BLESSING IN DISGUISE

Recent global developments could very well strengthen the case for India to be an interesting investment destination over the next decade. Here is a quick take on the global backdrop as it has been unfolding.

1. Global interest rates have been volatile with an upward bias. They are above the point where easy money can be considered an enabler for markets. If rates ease, that will only be due to recession fears. There is elevated risk of inflation and interest rates cannot be held down.
2. US is in the process of overhauling the terms of engagement with the rest of the world. This is not a mere generational change. This is a centennial event. Amidst the theatrics, this fact should not be lost sight of. Consequences will be serious and far-reaching.
3. Europe is being forced to come out of a stupor. While it is too early to build possible scenarios, European capital may be seeing some shift towards hard assets. This along with the trade shock underway will have notable implications.

We need to take stock of the long-term journey of India after 1991 to put the situation for India in context.

1. India has always been a difficult place to do business. Cost of capital has always been a challenge for Indian companies.
2. Indian companies have done their best when the going got tough. If cost of capital goes up globally, Indian companies who have their focus on ROCE will find that familiar. The exception to this are the so-called new age businesses who made it a business practice to burn capital that appeared to flow in free of cost.
3. India had licenses for every conceivable item and activity before 1991. It benefitted none other than vested interests in business, bureaucracy and politics. 1991 caused a big disruption. Indian growth picked up. Consumer India was born. Markets bloomed and flourished.
4. India had a lending system that was controlled by a central command all the way into the mid-nineties. The Central Bank (in effect the Federal government) fixed what savers earned, what interest rates lenders paid, which industries got credit flow and what was beneficial for whom. Once this was freed up, the financial sector boomed.
5. Mr. Trump is absolutely on solid facts when he says Indian tariffs are amongst the highest in the world. The irony is that we are left wondering who it is meant to benefit. The competitive part of the Indian industry will not be impacted much if tariff walls are demolished. Should Tesla import cars from the US or if American Whiskey is available to Indians who have the craving and the means, Indian industry may not lose much sleep.

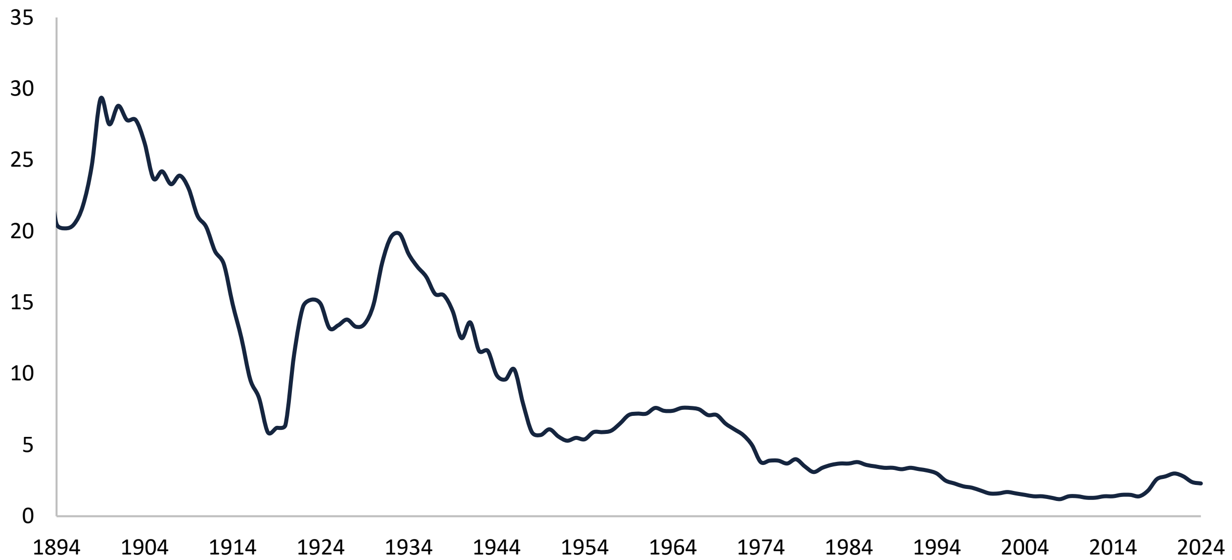
Protectionism has gone on too far and for too long. In fact, Mr. Trump may be doing India a favour by forcibly dismantling this regime. There is of course a catch. This could be very disruptive in the short run. Businesses that are truly competitive will benefit in the medium to long run. We see a big opportunity hidden in the current crisis. Market forces may accelerate reforms which have been forced into hibernation.

The shelf life of the argument that a developing nation like India can get away with high tariffs has run out. Not because we are becoming rich. The developed nations are facing indebtedness. Their societies are facing a crisis. India needs to find smarter ways of dealing with tariff negotiations.

Now, let us put down some facts to illustrate why bringing down barriers to trade is good for India even if that is being done at gunpoint.

US has really been the most open economy in the world

Much as Mr. Trump is not liked by many by now, he is right when he claims the US is the most open (large) market in the world.



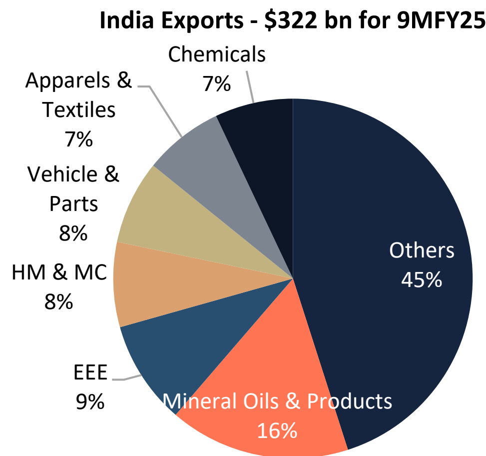
Source: U.S. International Trade Commission, Spark Fund Research.

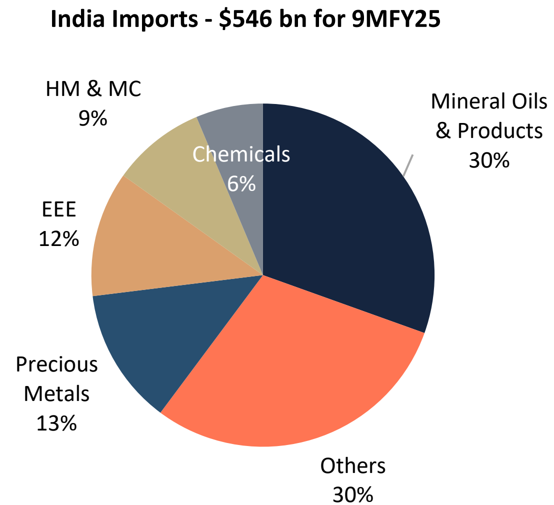
For over 75 years, US tariffs have been well below 10% and for over 50 years, below 5%. The new US administration is altering the terms of trade that governed US engagement with the rest of the world in a fundamental way. It is disruptive. Many experts believe the US may get hurt. Be that as it may. Mr. Trump's camp believes no one did anything to lower the mounting US debt and triple deficits. Whatever the merits of that debate, the US President has enormous powers, and he believes he has the mandate. The actions of the last two months clearly demonstrate a shift in US policy that is now decidedly inward-looking.

Conclusion – It is highly unlikely that the new administration will backtrack on the direction it is taking. The pace may slacken based on the pain this is causing. Countries like India will need to adapt.

India's external trade reflects certain realities

1. India runs a large trade deficit which is structural.
2. Oil and certain sticky items constitute the problem area in imports.
3. Exports are below potential. Part of the problem there is a protectionist mindset.
4. The cost of open borders on capital is that it cannot be semi-open. The notion that India is too attractive to miss should change. India is attractive if it is welcoming. We are a poor country that needs capital. We need to do better than others to attract that capital. Now is the moment to seize the opportunity, even if change is being forced on India.

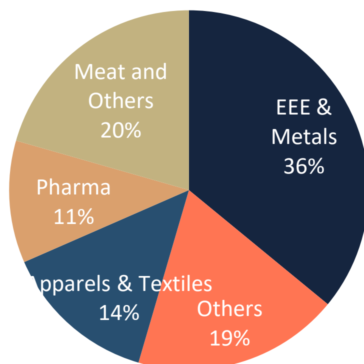


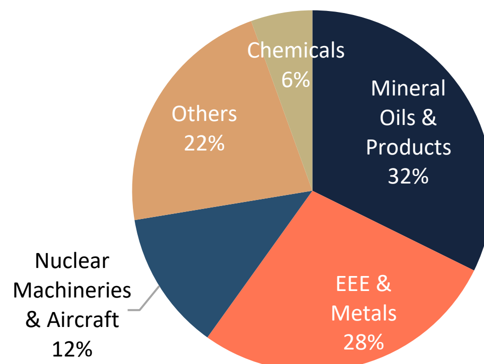


Note: EEE- Electrical Equipment & Components and Electronics, HM & MC- Heavy Machinery and Mechanical Components.

Source: Department of Commerce- MoCI, Spark Fund Research.

Indian export basket for merchandise is fairly diversified. Where we have exports, we are competitive. Indian businesses had to combat high cost of capital, poor infrastructure, a difficult bureaucracy, corruption and high taxes to compete in global markets.





Note: EEE & Metals- Electrical and Electronic Equipment with precious and non-precious metals.

Source: Department of Commerce- MoCI, Spark Fund Research

India runs a trade surplus with the US, even without considering about USD 100 bn+ of IT services exports. If tariffs are lowered on areas such as nuclear machines & aircraft, India will feel no impact. In pharma, Indian exports at over USD 11 bn are over 20 times imports at USD 0.5 bn. Imports are in life-saving drugs and India imposes a 10% duty. There is no need to have this import duty when the US has zero duty on Indian pharma exports. In agriculture, there could be a political backlash if duties are lowered. But it could be a watershed moment for the sector if tariffs are brought down and the shackles are removed. In an economic sense, India is not a loser if tariffs are brought down across the board. The unwillingness to let go of control seems to be the bigger challenge rather than the risk of lowering tariffs.

Indian consumers don't need government handholding for determining value

Indian consumers got a whole lot of choice after 1991 when licensing was junked. Indian savers got better value for their savings after its financial sector was liberalised. Indians are value conscious and will not splurge merely due to cheaper imported stuff due to lower tariffs.

Indian corporates have boomed after controls were dismantled

Look at the number of companies that sprang up with scale over the last three decades after liberalisation. The data is clear. Growth will accelerate if controls are removed.

Year	Companies: MCap > Rs.10k Crores & PAT > Rs.1000 Crores	Companies: MCap > Rs.10k Crores
FY95	1	2
FY00	5	11
FY05	22	28
FY10	53	87
FY15	74	137
FY20	86	166
FY25*	207	483

*Note: *Profits are calculated on TTM basis till Dec 2024 quarter.*
Source: Ace Equity, Spark Fund Research

India has a tiny share in the overall current account deficit of the US. Having said that, India is anyway caught in the crossfire over tariffs. The real challenge for India will emanate from the secondary impact of any slowdown in global growth. Any "concession "that India makes to pacify the US my not hurt Indian listed companies.

Where is the catch

1. There could be short-term disruption in the economy, businesses and markets.
2. For the economy, balance-of-payments will be an issue if tariff disruptions kick in and global growth slows.
3. Some businesses may find it tough. For others, margins can come down initially. The better managed companies may eventually get over this.
4. The pressure will not end with tariffs. The US will want access to India's financial sector (banking, insurance) and other areas. The time is not far when it may use IT services exports as a negotiating tool. It is open season and expect the unexpected.
5. A lower global growth in 2025 will affect IT services. This could have a cascading impact on domestic consumption growth as well.
6. The recovery from the midcycle correction may get pushed back. High frequency data on retail/auto sales and other indicators point to a continuation of weakness for now.

Most of these are global problems. In many ways, India is better positioned than most of the world. Many domestic oriented businesses, including financials and infrastructure names, are relatively unaffected. Indian market has a high proportion of such businesses.

Where does that leave the markets?

Markets have corrected steeply and may have factored the above at least in part. The big problem for the market is the never-ending one-sided chant from the bull brigade. This chant believes that buying regularly and, on all dips, will create investor wealth. This does not work when large segments of the market are simply un-investible based on valuations, liquidity and overall risk assessment. We have repeatedly pointed out that there are pockets in Indian market which are grossly over-valued. Small/midcap space is a clear case in point. As at the end of March, the median trailing 12-month PE of the NSE Small Cap 50 Index constituents (ex-loss-making names) stands at 45x (Source: Ace Equity,

Spark Fund Research). These stocks tend to rally whenever there is some relief from bad news. The notion that one man's over-valuation is another man's value pick is not tenable anymore. By and large, there is insufficient earnings growth here to justify this over-valuation. We are not in a global backdrop where momentum and money can bail out the bulls. There are many such pockets in the Indian market and that is one of the challenges in 2025.
We are in some ways getting into a phase similar to the late 1990s when the tail risk from reforms and global headwinds caused a lot of dislocation. This eventually led to a change in leadership in the market but set the base for a strong uptrend. Such shakeouts invariably take a toll. Given smoother flow of information and capital, the period of transition could be shorter this time around. We need to watch this space closely.

Reality is Creeping up – Trend returns are coming down adjusted for Covid

NIFTY 50 TRI Returns (%)	
FY25	**6.7**
FY24	**30.1**
FY23	**0.6**
3Y	**11.8**
5Y	23.7
6Y	13.8
10Y	12.1
15Y	11.9

Note: 3Y, 5Y, 6Y, 10Y,15Y Return calculated as on March 28, 2025. Returns greater than 1Yr are annualized.
Source: Ace Equity, Spark Fund Research.

Expect more volatility in returns with a downward bias. We are in a macro-driven market with many unknowns. Stock-picking cannot help when macro-risks are so dominant. Issues in unsecured lending, tariff challenges, slowdown from urban or rural stress, lack of adequate growth in end markets and slower government capex are macro issues. When momentum generated returns in names that benefited when these headwinds were absent, that was touted as smart stock-picking. It was never really about stock picking. Liquidity and momentum were at work. Momentum is unlikely to be back anytime soon.

In our assessment, headline returns will continue to be challenged. We need to be grounded in our expectations as much as we are optimistic. Between risk and returns, the role of risk has never been more important in equity markets.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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