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Investment Strategy
17 February 2025

Market Watch

Improving Risk-Reward?

Summary

Indian equities in correction territory (>10% fall from peak) amid slowing growth, persistent foreign investor selling and uncertainty over impact of US "Reciprocal Tariffs". Broader markets witnessing sharper drawdowns.

Fundamentals improving – Budget and RBI policy easing likely to put a floor on GDP growth. Equity fundamentals improving on the margin given robust earnings outlook, fairer valuations, and bulk of the pullback likely priced-in.

"Bridging the GAP" strategy key to navigate near-term volatility**.** We are OW equities and would buy-on-dips. Within equities, we are OW large-cap equities. We are OW medium- and long-maturity bonds and high-quality corporate bonds.

Background

The Nifty Index has corrected about 13% from its September 2024 peak, entering correction zone (>10% fall from peak). The broader markets have seen sharper drawdowns, with the Nifty Smallcap index in bear market - commonly defined as a drop of 20% from the peak. The weakness in risk assets has been driven by a confluence of factors:

1) Slowing economic growth and lacklustre corporate earnings since Q1 FY2025 compared to the strong pace of delivery in FY 2024.

2) Indian equities trading at a premium valuation, both on absolute and relative to major peers.

3) Sustained foreign investor outflows from equities (~USD -23bn since Oct 2024), off-setting the strong domestic investor inflows (~USD +35bn)

4) Uncertain global trade outlook with President Trump's policy priorities pushing back US Fed rate cut expectations. This has driven the USD higher and weighed on EM currencies and assets.

Indian equities in correction zone (>10% fall from peak)

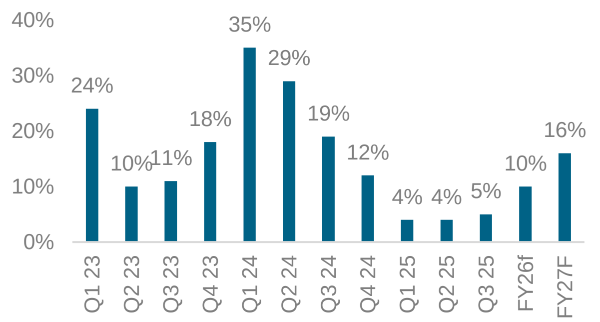
Change in index prices as on 14-Feb-2025

Index	Chg over 52 week high	chg YTD
Nifty	-12.7%	-3.0%
Nifty Midcap	-18.5%	-13.2%
Nifty Smallcap	-21.9%	-17.9%
NSE 500	-16.0%	-7.8%
Nifty Realty	-28.2%	-21.0%
Nifty Metal	-20.7%	-5.3%
Nifty Energy	-32.1%	-13.1%
Nifty Bank	-9.9%	-3.5%
Nifty Pharma	-13.0%	-11.1%
Nifty Infra	-18.4%	-6.4%
Nifty Auto	-20.3%	-3.3%
Nifty Commodities	-22.1%	-5.1%
Nifty IT	-10.4%	-4.7%
Nifty FMCG	-20.0%	-6.4%
BSE Utilities	-33.3%	-15.1%
BSE PSU	-28.5%	-12.8%

Source: BSE, NSE, Bloomberg, Standard Chartered

Earnings cycle appears to be bottoming out in Q3 FY25

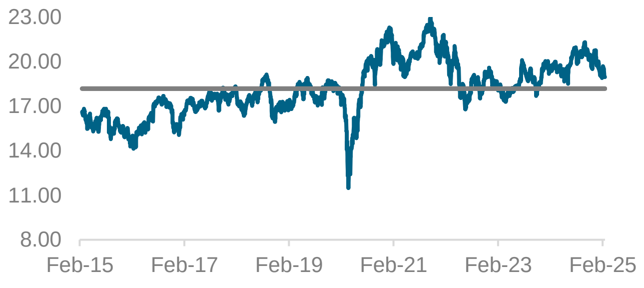
Nifty index EPS delivery (actual and forecast)



Source: Bloomberg, Standard Chartered

Valuations have turned more reasonable post the recent pull-back in domestic equites

Nifty index 12-months forward PE, 10-year average



Source: Bloomberg, Standard Chartered

What does this mean for investors?

Investors wonder if the current sell-off is the start of a larger bear market, defined as selloffs greater than 20%. In our opinion, the probability of that is low given:

Improving macroeconomic fundamentals. Historically, bear markets occur around significant economic slumps. Economic growth is expected to recover as the stimulus provided in the Union Budget 2025 and the commencement of RBI's policy easing cycle puts a floor on the cyclical GDP growth slowdown over the last few quarters.

Strong equity fundamentals. Q3 FY2025 earnings delivery has turned out better than initial estimates. EPS growth estimates for FY 2025-27 is at a robust ~13%, Further, post the pullback, valuations are fairer, with the Nifty index trading 19x 12-month forward P/E compared to its 10-year average of 18.2x and lower than peak valuation of 23x.

Major part of the pullback already priced-in. Pullbacks (index fall of 10% and above) are common in bull markets. Looking at the past 10%+ pullbacks over the 2005-2020 period, corrections have ranged from 10-15%, implying a significant portion of the current pullback (15% from the peak) may have already occurred.

Diversification key to navigating volatility

Stay OW Equities in Foundation allocations. While it is always very difficult to time precise market bottoms, with the growth environment and earnings outlook improving, we would use the current market pullback as opportunities to add exposure to equities. We are OW large-cap equities given greater margin of safety in terms of valuation and earnings.

Preserve the yield on bonds. Bonds as an asset class provides stable income and act as a hedge against growth slowdown or rise in equity market volatility. Investors have opportunities to lock-in attractive yields especially in medium- and long-maturity and high-quality corporate bonds. We expect the 10Y IGB yield to trend in the range of 6.25-6.50% over the next 6-12 months.

Multi-asset strategies and Gold key to navigate volatility. Multi-asset strategies with dynamically managed exposures to major asset classes (i.e., equity, debt, and commodities) helps improve portfolio diversification and risk-adjusted returns. Gold is a key portfolio hedge with strong central bank demand likely to be the major driver of performance.

Risks to our positive view – Persistent weakness in domestic growth and earnings and uncertainty over the impact of President Trump's "Reciprocal-Tariffs" are key near-term risks for Indian assets.

Forward returns strong during recovery cycles

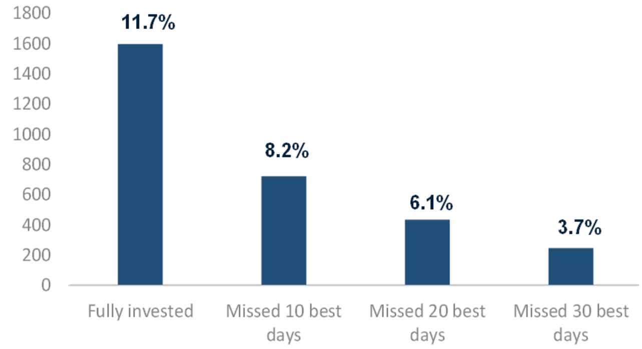
Nifty index performance (%)

Pullback	% peak to trough	duration (days)	6mth Returns	12mth Returns
Mar - May'05	-12.3%	52	24%	26%
Feb - Mar'07	-15.3%	26	25%	5%
Jul - Aug'07	-11.8%	28	27%	-9%
Jan - Mar'18	-10.2%	53	10%	2%
Aug - Oct'18	-14.6%	59	17%	16%
Jun - Aug'19	-11.4%	108	-23%	8%
Oct - Jun'22	-17.2%	242	20%	23%
Sep - Feb'25	-12.9%	123	NA	NA
Median	*-12.6%*	*56.0*	*20%*	*8%*

Source: Bloomberg, Standard Chartered

Investors face a significant Cost of Missing Out on some of the best days in the market if they stay out of it

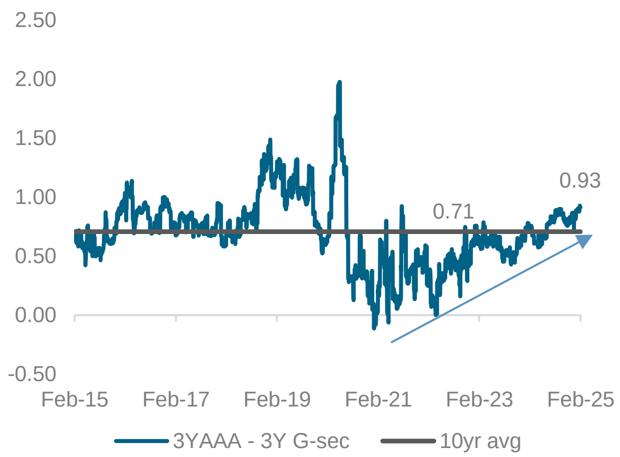
Nifty index returns when investors miss best trading days



Source: Bloomberg, Standard Chartered

High-quality corporate bond yield spreads over government bonds are at cycle-highs

Bond yield spread (bps), 3YAAA – 3Y Government bond



Source: Bloomberg, Standard Chartered

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