



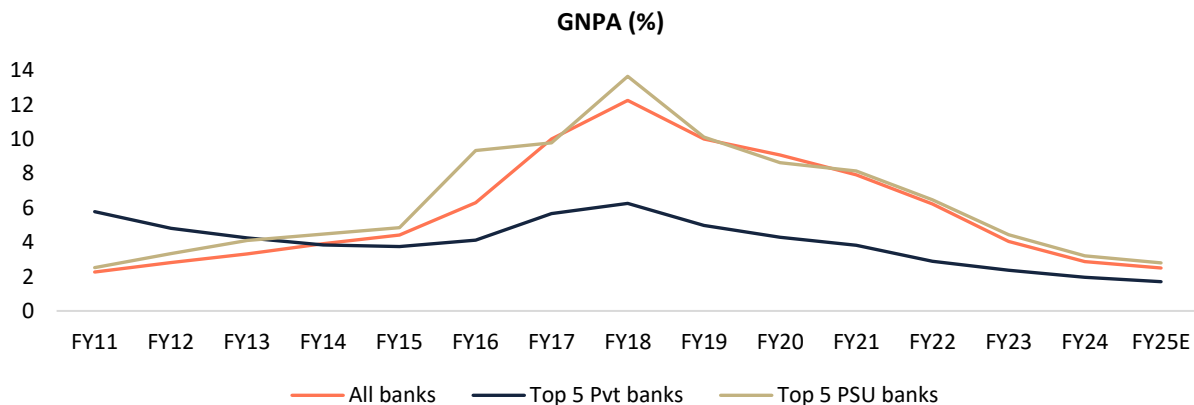
## TIME TO LOOK FOR GREEN SHOOTS

As we get into the new year, we see some clear positives for the Indian market, amidst the extremely cautious note we have been sounding for many months now. If you look at the returns so far for the current financial year, our stance is getting vindicated. We have been following the data and the logic from the same. We have avoided being an ostrich in the sand whose sole mission is to slice the data in a convenient way and conclude that Indian market looks good come what may.

Having said that, here are the clear positives as we wade into 2025.

### Banking system is in good shape

Look at NPAs, capital position, technology, or the quality of regulatory action. India scores high.



Note: Top 5 banks based on advances as on Sept 30, 2024.

Source: Reserve Bank of India, Ace Equity, Spark Fund Research

Why does this matter?

1. For the economic cycle to continue, credit conditions have to stay healthy. Strong bank balance sheets are an integral part of the required mix. India is in a good place on this now.
2. Most of the crisis situations we have seen over the last few decades – Japan in 1990, Asian crisis of 1997, GFC of 2007 – have all come from credit booms and busts. We are a fair distance away from one.
3. The probability of this mid-cycle correction ending well, and growth resuming will be linked to the ability of the central bank and the government to take counter-cyclical action. A robust banking system gives a lot of leeway to the policymakers, unlike in 2013-2019.
4. Technology adoption by Indian banks has been a standout achievement. This is a booster for productivity and for the economic cycle to resume its journey once the correction runs its course.
5. Indian banking regulator has done an exemplary job in recent years. This is a silent enabler of the possibility of a sustainable bull market in India and indeed a sustainable economy.

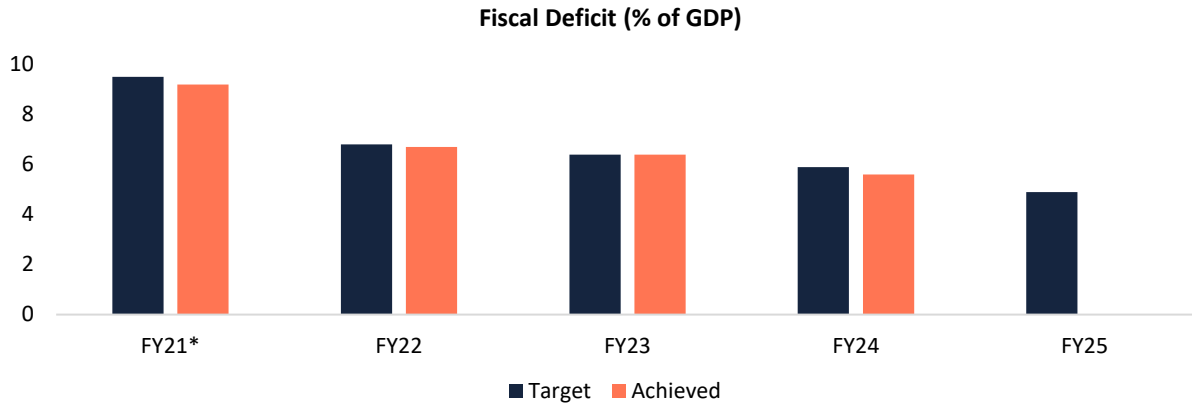
### Leverage is manageable

This was not the situation around 2013. At that time, certain corporate groups with quarterly run rate of EBITDA under Rs 1000 crores (which itself had some questionable accounting) had consolidated debt running into tens of thousands of crores and counting. There were external commercial borrowings and off-balance sheet structures which further under-stated leverage in that era. Projects were stuck in court or investigations. The banking system leverage actually was the mirror image of all the problems that India Inc faced then. The situation is far better now. Even in the case of leveraged groups facing scrutiny, the cash flow from operating entities is a point of comfort. Retail leverage is a touch of bother, but regulatory action has been swift, proactive and decisive so far.



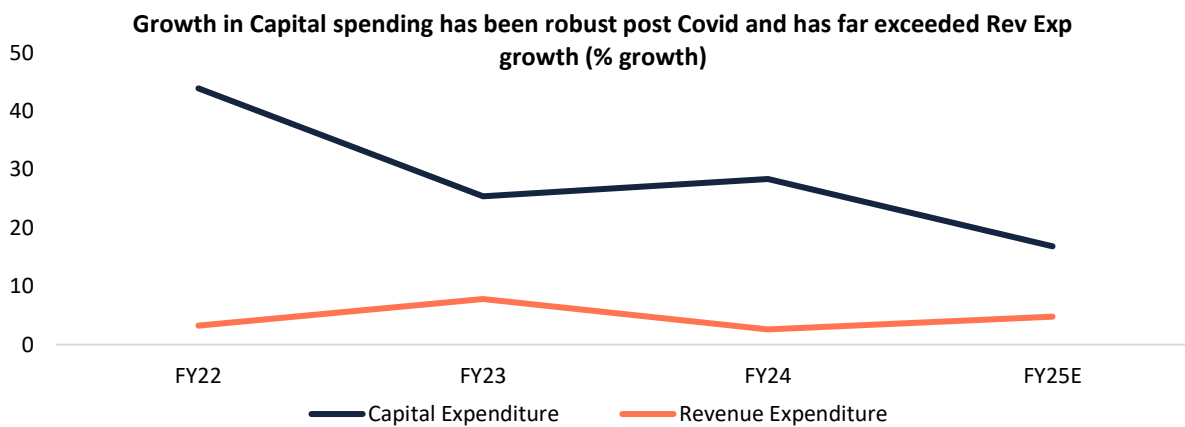
### Fiscal prudence has been commendable

In the post-Covid era, India did not deploy helicopter money in a big way. While absolute numbers on the fiscal side have long been discarded by all countries (and the world as a whole will likely pay a price for the same), India has done well.



Note: \*Revised target for FY21(Considering Covid Impact).  
Source: Ministry of Finance, Spark Fund Research

The quality of spending by the federal government in India has also been excellent so far.

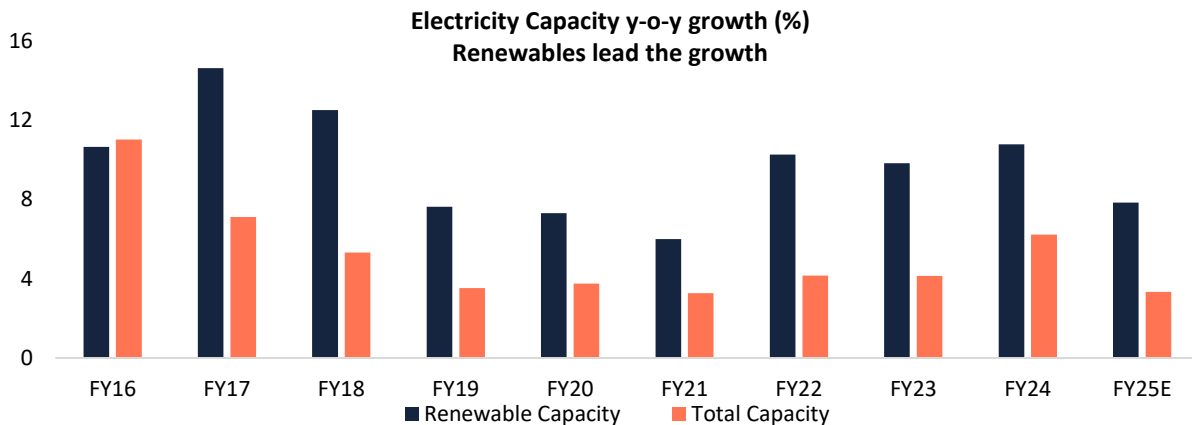


Source: Ministry of Finance, Spark Fund Research

This has no doubt resulted in a K-shaped recovery. The competitive race to the bottom in all states to give freebies and win votes is setting the stage for big trouble. But that is a different debate. The fiscal restraint by the federal government means that the economic cycle has miles to go. However, one cannot banish the downtrend in a huff by talking up the economy. It could take time and effort.

### New growth drivers are reaching a meaningful scale

Investments into renewable energy, contract manufacturing (PLI) and the rapid adoption of technology (e.g.- quick commerce, fintech) are all scaling up and are possibly beyond the tipping point. These are likely to create a similar ripple effect as the one when IT services took off around and after Y2K. This will result in employment generation though the employment problems of all Indians cannot be solved by any one or a combination of these developments. That problem will remain and exert a drag. In part, the cyclical slowdown reflects the aftermath of uneven recovery, and the freebie culture is the consequence of the socio-political pressure from the same.



Source: Niti Aayog, Spark Fund Research

### Virtuous cycle in pockets with riders attached

The upward stroke in the K is rocking in many ways. Pockets of discretionary spending are showing robust traction. This includes the rebound in travel & leisure, healthcare spending in certain segments, boom in savings and activity through capital markets and buoyancy in pockets of real estate. This list is bigger. Following caveats are in order

1. The consumer spending overall is clearly two-faced and the outlook for the anaemic areas is not good. The perennial rolling optimism has no basis.
2. The growth is clearly lopsided and is already revealing the cracks that will emerge in a democratic polity and diverse society. These cracks will widen and cause issues.

For the market though, this has given opportunities to harvest, and the bulls have done this in style. They may have gone overboard but that is the nature of the beast.

### What does the above mean for the market in 2025?

The above means that we are likely to find sustainable supports in the market once certain realities are priced in. The import of the confluence of positives is that the economy should make a comeback, possibly in the latter part of 2025. Earnings should also come back though the sectoral/segmental leadership can pose a serious threat to the old order. Some stocks/segments which were deified for years due to high ROCE/ROE and admittedly good execution are coming under the hammer. They may crash or go sideways for long. Many mid/small caps also need to fall a lot. Pockets of the market are in a bubble and are being held up by liquidity alone. While the argument is that there are new methods of looking at valuations, we have seen this scene play out in India and abroad many times. The IPO frenzy and the chorus over how losses have to be viewed leniently and the jargon surrounding this is nothing new. We saw it in 1990s. The only difference was that the market was smaller and there were fewer cheerleaders. There was no internet and social media then which transmit the signals fast and create a larger-than-life image to these propositions. In the end, there is no way financial assets can be propped up without solid underlying profits/cash flows supporting these. In addition, there is a price for a certain level of profit.

More to the point, the 14% CAGR Nifty return in the last five years is well above trend and cannot form the basis for setting expectations. The ongoing correction holds out the promise to perform the Dharma of free markets – which is to purge excesses from time to time. If it manages to do this, we could get into a better base for the market to stand on.

Which brings us to this crucial question.

### Where does the market stand at present

The market is beginning to wind down the excesses. However, there is huge resistance from the ecosystem of those who drive the narrative. Commercial interests may dictate that they are averse to any downward re-set-in equity markets. That said, the underlying asset-weighted action in the market is concerning. Sellers are large holders such as promoters (blocks), companies through issuances (QIPs) and private equity (through IPO). Buyers are retail through mutual funds. Or pockets of HNIs who believe



they can risk a part of the extraordinary returns they have earned recently. Market volumes are misleadingly inflated due to the nature of activity. The spin doctors are the intermediaries who benefit from this party going late into the night. The narrative comes from admittedly brilliant minds who are paid to spin this to perfection and comfort all participants that everything is going to be all-right. The fuel is greed. This is a very risky backdrop prone to asymmetric outcomes.

The above backdrop may cause more pain in some segments at the least. Everything is not going to be all-right for everyone. The asymmetric positioning can produce even more volatility this year than we saw in 2024. This cannot detract from the fact that the underlying growth in India will resume. 2025 should set the stage for the next phase of the growth cycle in India. While any illogical surge in the market could eventually be a source of bigger downside risk, we can see the seeds of optimism sprout from the rugged terrain in front of us.

**Warm regards,**

**P Krishnan (CIO) and Team Spark Fund**

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