

ILLUSTRATION: BINAY SINHA



India in 2026

The market setup for next year is far better than in 2025, provided domestic flows continue to be robust

The Indian markets are ending calendar year 2025 on a subdued note. While they are near an all-time high, India has been the worst-performing major equity market in the world. Flat in US dollar (USD) terms, we have been left behind by global emerging-market (EM) indices, which are up 29 per cent in USD as of end-November 2025. This is the worst relative performance for India since 1993. India has now dropped to third place in terms of EM weighting and is just about half the weight of China. Only 15 months ago, there was serious talk of India overtaking China — how narratives change!

India has also been shunned by foreigners, with foreign portfolio investors (FPIs) selling over \$18 billion in 2025 year-to-date, marking five years of zero flows. The saving grace has been domestic flows, which continue to power ahead, with \$80 billion invested by domestic institutional investors to date and the number of investors crossing 135 million.

India has lost mindshare with global investors. Most are underweight the country and see no reason to raise weightings. We are not part of the artificial intelligence (AI) trade, and have disappointed on both growth and earnings. You can't be the most expensive market in the world, as India was coming into 2025, and then deliver negative earnings revisions and single-digit earnings. India is a consensus underweight at the moment.

However, looking into 2026, the prospects look better, to me at least. My more optimistic take is based on a few assumptions or building blocks.

India will see an acceleration in nominal gross domestic product (GDP) growth, which is the most critical variable for corporate earnings. In the latest quarter

while we had strong real GDP of 8.2, the GDP deflator was only 0.5 per cent, yielding nominal GDP of 8.7 per cent. Given that the 10-year average for the GDP deflator is about 5 per cent, formal inflation target of 4 per cent (+/- 2 per cent) and the willingness of the Reserve Bank of India to cut rates and increase liquidity, inflation should normalise. As nominal GDP accelerates back to double digits, this will drive a clear acceleration in corporate earnings. Aiding earnings further is the sense that on the ground, demand is coming back across categories as the goods and services tax (GST) cuts have catalysed consumption.

Foreigners are the most underweight India I have ever seen. If the EM equities outperformance continues, flows into the asset class will follow. Most global institutions are underweight EMs, given its awful performance over the last 15 years. These same institutions are however worried about their USD exposure and over reliance on US equities for returns. As money comes back into EM equities, India will also get its share, as the underweight will not likely increase.

We have forgotten how markets trade with simultaneous domestic and foreign buying, as we have not seen this for five years now. There is the scope for quick and rapid price action.

Sometime in 2026, there is likely to be a wobble in the AI trade. The thematic may not come to an end, but a wobble is definitely likely. Some rethink and doubts are only natural, even if temporary. India will be a big beneficiary of any cooling of sentiment towards AI. We have not participated in this trade and will be seen as a hiding place. For context, 75 per cent of the EM equity index is made up of only four markets (China, Taiwan,

India, and Korea). Except India, all the other three have been big beneficiaries of the AI trade. If money were to come into EM equities and the AI thematic goes out of fashion, India will be the obvious place to put capital.

India is also developing a positive reforms narrative. The government seems less complacent on growth, is taking steps to support consumption and is starting to move on structural reforms. Declogging the regulatory cholesterol finally seems to be on the agenda.

India also does not get enough credit for its macro stability. We have delivered strong growth over the last five years, despite reducing the fiscal deficit by 500 basis points. The majority of our fiscal adjustment is done. No other large economy has moved on fiscal adjustment. All macro indicators are green. The cost of capital should reflect the reduced macro volatility.

It is only logical that sometime in 2026 we will have a trade deal with the US. We are currently paying higher tariffs than China. Unless the US no longer considers China a strategic rival, this is illogical. Common sense will eventually prevail.

On both valuations and the rupee, we have already made the bulk of the adjustments. While we would always want markets to be cheaper, valuations today are about 15-20 per cent lower than the peak of September 2024. We are now more in line with long-term averages. The rupee has been the worst performing currency in Asia. From here we should see a period of stability and less drag on USD returns. We do not have a current account problem with oil at \$60 and if you believe that the USD is in a downwards adjustment phase, further relative rupee weakness seems unlikely.

The one major assumption that you have to make to be bullish is that domestic flows continue to be robust. Despite 15 months of no returns, mutual fund retail flows continue to track about \$3 billion per month. Both the number of investors and the share of non-Tier 1 cities in flows continue to increase. If these flows turn negative, all bets are then off. The markets will not hold. India is able to hold premium valuations because of the hothouse effect of structural domestic flows.

The other worry is the deluge of paper from new issuances and block deals. Investors will hopefully self-regulate and only allow good quality paper at sensible valuations to come to market. It is opening up opportunities in the secondary markets as investors chase new issuances. Unchecked, this flow can stall the market.

Net net, I think the setup entering 2026 is far better than in 2025. Markets are 20 per cent cheaper, India is unfashionable and delivered its worst relative performance in 30 years, earnings are accelerating, government is showing intent on reform, no macro imbalances, and domestic flows remain rock solid. India offers a good risk/reward. We should do well on an absolute basis even if the AI fancy continues, but can deliver very strong relative performance if the AI theme falters. For global investors looking to hedge their AI and US exposures, we present a good risk adjusted opportunity.

The author is with Amansa Capital



AKASH PRAKASH

The Two Sides Of India's Stock Market Story

Domestic investors are confidently investing while foreign investors seem nervy.
We will have to wait to see who turns out right

Neeraj Kaushal



The Indian economy presents a paradox. Post-Covid, it has been the world's fastest-growing large economy. India's GDP growth has surpassed even Indian govt's own projections as well as those of World Bank and IMF.

Yet, foreign portfolio investors seem somewhat unconvinced. They consider the risk of investing in India high. They have often made their opinion known by voting with their feet. The net foreign portfolio investment in stocks was tepid last year, and this year so far, there has been a net withdrawal of \$17.7bn. Persistent selling by foreign portfolio investors and private equity funds, many believe, has brought the rupee below the ₹90 to a dollar mark. Which is good news for Indian exporters, but ironically, reduces returns on Indian equities for foreign investors.

The question is: Why do foreign portfolio investors consider investing in India risky? Four factors.

First, Indian stocks are exceedingly overvalued with a P/E ratio of 23. It means on average Indian stocks on Nifty are priced 23 times higher than their annual net profit. As a comparison, the P/E ratios of Chinese, Indonesian, and Brazilian stocks are between 8 and 14. Indian stocks have the highest P/E ratio among emerging economies and are almost as high as the P/E ratio of S&P 500 companies in US.

As one would expect, foreign investors are more comfortable with the high P/E ratios of US stocks than Indian stocks. US S&P 500 is 40% tech or tech-focused companies. Overvaluation of these stocks reflects AI exuberance and expectations of high productivity and growth in tech stocks.

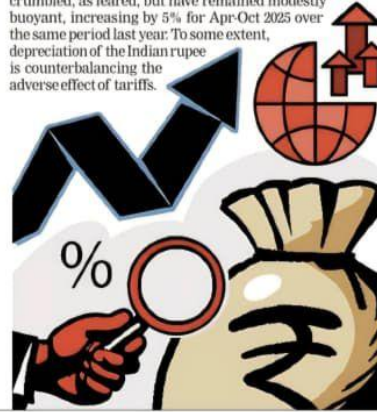
Indian overvaluation, on the other hand, is substantially linked to the steady monthly pouring of investments through SIP (Systematic Investment Plan), crossing ₹29,000cr in Oct. Overvaluations of Indian stocks combined with rupee depreciations lower returns for foreign portfolio investors (FPI). One

estimate shows that the one-year Nifty return for foreign portfolio investors is 0 in dollars.

Second, Trump's tariffs (reciprocal plus penalties on account of Russian oil purchases) and the hike in H-1B visa fee are most severe on India. Thus, even as the Indian economy is growing fast, global headwinds are worsening for India. FPIs see this as a warning signal.

US has slapped one of the most onerous tariff increases on Indian exports – as high as 50% on many items – resulting in a slump in Indian exports to US by 29% between May and Oct 2025. Oddly, the decline in exports is equally large for items that are exempt from tariffs or items whose tariffs have not changed. It is a signal that US demand is weakening and Trump policies have created a negative atmosphere for Indian exports, beyond tariffs.

The saving grace is that Indian exports, overall, have not crumbled, as feared, but have remained modestly buoyant, increasing by 5% for Apr-Oct 2025 over the same period last year. To some extent, depreciation of the Indian rupee is counterbalancing the adverse effect of tariffs.



There is some hope that India will negotiate out some of the penalties in its next round of trade talks with US. USTR is visiting India this week and the two sides hope to make "strong progress", but the visit is not part of the official round of negotiations. It appears neither party is in a hurry to clinch the deal. Hence, FPIs remain sceptical.

Third, the momentum of economic reforms that has in the past boosted foreign interest in the Indian economy appears to be slackening. Last month, GOI notified four new labour codes, almost five years after they were passed in Parliament and only after 19 state govt's had implemented them. Happy with a 7%-plus annual GDP growth, GOI does not want to rock the boat with politically difficult economic reforms.

Fourth, while no one accuses govt data authorities of fudging GDP statistics, scepticism on numbers weakens the growth story. In general, economic data systems of developing countries are weaker than those of industrialised economies. Foreign analysts have long been unconvinced by the Chinese GDP data and have even accused the Communist party of fudging numbers. But in the end, as the saying goes, the test of the pudding is in the eating; and the Chinese economic pudding is not just the largest in the world (in purchasing power parity terms), it is leading in many high-tech sectors.

The Indian growth story gains strength if it remains consistent and continues. Arguably, average growth data, taken over multiple years, takes care of some of the deficiencies in the GDP data collection and deflator. If so, the Indian growth story, at 7%-plus – annual growth over the past four years – appears impressive.

In any case, domestic investors are convinced by these numbers, and are happily pouring blindly into Indian stocks via SIP. At the macro level, it has made India less dependent on FPI volatility. Foreign investors are sceptical and unwilling to commit. Time will tell if FPIs are making hasty decisions or Indian investors are being too complacent.

The writer is Professor of Social Policy at Columbia University