This Too Shall Pass

We believe Indian equities offer a good investment opportunity at current levels, driven by a healthy 20 month time and 10% price correction from the September 2024 peak that has reduced Nifty valuations by 22% from peak levels. Valuations are now below their long-term average, with the Nifty 1 Yr Fwd. PE at 16.7x compared to its 10-year average of 17.8x.

Over a three-year period, the gains from current levels should be significant – our view is 14-15% CAGR, 45-50% in all, assuming P/Es revert to average levels of 17.8x and low teens earnings CAGR over the medium term.

While India's Balance of Payments (BOP) has recently been pressured by FDI repatriation, driven by a spike in stake sales by Private Equity and MNCs, the underlying economy remains resilient. The Current Account Deficit (CAD) has actually moderated to ~1% in FY25 & FY26. While it is tough to forecast oil prices especially for next few quarters, even if they average USD 100/bbl for FY27, India's oil imports would rise by USD 45-50bn (~1% of GDP). All else being equal, this would expand the CAD to nearly 2%, a level which is quite manageable at least for a year or two given the Foreign Exchange Reserves of nearly USD 700bn.

Furthermore, muted primary markets and low investor appetite for IPOs and stake sales (2 out of 3 IPOs since April 25 are trading underwater) should cause net FDI inflows to rebound from almost zero over the past two years, partly offsetting the BOP impact from an increase in oil import bill. A muted primary market also means that robust domestic flows will remain concentrated in the secondary market, continuing to drive steady absorption of FII selling. As the war situation / oil markets stabilize, it is reasonable to expect FII selling to stop / moderate. Following normalization of India's premiums over EMs and underweight positioning of FIIs, the size of India's economy coupled with strong growth prospects should encourage FIIs to not just not sell but to buy overtime.

Higher oil prices + INR depreciation will lead to inflation, which is typically a passthrough for equity investors, as companies raise prices to offset higher input costs. On the other hand, debt investors tend to lose purchasing power in an inflationary environment.

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22nd May 2026

There are now signs that the current ceasefire is likely to convert into lasting peace, serving as a positive catalyst for the markets.

In the unlikely event that peace talks collapse and crude oil spikes to USD 130-150/bbl, a 10–15% short term correction cannot be ruled out. However, we believe even in this scenario three-year returns of ~50% remain protected by the economy's structural growth and current valuations.

In view of the above, we recommend that investors deploy nearly half of their planned equity allocation of the next few quarters at current market levels and the balance when clarity emerges on the Iran situation either way.

The current situation reminds of the following words of Winston Churchill :

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."

Warmly,

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