Teflon Market?

Not any more perhaps.

Indian market has under-performed the global indices over the last two years. This has caused considerable anguish for investors. Foreign investors have sold Indian stocks on a consistent basis. Indian retail has been willing buyers so far. Some experts have come forward to call out the data for what it is. Meanwhile, some still have index targets that range from 10% above the recent high to even 25% higher.

We have made this point last month that there is little merit in trying to set a specific downside target for India despite formidable headwinds. These include a very adversarial US administration whose actions can cause macro instability particularly on the currency front. Other factors that should restrain investors include

1. The distinct possibility that the marginal utility from the huge dollops of stimulus that the government rained on the economy will prove to be less than commensurate with the input. At best, it looks uneven with certain sectors like auto and insurance getting a fillip. On others, we are back to talking up pedestrian growth powered by low base effect as the beginning of something big.
2. An unusual phase for India where the nominal GDP growth is anaemic even as reported real GDP numbers are seemingly robust. While we can debate the deflator itself, what should worry investors is that we ought to be concerned about nominal growth. What we own are producers and they cannot derive anything out of a growth completely devoid of pricing power. China had nominal growth close to the real growth but then the number was much higher, and the market recognised the challenge by pricing itself way lower. Even to date, China compensates for the risks with a lower valuation.
3. An IPO frenzy that defies all logic. Much as we agree that one man's discomfort is another man's opportunity (the IPO bulls or stags claim that the naysayers do not get the perspective right), there is absolutely no precedent that any market has ended well when minority investors have paid high valuations to promoters who want to exit on the premise that the former have a much sharper clairvoyance on future opportunities.

Despite all of the above, we maintain that it is of no great practical use to call for quantifiable downsides. The reason is that we are used to India being a Teflon market.

Nothing stuck to it. So far.

Factor risks have not derailed Indian market even though the economy could not avoid the pressures from such developments at various points in time. Factor risks quantify and correlate outcomes taking into account macro factors such as interest rates, commodity prices, inflation, valuation excesses, geopolitical risks and similar ones. Indian economy has been adversely hit whenever some of these have gone against us.

We are stuck at a per capita income of USD 2,695. The incremental per capita income added by India pales in comparison to the incremental add in other leading economies.

GDP per Capita ($)	2010	2024	Incremental GDP per Capita
Singapore	47,237	90,674	43,437
United States	48,643	84,534	35,891
Hong Kong	32,550	54,075	21,525
Taiwan	19,180	34,060	14,880
Germany	42,397	56,104	13,707
United Kingdom	39,778	53,246	13,468
Denmark	58,105	71,026	12,922
Australia	52,314	64,604	12,290
South Korea	24,071	36,239	12,167
China	4,629	13,303	8,674
Canada	47,561	54,340	6,780
France	40,695	46,103	5,408
Sweden	52,543	57,117	4,575
Italy	35,857	40,385	4,528
Mexico	9,729	14,186	4,457
Russia	10,675	14,889	4,214
Thailand	4,974	7,347	2,373
India	1,348	2,695	1,347

GDP per Capita ($)	2010	2024	Incremental GDP per Capita
Brazil	11,403	10,311	-1,093
Norway	88,163	86,785	-1,378
Japan	44,968	32,487	-12,481

Source: World Bank, Spark Fund Research

This is despite the fact that India has a base which is low and compares poorly with many other third world countries.

Yet the market has continued to surge. This has led to many examples of companies that have created massive shareholder value. It has been argued that bottom-up stock picking has been able to identify such stocks and manage residual risk in a manner that has benefited investors. It is creditable that there have been companies which have created value by executing well in an economy that has ranked lower in creating income for its citizens. Some Indian companies have indeed stood out and the opportunity to benefit from their excellence in delivery was mined by investors.

No. of stocks that have generated 20% CAGR from 2015 to 2025

Country (Mcap >$ 1 billion)	No. of stocks
USA	184
India	126
Taiwan	48
Japan	44
China	44
South Korea	23
Sweden	13
Brazil	10
UK	9
Norway	4
Russia	0

Note: Price return calculated for 10-year period ended Dec 31, 2025
Source: Bloomberg, Spark Fund Research.

The assertion from Indian fund managers that India is a great stock-picker's market rests on this. The confidence in the optimism to leverage the opportunity that this seemingly brings about is palpable. This appears to be a clear winner when presented as a marketing message. However, when you look at cause and effect, there are certain difficulties that the data presents. When we compare earnings growth and stock returns, the data looks less impressive. Further, the dichotomy has been even more stark in the post Covid period.

Market Cap Range Rs. Crores (For stocks that have 20% CAGR from 2015 to 2025 and have market cap > Rs 10000 crores)	Median Numbers			
	10 YR Price CAGR (%)	10 YR EPS CAGR (%)	5 YR Price CAGR (%)	5 YR EPS CAGR (%)
Top Sextile (1,11,000 - 22,00,000)	27	16	30	23
57,000 – 1,11,000	27	20	45	29
28,000 – 57,000	29	22	34	20
19,000 – 28,000	24	20	40	25
13,800 – 19,000	28	17	55	24
Bottom Sextile (10,000 - 13,800)	32	28	64	33

Note: Market Cap, Price return for Period ended Dec 31, 2025; 10 Yr EPS CAGR: FY15-25, 5 Yr EPS CAGR: FY20-25
Source: Bloomberg, Spark Fund Research

The compounders have faltered

If we look at the expected implied earnings of companies that had healthy CAGR as analysts saw in early 2020 (Estimated by factoring in the explicit EPS projections and extending the same expectation to FY26), the challenges faced by the fabled Indian compounding story come out clearly. The evidence is even more damaging when you consider the newly listed companies that have been assigned steep starting valuations by the market based on a high bar of expectations.

Company Name	Implied FY26 EPS based on FY19 EPS	FY26EPS Estimate	Overachieved /Underachieved (%)	FY26E P/E
Kaynes Technology India	51	69	35	50
Dixon Technologies (India)	130	170	30	61
Info Edge (India)	16	20	26	63
TVS Motor	64	77	21	48
PB Fintech	12	14	14	117
Persistent Systems	116	121	4	50
Coforge	43	44	1	38
Tata Consultancy Services	141	142	1	22
Bharti Airtel	47	46	-3	43
SBI Life Insurance	31	27	-13	73
Tata Consumer Products	21	16	-22	69
Delhivery	4	3	-25	137
Astral	32	21	-33	69
Go Fashion (India)	24	15	-38	26
Avenue Supermarts	80	47	-41	78
Reliance Industries	105	60	-43	23
Vinati Organics	84	45	-47	34
JSW Steel	72	37	-48	33
Trent	98	51	-48	74
Eternal	1	0	-67	626
FSN E-Commerce Ventures	4	1	-81	326

Note: Green represents companies listed since CY17.
Source: Ace Equity, Research Reports, Spark Fund Research.

This is from a sample where market expectations could be estimated from data going back 5-6 years and for some notable names that were listed in the last few years. The miss on expected earnings was equally big or higher in several stocks in sectors which have been multi-year market favorites. Examples include consumer biggies such as Asian Paints, Hindustan Unilever, several other consumer names and most leading IT services companies in the last 3-4 years. In the above list itself, the current valuations speak for themselves where expectations have been exceeded. The point here is that while many Indian companies have executed well in a difficult environment, the stocks have been rewarded more than proportionately. That is what is creating a steep and slippery slope right now. The unfortunate impasse is all too evident when we look at the table below.

Valuation of compounders in other markets

Company Name	Countries	Trailing P/E	5 Yr Price Return (%)
Nvidia	USA	41	71
Alphabet		29	30
Apple		33	14
Agricultural Bank of China	China	7	14
Ind & Comm Bk of China		7	6
Tencent Holdings		22	-1
Hitachi	Japan	30	44
Mitsubishi UFJ Financial Group		15	43
Toyota Motor		13	19
SK Hynix Inc	South Korea	15	49
Hyundai Motor		10	17
Samsung Electronics		22	14
Delta Electronics	Taiwan	51	34
TSMC		20	25
Hon Hai Precision Industry		15	15

Note: Trailing P/E = Price as on Jan 31,2026 divided by CY25E/FY26E EPS
Source: Bloomberg, Spark Fund Research.

Despite considerable miss to earnings, most of the Indian stocks trade at much higher valuations as compared to the stocks in other markets that have performed well. The current price multiples of many of the stocks in USA, Japan or China are reasonable despite robust price performance.

The Indian compounders have faltered in recent quarters. The reasons are not hard to find

1. Indian growth has lagged lofty expectations. Consumer incomes have grown but not to the extent dreamed of by investors (and consumers themselves).
2. Income growth has been uneven. The unorganised sector has suffered after the introduction of GST and after Covid. This sector is a big employer, and this is where most Indians are to be found. At the bottom of the pyramid, welfare measures have mitigated the shock, but these are not enough to drive the kind of consumption that will flow through to company earnings. Wealth effect has driven consumption in certain pockets but even this is moderating now.
3. Competitive intensity has been intense. This is evident from sagging margins of companies across the board.
4. Indian companies are executors and not innovators, a point which we made earlier as well. This does not help sustain high valuations.

We are now staring at some realities

1. The era of PE expansion is over. The pendulum may be swinging to the other side and that can cause pain.
2. Regularly investing in an overvalued asset class does not create wealth.
3. Loss making companies who tout fancy jargon to justify high IPO pricing will likely lead to a messy unwind.
4. Foreigners will be back only when valuations are attractive enough to give margin of safety.

The Teflon effect is wearing off

The sheen has come off the Indian market. This is not a time to look for multi-baggers just because the same worked five or ten years back. We reiterate that there is no merit in expecting deep drawdowns at the index level. However, force-fitting growth themes into a difficult backdrop can backfire. Equities are risky and by banking on rosy outlook and glib storytelling to build unrealistic expectations, the outcome could turn out to be an unmitigated disaster.

There will be a time for stock picking and finding great companies. We are not there just yet. This is the time to manage risk. We have been saying so for at least six quarters. There is merit in repeating this. The soot is sticking to the Teflon market. It could corrode capital. Stick to quality but at the right price. This is a time to build allocation to equities in a calibrated manner. Not the time to check out but move with caution.

Risk is what people are reluctant to see before it is too late. Out-sized opportunities will be there in a growth economy like India. At times, we need to wait for our turn.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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