Taking Stock

Over the last eighteen months, our newsletters have taken a consistent position that while India's growth remains broadly on track, that growth may not translate to market momentum and that equity markets will keep facing headwinds. We stressed that the market outcomes would be heavily influenced by valuation discipline, global cost of capital, global allocation dynamics and by sector and situational selectivity.

Following is a summary of the titles & central theme of our newsletters and remarks on what panned out

Month	Newsletter Header	Remarks
Jun 2024	The jigsaw that does not resolve	This has been on the dot. Growth has been uneven across sectors and markets
Jul 2024	Nifty @ 25000 – Has the market become complacent?	Nifty has compounded at just 3% p.a from 1st August 2024 to 31st December 2025
Aug 2024	Time to pause and take stock	Larger companies and leaders have stood out
Sep 2024	The China Conundrum	Shanghai Composite is up by 19% since 1st October 2024 even as Nifty is **down** by 6% (in USD terms, till 31st December 2025).
Oct 2024	What is the data telling us	We actually underestimated the severity of the midcycle correction that we called out
Nov 2024	The chemistry of flows	Liquidity vs Logic – While there was a reality check in H2 of FY25, liquidity has remained the elephant in the room. Persistent foreign selling was absorbed by resilient retail domestic flows into Indian stocks
Dec 2024	Time to look for green shoots	January-March 2025 proved to be the best time to time market entries
Jan 2025	My name is bond. US Bond	US bond yields and USD have since been on prime-time discussions incessantly
Feb 2025	The FPI enigma	We flagged the concerns and pointed to the negative vibes. FPIs have continued to sell India
Mar 2025	Blessing in disguise	India has accelerated trade deals since then. Examples include UK, parts of EU and New Zealand. An FTA with EU is almost done. The standoff with the US is something that we did not foresee
Apr 2025	Wall of worries; Hall of mirrors	Private capex has not picked up. Sentiment around capex remains muted
May 2025	The Tortoise and The Bear	Consumer demand has been tepid. The anaemic recovery in many consumer pockets validates the thesis
Jun 2025	End Markets– The Holy Grail	Continues to be key – unresolved issues continue in sizing up end markets
Jul 2025	Equity overload	We recognised the severity of the mid-cycle correction. Margin of safety has vanished and the drag from supply of paper has continued since then
Aug 2025	GST 2.0 – How good will be the feel good?	While there has been positivity and a bump-up in festival demand, will the momentum sustain across the board? It is still unclear
Sep 2025	Their Currency – Our Problem	INR depreciation has since been a key policy concern. It is a worrisome policy challenge for 2026
Oct 2025	Watch out for demand. Supply takes a bow for now.	Jury is out on sustainability of demand. Uneven recovery looks to be the new normal
Nov 2025	New High – Low momentum	The lack of momentum is all too palpable

Source: Bloomberg, Spark Fund Research

Growth to continue but no free run

While we called out the midcycle growth pangs that we saw in front of us in the middle of 2024, even our conservative stance could not capture the magnitude of the same. Tariff tantrums may have exacerbated the challenge. All cylinders are not firing despite significant reliefs – fiscal stimulus through a direct tax cut, a massive GST cut and monetary easing of four cuts totalling to 125bps. We still believe that 2026 and FY27 should see a continuation in growth recovery from the midcycle setback. However, in consumption, it will be two-paced. Private capex is likely to be patchy and the dependency on public capex will continue. On the other hand, there are headwinds from trade, currency and the K-shaped nature of the recovery.

Market faces significant valuation and earnings headwinds

This played out as we had warned

Index	Annualized return for 18 months ended Dec-25 (%)
Nifty 50	5.8
Nifty Midcap 100	5.6
Nifty Smallcap 100	-2.2

Source: Bloomberg, Spark Fund Research

The bad headline numbers mask the considerable pain within. 59% of BSE-500 stocks trade at least 20% or lower from their respective highs during this period. And 80% trade at least 10% lower. Drawdowns have been much more vicious in many instances.

Index	Annualized return for 18 months ended Dec-25 (%)
Nifty PSU Bank	10.3
Nifty Pharma	9.8
Nifty Bank	9.0
Nifty Metal	9.0
Nifty Auto	7.7
Nifty IT	3.1
Nifty FMCG	-1.5
Nifty Realty	-19.2

Source: Bloomberg, Spark Fund Research

Fewer stocks and sectors are driving the laboured uptrend. When there is bad news, drawdowns are disproportionate and buyers disappear. PE funds, promoters and FPIs have been on the selling side and retail has been buying relentlessly through mutual funds. Price discovery conceals considerable risks that have built up in the system. Hypocrisy and denial have trumped everything else in data interpretation.

Global Matters

We highlighted the importance of global comparisons – both across geography and history. We have been stressing all along that global factors matter and global cost of capital is key. Subsequent developments on the trade front, the movement of the USD and the significant under-performance of Indian equities have completely vindicated this.

Index	CY2025 returns in USD terms (%)
Nifty 50	5.2
S&P 500	16.4
Nasdaq 100	20.2
Shanghai Composite	23.7
Nikkei 225	26.8
EURO STOXX 50	34.1
Ibovespa, Brazil	50.9

Source: Bloomberg, Spark Fund Research

Global emerging markets are outperforming India by about 25% and India's weight which we had cautioned investors about in September 2024 (refer to the newsletter that raised concern over India's 20% plus weight) has since come down. Global factors continue to matter and we will dwell upon it in our discussion on the outlook.

Watch out for consumer demand and divergences across sectors
We consistently flagged the sagging consumer demand and the K-shaped nature of the recovery. Even after the income tax cut, we voiced our concern over this (May 2025 newsletter). Demand remained tepid and in September, the government resorted to a massive stimulus through GST cuts. While this is a positive, we have continued to caution against unabated optimism. Uneven recovery continues. On the stock front, consumer stocks have been a slow-motion train wreck in many instances.

We also expressed our concern over IT sector and this has been in evidence most of 2025. There has been a recent improvement in the sentiment but the overall environment for large IT services players remains challenging.

On the flip side, we have maintained positivity on financials. We have argued that proactive regulatory action by RBI would prove beneficial for companies and eventually for stocks. While there has been volatility, financials have outperformed, including some of the insurance stocks which we have regarded as a better way to ride the B2C opportunity. Capital market players have also performed but here, we missed the bus due to our concerns on valuations and potential cyclicality.

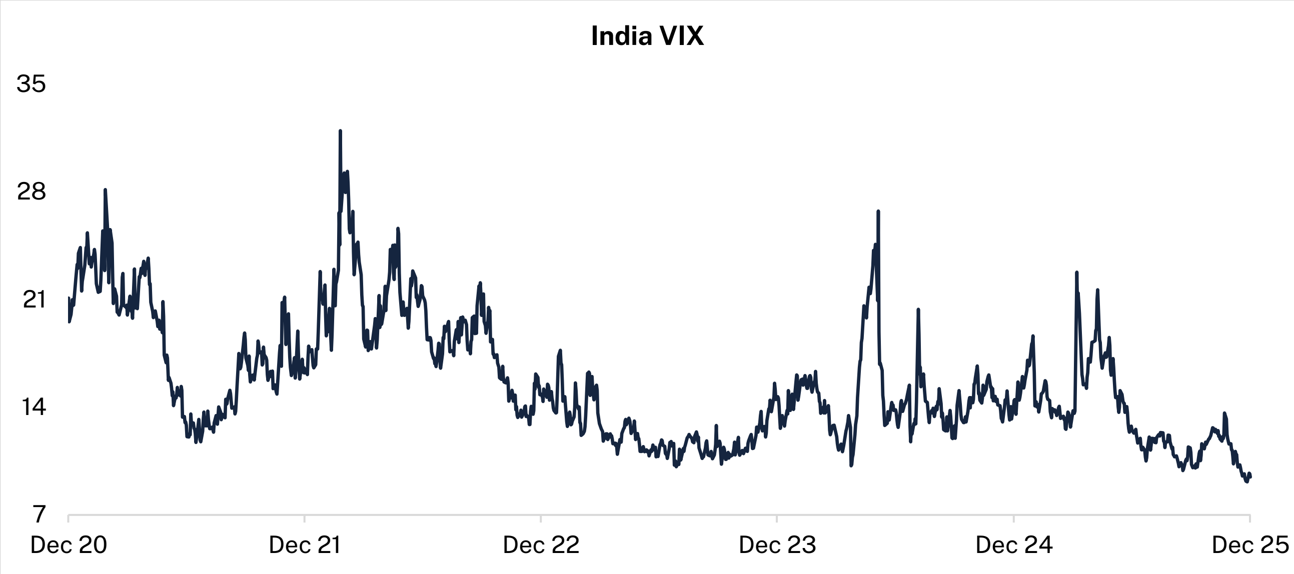
Complacency and the build-up of invisible risk
We have maintained that there are risks building up in the system and the same are being glossed over through convenient narratives. The continued resilience of fund flows into equities has broadly averted major drawdowns at the level of indices. The returns remain muted in absolute terms which has not surprised us. What has come as a surprise is the extent to which compulsions (lack of alternatives as fixed income returns on a post-tax basis are admittedly unexciting) drive continued allocation to equities. This led to the creation of what we call an "approved list" of stocks. These are stocks that institutional investors have propped up even when there have been material misses to estimates and valuations have remained dangerously high. We missed seeing this unfolding. We remain unconvinced but acknowledge that glib storytelling can sustain returns for a certain period. This tends to affect performance if one does not swim with the tide and that is pushing money into these stocks. Downsides are eventually opening up with a lag (EMS stocks for instance). Many of the new age companies continue to pose conundrums which we struggle to reconcile. In our assessment, the tail risk from the invisible risks can produce a very nasty hangover.

What are the key takeaways for 2026

Takeaway 1 – Expect more of the same

Trend returns in Nifty stand at 13% for ten years. Five-year returns stand at a higher level. Mean reversion itself poses headwinds to near term returns. Further, it is hard to make a case for the Nifty to do better than nominal GDP growth even with a liberal dose of optimism. Everything we analyse suggests that there is no realistic possibility of a structural lift-off in earnings growth that exceeds top-line growth. India does not have innovator companies to talk about and so we are left with executors and disruptors. Top-line growth will be a function of nominal GDP growth and earnings growth may try to chug along. Of course, there are cyclicals and there are large end markets opening up for specific companies. However, the inexorable weight of numbers will impact returns. This implies the possibility of low double digit market returns for some time if not lower.

Takeaway 2 – Complacency remains the elephant in the room
Let us look at India VIX which is a measure of how investors view volatility (risk)- VIX largely measures expected volatility over the next 30 days. This is effectively at all-time low.



Source: Bloomberg, Spark Fund Research

A very low VIX is a sign that all is well. VIX is not a great lead indicator. It is more of a concurrent indicator. The progression of this measure shows that over the past many months and quarters, investors have digested all of the bad news and have grown more and more comfortable. They are now expecting no bad outcomes on a rolling 30-day basis. What this implied volatility numerical construct tells us is that the immediate future appears secure. On the other hand, Indian investors are fed this narrative, which they seem to believe in passionately, that in the long run, equities will always do well. Combine both and there is supreme complacency. When a 5.8% annual return (18 months) in equities is viewed as better than a 6.5% sovereign bond yield just because tax is lower on equities and everyone expects magic to unfold if you hang in there, that should set us thinking. Risk has been consigned to the dustbin of discussions. Market strategists and pundits are using clever phraseology to paint a rosy picture (as always) while presenting disclaimers on their inability to comment on stocks. For instance, someone cannot comment on Indigo but believes that the airline sector in India looks exciting after the latest turmoil. The irony on wordplay cannot be starker than this.

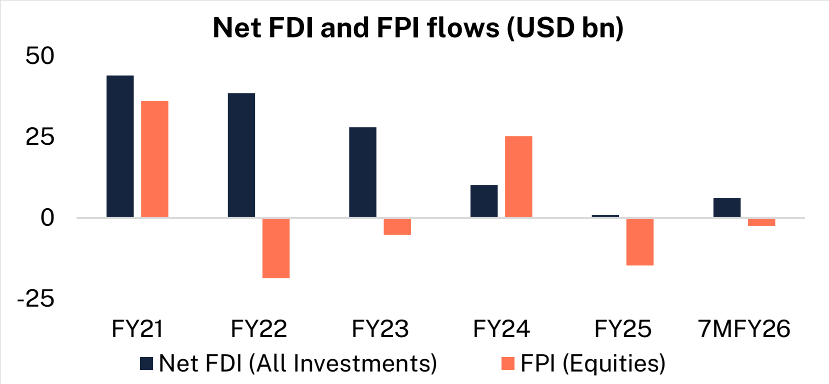
We conclude that the elephant in the room is fattening itself on the self-seeking narratives of experts who are inherently conflicted and if this goes on, the room will get too uncomfortable.

Takeaway 3 – Macro is sending contradictory signals

Inflation is benign. Rates are low. Leverage is low. Midcycle correction is at least substantially done. There are green shoots in demand. Earnings downgrades appear to be ebbing away. Is that not flashing green all around?

Wait a moment. Look at INR. Indian policymakers are once again saying this that the level of INR does not matter. They have been saying so for the last N years. The level of INR matters. If we as an economy need to have savings and future spending power, the level of INR should matter. The massive depreciation in the INR has eroded the savings of Indians. Such erosion has already bitten a chunk off future purchasing power. For the wealthy Indians, it may matter less. This INR erosion (It is no longer just deprecation) *hits* the middle class Indian and the poor Indian severely. Of course, the policymakers are in an unenviable position. There is no way the INR can be propped up structurally and thus, they are stating a fact when they say that INR will find its level.

The problem is this. There is FDI outflow in recent months apart from incessant FPI selling. In 2025, the INR tanked against USD when most EM currencies fell against EUR and rose against INR.



	% of Offer for Sale in NSE Mainboard IPO
FY22	64
FY23	73
FY24	53
FY25	65
8MFY26	59

Source: NSE, Reserve bank of India, Spark Fund Research

Note that most of the capital raising in IPOs has happened through OFS. A good chunk of this is selling by PE funds and other strategic investors who are decamping with the proceeds converted to USD. What is changing is that the INR depreciation is now moving away from coffee table discussions in media newsrooms where dream merchants from the equity/fund fraternity do storytelling. A former RBI Governor and a former SEBI member have flagged off the overvaluation in equities as a concern for forex stability. There is a clear risk that in 2026, the government and policymaking will be compelled to move away from their uninhibited love for Indian equities. Macro is not so good to continue with indulgences of that kind.

Takeaway 4 – A cautious stance is a false equivalence to fears over a bear market

One lesson of the last eighteen months is that it is futile to keep calculating the odds for a bear market. There are definitional issues with this to begin with. In the current context, only a catastrophe of great proportions can create a bear market as defined by a 20% or more fall in the leading index (Nifty 50). The ability to assign a probability to this is almost non-existent. It is therefore advisable to scout for opportunities when there is some level of chaos. A cautious stance can and needs to co-exist with sensible and calibrated equity allocation.

In a nutshell……………

1. Investors should pay attention to allocation - allocation does not mean just the diversification into somewhat difficult assets like Gold/Silver/Foreign equities. Or to bonds alone. It could also mean whether allocation is addressing sensible investing in equities.
2. If idle cash generates only about 6% pre-tax returns and tax is high, these should not be major factors to bother with. This cash could be a strategic tool for taking advantage of equity market volatility. In our view, there will be shocks along the way.
3. While market returns may trend down (which is our long-term call), there is merit in remaining invested in good quality stocks as timing can only work to some extent.

We foresee opportunities for alpha generation emerge in the coming year. In that sense, a more constructive stance on equities is warranted in 2026. Risk-adjusted returns will assume much greater significance.

The last eighteen months has been a humbling experience overall. We were able to read the tea leaves and our cautious and contrarian calls were certainly relevant. However, at the portfolio level, it was not an easy time to translate this understanding to outcomes that made a real difference. It is this value add that we will be working towards in the coming times even as unbiased analysis needs to underpin any robust investment process.

Warm regards,

P Krishnan (CIO) and Team Spark Fund