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India – A breather, not a breakdown

Mugunthan Siva, CIO
INDIA AVENUE INVESTMENT MANAGEMENT
+61 466 24 701

Despite India's robust macroeconomic trajectory, anchored by resilient GDP growth, strong domestic demand, and rising global relevance, its equity market performance over the past 12 months has been underwhelming.

Short-term softness reflects valuation resets, earnings moderation, and global risk aversion, not structural weakness. Over a five-year horizon, India remains the top-performing equity market globally, delivering 18% annualised returns in USD terms, and maintaining leadership even in AUD terms.

AUD-based returns (as of end 29.08.2025)	1 Year	3 Years p.a.	5 Years p.a.
MSCI India	**-8.5%**	**9.4%**	**15.9%**
MSCI World	19.9%	20.3%	15.7%
MSCI Australia	12.4%	13.1%	12.6%
MSCI EM	21.1%	12.5%	7.8%
MSCI China	53.0%	11.6%	0.4%

Source: MSCI

Over the past five years, India has delivered stellar equity returns, prompting many global investors to treat it as a distinct subset within the equity asset class. Yet, the last 12 months have been startlingly weak, raising questions despite the strength of India's macroeconomic fundamentals.

Valuation Reset

- India's forward P/E peaked at 25x in September 2024, fuelled by US$5bn/month in domestic liquidity
- This followed 20% annualised earnings growth from FY20–FY24, as India rebounded strongly post-COVID

Softer Earnings

- FY25 profit growth normalized to ~11%, closer to long-term averages
- IT services and FMCG posted muted results amid margin pressure and global demand softness
- Exporters faced headwinds from weak global trade and pricing pressures

Trade Wars & Geopolitics

- US tariffs disrupted global supply chains, complicating India's export ambitions
- India's goal of US$1 trillion in merchandise exports by FY30 (15% CAGR) faces compliance and logistics hurdles

Currency Volatility

- The AUD appreciated from ₹56 to ₹58, eroding unhedged returns by ~4% over the past year
- Currency drag has masked underlying performance for Australian investors

India Avenue Equity Fund

Over the past 12 months, our Fund has underperformed its benchmark by 2.4%, after accounting for management fees and Indian capital gains taxes. This short-term softness reflects broader market dynamics, including valuation resets, softer earnings, and negative sentiment.

1 year	3 years p.a.	5 years p.a.
-10.89%	10.42%	17.34

The underperformance has been driven by:

- Overweight positions in export-oriented sectors like IT Services and Pharmaceuticals were impacted by US tariff uncertainty, which disrupted global supply chains and dampened sentiment.
- The market rotated toward Finance, Consumption, and local demand-driven sectors, where we remained underweight due to valuation discipline.
- Our small-cap overweight, a segment with superior earnings growth, underperformed relative to the Nifty 50, driven by valuation compression and liquidity dynamics from local investor flows.
- Our underweight to Banks, which comprises ~30% of the benchmark, and to Metals and Infrastructure, reflected our caution around cyclicality and stretched valuations.

Periods of underperformance have historically coincided with:

- **2018–2019**: Overvaluation and slowing macro
- **2022**: Inflation and rate hikes
- **2025**: Tariff-driven recalibration of earnings expectations

Yet in each case, our long-term discipline and thematic conviction have delivered net outperformance over 3 and 5 years.

What have we done?

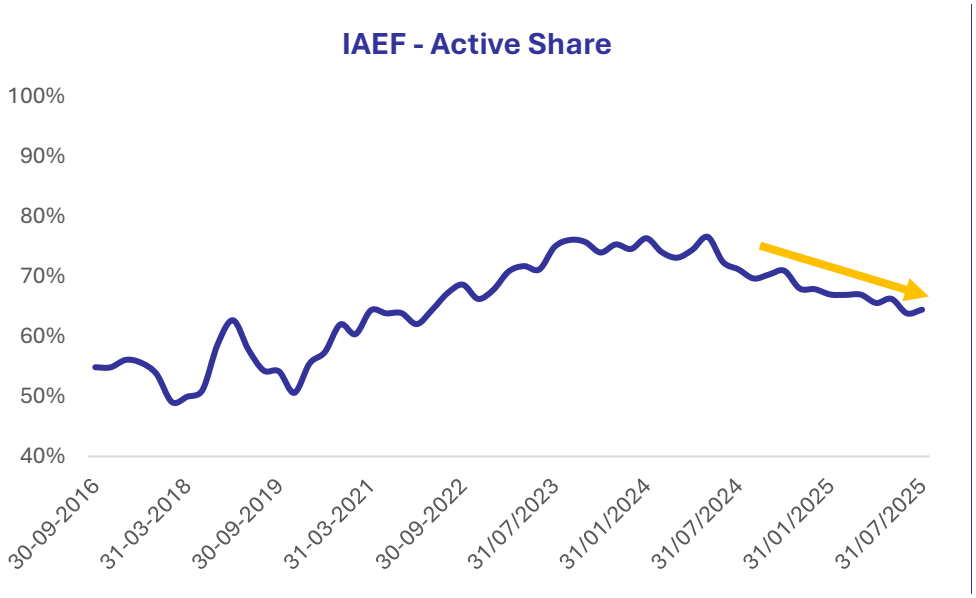
Over the last 12 months, we observed a shift in the market environment that appeared less conducive to our investment process, particularly one that favours high-conviction, bottom-up stock selection in small and mid-cap segments.

In response, we made a deliberate decision to reduce our active share by increasing exposure to large-cap stocks, aligning more closely with benchmark composition while maintaining our core investment principles.

This tactical adjustment was driven by:

- Elevated macro uncertainty, including tariff risks and global trade disruptions
- Valuation compression in small caps despite strong earnings momentum
- Rotation into benchmark-heavy sectors like banks and consumption, where we've historically been underweight due to valuation discipline

We remain conviction-led but adjust our positioning when market dynamics warrant it.

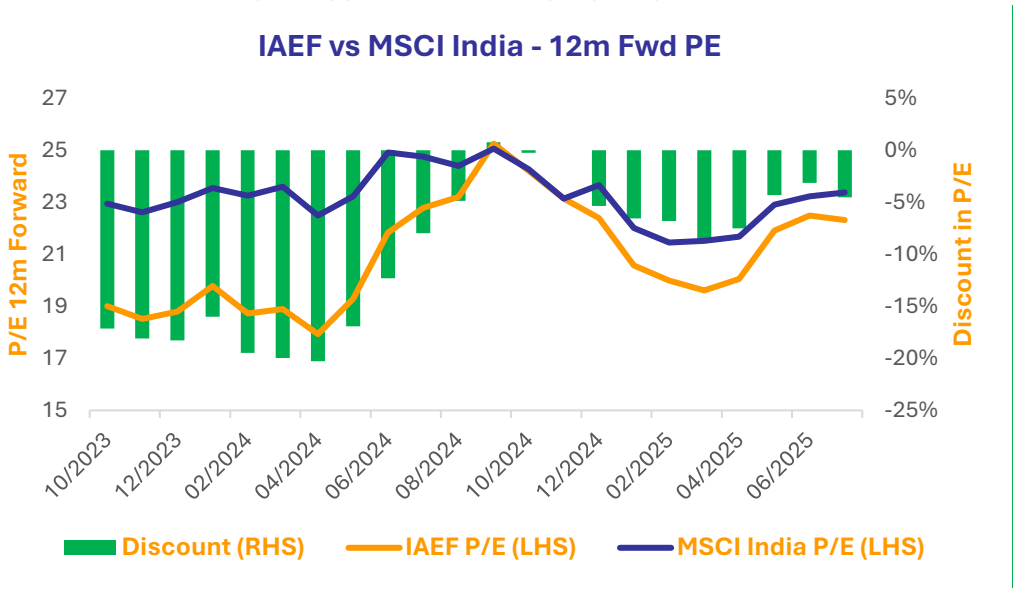


Source: Foresight Analytics

Our investment philosophy is rooted in identifying **growth companies at sensible valuations**, particularly **lower down the cap curve**. This approach allows us to uncover businesses:

- Growing faster than the broader market
- Trading at more attractive valuations
- Often overlooked by benchmark-heavy strategies

By September 2024, that edge had temporarily narrowed. Stocks across the cap spectrum, whether cyclical or structural, were trading at elevated valuations. Our fund's typical discount to benchmark P/E had effectively disappeared, driven by liquidity and sentiment.



Source: Foresight Analytics

The "discount" P/E our fund typically operates with is now more attractive than it was 12 months ago. This creates fertile ground for rebuilding high-conviction exposure in companies with strong earnings momentum and long-term potential.

Outlook

Over the past six months, India's macroeconomy has not stood still—it's quietly accelerated. While equity markets have paused, the underlying economic engine continues to fire on multiple cylinders.

Macro Resilience

- Composite PMI at 63.2: A 17-year high, with services seeing the fastest new order growth since 2010 and solid employment gains
- Interest Rate Cuts: RBI has delivered 100bps of easing (6.50% → 5.50%), with scope for more if real growth moderates from 7.8% YoY in Q2 FY26
- Inflation Control: CPI dropped to 1.6% in July 2025, offering policy flexibility and boosting real incomes

Policy Tailwinds

- Union Budget FY26: Income tax relief for lower brackets and GST rationalisation across key categories
- Capex Surge: Central government capital expenditure up 33% YoY in the first four months of FY26, with state-level pickup expected
- Southwest Monsoon: At 105% of LPA, supporting rural wealth and easing food inflation
- FTA Momentum: UK deal signed, with more in the pipeline, accelerating India's pivot from US-centric trade

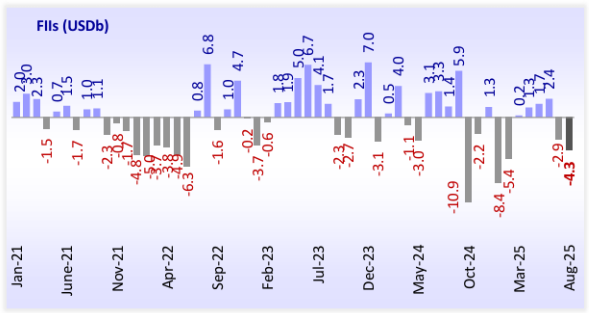
Strategic Portfolio Positioning

- Domestic Demand: Liquidity injections and policy support should drive a Q4CY25 consumption rebound → Our Fund has increased exposure to financials and consumption stocks to capture this inflection
- Export Valuations: Tariff uncertainty has reset valuations in IT Services and Pharmaceuticals, creating asymmetric upside → We remain overweight in these sectors, anticipating a more favourable trade environment

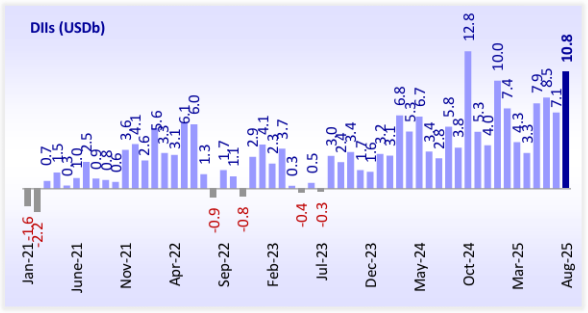
FII Sentiment & the Return Path

- FIIs have rotated out of India toward China, Korea, Taiwan, and broader Ems
- Yet India's macro strength and earnings resilience remain unmatched → We expect FIIs to re-engage, reinforcing the structural story already embraced by local investors

FIIs record equity outflows for the second consecutive month in Aug'25



DIIs' monthly equity flows continue to be robust



Source: Motilal Oswal, Bulls & Bears August 2025

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