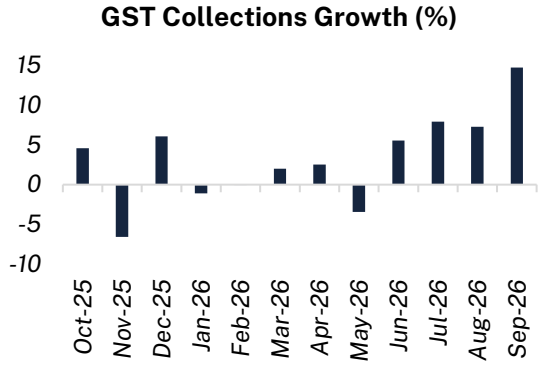
Since SMID indices consist of names that are a motley mix, looking at the aggregates may not be the best way to analyze this. That said, and as stated above, earnings growth in this space has been accelerating noticeably over the last 2-3 quarters in one set of names and that is a sizeable subset.

2. *High frequency indicators have been flashing green for several months. Demand has been good across major economic segments after the government announced the GST cut last September.*



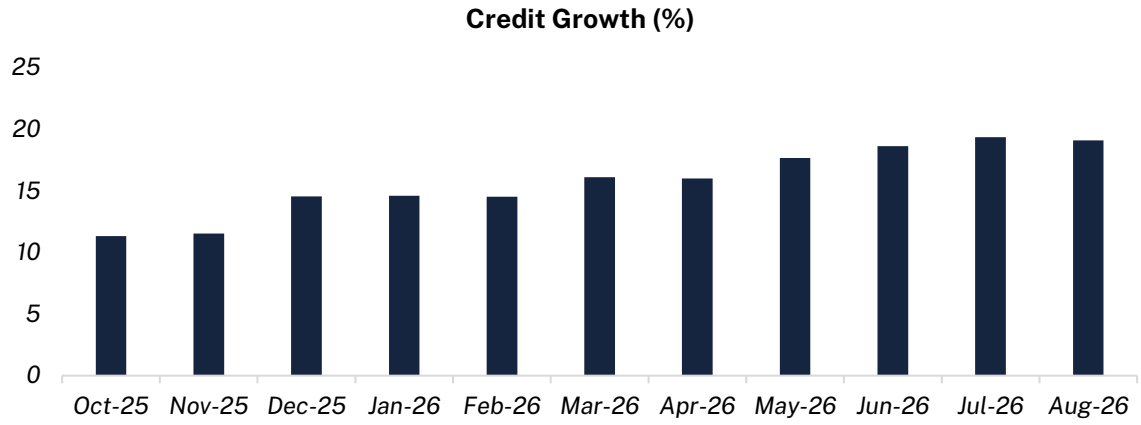




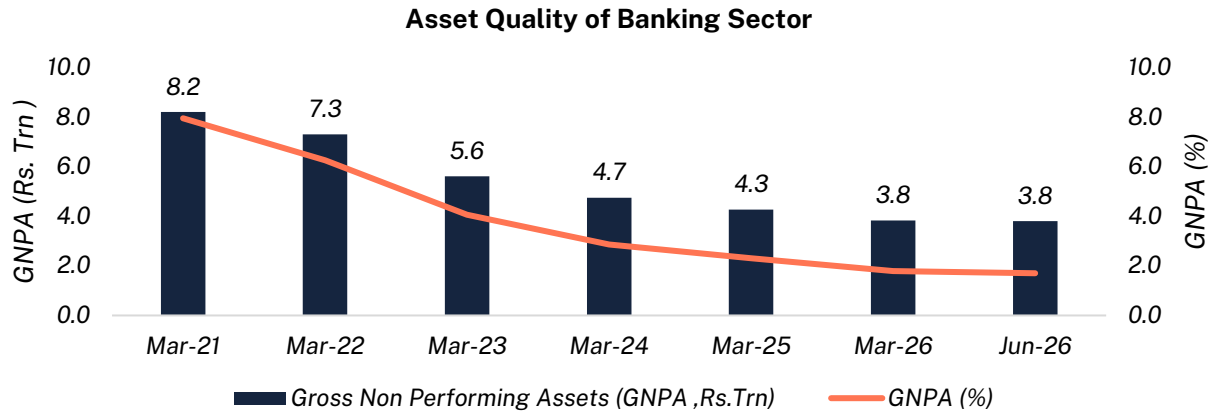


Source: Ace Equity, Bloomberg, Spark Fund Research

3. *Credit conditions have been benign and have been pointing to favourable conditions for a cyclical recovery.*

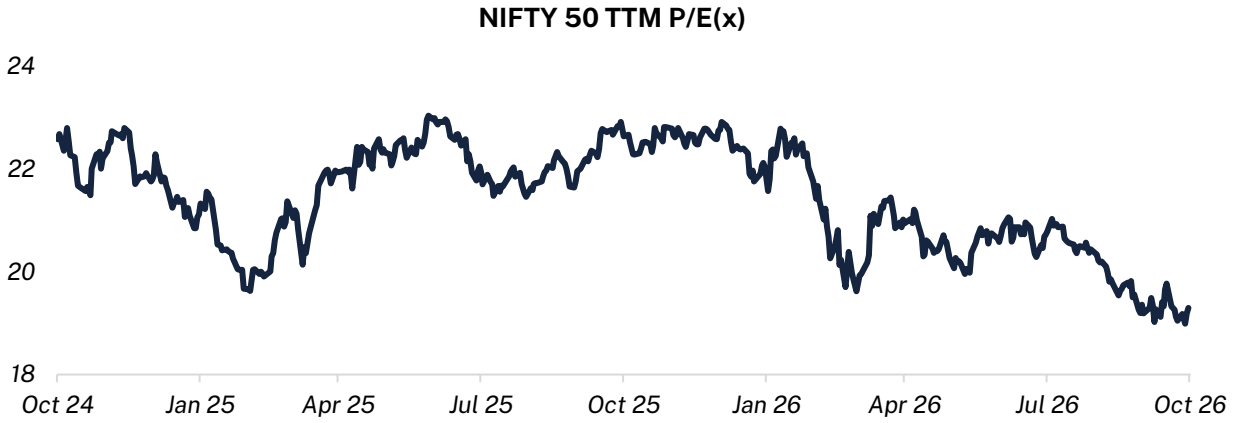


Source: Reserve Bank of India, Spark Fund Research



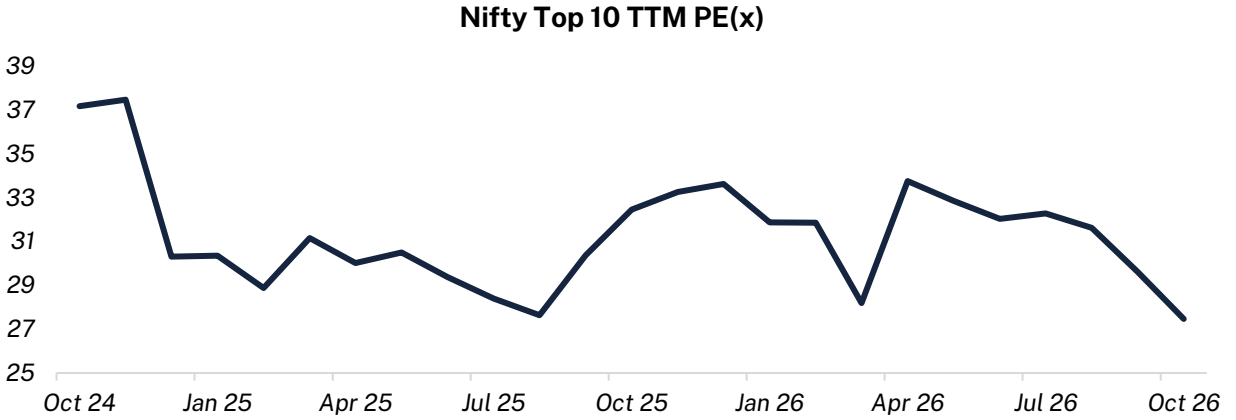
Source: AceEquity, Spark Fund Research

The protagonists have also been pointing out that valuations have softened. At the headline level, they are right.



Source: Nifty Indices, Spark Fund Research

Even at the granular level, valuations for major constituents of the Nifty have come down.



Note: Nifty Top 10 stocks constituents monthly end PE with current weight is considered for calculation
Source: Ace Equity, Spark Fund Research

Yet there is investor angst. What is the market seeing which the narrative within India is not seeing or in sync with?

Investments are below the watermark

DII	Weighted Average Nifty buying level
Jan 01, 2021 to Oct 30,2026	*22,714*
Jan 01, 2022 to Oct 30,2026	*22,970*
Jan 01, 2023 to Oct 30,2026	*23,688*
Jan 01, 2024 to Oct 30,2026	*24,119*
Jan 01, 2025 to Oct 30,2026	*24,346*
Jan 01, 2026 to Oct 30,2026	*24,088*

Source: Money Control, Spark Fund Research

The domestic institutions have been persistent buyers in India in the post-Covid period. The retail has been consistently investing into equities. The data now shows that almost all of that investment are now losing on a mark-to-market basis at the aggregate level.

While it is argued that bulk of these flows are long term and are not backed by leverage, this has happened at valuations higher than India's peer markets. FPIs have been given a comfortable exit by these flows. Has the positive narrative around the infallible aura of Indian equities led to a transfer of wealth from the Indian middle-class investors to the foreigners? This question will haunt the markets.

IPOs are being bought into at high valuations. On the back of this, an inexhaustible supply of paper is coming about. We have seen this script play out in other EMs, in China for sure. Paper supply will always overwhelm demand when such demand is valuation agnostic. That is a characteristic of free markets. And when such paper supply comes, it will look like good quality, and it will feel like it is at a significant discount to the market leaders. Nobody will easily notice that the market leader trades at valuations that do not make sense. Any voice against this is likely to be drowned out. This is typical and not surprising at all.

What is intriguing is that the market reaction is counter-intuitive to fundamental news flow.

What is the market seeing in India

The above backdrop is important and now, we will flag a few points – which we think is concerning the market.

1. *Indian macro is weaker than it looks*
   In particular on the balance of payments front, India is vulnerable. India's BoP has very rarely balanced itself without capital flows plugging the negative gap. The investment is negative now for a while. This has led to the currency becoming one of the worst performers for any major economy. Let us restate the Nifty returns in USD terms.

CAGR	Nifty 50 (in USD terms)
1 year	*-17.5*
2 year	*-8.9*
3 year	*1.4*
5 year	*0.3*

Source: Bloomberg, Spark Fund Research

Now, we know one of the many reasons why FPIs have been consistent sellers in India.

2. *A depreciating INR destroys purchasing power*
   While policymakers have generally taken a view that the depreciation in INR has been a normal mechanism of fair value discovery and a required reset, the weak INR destroys the value of domestic savings and erodes purchasing power. To the extent that today's savings represents tomorrow's consumption, savers in this country have been getting shortchanged for a long time. They need to contend with the reality that they are likely to be crowded out every year. A lot of consumption is dollarized, and this debasement of domestic savings has never helped. The K-shaped recovery has then eroded the purchasing power of Indian middle class. Indian incomes have therefore not grown to a level where investor expectations on end market size have come anywhere close within the intended timeframes.

3. *Regulatory drags where profitability has been visible*

Perhaps in response to the K-shaped recovery, regulatory intervention has sought to transfer value away from businesses. Recent examples include insurance and healthcare.

Nifty 50	%
Banking	*30*
Insurance	*1*
Telecom	*8*
Power Generation & Transmission	*2*
Oil & Gas	*3*
Coal	*1*
Airline	*1*
NBFC	*3*

Source: Nifty Indices, Spark Fund Research

About half of the Nifty are regulated businesses. What is left out is facing structural issues (IT services), K-shaped recovery (consumer) or global cyclical challenges (metals, petrochemicals). Many businesses are in turn dependent on these regulated businesses to varying degrees. No wonder valuations have been hit with a double whammy (higher global cost of capital and regulatory squeeze). Regulated businesses have never got premium valuations and if a chunk of the market is perceived as a hostage to regulations, it should not surprise us if everything is derating. It is not our point that regulated businesses are not investment worthy. The FPIs may be taking a view that if a lot of this market suffers regulatory squeeze (including taxation), high valuations in pockets of the market are not defendable.

4. *Inflation and global demand destruction*
   Food inflation is sure to pick up. Imported inflation through higher energy costs is yet to fully reflect in prices. Now, we are staring at the distinct possibility of a full-fledged global demand shock. Even as current earnings numbers are excellent, the market may be sniffing what lies ahead. While Indian investors and pundits have always ascribed high Indian valuations to the market looking ahead, the market can also look ahead to negative news that lies ahead.

5. *Foreigners have choice*
   India has largely missed the AI boom. There are hardly any innovation driven companies in India. While many Indian names are excellent in execution, the market is now making it clear that there are limits to the amount of imagination investors can conjure up on the valuation of these names.

   The domestic liquidity that has been hell-bent on investing in equities whatever the merit of circumstances, has been chasing up the paper supply that is pouring in. Some of that supply has been good quality and the huge depreciation in INR has made many Indian businesses more competitive along with the China+1 tailwind. These assets have been getting astronomical valuations but many of these stocks are illiquid when it is time to exit.

   This is the set-up of the Indian market as we see a global environment which is far from favorable. Having said that, the positives that we have identified and listed remain in place. Indian large caps, in many instances, have become attractively valued. The market is indeed seeing some risks which domestic investors do not want to acknowledge. Often, price destruction is indiscriminate in such situations. That could lead to the best opportunity for investors after the forced sell-off of Covid. The time to have adopted a negative stance on Indian equities was one or two years back. We now feel that a clear opportunity could lie ahead for allocating into stocks. It is not going to be easy. But a confluence of challenging global macro and over-extended posturing by domestic investors can lead to a great buying opportunity. Time to take guard and draw up plans.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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