New High – Low momentum

The market touched a new all-time high after a gap of about 15 months. It is fair to say that the celebrations have been muted as against past instances of such milestones. Optimists view this as a positive. If there is no celebration, there is no euphoria and hence the market is on sound footing and so goes the argument. Pessimists point to persistent FPI selling, lack of broad-based participation as evidenced by many sectors and stocks trading way below their highs and uncertain global outlook. The reality is that the market has compounded at just 10.1% since the end of FY24. This number will read as much lower if you reckon the last 18 months since the new government took office. Trend returns are curving down, and this has been a central message in our newsletters over the last eighteen months. There are headwinds and the market is not finding it easy.

The cognitive dissonance faced by the market is not surprising. The market is throwing up conflicting signals. The economy is doing well. The Q2 GDP data confirms that though the optics around the low deflator need to be kept in mind. Nevertheless, this was a good print, and this is in spite of the economic projectiles that the US has hurled at us for no good reason. We believe that the midcycle adjustment in the economy has run its course. Growth should remain robust. While all is not flashing green, macro is mostly in a good place and leverage is low. So is inflation. India looks good overall. But the market and economy need not be at the same stage in their respective cycles. Earnings growth, which ought to be central to the market, is facing headwinds. It is tepid. And some part of the earnings slowdown is structural with no easy remediation. But who cares? And therein lies the root of the dissonance.

Hard data shows that behavioural factors control the price discovery in today's market to an extent completely unprecedented. It is a truism to state that prices will finally be a function of supply and demand. That is obvious. The forces driving supply and demand have undergone a major metamorphosis in recent years. Earlier on, demand for equities was broadly based on earnings (net earnings, cash earnings, earnings before what you pay for cost of capital & taxes – in short, some kind of earnings). The multiple on this was referenced in some manner to the yield on sovereign bonds (risk-free rate). It was not always the case that the multiple to earnings had a direct correlation with bond yield. However, there was some sort of anchoring bias towards this. For example, if bond yields were at say 8% and equity earnings yield was 6% (Implying a market PE of about 16, however imperfect the concept of a market multiple might be), it was conceivable that the growth in earnings will make equities attractive based on assessment of the probability of such growth. Individual stocks traded at 20-30 times earnings because the earnings growth was estimated at a level meaningfully above nominal GDP growth. Supply came into play as well. For multinational companies where supply of stock was restricted (they would not dilute) and return on equity/capital was much higher than cost of capital, the market bestowed premium valuations. Hence, we started to see multiples above 30 and going higher. After all, everyone wanted a piece of India growth story and why not pay up to get quality. Premium valuations for India were born and assiduously built up by a combination of good quality businesses with stringent capital discipline, presence of role models in good governance, some non-linear growth stories of the time (e.g.- IT services) and above all a powerful narrative fuelled by some great storytelling. Indian stocks benefitted from bad examples like South Korea (a landmine for minority investors as far as governance went). China followed policies which were considered unfriendly for minority shareholders (preponderance of government owned companies, banks which were opaque with numbers, a financial system which acted as the extended arm of state policy etc) and hence India's emerging market premium kept expanding. India delivered superior returns as a market though China did way better as an economy. The outcomes would be even more skewed if you were to remove the strong performance of the Chinese market in the last one year.

Index	20Yr CAGR (%)
NIFTY 50	12.1
Shanghai Composite	6.5

Note: Return as on 28-11-2025.

Source: Bloomberg, Spark Fund Research

This is the backdrop against which Indian corporates have been raising capital from foreign investors and the secondary markets have been attracting foreign flows. Indian start-ups followed suit and have broadly followed the Silicon Valley form of capitalism including a liberal use of the fancy jargon and talking up the stories.

Abundant liquidity, presence of an Anglo-Saxon legal system, English language and the other factors mentioned above have spawned an equity cult which has now assumed a larger-than-life image. Relative valuations have hijacked the narrative and that too with relativity expressed based on what outcomes the protagonists want. Take EV/EBITDA. This metric was used in various markets and situations primarily as a benchmarking tool to smoothen out the rough edges caused by vastly differing interest rates in various jurisdictions. Analysts now attach target multiples for this which optically resemble PE multiples precisely and only because that seems more presentable (Where else on earth is an EV/EBITDA of 25 or 30 times stacking up and why). When PE is inconvenient, it has been castigated as a bad measure. As a market, the anchoring bias towards bond yields (risk free returns) has been uprooted and carried away by the winds.

In more recent times, a new breed of companies has swamped the listed market and captured the imagination of investors – including the so-called professional investors. These are the Unicorns and their ilk. They don't have to make profits at all (or have to report meagre profits just to ensure that they are not loss making). We have been educated by their proponents that the losses they pile up are accounting entries and qualify as investments. The accounting profession is unable to capture their wonderful reality and so there is no need to question the losses. As time has gone on, we are now seeing no attempt to give any logical reason at all for the prices that IPOs are demanding (other than pointing out that others have got such pricing and so that is enough). A series of fund raises precede (aptly named Series 1,2 to N) the IPO, each typically at higher valuations. If "marquee" investors have lapped them up along the way, the IPO round ought to be at a higher price than the Nth round of funding, N being the one before the IPO. The logic is conveniently compelling for all parties concerned. This, of course, is christened as a "win-win".

In good old days, this was called a Ponzi scheme. Today, any allusion to such terminology is close to blasphemy particularly coming from a Fund Manager. How can one decry a wonderful wealth creation machine that is showering our glorious nation with riches, and which promises to uplift middle-class Indians to everlasting prosperity. This is the behavioural backdrop against which Nifty has touched an all-time high.

Yet, why the dissonance?

1. Behaviour can turn on a dime. It is fickle.
2. History has some painful lessons to offer. While everyone believes history does not apply to India, they are watching over their shoulders. After all, no one wants to trust even their shadows.

While there is this incessant patting of each other's back in the financial community for what the market has delivered and mutual reassurance that everything is going to end well if only one remains a true believer, there is some sort of diffidence. When stocks are falling on some bad news with not much fundamental consequence, they are tending to fall in dollops of double-digit percentages. Such dissonance is likely to stay put.

The one thing that can make a difference is a dramatic breakout in earnings of companies. Indian companies are not innovation driven and hence non-linear earnings cannot come about so easily. They have been good on execution and in mining arbitrage of various types – labour arbitrage, regulatory arbitrage, reform gaps and so on. Earlier on when incumbents got protection because of the government blocking market access to competition, they rocked. The scenario has changed now. The very forces driving superior economic growth and lower inflation are also seeing intense competition pick up. This is likely to impact ability to generate profit growth superior to revenue growth. The Chinese experience ought to give us some insights.

High on scale – not in profits and no fancy valuations

Chinese companies in various segments that grew with the growth of China

Sector	Company Name	FY24-Revenue (Mn. $)	MCAP (Mn. $)	Revenue CAGR (%)	PAT CAGR (%)	TTM P/E (x)
EV Battery Manufacturing	Contemporary Amperex Technology (CATL)*	50,282	2,41,936	52%	55%	26.0
Social Commerce / Marketplace	Pinduoduo Inc*	54,702	1,64,793	76%	***NM***	11.8
Life Insurance & Pensions	China Life Insurance Co Ltd	71,747	1,53,753	3%	8%	4.1
Smartphones & IoT	Xiaomi Corp*	50,823	1,37,241	5%	26%	21.1
New Energy Vehicles (NEV) / Automakers	BYD Company Ltd	1,07,936	1,19,215	22%	17%	20.5
Semiconductors / Foundry	SMIC (Semiconductor Manufacturing Intl.)	8,030	85,129	14%	-197%	132.0
Local Services / Food Delivery	Meituan*	46,890	80,459	32%	***NM***	***NA***
Baijiu / Distilled Spirits	Wuliangye Yibin Co Ltd	12,386	64,652	15%	16%	16.1
Direct E-commerce & Logistics	JD.com Inc	1,60,955	43,492	49%	***NM***	***NA***
Home Appliances / White Goods	Haier Smart Home Co Ltd	39,722	34,782	13%	19%	10.8
Sporting Goods & Retail	Anta Sports Products Ltd	9,837	30,594	18%	17%	14.4
Aviation / Airline Group	Air China Ltd	23,154	18,653	9%	-189%	***NA***
Personnel care products	Hengan International Group Co Ltd	3,149	4,184	5%	1%	12.8
Education	New Oriental Education & Technology Group Inc	4,314	8,767	20%	14%	37.7
Luggage/Apparel	Samsonite Group SA	3,589	3,420	9%	-1%	11.3
Jewellery	Chow Tai Seng Jewellery Co Ltd*	1,929	1,990	20%	8%	13.6
Footwear	Zhejiang Red Dragonfly Footwear Co Ltd*	297	509	-3%	-186%	***NA***

Note: TTM P/E & Market Cap as on 28-11-2025, Revenue and PAT CAGR calculated for 15 years as on 31-12-2024. Companies marked with '': Revenue and PAT CAGR calculated from closing date of FY in which company was listed to 31-12-2024. Above companies FY and CY are same except New Oriental whose FY end is May. NM: Not Meaningful due to negative PAT in the base and NA: Not Applicable.*

Source: Bloomberg, Spark Fund Research

Just look at the scale that these Chinese companies have reached. Even as they have scaled up, they did not see commensurate profit growth in most instances. A look at their valuations gives us an idea on what could be in store for a variety of Indian businesses.

The high valuations that the market offers to some of the new age businesses hinges on their reaching scale and on an unconditional assumption that profits will follow scale without exception. We have seen scare over profits in the traditional consumer names and in IT services. As they are mature businesses, the market is not able to sustain the fiction over their non-existent moats. We have seen some serious under-performance as a result. The new age businesses and the freshly minted IPO brigade are exempted from scrutiny for now. Chinese companies have reached scale in many of these areas. The outcomes there ought to act as a reference point. But this will be camouflaged till something gives. It is now up to each investor to remain vigilant.

Ignore the new highs – we are in a new world

Once a new high has been scaled, it is easy to mark new highs frequently as such is the math. It may mean nothing. History is a good teacher but a poor alarm clock. We need to keep in mind China as they delivered what GDP growth is supposed to deliver – a better life for a good proportion of their citizens. Despite that, the market in China went moribund for long. What worries us the most is the conviction amongst Indian investors that nothing can go wrong with Indian equities if only you manage to cling on. The fervour is almost akin to a religion. You need to be a believer and that is what will deliver nirvana.

Leave the difficult questions for the investment theologians. That is how the protagonists are comforting the believers and those who have missed out. But the reality will refuse to go away. Equities are a risky asset class and the returns over the last 18-20 months tells us that the returns here can be tepid for long periods. But no one believes there is a risk. And that is the problem. We are afraid this problem will not go away as it suits most market participants to not ask questions for now.

Having said that, we have no reason to be indiscriminately pessimistic. Data does not warrant that. The government has taken several counter-cyclical measures which are likely to impact growth positively. The capex cycle has legs to run and leverage is not high either at the corporate or at the household level. In the latter, central bank intervened to quell incipient trouble last year. Indian regulators have been pro-active and that is positive for equities (as risk is being mitigated by them). Overall, the market is in a reasonable place.

Not being negative need not imply unfettered positivity. We may have entered a no-man's land. The process of mean reversion to trend returns in the Nifty is still underway. That would imply low momentum. As long as stocks track earnings in some manner and there is an acceptance that the multiple you pay should have a reference to timeframes as well as risk-free assets, and as long as such stocks do not completely vanish, hope can still carry the day. Welcome to the bull market where tired bulls have to avoid landmines while they gallop.

Warm regards,

P Krishnan (CIO) and Team Spark Fund

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