



A clear derating

Markets risk underperformance if we don't regain our growth credentials

If we look at data from January 1, 2025, to the end of February 2026, 14 months of heightened global volatility, we see some interesting trends. This period is before the Iran war and thus not affected by recent developments. Looking at exchange-traded funds as the barometer of individual market returns, we see that this has been a time of strong financial returns. Emerging market (EM) equities were up 51.4 per cent, international equities were up by 47 per cent, the United States rose by 18.4 per cent, and total world equity returns were 28.3 per cent.

In contrast, over this same 14 months period, India was down 0.7 per cent, the second-worst performing market in the world, with only Saudi Arabia performing worse. In fact, India and Saudi Arabia are the only two markets that are actually down (all returns in US dollar). This is when Korea has tripled, Brazil is up 80 per cent, and Taiwan has risen by more than 50 per cent.

We have underperformed the EM benchmark by 5,000 basis points in just 14 months. Being overweight India has been a career finishing move! In this context, one can understand why nearly every foreign fund is currently underweight the country.

Absolute foreign ownership of the Indian market is at a 15-year low, and we see foreign portfolio investors (FPIs) selling on a daily basis. India has received zero net foreign flows over the last five years, a very long time indeed. What are some lessons from this period of unprecedented Indian underperformance?

First of all, there was, to my mind, a sense of complacency among policymakers. Our markets had done very well, and many other large EM countries were seen as uninvestable. We are the fastest-growing economy in the world — where else will FPIs go? This was

the narrative. This myth has been debunked. If they wish, FPIs can totally ignore us. Five years of net zero flows. There are always choices for capital, and capital only chases potential returns. If we do not offer a good risk/return proposition, nobody will come.

In the above context, do we really need to further lower prospective returns by being the only large market in the world to impose capital gains taxes on foreign investors? Is the incremental tax revenue worth the loss of absolute capital flows?

There is also a clear derating underway for India. Valuation multiples are compressing. Multiples reflect investor confidence in growth rates and the duration of growth. Falling multiples imply less confidence in both. We are in the midst of what I call growth purgatory. We are transitioning from a growth multiple towards value. The investor base will also churn away from growth investors to value specialists. The transition period is the valley of death, as growth investors keep selling and the market drifts till it becomes cheap enough for the value folks to get attracted.

Given that India began this journey as the most expensive market in the world, we have a long way to go before we can be considered cheap and show up on value screens. The market will keep underperforming till the transition to a value multiple is complete. This can take years. Rather than wait for the market to become cheap, the better way to get out of this trap is to regain our growth credentials and, hence, the growth multiple.

India has derated as our growth slowed, earnings stalled and a narrative gained ground that we cannot innovate or manufacture. Just as we slowed to single-

digit growth, markets like Korea saw earnings jump by 100 per cent.

We are seen as being behind in all the new technologies, be it electric vehicles (EVs), renewables, artificial intelligence (AI), or automation. AI is seen as undercutting our biggest edge, namely cheap, high-quality white-collar talent. Many feel that India will get caught in the middle-income trap.

We need to accelerate and give more confidence that our growth is sustainable. How do we deliver 7-8 per cent gross domestic product growth in the world of AI and trade barriers? Are we doing enough to fundamentally improve our productivity and competitiveness? We also need to highlight the work being done in India on newer technologies and how we can compete. It is not true that we cannot innovate — and we need to change this narrative.

As the AI trade moves on from semiconductors, data centres and electrification towards real-world applications and the services needed to propagate the new technology, this should also help India. As the market focuses attention on the return on investment of AI investments, our strengths will become more evident.

India has this ability to generate numerous long-term compounders, across industries, which is almost unique in the EM world. This has to come back into focus. Our growth is secular and predictable. The AI trade has supercharged growth across the EM world, but this is front-loaded and cyclical. Shareholder value is created through economic growth, entrepreneurial energy and disciplined capital allocation. India is a rare market with all three.

The other clear takeaway is the dependence of our markets on domestic flows. They have kept us afloat. Investors have made no money for almost two years now. We have to hope they remain patient and flows maintain their momentum. There can be no policy changes that may put these flows at risk.

At a time of no foreign flows, stagnating domestic flows and no returns, the initial public offering (IPO) markets have been incredibly robust. IPOs have raised nearly \$43 billion over the last two years, with additional \$100 billion raised through block sales and placements. This issuance and placements have sucked up all the new flows, reinforcing the lack of interest in the secondary markets. The flow of IPOs and placements has to slow down for the markets to deliver strong returns.

My own sense is that investors are already turning cautious and selective on these new issuances. Many of the proposed new issuances will not happen, and definitely not at the prices the sellers or bankers wish to see. Companies will have to be more flexible and realistic on valuations, or risk not being able to launch the issue at all.

India is a bit in the doghouse at the moment. There is record underperformance and under-ownership. Some of this is cyclical and will turn on its own. However, we also need to regain our growth credentials. For this, both the government and companies have a role to play, as do investors. We are sometimes our own harshest critic. I think our supposed lack of innovation and inability to compete are exaggerated, a narrative partly fed by investors themselves. I continue to believe that we will regain our growth momentum and will not be consigned to a value multiple. If I am right, then the coming months will prove to be a good time to invest. If I am wrong, then we have much more underperformance ahead of us.

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