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SBI FUNDS MANAGEMENT LIMITED

India Newsletter

February 2025

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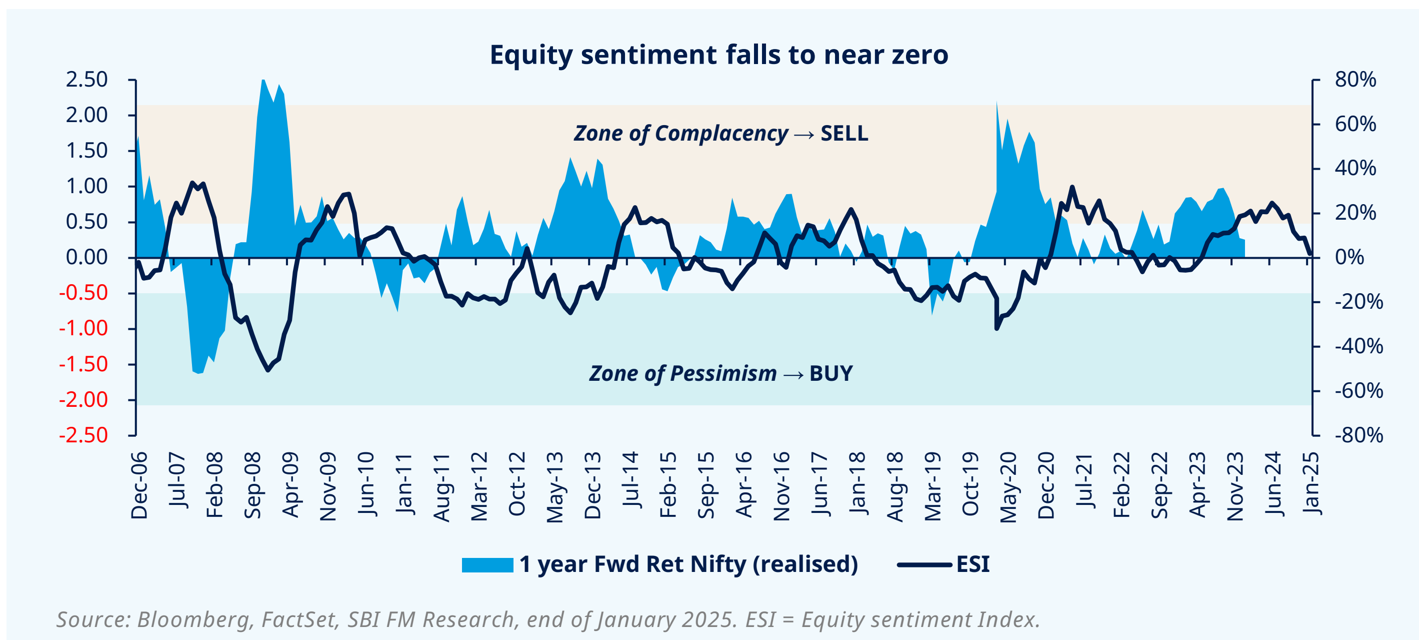
MARKET OVERVIEW: Indian market update

In January, the MSCI India Index experienced a decline of 3.6%, underperforming the MSCI Emerging Markets Index, which rose by 1.7%. Among various sectors, Energy, Consumer Staples, and Communication Services emerged as the strongest performers, while Real Estate, Health Care, and Industrials faced the most significant challenges. Notably, large-cap stocks outperformed their mid- and small-cap counterparts, with the MSCI India Large Index declining by 2.7%, compared to –7.7% in the MSCI India Mid Cap and –10.7% in the MSCI India Small Cap.

Our proprietary Equity Sentiment Index has fallen to near zero. The sentiment measure works as a contrarian indicator. The Sensex traded at a price-to-earnings (P/E) multiple of 23.6x in January 2025, above its historical average of 20.4x, placing it in the 75th percentile since 2001. While valuations may appear moderately elevated, it is essential to consider them in the context of growth rates, as averages can obscure significant variations, particularly in a diverse market like India.

In the near term, macroeconomic challenges — including pressures on domestic growth and earnings, as well as escalating global tariff tensions — may contribute to market volatility. However, as volatility subsides, we anticipate that markets will become more discerning, favouring companies with robust business models, long-term earnings visibility, and sustainable cash flows. Despite short-term headwinds, the equity narrative in India remains anchored in an earnings upcycle. Corporate profits as a share of GDP have rebounded over the past four years, following a 12-year secular decline (2008–2020). In a growing market like India, rigorous on the ground research and bottom-up stock selection are crucial for generating differentiated alpha.



Source: Bloomberg, FactSet, SBI FM Research, end of January 2025. ESI = Equity sentiment Index.

DID YOU KNOW?
Is Indian market bottoming out? Good news for long term investors

The Indian markets have recently undergone a correction, driven by various factors. While we believe this correction is not yet complete, there are positive developments for investors. We will briefly examine both the challenges and the encouraging signs.

1. Valuations

As noted in our previous monthly newsletters, some segments of the market, especially mid- and small-cap stocks, were trading at excessively high valuations compared to their underlying fundamentals. This situation was influenced by factors such as a slowing economy, declining earnings, and geopolitical issues, including the implications of the Trump Trade. Additionally, certain large-cap sectors, such as infrastructure, defence, and government-owned companies, were also deemed expensive.

Given the historical valuation differential — where small caps typically traded at a 30% discount to large caps, but recently traded at a 40% premium — our view at SBI FM is that the correction in small and mid-caps was overdue, resulting in a more pronounced decline compared to large caps.

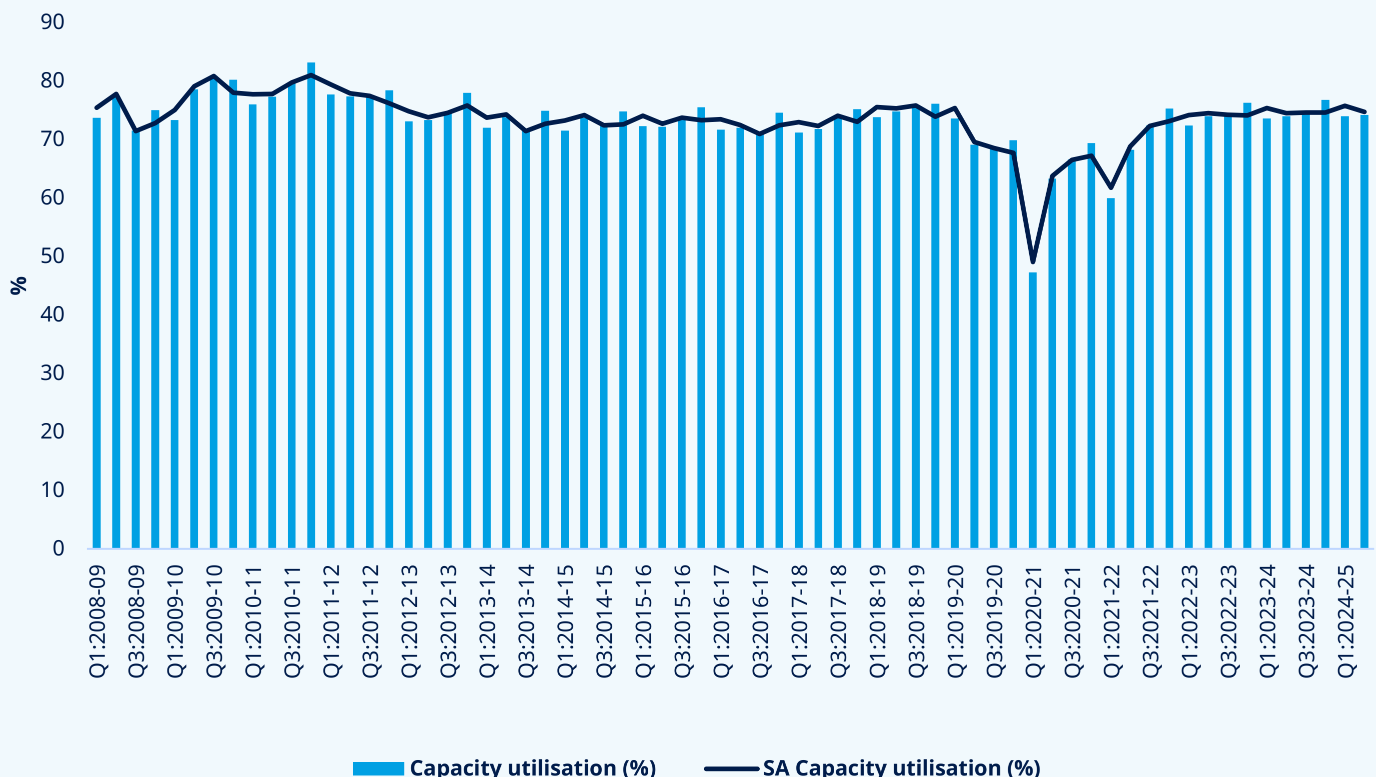
On a positive note, as India undergoes significant transformation, there remain abundant granular investment opportunities despite high valuations. Furthermore, recent corrections have narrowed the valuation premium considerably, providing a greater margin of safety.

2. Slowing economy

The latest GDP print for the quarter ending in September was weaker than anticipated due to well-known factors such as elections and weather conditions. The December GDP data, expected to be released by the end of this month, is likely to show improvement compared to the September figures, as economic activity has picked up since then. This recovery is also reflected in various high-frequency data indicators.

High-frequency indicator: Capacity utilisation survey of the manufacturing sector

The capacity utilisation in the manufacturing sector increased marginally.
Manufacturers also reported a higher sequential (q-o-q) growth in new orders.



Source: Reserve Bank of India's Forward-Looking Surveys (OBICUS); SBI Funds Management Limited, February 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

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High-frequency indicator
Consumer confidence survey

Household assessment on the one-year-ahead outlook remained firmly optimistic, even though the current confidence for the current period marginally declined.

Source: Reserve Bank of India's Forward-Looking Surveys; SBI FM Research, February 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

Encouragingly, in a democratic context, this is a self-correcting process; the government typically takes action to stimulate growth during slowdowns to garner popular support and secure electoral success. This was evident in the recent budget, which included tax exemptions aimed at boosting consumption and a focus on capital creation. Additionally, the central bank has initiated an easing cycle, although future cuts will need to be monitored closely. In our assessment, GDP appears to have bottomed out and has shown signs of recovery since the end of September.

3. Slowing corporate earnings

This slowdown, linked to the broader economic deceleration, was anticipated but perhaps underestimated by the market. Earnings expectations had been elevated initially, and some rationalization was expected, given that most margin benefits from efficiencies and lower input costs had already been realized in prior quarters.

On a positive note, earnings for the latest quarter have not been as disappointing as feared. Currently, we anticipate double-digit earnings growth in FY26E, although there is an increased need for discernment across companies and sectors. We expect sectors such as Industrials, Consumer Discretionary, and Materials to lead earnings growth in FY26E. The downward revisions in earnings expectations seen in recent quarters have also contributed to a more reasonable outlook.

4. Expectations of a slowdown in domestic flows

This concern has emerged recently. Since the equity market correction began in September of last year, there has been apprehension regarding a potential decline in domestic flows into mutual funds, particularly retail systematic investment plans[1] (SIPs).

Positively, the industry — comprising asset management companies (AMCs) and distributors — has made commendable progress in two areas: investor education regarding long-term investing and market penetration into Tier 2, 3, and 4 cities[2]. Once the current uncertainties settle, we expect investors to return, should they choose to exit. Equities continue to represent one of the most competitive options for long-term wealth creation.

Moreover, market breadth has been improving as companies mobilise funds through capital markets.

[1] A Systematic Investment Plan (SIP) enables investors to invest a fixed amount in mutual funds regularly, promoting disciplined saving and reducing market volatility impact.

[2] Tier 2, 3, and 4 cities refer to urban areas in India classified based on population and economic development. Tier 2 cities are smaller than Tier 1 (major metropolitan) cities but are growing rapidly, while Tier 3 and 4 cities are even smaller and less developed.

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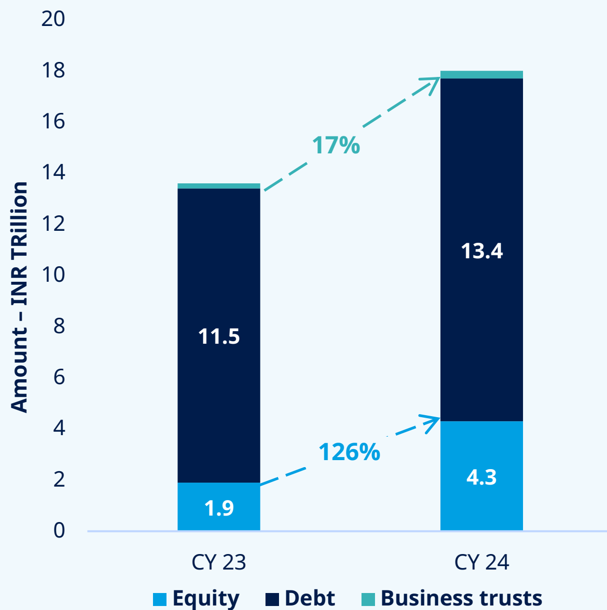
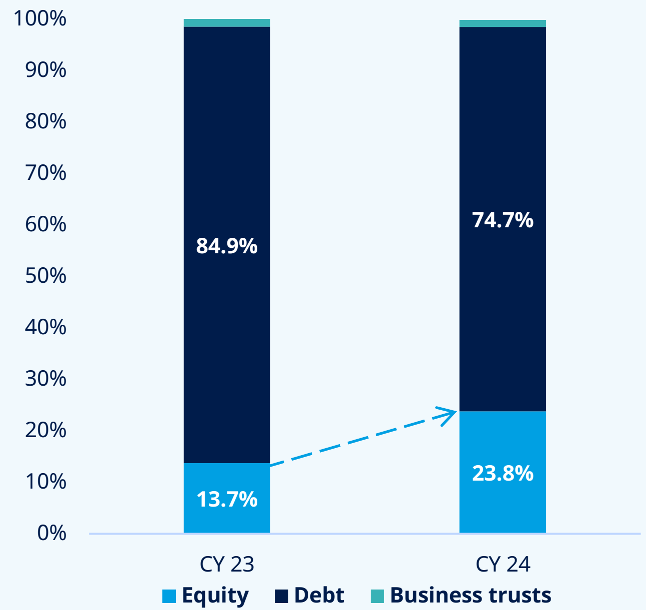
Fund mobilisation through the Indian Capital Markets in 2024

While the funds mobilised through equities surged by 126% (YoY), those through debt markets increased by 17% (YoY).



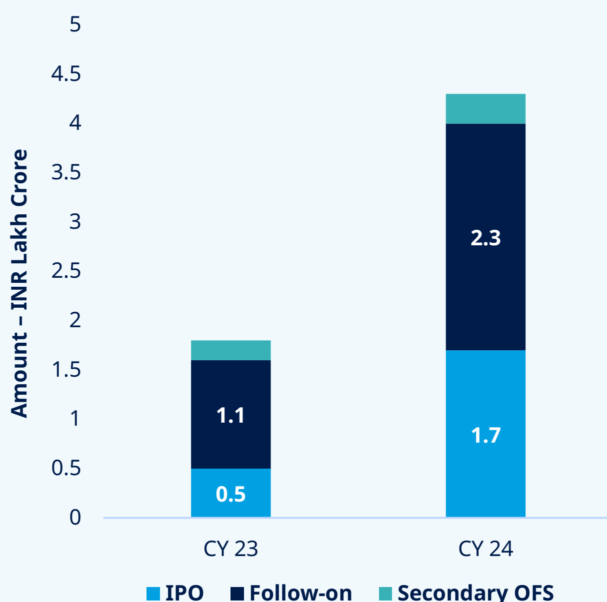


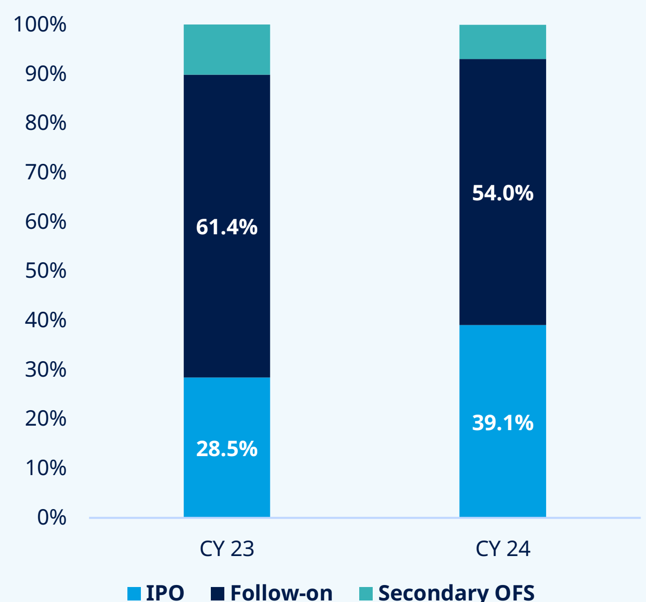
Note: Funds mobilized are calculated as the difference between the outstanding credit as of Nov'24 and Nov'23 (Sectoral deployment of bank credit available until Nov 24). Conversion: 1 lakh = 0.1m. CY refers to the calendar year.

Source: Reserve Bank of India; Bloomberg; NSE-EPR, January 2024; SBI FM Research, February 2025. For illustrative purposes only. We are not soliciting or recommending any action based on this material.

Equity fund mobilisation in 2024

Equity markets saw 268 new IPOs in 2024, with 90 on the Main Board and 178 on SME Emerge. By Dec '24, the National Stock Exchange had 2,673 listed companies, including 587 SMEs.





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Global Factors

5. Uncertainty regarding the next move by the new U.S. administration, especially on tariffs

While India is primarily a domestic-focused economy — where domestic consumption and investments account for over 90% of GDP — uncertainty in this area is impacting both Indian and global markets. India is a significant exporter of services, which tend to be more resilient to global shocks than goods; however, there are concerns that the new administration may shift its focus to services after addressing goods.

Sanctions also pose a concern. A few weeks ago, the new U.S. administration imposed sanctions on oil flowing from Russia, from which India had benefited due to lower prices.

6. Flight to safety

The rising 10-year U.S. Treasury yield, a stronger U.S. dollar, and better-than-expected U.S. corporate results have heightened investor anxiety regarding emerging market assets, including those in India. Foreign investors have been divesting from Indian assets for over five to six months. Until now, domestic investors have supported the market, but concerns about their potential exit have added to investor worries.

Additionally, the Indian currency has depreciated by 3–4% against the U.S. dollar since October/November, further contributing to capital outflows. India maintains a manageable current account deficit, with imports exceeding exports. However, new global dynamics — such as increasing barriers to capital, goods, and technology flows, along with the weakening of global institutions — have raised concerns about India’s position in the evolving world order.

Is the correction done or overdone?

We do not believe the correction is complete, but it is not overdone either. Just as gravity pulls matter to the ground, fundamentals will ultimately realign stock prices with reality — the question is not “if” but “when”. That said, the recent corrections have significantly narrowed the valuation premium.

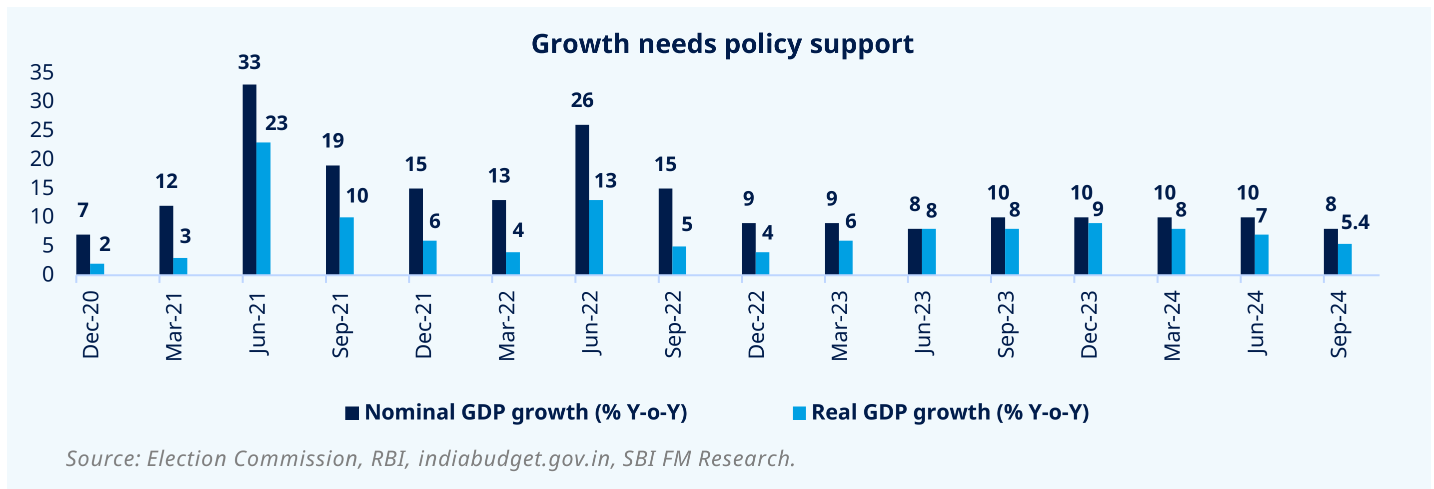
UNION BUDGET: Steps for consumption revival

In recent months, the Indian economy has exhibited signs of a cyclical slowdown, necessitating timely policy intervention. Consumption has emerged as the most vulnerable segment. Against this macroeconomic backdrop, and with a commitment to maintaining the fiscal glide path, the Indian Union Budget for FY 2025–26 was presented. The budget aims to stimulate consumption by reducing the tax burden on the middle class, which is expected to yield aggregate tax savings of INR 1.1 trillion[3]. Our analysis indicates that approximately 10 million taxpayers fall within this income bracket, potentially increasing their take-home income by 4–7%. This could provide a positive impetus for discretionary consumption demand. Over time, increased discretionary spending may also drive an uptick in corporate capital expenditure.

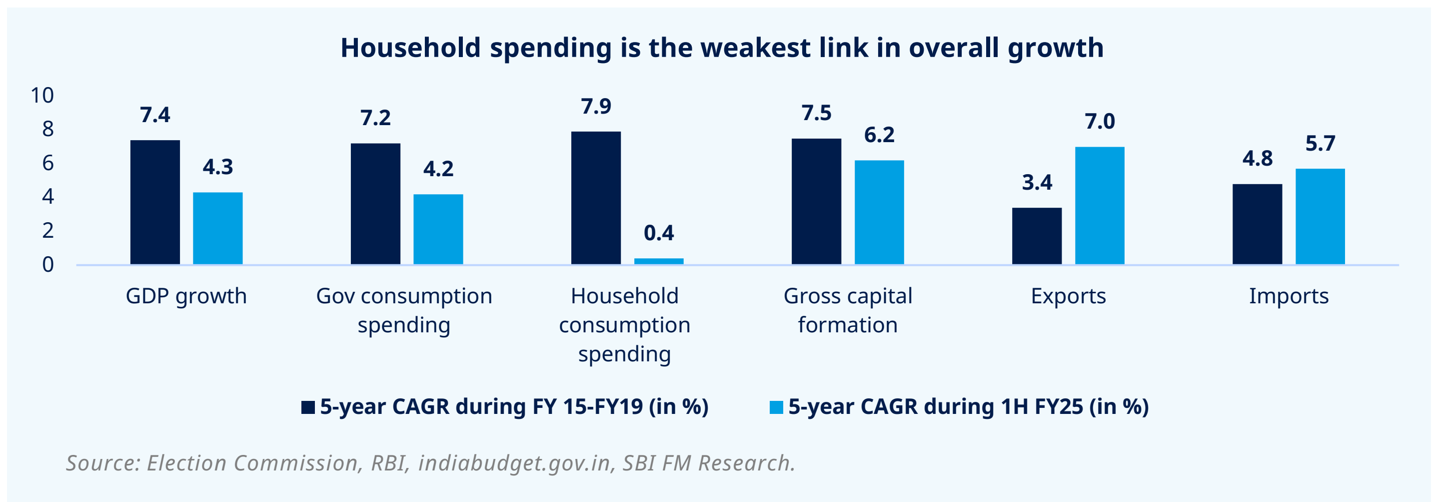
Additionally, the Budget emphasises deregulation and improving the ease of doing business, particularly for Micro, Small, and Medium Enterprises (MSMEs), which is expected to support employment growth. While the consumption boost comes at the expense of revenue foregone, capital expenditure allocations have increased by 10%. Key sectors such as power, urban infrastructure, housing, and metro development have received greater focus. However, expectations regarding certain telecom sector dues (AGR dues[4]) waivers, an extension of the concessional tax rate for the manufacturing sector, and an expansion of the PM-Kisan (agriculture) budget were not met. Overall, the budget aims to strike a delicate balance between boosting consumption and maintaining the fiscal glide path.

[3] As of Feb 26, 2025, FX rate is approximately 1 INR = 0.011 EUR, making the aggregate tax savings = to €12.1 billion.

[4] AGR dues refer to "Adjusted Gross Revenue" dues, which are payments that telecom companies in India owe to the government. These dues are calculated based on the total revenue generated by telecom operators and are a significant source of revenue for the government.



Source: Election Commission, RBI, indiabudget.gov.in, SBI FM Research.



Source: Election Commission, RBI, indiabudget.gov.in, SBI FM Research.

Can the Budget stimulate the growth?

The Economic Survey, released prior to the Budget, projected India's FY25 growth at 6.5%. However, aggregate corporate sector salaries have been growing at 6–8% over the past five to six quarters, with certain segments likely to see growth accelerating to the mid-teens, which is a positive sign for urban income and consumption. Meanwhile, FY25 has experienced a sharp shortfall in key expenditures, particularly in rural-focused schemes and various capital expenditure segments, likely due to the election-related slowdown. The government aims for a stronger push in the coming year. Given these factors, while the budget has not aggressively prioritized growth, we believe that fiscal stimulus will be more effective than in FY25. Additionally, monetary policy has begun to ease, with the RBI's Monetary Policy Committee (MPC) reducing the repo rate by 25 basis points to 6.25% (SDF[5] rate at 6.00%, MSF[6] rate at 6.50%). Consequently, we estimate FY26 growth in the range of 6.5–7%, compared to a projected 6.3% in FY25.

[5] *SDF (Standing Deposit Facility) allows banks to deposit excess funds with the RBI at a set interest rate.*

[6] *MSF (Marginal Standing Facility) enables banks to borrow overnight funds from the RBI at a higher rate to address liquidity needs.*

Important information – Marketing Communication

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