



## Their Currency – Our Problem

USD has been on a slippery ground. DXY, the widely used measure of USD, is falling since earlier this year and is now down about 11% from its peak. The last major decline of the USD was before the global financial crisis. The DXY fell by 33% back then. In the current round, experts believe that a further 25% drop of the USD may be on the cards.

The decline in USD is much more problematic for the world at large than in the past. Why?

1. The sovereign debt levels in the developed world and in China are at unsustainably high levels.
2. Global growth is faltering. The US itself may be knocking on a recession. China or Europe do not have a great structural outlook either.
3. The US has become protectionist after decades of being the foremost proponent of free trade. USD has indeed been a beneficiary of US policies for the past few decades. The snapback can be painful.
4. The other major economies are not in a position to do heavy lifting.
5. Cross-border capital flows have witnessed a surge over the last few decades and progressively so. It is not just trade that impacts currency. Capital has become an elephant in the room.

In short, we are in a far more complex situation right now. It is also a set-up that can have asymmetric consequences on the downside when things go south.

We are concerned about the impact of a volatile USD on equities and in particular, Indian equities. India is not finding it easy. One, India runs a trade deficit though the overall current account deficit has been showing an improving trend. Two, a good part of India's imports is priced in USD. Actions from the US need to be viewed against this backdrop. Even if India and the US deescalate on the prevailing trade tensions, the adversarial approach from the US is unlikely to abate. This will be an overhang. Currency depreciation can be more painful for stocks and on private wealth than it is for the economy. The economy itself may have a secondary impact, and this is the negative feedback loop we need to be cognizant of.

## The dance of the USD



Source: Bloomberg, Spark Fund Research

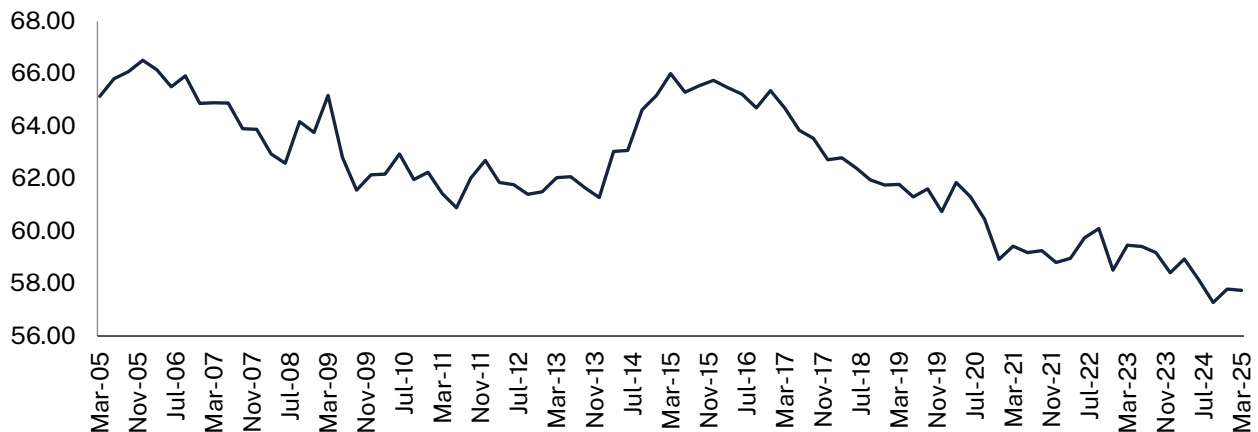
Post World War -II, major currencies of the world were pegged to the USD, and the supply of the USD was backed by gold reserves at the US Fed. The US was the fastest growing major world economy after the war and accumulated an export surplus as well (believe it or not). The credibility of the USD grew with the trust in the Bretton Woods system which the US Fed instilled and nurtured as its custodian. The Vietnam war, the oil shock of the 1970s, slowing growth and higher inflation exerted pressure on the system. After the 1985 Plaza accord, the DXY had a major reset downwards. After that, the USD saw



periods of rise and fall. The last major fall of the USD happened between 2001-2005. In the post GFC world, the USD remained relatively firm against other major currencies. This is despite growing debt levels and a US Fed that has expanded its balance sheet in a major way. This is all set to have a reset.

Meanwhile, though US has not been doing anything to safeguard the trust as the issuer of the world's reserve currency, the extraordinary privilege the USD enjoyed has grown over time. This privilege is coming under fire.

**USD Share (%) of Global Allocated Forex Reserve**



Source: International Monetary Fund, Spark Fund Research

US kept importing from the rest of the world, in particular China and Japan. In effect, the current account deficit has been funded by the issuance of treasury bonds which the very same countries have ended up holding. If the sovereign balance sheet of the US belonged to any other country, the sovereign rating would have suffered major blows. But then, the US has the USD. The world lacked alternatives.

What has complicated the situation now is a US administration which has worked overtime to destabilise the multilateral system which the US helped create and foster. This is an extraordinary moment in economic history. Without making any grandstanding remarks, what we need to understand is that this is impacting capital around the world and not just trade. The impact will continue to be felt, and we need to take note. To begin with, there are two trends that are visible.

1. The rise of gold – Gold has become a significant safe haven asset. Post-covid, gold has returned 105% (Sept-2020 to Sept-2025) in USD terms and has now entered private balance sheets as an increasingly integral part of the allocation mix. From being a hedge against monetary inflation, gold is threatening to become a return driver. This can be a dangerous trend as gold is not a productive asset. No one seems to care because TINA has taken over.
2. Flight away from US bonds – The major central banks are reducing their holding of US Treasury. While there is no cliff effect on the yields yet, the implications can be profound. A lot of the US policy action on trade seems to be to engender financial repression. US may be looking to inflate away its huge debt. All kinds of scenarios are being projected. What is clear is that once again, we are at a critical moment in the evolution of capital and wealth.

### Impact on India

INR has depreciated against the USD more steeply in recent times than the longer-term trend. What is worrying is that INR has depreciated against the USD even as the USD has tanked against the other major currencies. This is a double whammy. In essence, the purchasing power of the INR and its position as a store of value have eroded. This has implications on investors as by definition, these are people with surplus savings and now more than ever, an increasing share of savings is housed in paper assets.



| Against the below | How much is this currency down (%) |       |
|-------------------|------------------------------------|-------|
|                   | INR                                | USD   |
| Euro              | ↓ 14%                              | ↓ 12% |
| Japanese Yen      | ↓ 9%                               | ↓ 6%  |
| Taiwanese Dollar  | ↓ 10%                              | ↓ 2%  |
| Chinese Yuan      | ↓ 6%                               | ↓ 7%  |
| Thai Baht         | ↓ 9%                               | ↓ 6%  |

Note: Changes are CYTD till September 30, 2025

Source: Bloomberg, Spark Fund Research

The drop in INR should have increased the competitiveness of Indian exports. In practice it is not reflecting in numbers. There is no evidence of market share gains in good exports that we can attribute to currency. On the services front, there is practically no competition to India in IT exports from other countries. You may not expect revenues to benefit. However, the net profit growth of the top five Indian IT services companies is 6% for FY22-25 even as the INR depreciation against a USD/EUR/GBP basket in the 60/30/10 ratio is 3% for FY22-25. Despite tailwinds from the currency, the profitability did not get a boost. It would appear that the listed IT services players are milking the currency tailwinds and hardly adding value of their own. Meanwhile, Indian purchasing power has been eroded systematically, and this affects the middle class in the long run. Savings represent spending power in future, and it is clear who is paying the price. For the upper middle class and the wealthy, INR as a store of value is taking a hit silently. The impact of future buying power on your preferred basket of goods and services (e.g. foreign travel or foreign education cost) can be much more damaging than is understood.

Exports in certain segments have grown for other reasons. There has been a stellar growth in electronics exports and also in Global Capability Centres for software exports. The current account has remained stable for India. However, it is still a deficit and there lies an Achilles heel for India. India has funded its current account deficits through foreign buying in its equity markets. This may have distorted equity prices in India while exposing India to the vulnerability of high-pressure selling. Even on the F&O front, the data shows that Indian retail investors transferred private wealth to foreign investors in what is essentially a zero-sum game. For the last five years, FPIs have been net sellers in India's equity markets. The data shows that FPIs have been consistent sellers. FPIs have cashed in on the higher valuations and the opportunity that it presented. Now, the private equity funds are selling via blocks or through IPOs, once again taking advantage of higher valuations. We observe with deep concern that the public markets are absorbing this torrent of overpriced stocks. There will be hell to pay going ahead.

| Period           | Net FPI (Rs. Bn) | USD / INR change (%) |
|------------------|------------------|----------------------|
| Oct-20 to Mar-21 | 1,792.8          | -0.9                 |
| Apr-21 to Sep-21 | -435.8           | 1.5                  |
| Oct-21 to Mar-22 | -2,309.9         | 2.1                  |
| Apr-22 to Sep-22 | -1,559.1         | 7.3                  |
| Oct-22 to Mar-23 | -425.8           | 1.0                  |
| Apr-23 to Sep-23 | 289.7            | 1.0                  |
| Oct-23 to Mar-24 | -408.4           | 0.4                  |
| Apr-24 to Sep-24 | -757.0           | 0.5                  |
| Oct-24 to Mar-25 | -3,205.1         | 2.0                  |
| Apr-25 to Sep-25 | -913.7           | 3.9                  |

Source: Ace Equity, Bloomberg, Spark Fund Research



While the correlation is hard to establish given the multiplicity of factors governing currency movements, the pressure on the INR seems to intensify whenever there is FPI selling. Expensive valuations and the fear of USD fall only exacerbate this selling. We are constrained to make this observation. A systematic wealth leakage is happening at higher valuations from Indian investors to foreigners. The end game need not be pleasant for those who keep buying at valuations that don't make sense.

### **The way forward**

These are testing times for savers who have their surplus invested in paper assets. The race to the bottom by the major currencies does not augur well for wealth preservation. This process is being triggered by the USD in a world where the USD has no substitute. Since savings represent future spending power, those with capital surplus are on a sticky wicket when the faith in USD is eroding. Diversifying into assets such as gold can cushion the impact. Diversifying into foreign equities can help but as a trade, that was probably last year's trade. There are limitations to what can be achieved if investors are hell-bent on objectives such as an obsession to beat risk-free rate in all periods. The current phase in global financial markets could be one where synchronised wealth erosion is a big and live risk. Comparisons with 2007 and warnings from experienced global voices are there for everyone to see. For now, these warnings are being ignored. This is not surprising as this is exactly reminiscent of previous periods when risk kept building up and the same was glossed over until it was too late to act.

In a normal scenario, equities would have offered a hedge against this erosion in value of currency. The underlying cash flow stream in equities represents a good hedge. However, the level at which Indian equities are valued, this defence is non-existent in most instances. In this context, we would like to reiterate that the Nifty index PE of 21 or so is completely misleading. Most managed portfolios hold stocks which trade nowhere near this number. Index valuation which is meant to be a barometer on overall markets, is now a tool to perpetuate the denial over high equity valuations.

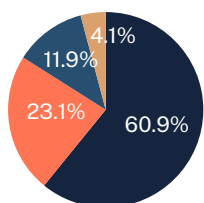
At the same time, equities with strong underlying hard assets could be a potential hedge against the decline in USD and other paper currencies. In a scenario where paper currencies come under a cloud, these equities can show resilience, subject to reasonable underlying valuations. INR stands on a weak wicket because it is dependent on short-term capital flows. Mere INR depreciation does not help India's exports, but it can adversely impact capital flows. This is in play right now. Tariffs and weak global demand do not help India's cause. If equities become reasonably valued, FPIs can return. That is not proving easy given the current domestic liquidity set-up. The instability in the USD comes amidst all this. Beware of resets that cannot be timed well but need to be dealt with.

**Warm regards,**

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



### Portfolio Composition



- Large Cap (17 stocks)
- Mid Cap (8 stocks)
- Small Cap (6 stocks)
- Cash and cash equivalents

### Portfolio Monitorable

|                                         |       |
|-----------------------------------------|-------|
| Leverage (ex – financials)              | 21.7% |
| % of AUM in stocks with promoter pledge | 13.0% |
| Valuation – FY26E median P/E (x)        | 26.0  |
| Valuation – FY27E median P/E (x)        | 22.8  |

*Note: Actual portfolios may vary depending on timing of entry into the strategy as well as investor restrictions. Number of stocks held, their weights and cash level may vary across investor portfolios, and the above is a representative illustration only. Market cap is as per SEBI guidelines.*

1. We kept the portfolio composition steady during the month. The market trend was weak during the month amidst continued FPI selling. Broadly, the consolidation continued in a zone below last year's all-time high.
2. We sold the small holding we had in Tata Consultancy Services. The sector continues to battle adverse news flow, and it is unclear whether any triggers can emerge in the near term for a sustainable turnaround.
3. We rationalised weights in a few stocks in banking and continued to trim Updater Services.
4. Bajaj Auto is the new addition to the portfolio. We see automobiles as an area within consumer discretionary space where the GST cut can make a meaningful impact on demand. We already hold Mahindra & Mahindra as well as Ashok Leyland. Bajaj has a strong export base apart from the domestic presence. Its export markets are diversified and do not depend on developed economies. We see multiple triggers over the next few quarters for above-market and reasonable returns in the stock.

*Note: The above may not apply to new portfolios that have been in the phase of capital deployment. The overall thought process has been similar.*

### Risk Assessment

1. There is no single major factor that stands out which can be identified as a trigger for a major decline in stock prices in India. This is reflected in the India VIX which touched a multi-year low recently. This represents a certain degree of complacency and the same also masks several underlying areas of concern.
2. The IPO market is absorbing a lot of liquidity. In our assessment, the valuations do not make any sense and there is no good reason why investors are willing to pay premium valuations to businesses that are not unique in any way and where the price discovery mechanism does not offer any comfort. The investor buying in domestic funds could be the sole reason and such situations have led to major investor loss in the past.
3. We note that the sellers in equity markets are FPIs, private equity investors and promoters, as is seen from the data on block sales. Buyers are retail Indian investors through mutual funds. This is a red flag, and the market is ignoring the same now.
4. There is no sign of earnings pick-up in any sector though the downgrades may be abating. The global news is not encouraging, the INR is weak, and the tariff issue remain unresolved. While one could argue that all the bad news is in the price, that assertion is based on hope rather than any clear logic backed by data.
5. The market enters the second half of the financial year looking for catalysts to emerge on the upside even as several potential risks are yet to clear out. While we believe our portfolio holdings have been chosen to mitigate these risk factors, these names are relatively more liquid and can suffer price correction if there is any adverse turn on sentiment.



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