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SBI FUNDS MANAGEMENT LIMITED

India Newsletter

January 2025

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MARKET OVERVIEW: Indian market update

Indian market views

Calendar Year 2024 (CY2024) turned to be a year of contrasts for Indian equities. **The first half was marked by strong optimism, while the latter half witnessed a normalization in market sentiment**. For CY2024, the MSCI India Index rose by 11.1% in USD terms, outperforming the MSCI Emerging Market Index, which increased by 5.1%.

In December, the MSCI India Index declined 2.9% underperforming the MSCI Emerging Markets Index, which fell by 0.3%. Among sectors, Healthcare, Real Estate and Information Technology outperformed, while Utilities, Energy, and Materials underperformed. In terms of market capitalization, midcaps outperformed, with the MSCI India Mid Cap Index rising by 0.7%, compared to declines in the MSCI India Large Cap (-3.6%) and MSCI India Small Cap (-1.2%).

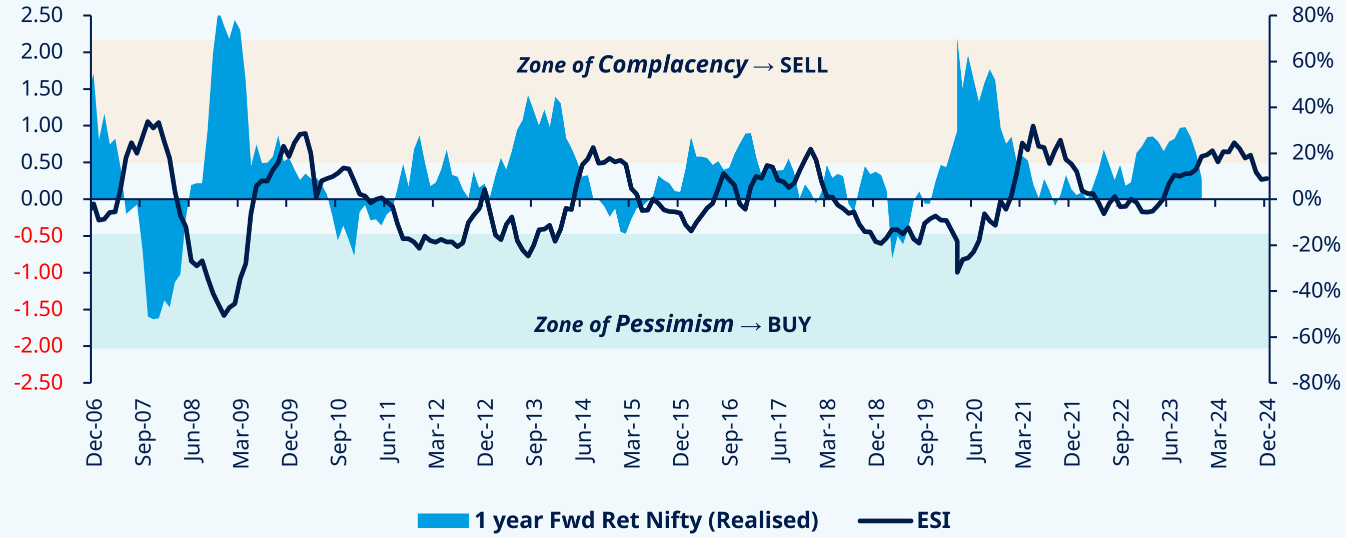
The Indian economy exhibited signs of a moderate slowdown. In Q2 FY2024-25 (July-Sept), GDP growth slowed to 5.4% year-on-year, below projections by the Reserve Bank of India (6.7%), market consensus (6.4%), and SBI FM's estimates (6.0%). Contributing factors included election-related spending slowdowns and adverse weather conditions that disrupted construction activities. However, **high-frequency indicators for October and November suggest a modest recovery,** supported by rural consumption and increased government spending aimed at achieving fiscal targets. These factors are expected to lift GDP growth marginally over the next two quarters.

FYTD earnings were mixed, with downward adjustments in Materials, Industrials, Consumer Discretionary, Energy, Consumer Staples, and Financials. Conversely, the Healthcare sector saw upward revisions. FYTD, consensus earnings per share (EPS) projections have seen marginal downgrades, with the Nifty expected to achieve a 12.0% EPS CAGR over FY24-FY27.

At SBI FM, we are optimistic on India's retail inflation. A favourable base effect from prior vegetable price surges, coupled with subdued consumer demand, is **expected to keep core inflation in check.** Projected telecom tariff hikes (15-20%) by mid-2025 and steady electricity tariff increases (5-6%) are factored into our analysis. Transportation costs remain stable, supporting an average Consumer Price Index (CPI) below 4.5% in FY26. On the monetary front, the RBI may adopt measures to support growth, given slowing credit and deposit growth. A shallow rate-cutting cycle cannot be ruled out.

Our proprietary Equity Sentiment Index remains out of the Zone of Complacency. The sentiment measure works as a contrarian indicator. The Sensex traded at a price-to-earnings (P/E) multiple of 23.9x in December 2024, above its historical average of 20.4x, placing it in the 81st percentile since 2001. While valuations appear still elevated, they should be viewed in the context of growth rates, keeping in mind that averages can obscure significant variations, especially in a market as broad as India.

Equity sentiment index fell out of the Zone of Complacency



Source: Bloomberg, FactSet, SBIFM Research; ESI = Equity Sentiment Index

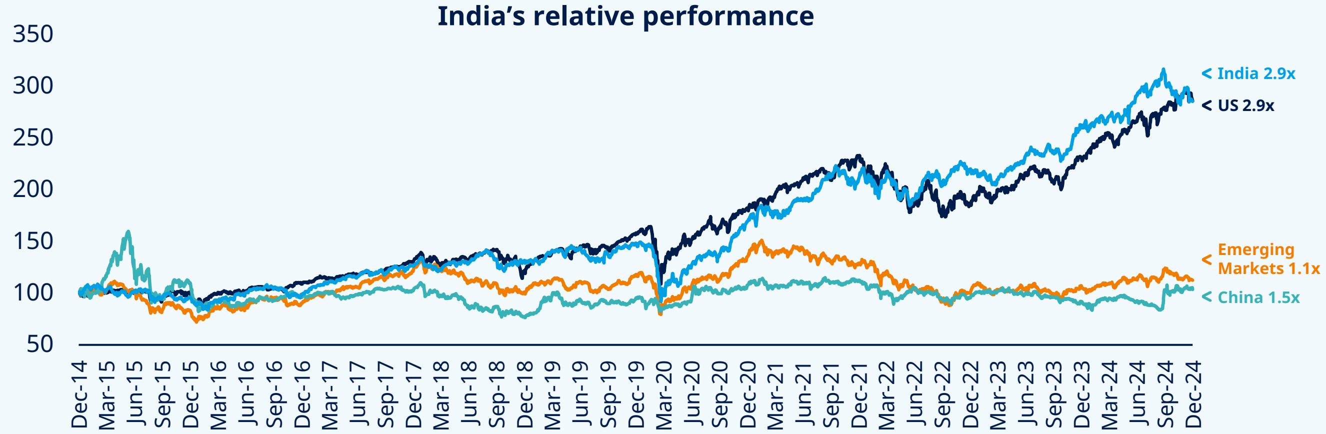
DID YOU KNOW?
Beyond narratives – long term view of the Indian market

As highlighted in the December India Newsletter, the Indian equity market delivered positive returns for the ninth consecutive year in 2024 (in local currency terms). However, recent market corrections have sparked narratives questioning the sustainability of the Indian economy and equity market. In our view, **it is critical to look beyond these short-term narratives and focus on the structural, long-term trends.**

Over the last decade, India's Nifty has gone up by 2.9x (in local currency) despite several significant disruptions. On a positive note, these **disruptions have transformed the business landscape**, benefiting stronger and more adaptive companies, even though they caused considerable pain to investors in the short term, as share prices corrected. Likewise, the current environment, while not as severe as in the past, is **paving the way for new transformations** and, importantly, helping to bring down the frothy valuations of "narrative-driven" companies that have been more focused on selling their shares than on their actual products.

In the past, **India has turned multiple inefficiencies in its economy into opportunities.** This is evidenced in its relative performance to global peers.

India's relative performance

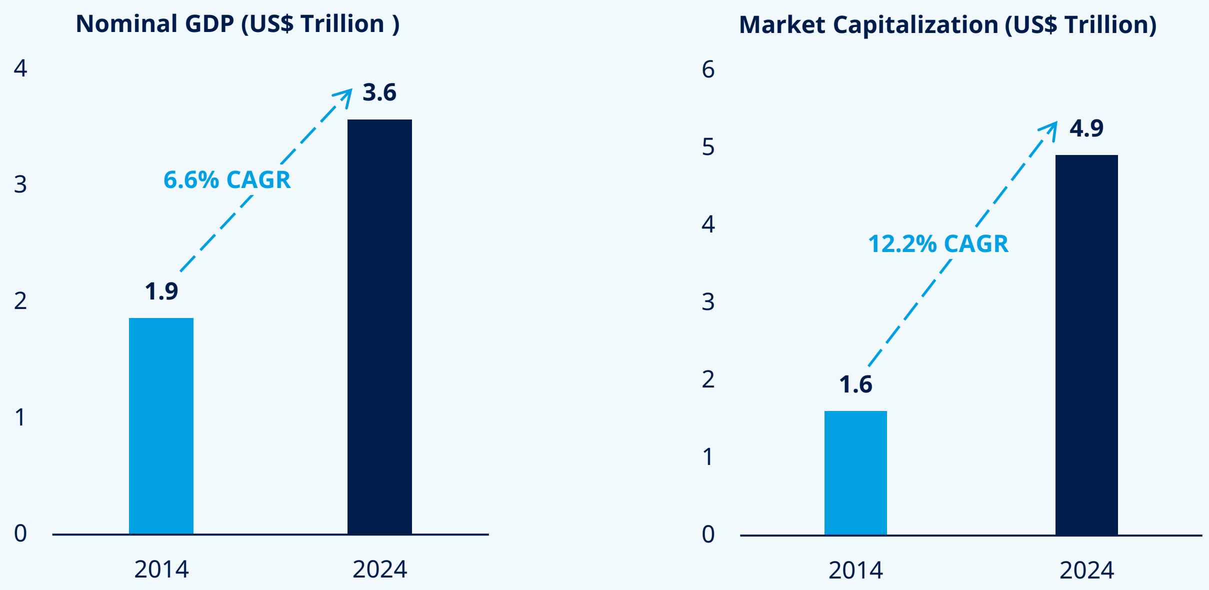


Note: The above data is from 31 Dec 2014 to 31st December 2024. We have taken the following indices for each country: India= Nifty Index; US=S&P500 Index; Emerging Markets= Emerging Market Index (MXEF); China= Shanghai Stock Exchange Composite Index (SHCOMP).

Source: Bloomberg; SBI Funds Management Limited, January 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

The returns in the market and the growth in market capitalization are commensurate with the growth in the economy.

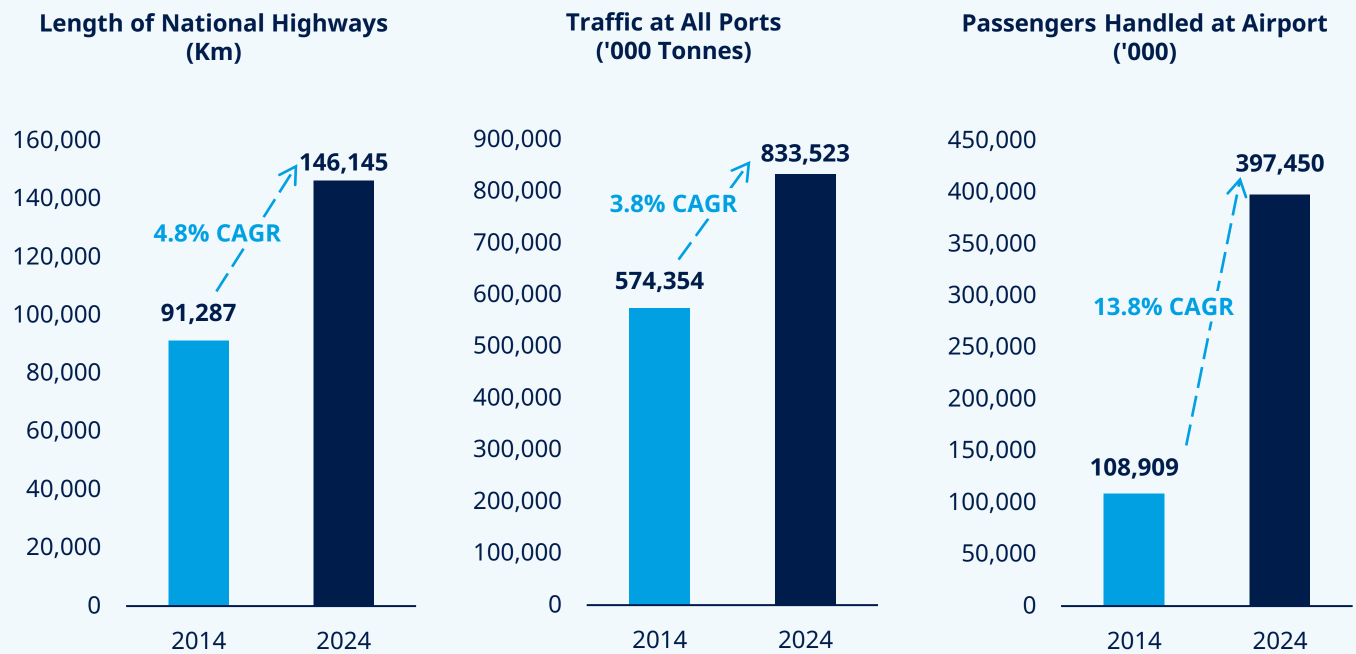
Economic growth & stock market



Source: MoSPI; Bloomberg; SBI Funds Management Limited, January 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

Key on-the-ground economic indicators continue to highlight the **resilience and dynamism of the Indian economy.**

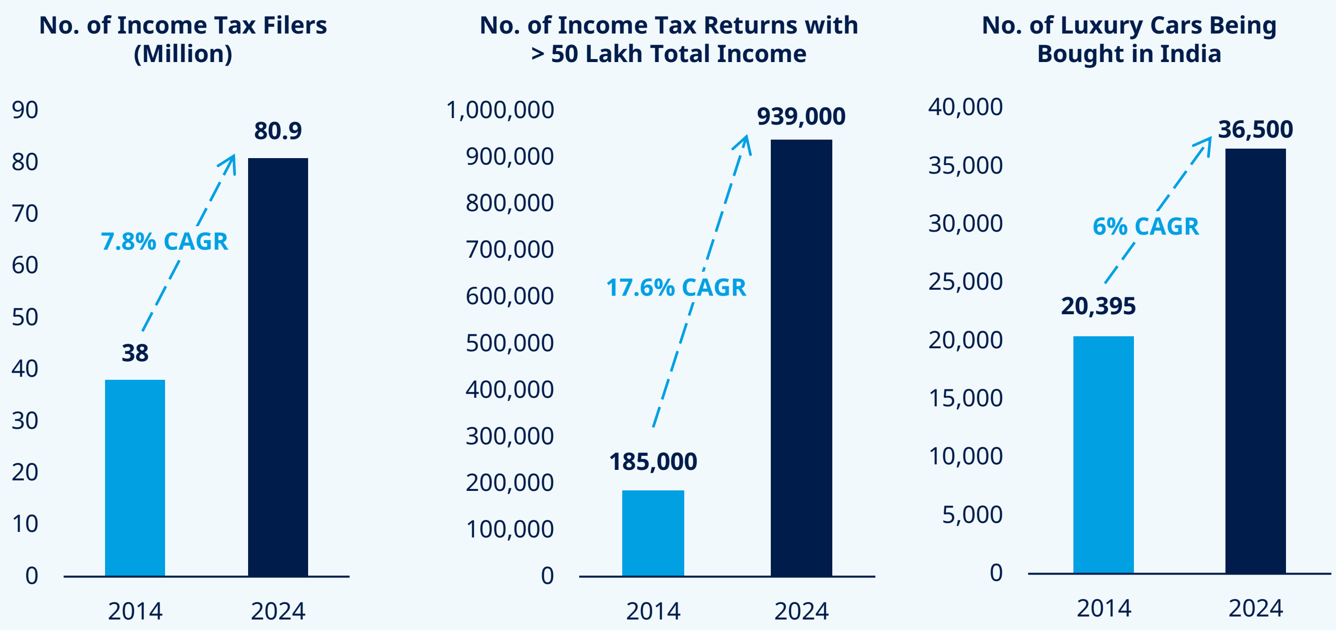
On-the-ground activity indicators



Source: Ministry of Road Transport & Highways; Indian Ports Association; Airport Authority of India; Industry Reports – Autocar India; SBI Funds Management Limited, January 2024. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

This sustained economic growth has translated into rising household wealth.

Rising wealth

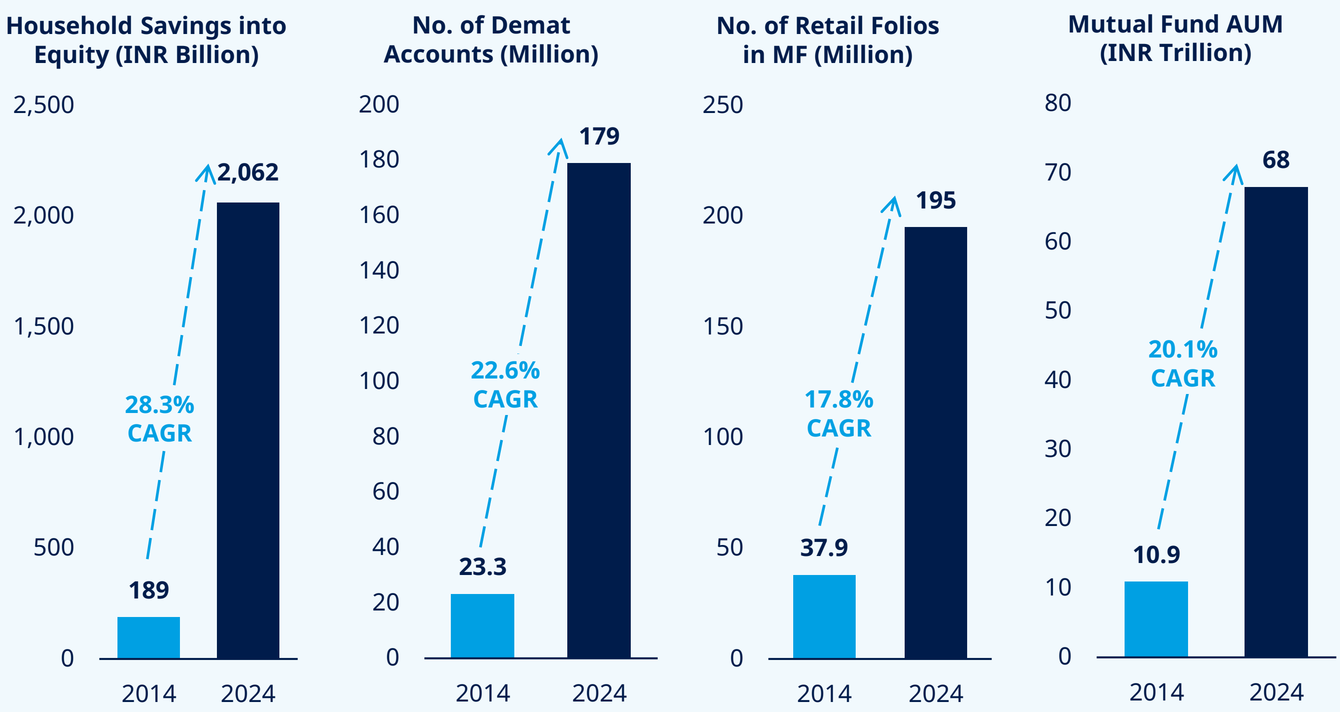


Source: Income Tax Department; Government of India. SBI Funds Management Limited, January 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

**10 lakh = 1 million*

As a result, Indian investors are increasingly looking for sources of diversification and turning to equity markets.

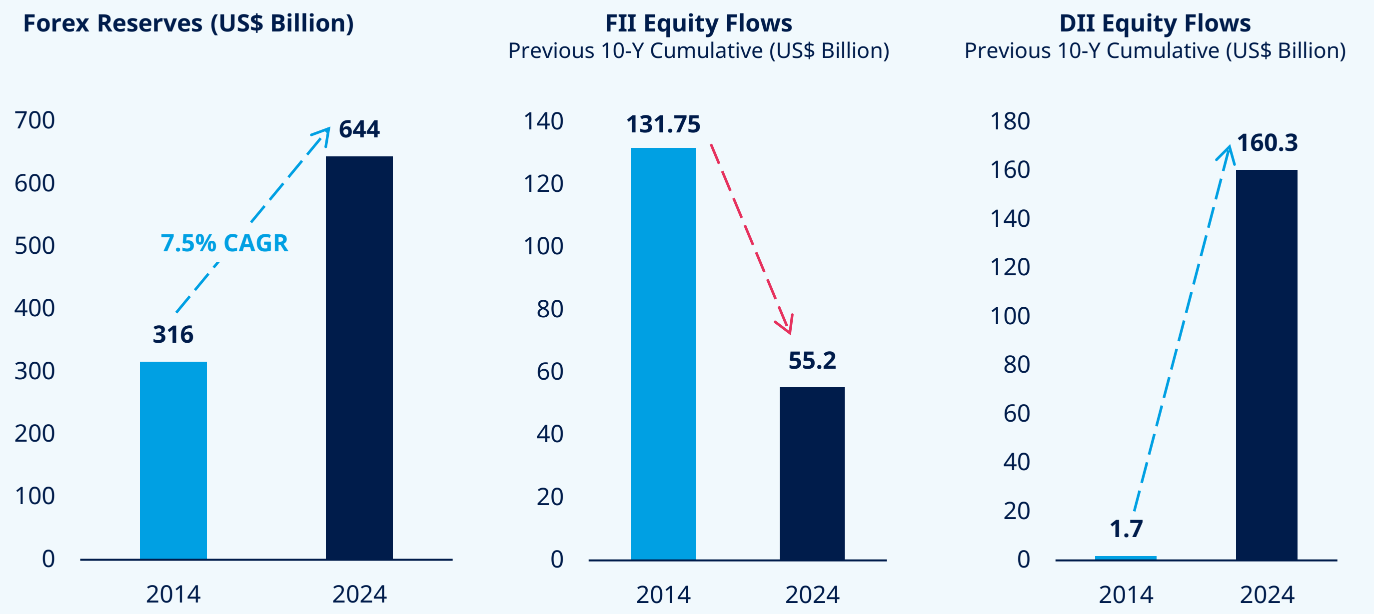
Household – allocation of savings



Source: MoSPI; NSDL; CDSL; AMFI; SBI Funds Management Limited, January 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material. A demat account is an account that allows investors to hold their securities in an electronic format rather than in physical certificates.

At SBI FM, we recognize that the pattern of money flow in the economy and equity markets underscores broader trends, reinforcing our confidence in the long-term growth trajectory of the country.

Flow of money – foreign and domestic



Source: Reserve Bank of India; Bloomberg; SBI Funds Management Limited, January 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

HOT TOPIC: CY2025 annual outlook

In our view, a year has become too long a time frame in the investment world. On the macroeconomic front, policy **actions from the new U.S. administration will play a pivotal role in shaping global economic dynamics**. However, the **Indian economy remains relatively insulated from potential impacts**, such as reduced U.S. imports due to tariffs.

Share of US imports (%)

Country	2018	2022	2023	2024 (1H)
Mexico	13	14	15	16
China	22	17	14	13
Canada	12	13	14	13
Japan	6	5	5	5
Korea, Republic of	3	4	4	4
Vietnam	2	4	4	4
India	**2**	**3**	**3**	**3**
European Union (27)	17	17	19	19

Source: ITC Trademap, SBIFM Research, 2024.

In the near term, India's trajectory should be driven predominantly by domestic factors. We foresee incremental adjustments in monetary and fiscal policies aimed at bolstering growth. On the monetary side, macroprudential measures may ease, with liquidity management taking center stage. While the likelihood of a rate-cutting cycle remains low, it cannot be entirely ruled out. On the fiscal front, a more measured approach to fiscal consolidation is anticipated. The fiscal deficit is likely to narrow by 20–30 basis points annually in FY25 and FY26, compared to the sharper reductions of 80–90 basis points seen in recent years. The Union Budget 2025 is expected to focus on boosting revenue expenditure and refining income tax policies, which could support a recovery in GDP growth to approximately 7% in FY26 from an estimated 6.3% in FY25. Early 2025 may witness investment growth outpacing consumption, though consumption is likely to pick up later in the year, aided by supportive policy measures.

In equity markets, the normalization phase observed in the latter half of 2024 appears poised to continue into 2025, leading to a shift in market dynamics. The defensive positioning of the market reflects a confluence of factors, including high initial valuations, elevated market sentiment earlier in CY2024, and near-term pressures on corporate earnings. While this consolidation phase has altered the market landscape, **it is likely to redirect attention toward fundamentals.**

We anticipate the market **becoming increasingly selective in 2025, emphasizing companies with robust business models, consistent earnings growth potential, and sustainable cash flows.** As market breadth narrows, this could mark a departure from the broad-based rally of recent years. The year is expected to highlight significant shifts in market leadership, rewarding fundamentally strong businesses and reinforcing a more discerning investment approach.

Over the long term, India's force vectors, such as demography, urbanisation, trade, environmental imperatives, and the geopolitical rewiring of supply chains remain prominent. Notwithstanding a few hiccups, we expect these factors to continue supporting the country's growth. At the company level, the adoption of technology and public digital infrastructure is fuelling innovation and creating unprecedented business opportunities. India is emerging as a reliable global supplier, leveraging its human capital and fostering the growth of disruptive business models.

The transformation of India's equity market reflects these shifts. **The market now offers diverse opportunities across market caps and sectors, a robust pipeline of issuances in emerging industries, and improved liquidity.** This evolution enhances India's attractiveness to global capital, reinforcing its trajectory toward a vibrant economic landscape.

Key risks include geopolitical uncertainties, policy actions from Trump administration, and elevated domestic market valuations, which may add volatility. However, abundant granular investment opportunities exist, driven by transformational changes in the economy. **In a growing market like India, rigorous on the ground research and bottom-up stock selection are key to generating differentiated alpha.**

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