

EQUITY OUTLOOK 2026

Positioning for the Next Phase of the Cycle

Abstract

We assess Indian equities heading into 2026 amid resilient domestic growth and a shifting global backdrop. With valuations elevated and earnings dispersion rising, we expect returns to be increasingly driven by fundamentals, selectivity, and earnings delivery rather than broad-based multiple expansion.

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* Represents aspirations, and
not current job positions

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Executive Summary

We expect Indian equities to enter 2026 with structural support from resilient domestic growth, improving earnings momentum, and policy continuity. In our base case, we see India's benchmark equity indices gaining further traction through the year. JPMorgan's latest strategy note targets the Nifty50 at 30,000 by the end of 2026, underpinned by supportive macro conditions, stable fiscal and monetary settings, and a robust domestic investor base. We continue to prefer domestic-facing sectors that benefit directly from internal demand dynamics and expect these to outperform export-dependent sectors over the outlook horizon.

Macro fundamentals remain supportive. Inflation has moderated, allowing the Reserve Bank of India to maintain a growth-oriented stance while balancing price stability. Nominal GDP growth remains elevated relative to peers, driven by consumption resilience and infrastructure investment. Earnings growth across the market is expected to recover from the muted pace seen in the prior year, with analysts projecting a rebound in corporate profitability and a normalization of valuations closer to long-term averages.

Market dynamics in 2026 are likely to be shaped by several key drivers. First, a recovery in the corporate earnings cycle should bolster investor confidence as earnings growth moves into double digits. Second, diversified capital formation through both the primary and secondary markets is expected to deepen market liquidity. India's IPO pipeline remains strong, with a significant number of companies preparing to access public markets and substantial fundraising targets already in place.

While the outlook is constructive, risks remain. Valuations in certain market segments appear extended and may be vulnerable to shifts in global liquidity conditions or external shocks. Foreign portfolio investor flows have been volatile, and valuations relative to emerging markets remain elevated, underscoring the need for selectivity. Nonetheless, relative to peers, India offers compelling structural growth opportunities supported by strong domestic demand, ongoing reforms, and broadening investor participation.

Overall, we view 2026 as a transition year in which returns will be more closely aligned with fundamentals, sector positioning, and earnings delivery rather than broad multiple expansion. Portfolio positioning should emphasize quality earnings growth, balance sheet resilience, and exposure to sectors with durable competitive advantages. Discretionary positioning should remain selective, with a disciplined risk framework to navigate potential volatility while capturing structural opportunities in India's equity markets.

India Macro Backdrop

Growth Outlook

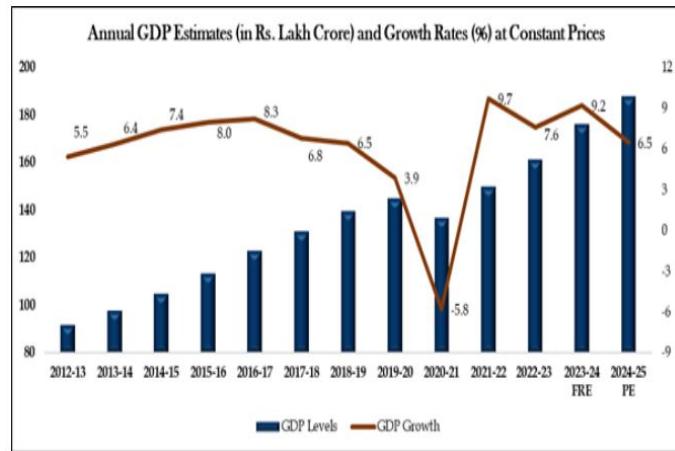
We continue to see India's economic expansion outpacing most major economies, and we view this performance as being firmly anchored in resilient domestic demand, strong consumption dynamics, and a sustained upswing in public and private investment. We observe that household spending remains broad based across urban and rural segments,

supported by improving labour market conditions, steady income growth, and a gradual normalization of inflation. At the same time, we believe that the ongoing push in infrastructure spending and capacity expansion across manufacturing, logistics, energy, and digital sectors is reinforcing medium term growth potential. High frequency indicators across mobility, electricity demand,

GST collections, credit growth, and capital goods production suggest that economic momentum strengthened meaningfully through late 2025, with some quarterly GDP estimates exceeding 8 percent. We see this as one of the strongest growth outcomes in several years and indicative of an economy operating with increasing confidence despite a challenging global backdrop.

We note that policy coordination has played a central role in sustaining this expansion. We believe that fiscal policy has remained growth supportive, with capital expenditure prioritized in ways that crowd in private investment and improve productivity over time. At the same time, we see monetary policy evolving in a calibrated manner, balancing inflation management with the need to preserve growth momentum. This policy mix has helped anchor expectations, sustain financial conditions conducive to investment, and absorb periodic external shocks. We also observe that domestic credit growth remains healthy, corporate balance sheets are relatively strong, and banks are well capitalized, all of which support our constructive view on the durability of the current expansion.

Consistent with these developments, we note that the Reserve Bank of India has revised its growth forecasts upward for FY25-26, reflecting stronger than expected outcomes in the early quarters of the fiscal year. We see the RBI's latest projections placing real GDP growth at around 6.8 percent, while subsequent internal assessments and updated data on output, demand, and sectoral performance suggest that growth could be closer to 7.3 percent. We interpret this upward bias as a reflection of persistent strength in domestic activity rather than a short-lived cyclical spike. Looking ahead, we see growth forecasts



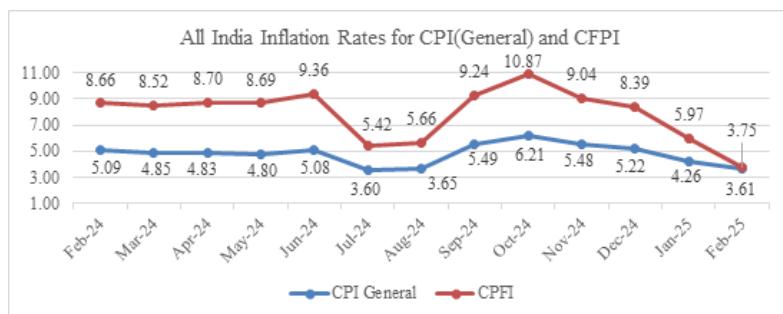
for the opening quarters of FY27 remaining above trend, which reinforces our view that momentum is likely to carry forward into the next fiscal year, supported by continued investment, stable consumption, and improving supply side capacity.

At the same time, we remain mindful of external risks that could temper the outlook. We believe that global trade tensions, tariff uncertainty, and slower growth across key external markets pose downside risks to export performance and capital flows. We note that protectionist policies and geopolitically driven trade barriers could weigh on manufacturing exports and introduce volatility into external financing conditions. Policymakers have acknowledged these challenges, and we agree with the assessment that while domestic growth drivers remain strong and increasingly self-sustaining, external headwinds continue to represent a key source of uncertainty. On balance, however, we believe that India's growth story remains compelling, with domestic fundamentals providing a meaningful buffer against global volatility and positioning the economy favourably relative to its peers.

Inflation Dynamics

We view India's inflation environment as having shifted decisively into a far more benign phase compared with recent years, and we see this as a critical macroeconomic development that strengthens the durability of the current expansion. Headline Consumer Price Index inflation has consistently undershot the Reserve Bank of India's 4 percent medium term target, reflecting a confluence of favourable base effects, a sustained moderation in food prices, and easing pressures across key global commodities. We also note that proactive policy measures, including targeted supply interventions and the rationalization of indirect taxes, have helped limit pass through to retail prices and contributed to better anchoring of inflation expectations among households and businesses.

We see the RBI's latest inflation forecasts for FY26 as underscoring this



improvement in price dynamics. The central bank now projects headline inflation to average around 2.6 percent for the fiscal year, marking a material downward revision from earlier estimates. We interpret this as evidence that inflation outcomes in recent quarters have been meaningfully better than anticipated, particularly in food and fuel components, while core inflation has remained relatively contained. We also note that some projections suggest inflation pressures could remain subdued into the early quarters of FY27, reflecting continued normalization in supply conditions, stable demand

side dynamics, and the absence of broad-based price pressures across goods and services.

In our view, this low inflation environment has important implications for both policy and growth. The moderation in inflation has created space for a more accommodative monetary stance, allowing policymakers to focus on supporting growth without compromising price stability. We believe that lower inflation is also directly supportive of real incomes, which is especially important in an economy where private consumption accounts for a large share of aggregate demand. As purchasing power improves, we expect household spending to remain resilient, particularly across discretionary categories, services, and consumer durables. We also see softer inflation reducing uncertainty for businesses, which can support planning, investment decisions, and hiring intentions.

We further note that benign inflation dynamics improve financial conditions more broadly. Lower inflation helps contain real borrowing costs, supports credit demand, and eases pressure on corporate margins by stabilizing input costs. In our assessment, this environment is conducive to sustaining the ongoing investment cycle, particularly in sectors linked to infrastructure, manufacturing, and services. We also believe that improved inflation outcomes enhance policy credibility, reinforcing confidence among domestic and foreign investors in the macro framework.

That said, we remain mindful that the inflation outlook is not without risks. While near term trends are favourable, upside risks persist, primarily from supply side factors. We see weather related disruptions as a key area of vulnerability, given their potential impact on agricultural output and food prices. We also recognize that volatility in global energy markets could reintroduce pressure on fuel and transport costs, particularly if geopolitical tensions escalate or supply conditions tighten unexpectedly. In addition, we acknowledge that shifts in global trade policies or supply chains could generate imported inflation at the margin, even if domestic conditions remain well managed.

Policymakers have emphasized the need for vigilance and a data dependent approach, and we agree with this assessment. We expect the RBI to continue balancing the opportunity to support growth through calibrated easing with the imperative of preserving price stability. In our view, the current inflation backdrop provides a favourable starting point for this balancing act, offering flexibility while reinforcing macro stability. Overall, we believe that the sustained moderation in inflation strengthens India's growth outlook, supports domestic demand, and enhances resilience against external shocks, even as close monitoring of evolving risks remains essential.

Monetary Policy and Interest Rates

We assess India's monetary policy as having evolved in a highly calibrated and deliberate manner in response to the prevailing macroeconomic environment, reflecting the Reserve Bank of India's careful balancing of its dual objectives of sustaining growth while maintaining price stability. We observe that after a series of policy rate cuts delivered earlier in 2025, the RBI's Monetary Policy Committee opted to maintain the repo rate at 5.5 percent in recent reviews. We interpret this decision as signalling a neutral stance, designed to provide time for earlier easing measures to fully transmit through the broader economy while retaining sufficient flexibility to respond to evolving risks. In our view, the pause reflects the RBI's recognition that although domestic growth momentum is strong, certain risks remain, including potential volatility in global financial markets, uncertainties arising from trade policy shifts, geopolitical tensions, and the ongoing calibration of supply side conditions across key sectors of the economy.

We see the RBI's approach as consistent with a strategy of measured policy management, in which accommodative measures are applied in a calibrated manner to support private consumption, investment, and credit growth without compromising the central bank's inflation mandate. In particular, we note that domestic analysts, including ICRA, have described the policy stance as dovish, emphasizing that the combination of neutral policy and subdued inflation provides room for additional easing should the transmission of earlier rate cuts strengthen and growth momentum remain robust. We also observe that market expectations have increasingly factored in the potential for further adjustments to policy rates in late 2025 or early 2026, contingent on macroeconomic outcomes, inflation trends, and evolving domestic financial conditions. In our assessment, this forward-looking positioning reinforces confidence that the RBI's approach remains both flexible and data dependent, allowing it to respond effectively to changing conditions while maintaining a credible commitment to price stability.

We place India's monetary policy stance in the broader context of global trends and note several points of comparison. As inflationary pressures have moderated across a number of major advanced economies, central banks have increasingly shifted toward neutral or accommodative postures, while in some cases retaining optionality for further easing should growth underperform. We also recognize that divergences persist across economies due to differences in inflation trajectories, labor market tightness, fiscal policy orientations, and financial system characteristics. Within this global context, we see emerging market central banks, including India's, taking a proactive approach to support domestic economic activity. We view India's policy framework as emphasizing measured accommodation, enabling investment, consumption, and credit expansion, while simultaneously safeguarding against potential disruptions from capital flow volatility, imported inflation pressures, or global financial shocks.

We further observe that the RBI's strategy provides several advantages for the domestic economy. First, maintaining the repo rate at a neutral level allows the effects of earlier policy easing to flow through the banking system, supporting household borrowing, corporate investment, and broader financial intermediation. Second, we see the neutral stance as providing policy flexibility, which allows the central bank to react to upside inflation surprises or sudden external shocks without resorting to abrupt tightening that could disrupt growth. Third, we interpret the RBI's emphasis on a data dependent approach as critical for reinforcing credibility with both domestic and international market participants, underpinning stable financial conditions and sustaining investor confidence in the macroeconomic framework.

In our view, the RBI's measured approach also strengthens the transmission of monetary policy through multiple channels. We observe that lower and stable interest rates support credit demand from households and businesses, thereby reinforcing consumption and investment activity. We also note that supportive policy encourages capital formation in critical sectors such as manufacturing, infrastructure, and services, while helping to sustain employment growth and household income. In addition, we see the policy stance as helping to moderate financial market volatility, as clear guidance on the central bank's intentions reduces uncertainty and stabilizes expectations for interest rates and inflation.

On balance, we believe that India's monetary policy in 2025 reflects a careful and proactive approach. We see it as supportive of the economy's ongoing momentum while preserving flexibility to respond to potential risks. We view the combination of neutral policy, subdued inflation, and continued policy accommodation as reinforcing a favourable environment for growth, consumption, and investment, even as the RBI remains vigilant regarding both domestic and external uncertainties. Overall, we assess that India's monetary policy framework is well aligned with broader macroeconomic objectives, balancing short term growth support with medium term stability and credibility, while reflecting a clear awareness of global trends and emerging market dynamics.

Fiscal Policy and Structural Drivers

We assess fiscal policy as continuing to play a central and highly strategic role in India's macroeconomic framework, providing a key complement to domestic demand drivers and monetary policy. We observe that the government has prioritized targeted support for infrastructure development, capital expenditure, and structural reform initiatives, all of which are designed to enhance the economy's long term growth trajectory. In our view, these measures are not only supportive of near-term demand but also contribute to productivity improvements, stronger supply side capacity, and increased

competitiveness across key sectors such as manufacturing, logistics, energy, and digital services. We also note that the government's fiscal stance has been carefully calibrated to balance the objectives of sustaining growth while maintaining debt sustainability and fiscal prudence, reflecting a broader strategic approach to macroeconomic management.

We expect the upcoming Union Budget for 2026-27 to reinforce this approach, with a continued emphasis on fiscal consolidation, institutional reforms, and enhanced revenue mobilization. We see the budget as likely to incorporate recommendations from industry bodies and policy experts, aimed at creating a sustainable fiscal framework that supports investment, encourages private sector participation, and ensures transparency in government finances. In our assessment, measures that strengthen institutional processes, improve tax compliance, and rationalize subsidies are critical for preserving fiscal space, enhancing policy credibility, and supporting the medium-term growth outlook. We also view the anticipated focus on capital expenditure and infrastructure investment as a direct lever for stimulating domestic demand, generating employment, and crowding in private sector investment, thereby reinforcing a virtuous cycle of growth.

We observe that structural measures such as the rationalization of the Goods and Services Tax have had meaningful macroeconomic effects. We believe that GST rationalization has contributed to the benign inflation environment by improving the efficiency of indirect taxation, reducing distortions, and helping moderate price pressures across key consumer and intermediate goods. We also see these reforms as supportive of consumption and overall market sentiment, as businesses and households benefit from greater clarity, simplification, and predictability in the tax framework. In our view, such measures are an important complement to monetary policy accommodation, creating a supportive ecosystem for private consumption and investment growth while maintaining overall macro stability.

We also note that the government's structural policy initiatives extend beyond taxation and spending. We see efforts to enhance regulatory efficiency, promote public private partnerships, and streamline investment approval processes as key elements in strengthening long term economic resilience. In our assessment, these initiatives not only foster a more favourable business environment but also encourage innovation, improve competitiveness, and help integrate the domestic economy more effectively with global supply chains. We also observe that these reforms are designed to ensure that growth remains inclusive, with a focus on employment generation, skill development, and improved access to infrastructure across both urban and rural regions.

We believe that the combination of targeted fiscal support, structural reforms, and careful attention to debt sustainability positions India to maintain robust growth momentum even amid evolving global conditions. We also see the government's approach as reinforcing policy credibility, which is critical for investor confidence and the

effective functioning of financial markets. In our view, fiscal policy is not only supporting current demand and investment cycles but also laying the foundation for a more resilient and higher growth trajectory over the medium term. Overall, we assess that India's fiscal framework, through a combination of expenditure prioritization, revenue enhancement, and structural reforms, remains a central pillar of macroeconomic stability, directly supporting growth, consumption, and investment while ensuring that the economy is well positioned to navigate both domestic and external challenges.

External Environment and Risks

We assess the global macroeconomic environment as continuing to be uneven and highly dynamic, with growth prospects varying significantly across major economies and ongoing policy uncertainty in developed markets. We observe that trade realignments, geopolitical tensions, and shifts in monetary policy in advanced economies have introduced volatility into capital flows and exchange rates, which in turn have implications for emerging market stability. We note that these external developments could influence investment decisions, borrowing costs, and financial market sentiment in India, even as domestic conditions remain resilient. In our view, the combination of external risks and global policy uncertainty underscores the importance of a cautious and responsive policy stance, particularly in managing exchange rate pressures, capital flows, and financial market volatility.

We believe that India's internal demand drivers continue to provide a strong foundation for sustained growth. We observe that private consumption remains broad based and resilient, supported by rising household incomes, stable inflation, and ongoing labor market improvements. We also see that investment in infrastructure, capital goods, and strategic sectors continues to expand, reinforcing medium term growth potential. In our assessment, these domestic fundamentals create a buffer against external headwinds, allowing the economy to maintain momentum even in a volatile global context.

Looking ahead to 2026, we see India's macro outlook as characterized by a combination of strong domestic growth, subdued inflation, and a cautious but supportive monetary stance. We note that monetary policy remains flexible and data dependent, allowing the Reserve Bank of India to balance growth support with the need to preserve price stability. We also observe that fiscal policy, through targeted capital expenditure, revenue measures, and structural reforms, continues to complement monetary policy by supporting investment, consumption, and long term productivity improvements. In our view, these coordinated policy efforts are critical to maintaining macroeconomic stability while reinforcing investor confidence and financial market resilience.

We further assess that structural reforms remain central to India's ability to sustain growth in a challenging global environment. We see initiatives such as Goods and

Services Tax rationalization, labor law reforms, regulatory streamlining, and investment facilitation as enhancing both domestic and external confidence in the economy. We believe that these reforms strengthen India's competitiveness, improve efficiency, and reinforce macro resilience, particularly in the face of external volatility and potential capital flow disruptions.

At the same time, we remain attentive to external risks that could influence growth and financial conditions. We note that slower growth in key trading partners, trade protectionism, and fluctuations in global commodity prices could weigh on exports, corporate margins, and investment sentiment. We also observe that global monetary policy divergences, particularly in advanced economies, could introduce volatility in capital flows, interest rates, and exchange rates, all of which require careful monitoring. In our assessment, these external factors highlight the importance of a calibrated policy response that is proactive yet flexible, balancing the objectives of supporting domestic demand, maintaining price stability, and safeguarding financial system stability.

On balance, we view India's macroeconomic trajectory in 2026 as constructive. We see strong domestic fundamentals, supportive fiscal and monetary policies, and ongoing structural reforms as providing resilience against global headwinds. At the same time, we emphasize that vigilant monitoring of external developments and timely, calibrated policy action will be critical to sustaining momentum, preserving macro stability, and ensuring that India remains well positioned relative to both emerging and advanced market peers.

Global Context and Spillovers

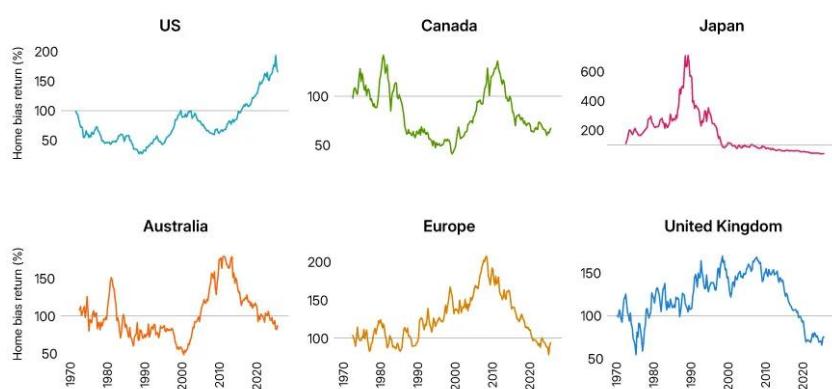
Uneven Global Growth and Terminal Slowdown

We assess the global economic environment as likely to remain characterized by modest growth in 2026, reflecting persistent headwinds from trade tensions, policy uncertainty, and slower momentum in developed economies. We observe that the latest projections from the International Monetary Fund indicate global GDP growth of approximately 3.1 percent for 2026, marking a slowdown from the higher growth rates seen earlier in the decade. We interpret this moderation as a consequence of the fading effects of front-loaded fiscal support, tariff-related policy adjustments, and the gradual unwinding of pandemic-related stimulus measures. In our assessment, the divergence between advanced economies and emerging markets underscores structural differences in growth drivers, signalling a broad-based moderation rather than a synchronized global expansion.

We see advanced economies, including the United States and key European markets, projected to grow at roughly 1.5 percent, reflecting subdued investment, labor market adjustments, and lingering uncertainty in policy frameworks. In contrast, we note that emerging markets and developing economies are expected to expand slightly above 4 percent, supported by domestic consumption, investment in infrastructure and technology, and ongoing structural reforms. We interpret this divergence as indicative of the stronger role of internal demand and policy flexibility in emerging markets, allowing these economies to partially offset weaker external conditions and maintain relatively robust growth.

We also assess India as positioned to outperform global averages in this environment. We observe that IMF projections place India's GDP growth near 6.5 percent in 2025 and 2026, a performance we attribute to resilient domestic demand, broad based consumption growth, and ongoing reforms across infrastructure, investment facilitation, and the regulatory environment. We see these domestic drivers as providing a buffer against slower global growth, while enabling India to maintain investment momentum, support employment generation, and sustain real income growth. In our view, India's growth trajectory in 2026 reflects both the strength of its internal demand base and the cumulative impact of policy measures that have enhanced productivity and competitiveness over the medium term.

We further note that global trade tensions and evolving tariff regimes continue to influence international economic dynamics. We see these developments as dampening global



trade volumes, inducing supply chain recalibrations, and introducing uncertainty for export-dependent sectors. We assess that slower external demand growth has implications for corporate investment decisions, cross-border capital flows, and sectoral performance, particularly in economies heavily reliant on trade. In our view, while India's domestic demand and investment drivers are robust, vigilance is warranted with respect to external shocks, as shifts in global trade patterns or protectionist measures could affect export growth, supply chain costs, and financial market sentiment.

Overall, we interpret the 2026 global growth outlook as moderate, with clear regional variations and structural divergences shaping economic outcomes. We see India as well positioned relative to global peers, supported by strong domestic fundamentals, ongoing policy reforms, and targeted investment in growth enabling sectors. At the same time, we

emphasize that external risks remain, and the trajectory of trade, capital flows, and global monetary conditions will need to be monitored closely to ensure that domestic momentum can be maintained in a volatile international environment.

Monetary Policy Divergence and Liquidity Dynamics

We assess that monetary policy stances across major central banks have become increasingly heterogeneous, reflecting diverging domestic conditions and differing approaches to inflation management, growth support, and financial stability. We observe that 2025 was characterized by a broadly accommodative cycle, with central banks including the Federal Reserve, European Central Bank, and Bank of England implementing one of the largest aggregate monetary easing phases in recent history. We note that hundreds of basis points of policy rate cuts were enacted across both advanced and emerging markets in response to slowing inflation pressures and moderating growth, providing a deliberate boost to liquidity and financial conditions.

We believe that the net effect of this extensive easing has been an increase in global liquidity, which has supported risk taking across asset markets, provided relief to financial conditions, and contributed to stronger portfolio flows into emerging market equities, corporate credit, and fixed income instruments. We also observe that the extended period of accommodative policy has compressed yields in fixed income markets, raised equity valuations, and encouraged investors to search for higher returns in developing markets. In our view, these developments have had a meaningful impact on capital allocation decisions, corporate funding costs, and broader market sentiment in emerging economies, including India.

We expect the policy mix to diverge in 2026 as individual economies recalibrate to local inflation dynamics, labour market conditions, and growth prospects. We note that this recalibration is likely to influence global currency markets, yield curves, and cross border funding costs, creating differential effects for countries depending on their external exposure and financial market integration. We see these divergences as highlighting the importance of monitoring external financial conditions and policy signals when assessing domestic macroeconomic stability and capital flow risks.

We further observe that liquidity spillovers from advanced economies continue to influence local conditions in emerging markets through multiple channels. We see that global credit conditions, portfolio rebalancing, and unconventional policy measures in large economies can affect asset prices, borrowing costs, and exchange rates in developing markets. We also note that these spillovers tend to temporarily lift equity valuations, lower local borrowing costs, and enhance market confidence, but they simultaneously heighten sensitivity to sudden shifts in global risk sentiment, monetary policy reversals, or financial market volatility. In our view, this dual effect underscores the

need for emerging markets to maintain robust macroeconomic fundamentals, flexible policy frameworks, and strong financial buffers to mitigate the impact of sudden external shocks.

On balance, we assess that the heterogeneous global monetary policy environment in 2026 presents both opportunities and risks for emerging markets. We see India as relatively well positioned, given strong domestic demand, supportive fiscal and monetary policy, and resilient structural drivers of growth. At the same time, we emphasize that careful monitoring of capital flows, exchange rate movements, and shifts in global liquidity conditions will be critical to sustaining financial stability and preserving macroeconomic momentum amid a complex and evolving international landscape.

Exchange Rates and Capital Flows

We assess that the evolution of global monetary conditions has a direct and material influence on currency markets, with significant implications for emerging economies, including India. We observe that periods of broad monetary easing in developed

Rupee has wiped all of its losses seen over 2025 so far



Source: LSEG

economies have historically coincided with a weaker US dollar environment, which in turn can reduce external funding pressures and support capital flows into higher growth markets. In our view, these dynamics are particularly relevant for India, where shifts in the strength of the US dollar and changes in interest rate differentials have direct implications for foreign portfolio

investment flows, the valuation of the Indian rupee, and broader external financing costs.

We also note that recent market conditions illustrate the inherent fragility of these transmission mechanisms. We see that radial shifts in dollar liquidity and pressures in forward markets have placed stress on emerging market currencies, including the Indian rupee. In particular, we observe that elevated forward premiums emerged due to excess dollar liquidity combined with regulatory constraints, reflecting a mismatch between cross-border funding availability and domestic hedging demand. In our assessment, these conditions highlight how global funding stress can spill over into domestic currency markets, amplifying volatility in asset prices and creating potential challenges for corporates and financial institutions if such pressures are not managed proactively.

We further assess that the interaction between global monetary policy and capital flows extends beyond currency valuation to influence sovereign and corporate funding costs.

We see that volatile foreign investment flows can drive movements in bond yields, increase equity risk premiums, and affect the cost of capital for both public and private sector borrowers. In our view, these dynamics underscore the importance of maintaining adequate buffers, including robust foreign exchange reserves, strong fiscal positions, and prudent external debt management, as essential tools to absorb external shocks while sustaining investor confidence.

We also note that policy calibration at the domestic level plays a critical role in mitigating the impact of external volatility. We see that effective regulation of capital flows, active management of currency hedging markets, and coordination between monetary and fiscal authorities can help stabilize the rupee and contain excessive swings in funding costs. In our assessment, such measures, when combined with strong macro fundamentals, allow India to maintain resilience against abrupt shifts in global liquidity conditions and to preserve the momentum of domestic growth.

On balance, we believe that while India benefits from periods of global easing and associated capital inflows, the volatility inherent in cross-border funding and currency markets requires ongoing vigilance. We assess that maintaining strong foreign exchange reserves, sound fiscal policies, and flexible monetary management is critical to managing these external risks. We see these elements as foundational for sustaining investor confidence, supporting stable funding costs, and ensuring that domestic asset markets remain resilient amid the evolving global monetary environment.

External Spillovers to Financial Systems

We assess that global macroeconomic developments continue to have a material influence on the domestic financial system through multiple channels, including trade, credit, and liquidity. We observe that the Reserve Bank of India has explicitly acknowledged the potential for external spillovers, such as trade policy shocks, geopolitical tensions, and shifts in global financing conditions, to affect the domestic credit cycle, asset quality, and bank lending behaviour. In our view, this recognition highlights the growing interconnectedness of international markets and the sensitivity of India's financial system to global developments. We also see that these external dynamics can have both direct and indirect effects on the domestic economy, influencing investment decisions, borrowing costs, and the overall functioning of financial markets.

We note that the RBI's stress tests provide important insights into the potential vulnerabilities of the banking system under adverse global scenarios. We observe that significant external shocks could lead to an increase in non-performing assets even under baseline conditions. In our assessment, this underscores the need for banks to maintain robust risk management frameworks, sufficient capital buffers, and proactive

provisioning practices. We also see that monitoring asset quality closely, especially in sectors with high external exposure, is critical to ensuring that domestic credit flows remain stable and that financial institutions continue to support economic activity. In our view, the results of these stress tests reflect not only the interconnectedness of global and domestic markets but also the importance of resilience within the banking system to absorb shocks while maintaining operational continuity.

We further observe that tighter global financial conditions or sudden reversals in investor risk appetite could trigger capital outflows, placing upward pressure on sovereign credit spreads and compressing domestic liquidity. We assess that these dynamics could constrain domestic credit growth, particularly affecting corporates that rely on foreign currency borrowing or external funding sources. We also see that elevated funding costs can influence corporate investment decisions, profitability, and overall financial stability. In our view, managing these risks requires coordinated macroeconomic policy, careful monitoring of cross-border capital flows, and targeted interventions to ensure that domestic financial conditions remain supportive of growth.

We believe that maintaining strong macro fundamentals is critical in this context. We see that robust foreign exchange reserves, prudent fiscal management, and a flexible monetary stance provide a buffer against external shocks and help stabilize domestic financial markets. We also note that regulatory oversight, including active supervision of banks and financial institutions, is essential for detecting vulnerabilities early and preventing the transmission of global shocks into domestic credit conditions. In our assessment, these measures are central to sustaining investor confidence, maintaining liquidity in the system, and ensuring that credit remains available to households and corporates alike.

On balance, we view India's domestic financial system as resilient, but we recognize that it remains exposed to global spillovers. We see that effective risk management, strong policy coordination, and adherence to sound macroeconomic fundamentals are essential for mitigating external pressures. We also assess that by maintaining adequate buffers, monitoring asset quality, and managing liquidity proactively, India can absorb shocks from global financial volatility while continuing to support credit growth, investment, and broader economic expansion. We view these elements as foundational to preserving financial stability, maintaining confidence in the banking system, and sustaining the momentum of India's macroeconomic growth trajectory in a challenging global environment.

Implications for Indian Equity Markets

We assess that the global macroeconomic backdrop and associated spillover effects will play a critical role in shaping risk-return dynamics for Indian equities in 2026. We observe that slower global growth, continued divergence in monetary policy across major economies, and ongoing uncertainty in trade and geopolitical developments are likely to contribute to heightened volatility and episodic repricing across cross-asset markets. We also see that selective monetary easing in developed economies may provide intermittent support to risk assets, including equities in emerging markets, but we believe that the sustainability of such gains will depend on the trajectory of global inflation, the pace of policy normalization, and broader investor sentiment toward risk.

We view these global conditions as reinforcing the importance of focusing on domestic fundamentals and earnings quality for Indian equities. We observe that sectors with significant export orientation or dependence on foreign capital flows may be disproportionately affected by external shocks, including currency fluctuations, shifts in global liquidity, or sudden changes in investor risk appetite. In contrast, we see that equities with strong linkage to domestic demand, resilient balance sheets, consistent cash flow generation, and pricing power are likely to exhibit relative outperformance. We also note that companies with robust operational efficiency, prudent leverage, and flexible cost structures are better positioned to navigate periods of global uncertainty while maintaining growth and profitability.

We further assess that investor outcomes in 2026 will be shaped by the interplay between global liquidity conditions and domestic growth differentials. We see that India's relatively strong domestic demand, continued structural reforms, and stable macro fundamentals create a favourable backdrop for equities, even as episodic external shocks introduce volatility. In our view, disciplined positioning and a focus on high-quality businesses will be essential for navigating these mixed conditions. We also observe that active management of currency risk is critical, given the sensitivity of foreign portfolio flows and export-oriented sectors to rupee movements.

Outlooks 2026

Real GDP growth forecasts (% change, yoy)

	2025	2026	2026 consensus
World	2.8%	2.8%	2.5%
US	2.1%	2.6%	2.0%
Euro Area	1.5%	1.3%	1.1%
Germany	0.3%	1.1%	1.0%
France	0.9%	1.2%	0.9%
Italy	0.6%	0.7%	0.7%
Spain	2.9%	2.4%	2.2%
China	5.0%	4.8%	4.5%
Japan	1.2%	0.8%	0.7%
UK	1.4%	0.9%	1.1%
Canada	1.7%	1.3%	1.2%
India	7.6%	6.7%	6.5%
Brazil	2.3%	1.8%	1.7%
Russia	0.5%	1.2%	1.0%

Source: Goldman Sachs Research, Bloomberg
All forecasts as of December 18, 2025.

Goldman
Sachs

We believe that a deeper understanding of global spillover channels, including interest rate differentials, capital flow dynamics, and cross-border risk sentiment, will be increasingly important for investors. We assess that monitoring these channels can help anticipate periods of stress or repricing and guide tactical adjustments in portfolios. In our view, a combination of strong fundamentals, careful risk management, and selective allocation to sectors with resilient domestic growth exposure will be central to achieving favourable outcomes in the 2026 Indian equity landscape.

On balance, we see the equity market environment as characterized by both opportunity and risk. We assess that domestic growth drivers, supportive policy frameworks, and corporate balance sheet strength provide a constructive foundation, while external volatility and global macro uncertainties will require vigilance, disciplined investment approaches, and proactive risk management. We view this combination of factors as shaping a selective, fundamentals-driven approach to Indian equities in 2026, where careful attention to earnings quality, domestic demand exposure, and structural resilience will be critical to navigating the evolving risk-return landscape.

Market Structure and Valuation

Valuation Frameworks in India

We assess that evaluating Indian equities requires a nuanced approach that integrates both traditional valuation multiples and cycle-adjusted frameworks to distinguish between transient overvaluation and structurally justified pricing. We observe that standard metrics, including price-to-earnings and price-to-book ratios, continue to serve as foundational tools for assessing market valuation. In our view, forward price-to-earnings ratios in India are elevated relative to historical norms, with 12-month forward PE trading well above long-term averages. We interpret this as reflecting robust corporate profitability and strong domestic demand, while also signalling persistent valuation risk that market participants must carefully consider. We also note that forward price-to-book ratios remain above decade-long averages, particularly when compared with other emerging markets, indicating that investment risk premia are relatively compressed and that a portion of expected returns is already priced into equities.

We further observe that incorporating cyclically adjusted valuation measures provides a more comprehensive understanding of long-term equity valuation regimes. We see that the Indian CAPE ratio, modelled on Shiller's cyclically adjusted price-earnings framework, smooths earnings over extended business cycles to account for episodic volatility. In our assessment, this approach helps to contextualize periods of apparent overpricing or under-pricing relative to structural earnings capacity, allowing investors to

better calibrate long-term return expectations. We also note that the CAPE framework mitigates the risk of relying solely on short-term earnings outcomes, which may be influenced by transitory shocks such as commodity price swings, regulatory changes, or one-off corporate events.

We assess that valuation analysis should also consider relative, risk-adjusted returns compared with alternative asset classes. We observe that in certain periods, earnings yield on Indian equities have fallen below post-tax government bond yields, challenging conventional risk-reward assumptions and highlighting the need for sustained earnings growth to justify current pricing. In our view, this dynamic underscores the importance of assessing equity valuations not only on an absolute basis but also relative to fixed income and other asset classes, particularly in a regime of historically low interest rates and abundant global liquidity.

We further see that understanding both absolute and relative valuation metrics is critical for portfolio positioning. We assess that equities with strong earnings visibility, resilient business models, and pricing power are better positioned to deliver attractive risk-adjusted returns even in a high-valuation environment. We also observe that cyclically sensitive sectors may exhibit greater volatility in valuations, requiring active monitoring and disciplined risk management. In our view, the combination of forward multiples, cyclically adjusted frameworks, and cross-asset comparisons provides a robust foundation for evaluating Indian equities and for setting realistic return expectations over medium to long horizons.

On balance, we assess that Indian equity valuations are elevated by historical standards, reflecting strong fundamentals and positive growth prospects, while also signaling heightened sensitivity to earnings disappointments or macroeconomic shocks. We see disciplined assessment using both static and cycle-adjusted measures, combined with an understanding of relative risk-reward versus other asset classes, as essential for navigating the current market environment and for making informed investment decisions over 2026 and beyond.

Valuation Premiums and Market Comparisons

We assess that Indian equities have historically traded at a meaningful premium relative to broader emerging markets and, at certain points, relative to developed markets. We observe that this premium reflects structural factors such as stronger expected economic growth, higher return on equity, and greater productivity relative to peer markets. We also note that while the relative valuation premium over the United States may have narrowed or temporarily disappeared in select periods, the premium relative to other emerging markets remains substantial. In our view, this persistent premium highlights India's structural advantages, including robust domestic demand, favourable

demographics, resilient corporate earnings, and ongoing reforms that enhance productivity and profitability.

We further see that this relative valuation premium has important implications for capital allocation and cross-border investment flows. We observe that foreign portfolio investors closely monitor relative valuation spreads, and we believe that an elevated premium increases sensitivity to global liquidity conditions and risk-off episodes. In our assessment, this dynamic can result in episodic or inconsistent FPI flows, even when domestic fundamentals remain strong, underscoring the importance of understanding global macro trends, investor sentiment, and cross-border funding dynamics when evaluating market performance.

At a cross-market level, we assess that India's forward valuations remain rich relative to key peers such as China, Indonesia, and the Philippines, even after a period of broad valuation adjustment. We see that this relative expensiveness reinforces the need for disciplined valuation management through both top-down and bottom-up approaches. In our view, investors must balance expectations for earnings growth, corporate profitability, and sectoral performance against the elevated market multiples, ensuring that portfolio positioning remains aligned with risk-adjusted return objectives.

We also observe that managing the relative valuation premium requires a focus on fundamentals and quality. We see that equities with strong domestic demand linkage, resilient balance sheets, and pricing power are better positioned to justify higher valuations, whereas export-oriented or cyclical sectors may be more sensitive to external shocks and global liquidity shifts. In our assessment, active monitoring of global risk sentiment, currency movements, and macroeconomic developments is critical to mitigating downside risk and navigating periods of volatility.

On balance, we view India's relative valuation premium as a reflection of structural growth advantages and investor confidence in long-term prospects. We see that while this premium supports continued interest from domestic and foreign investors, it also increases sensitivity to global macro developments, emphasizing the importance of disciplined, fundamentals-driven portfolio management. We assess that a combination of top-down macro awareness, bottom-up stock selection, and proactive risk management is essential for navigating Indian equities and achieving sustainable, risk-adjusted returns in 2026 and beyond.

Style Dispersion and Market Leadership

We assess that current market conditions in India exhibit pronounced style and segment dispersion, which we interpret as a hallmark of transitional equity cycles. We observe that large-cap indices, such as the Nifty 50, have reached record highs, driven by renewed earnings optimism, strong domestic macro fundamentals, and continued policy support. In contrast, smaller market segments, including the broader small-cap universe, have lagged behind, reflecting valuation-earnings mismatches, tighter liquidity conditions, and higher sensitivity to investor risk sentiment. We note that nearly half of small-cap constituents continue to trade well below prior highs, underscoring a widening divergence in performance across market capitalizations, sectors, and investment styles.

We further observe that this dispersion manifests across multiple factor dimensions, including size, value, quality, and momentum. We see that empirical studies suggest traditional factors such as size and beta remain relevant in explaining Indian equity returns, whereas the pure value factor has a more muted influence relative to global markets. In our assessment, these dynamics indicate that investors need to adopt multi-factor approaches that combine size, quality, and growth considerations to better understand relative performance patterns and capture return opportunities across heterogeneous market segments.

We also note that factor-based approaches in India increasingly integrate traditional valuation signals with quality, momentum, and growth metrics. We assess that this blending allows investors to navigate markets characterized by mixed signals, balancing the potential for cyclical mean reversion in valuations with the structural growth trajectories of high-quality companies. In our view, these multi-factor frameworks are critical for identifying sectors and stocks that can generate surplus returns while simultaneously controlling drawdown risk in volatile regimes.

We further observe that this style dispersion reflects the broader macroeconomic and corporate environment. Large-cap outperformance has been supported by companies with resilient earnings, strong balance sheets, and pricing power, whereas smaller companies with higher leverage or less predictable earnings have underperformed. We assess that this divergence is likely to persist in the near term, given ongoing global uncertainty, shifts in liquidity conditions, and investor preference for defensive or higher-quality exposures.

On balance, we view the current market environment as one that rewards disciplined, multi-factor investment strategies and careful stock selection. We see that combining traditional valuation analysis with quality, momentum, and growth lenses provides a robust framework for navigating style and segment dispersion. We also assess that understanding factor dynamics and macro linkages is essential for positioning portfolios

effectively, capturing upside in resilient segments, and mitigating downside risk in segments most exposed to market volatility. We believe that investors who actively manage these dimensions are better positioned to generate sustainable, risk-adjusted returns in the evolving Indian equity landscape.

Risk Premia and Equity Compensation

We assess that equity risk premia in India reflect the compensation that investors require for holding equities over risk-free assets, capturing both macroeconomic and corporate uncertainties. We observe that forward-looking studies estimate India's equity risk premium to be in the range of 6.7 percent to 7.0 percent, which we interpret as elevated relative to historical norms. In our view, this level of ERP signals that investors are demanding higher compensation for exposure to cyclical, external risks, and market volatility, even as the Indian economy and corporate sector exhibit strong growth prospects. We also note that this ERP aligns broadly with emerging market averages while incorporating structural variables such as macroeconomic volatility, corporate earnings uncertainty, and sensitivity to global liquidity conditions.

We further observe that risk premia vary significantly across market segments and investment styles. We see that smaller, less liquid stocks typically command higher premia due to lower market depth, information asymmetry, and higher earnings volatility. Conversely, we assess that high-quality, large-cap stocks with stable cash flows and resilient balance sheets tend to exhibit lower risk premia, reflecting their relative safety and predictability in volatile environments. In our view, the current earnings-valuation gap observed in smaller segments highlights the existence of an illiquidity premium that may not be fully priced, as expectations for earnings growth and valuation normalization remain uneven across the market.

We assess that a cross-sectional understanding of risk premia is essential for informed portfolio construction. We see that investors must balance anticipated returns against both systematic and idiosyncratic risks, particularly in an environment where earnings dispersion, style divergence, and factor heterogeneity remain elevated. In our view, integrating risk premia analysis into investment decisions allows for more precise calibration of sector and stock exposures, helping to optimize expected returns relative to risk while accounting for liquidity, size, and quality differentials.

We also note that ERP dynamics interact closely with broader macro and market conditions. We observe that changes in interest rates, global risk sentiment, and capital flow patterns can influence required premia, particularly for segments with higher external sensitivity. In our assessment, monitoring these interactions is critical to ensure that portfolio positioning remains aligned with evolving risk-return profiles and that exposures to cyclical or externally vulnerable stocks are managed prudently.

On balance, we view India's current equity risk premia as elevated but justified by strong domestic fundamentals, structural growth potential, and residual external and cyclical risks. We assess that incorporating cross-segment premia analysis, combined with factor and quality considerations, provides a robust framework for portfolio allocation. We also see that disciplined attention to risk-adjusted returns, illiquidity compensation, and style heterogeneity is essential for capturing sustainable equity performance in 2026 and beyond.

Liquidity, Market Participation, and Structural Drivers

We assess that the market structure in India has experienced a meaningful shift toward greater participation from domestic investors, which we view as a structural development that strengthens the resilience and depth of equity markets. We observe that retail investors and domestic institutional investors, including mutual funds, insurance companies, and pension funds, have increased their share of flows, creating a stable and predictable liquidity base. In our view, this enhanced domestic participation helps to cushion market volatility, providing a counterbalance to episodic swings in foreign capital and reducing reliance on external funding sources. We also see that the sustained growth of systematic investment plan inflows, rising mutual fund assets under management, and increasing engagement from pension and insurance funds have collectively contributed to a deepening of Indian equity markets. We assess that this deepening reduces short-term pricing frictions, enhances market efficiency, and improves the transmission of earnings and macro fundamentals into market valuations.

We further observe that while domestic flows have bolstered market stability, the concentration of liquidity in a narrower subset of stocks, particularly within the large-cap cohort, has introduced style and capitalization dispersion. We see that this concentration tends to amplify valuation premiums for index-heavy names, while mid-cap and small-cap segments frequently remain underpriced or disconnected from broader market rallies. In our assessment, this divergence creates both opportunities and challenges for investors. Large-cap stocks may continue to benefit from structural domestic demand, while smaller and mid-cap companies may present selective opportunities for investors with a disciplined, fundamentals-based approach who are willing to engage with segments that are currently underrepresented in domestic flows.

We also assess that the evolution of domestic participation will increasingly shape return patterns across styles and capitalization segments. We see that as structural flows from retail and institutional investors become more entrenched, the relationship between domestic investment activity and valuation dispersion will emerge as a key determinant of relative performance. In our view, sectors and stocks that attract concentrated domestic demand are likely to continue to experience re-rating, while segments outside

these flows may demonstrate delayed or uneven valuation adjustments. We further observe that this dynamic reinforces the importance of understanding the structural underpinnings of liquidity and capital flows when making allocation decisions, rather than relying solely on short-term market movements.

We assess that domestic investor participation interacts closely with broader macroeconomic and corporate fundamentals. We observe that robust earnings growth, stable inflation, and supportive policy measures enhance the impact of domestic flows, creating a more resilient equity market ecosystem. At the same time, we see that periods of external stress, sector-specific earnings surprises, or sudden shifts in market sentiment can create temporary dislocations, particularly in mid- and small-cap segments that are less heavily supported by domestic flows. In our view, careful monitoring of both liquidity distribution and structural participation trends is critical for understanding market dynamics and managing risk across different market segments.

On balance, we view the strengthening of domestic investor participation as a positive structural development for Indian equities. We see that it provides a durable liquidity base, reduces reliance on external capital, and supports a more stable market environment. At the same time, we assess that style and capitalization dispersion will persist as a defining feature of the market, with large-cap index-heavy stocks commanding premiums and mid- and small-cap segments presenting selective opportunities for disciplined investors. We conclude that understanding the interplay between domestic flows, valuation dispersion, and macro fundamentals is essential for portfolio construction, risk management, and navigating evolving return patterns across the Indian equity market.

Earnings Outlook

Growth Drivers, Margin Sustainability, and Revision Trends

We assess that corporate earnings will remain a central driver of equity returns in India throughout 2026, as markets transition from a valuation-led phase toward an earnings-driven environment. We observe that after a prolonged period of muted earnings growth and broad downgrades across successive quarters, early signs of a cyclical inflection in India Inc's profitability trajectory are emerging. In our view, this inflection is evidenced by the recent onset of aggregate earnings upgrades, marking the first net positive revision cycle in approximately five quarters. We see that mid-cap and large-cap companies are leading this turnaround, reflecting both sectoral resilience and the impact of structural growth initiatives, whereas small-cap earnings continue to face

pressures stemming from elevated input costs, financing constraints, and narrower revenue bases.

We further note that the reversal in earnings revision trends suggests that corporate profit expectations are beginning to adjust upward following an extended period of downward pressure. We assess that this shift is likely underpinned by a combination of factors, including stronger domestic demand, improved pricing power among high-quality corporates, and incremental operational efficiencies that have begun to materialize across several key sectors. In our view, these factors provide a constructive backdrop for equity markets, as positive earnings revisions often serve as a catalyst for multiple expansion and sustained investor confidence.

We also observe that the earnings momentum in mid- and large-cap segments is reinforcing the relative attractiveness of these stocks in the current market environment. We see that companies with resilient balance sheets, diversified revenue streams, and consistent cash flow generation are better positioned to benefit from cyclical improvements and maintain margin stability. In contrast, small-cap companies remain more vulnerable to volatility in input costs, financing pressures, and sector-specific shocks, which continues to weigh on their earnings revisions and investor sentiment.

We assess that the earnings revision cycle will be a critical factor in shaping sectoral and market-wide performance in 2026. We see that investors who focus on identifying companies with sustainable earnings momentum, pricing power, and margin resilience are likely to capture disproportionate upside, whereas segments with weaker profitability outlooks may continue to experience relative underperformance. In our view, monitoring the breadth and quality of earnings revisions, along with underlying drivers of margin sustainability, will be essential for calibrating investment strategies and aligning expectations with risk-adjusted return objectives.

On balance, we view the emerging shift from net negative to positive earnings revisions as a constructive signal for Indian equities. We see that mid-cap and large-cap companies are positioned to lead the market, supported by cyclical recovery, structural growth initiatives, and operational efficiencies. We assess that earnings growth, margin sustainability, and the evolving revision trends will collectively serve as primary determinants of equity performance in 2026, guiding both sectoral allocation and stock selection for investors seeking durable, risk-adjusted returns.

Earnings Growth Drivers

We assess that several key drivers are likely to underpin corporate earnings momentum in India as we move through 2026, forming a constructive foundation for equity performance.

First, we see domestic demand resilience as a primary driver of revenue growth across multiple sectors. We observe that consumer spending, services consumption, autos, consumer staples, and select discretionary segments have maintained strength despite macroeconomic uncertainties. In our assessment, this resilience supports sustained top-line growth, and we note that forecasts from leading brokerage houses indicate meaningful year-on-year earnings expansion for major indices, with some models projecting double-digit aggregate earnings growth beginning in the 2026 fiscal year. We view this trend as a structural feature of India's growth model, reflecting robust household incomes, favorable demographics, and continued consumption diversification.

Second, we assess that cost structure dynamics are contributing to margin stabilization and potential expansion. We observe that input cost pressures have moderated relative to the prior two years, driven by softer commodity prices, improved supply chain efficiencies, and better inventory management. We also note that while certain sectors, particularly those reliant on imported or globally linked inputs, continue to face headwinds, many firms have demonstrated disciplined cost containment strategies. In our view, these improvements are likely to feed through to operating margins, and rating agencies project that corporate margins could stabilize or modestly expand in early FY26, supporting sustainable earnings growth.

Third, we see reductions in interest burden as an important contributor to earnings sustainability. We note that the series of central bank rate cuts in 2025 has begun to alleviate financing costs for leveraged corporates. In our assessment, lower interest expenses improve interest coverage ratios, which enhances financial flexibility and reinvestment capacity, particularly in capital-intensive sectors. We observe that improved coverage ratios not only reduce default risk but also create headroom for strategic investments, acquisitions, and operational expansion, which can further reinforce earnings momentum.

Fourth, we assess sectoral contributions as playing a meaningful role in shaping aggregate corporate earnings. We observe that certain sectors, including commodities, telecom, and consumer goods, have delivered stronger sequential profitability, contributing positively to overall earnings growth. Commodity producers, in particular, reported improved earnings in recent quarters, while bank and IT sector performance remains mixed, reflecting both cyclical and structural pressures. In our view, the divergence across sectors underscores the importance of selective exposure and stock-level differentiation when assessing earnings drivers and potential return outcomes.

On balance, we see that the combination of domestic demand resilience, moderated input costs, lower interest burden, and supportive sectoral contributions forms a constructive platform for corporate earnings in 2026. We assess that these drivers are likely to sustain margin stability, support top-line growth, and reinforce earnings revision

trends. In our view, investors who focus on companies with robust demand linkages, disciplined cost management, and strong financial metrics are better positioned to capture sustainable, risk-adjusted returns in the evolving Indian equity landscape.

Margin Sustainability

We assess that margin dynamics in India for 2025–26 present a nuanced picture, reflecting both stabilization in aggregate operating performance and selective expansion across sectors. We observe that operating profit margins for India Inc are expected to improve modestly in early FY26, building on sequential recovery observed in prior quarters. In our assessment, aggregate margins are projected to settle around 18.2 to 18.5 percent in Q1 FY26, supported by easing input costs, improved operating leverage, and disciplined cost management. We see that this margin stabilization provides a foundation for earnings sustainability and underpins the emerging positive revision trend in corporate profitability.

We further observe significant sectoral variation in margin performance, highlighting the uneven nature of profitability trends across the corporate landscape. We note that sectors such as commodities and autos have demonstrated strong margin expansion, reflecting favourable pricing dynamics, operational efficiency gains, and cyclical tailwinds. In contrast, segments such as financial services and technology face headwinds from competitive pressures, higher provisions, pricing constraints, and slower external demand. In our assessment, this divergence underscores that sustainable margin improvement will not be uniform across all sectors and that investors must adopt a selective approach when evaluating corporate earnings quality and future performance potential.

We also assess that cost pressures remain a constraining factor for certain segments of India Inc. We observe that raw materials, logistics, and other input-related costs continue to impact profitability in specific industries. In our view, companies with strong pricing power, efficient supply chain management, and disciplined cost control are better positioned to convert revenue growth into sustainable margin expansion. We see that these firms are likely to outperform peers in terms of profitability resilience and earnings stability, particularly during periods of input volatility or sector-specific challenges.

We further note that the interplay between cost dynamics, operating leverage, and sectoral performance will be a key determinant of corporate earnings in 2026. We see that firms able to maintain margin discipline while leveraging revenue growth are likely to generate superior risk-adjusted returns. In our assessment, monitoring the sustainability of margins, understanding sector-specific cost pressures, and evaluating competitive positioning are critical for anticipating earnings trajectories and calibrating portfolio allocations effectively.

On balance, we view the margin environment in 2025–26 as constructive yet heterogeneous. We see a trend toward stabilization and selective expansion, with strong performance concentrated in sectors benefiting from pricing power, operational efficiencies, and favourable cyclical conditions. We assess that careful attention to sectoral differences, cost management, and operating leverage will be essential for investors seeking to identify companies capable of sustaining margins and driving earnings growth in 2026 and beyond.

Revision Trends

We assess that the earnings revision cycle continues to serve as a key barometer of market sentiment and profit expectations in India, providing insight into the evolving trajectory of corporate profitability. We observe that after a sustained period of downward revisions, analysts have registered a net upgrade in consensus earnings estimates for FY26, led primarily by mid-cap and large-cap companies. In our assessment, this inflection reflects growing confidence in the earnings trajectory of a broad set of listed firms and signals that analysts are beginning to incorporate improved profitability prospects into forward-looking estimates. We also note that small-cap earnings estimates remain under pressure, continuing to adjust downward in aggregate, which highlights persistent stress in that segment and underscores ongoing performance dispersion across market capitalizations.

We further observe that earnings momentum is expected to strengthen meaningfully through FY26–27. Forecast models from independent research suggest year-on-year growth in the range of 10 to 15 percent, reflecting cyclical improvement, revenue leverage, and operational efficiency gains. We see that this rebound in earnings momentum is contributing to a shift in valuations toward levels more aligned with underlying fundamentals, rather than being driven solely by sentiment or market optimism. In our view, this adjustment provides a constructive foundation for earnings-driven market performance, reinforcing the importance of monitoring revisions to gauge both sectoral and market-wide confidence.

We also note that recent quarterly results provide mixed signals, reflecting heterogeneous earnings performance across sectors. Aggregate net profits among thousands of listed firms rose by approximately 10.8 percent year-on-year, indicating that a recovery in earnings is underway. In our assessment, much of this improvement has been driven by commodities and non-BFSI businesses, which have benefited from favourable pricing dynamics and robust domestic demand. At the same time, certain legacy sectors, including banks and traditional services firms, exhibited relatively subdued growth, reflecting competitive pressures, provisioning requirements, and slower external demand. We see this heterogeneity as reinforcing the need for selective

exposure and careful stock-level analysis to identify companies with sustainable earnings momentum.

On balance, we view the current earnings revision cycle as a positive signal for Indian equities, particularly in mid-cap and large-cap segments where upgrades are most pronounced. We assess that sustained earnings momentum, combined with margin stability and sectoral differentiation, will be key determinants of equity performance in 2026. We also see that monitoring revisions, earnings heterogeneity, and sectoral drivers will remain essential for investors seeking to align valuations with fundamentals and to capture risk-adjusted returns in a market characterized by both cyclical recovery and selective stress across segments.

Capital Flows and Ownership Trends

Domestic Participation, FII Flows, and Market Liquidity

We assess that Indian equity markets are experiencing a pronounced shift in the composition and drivers of capital flows as we approach 2026, with material implications for market behaviour, volatility, and return patterns. We observe that domestic institutional investors have become increasingly important relative to foreign institutional investors and foreign portfolio investors, both in terms of net flows and overall ownership share. In our assessment, this evolution reflects the deepening financialization of Indian savings, as well as rising participation from retail investors, mutual funds, and other domestic intermediaries, which together create a more stable and predictable liquidity base.

We further note that global investors are recalibrating portfolio allocations in response to external volatility, shifts in global liquidity conditions, and evolving risk-return considerations. In our view, this dynamic has contributed to a more balanced ownership structure in Indian equities, reducing dependence on episodic foreign flows and mitigating the impact of sudden cross-border reversals on domestic markets. We see that as DIIs increasingly anchor market liquidity; they help absorb volatility during periods of external stress, providing structural support to valuations and reinforcing the importance of domestic demand-driven market drivers.

We also observe that the evolving mix of capital flows has implications for market behaviour across segments and styles. In our assessment, large-cap stocks that are heavily held by domestic institutions may continue to benefit from concentrated buying, which can support valuation premiums, whereas mid- and small-cap segments, which are less represented in domestic flows, may experience more episodic pricing dislocations. We see that this divergence reinforces the need for selective positioning

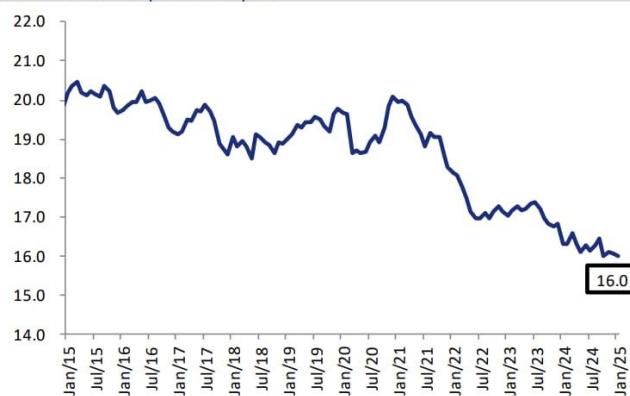
and careful risk management, particularly when considering segments that remain sensitive to external flows or liquidity shocks.

On balance, we view the shift toward greater domestic investor participation as a constructive structural development for Indian equities. We assess that it enhances market stability, deepens liquidity, and reduces reliance on external capital, while also introducing differentiated return dynamics across market segments. We see that understanding the composition of capital flows, the relative influence of domestic versus foreign investors, and the associated implications for volatility and valuations will be critical for portfolio construction, risk management, and capturing sustainable, risk-adjusted returns in the 2026 equity landscape.

Foreign Institutional Investor Trends

We assess that foreign participation in Indian equities has exhibited significant volatility through 2025 and into late 2025, reflecting the sensitivity of global investors to risk sentiment, interest rate expectations, and currency dynamics. We observe that after

Exhibit 1. FII ownership of Indian equities



extended periods of net selling exceeding ₹1.5 lakh crore over much of 2025, foreign portfolio investors intermittently returned to the market, with modest inflows recorded in select months such as October, when FPIs invested approximately ₹14,610 crore following a sequence of net outflows. In our assessment, this pattern illustrates the episodic and reactive

nature of foreign flows, which continue to be closely linked to global macro developments and investor risk appetite.

We further observe that, despite these intermittent inflows, the broader trend indicates challenging conditions for foreign capital in Indian equities. We see that net foreign inflows in 2024 amounted to just about ₹1,600 crore, sharply below historical averages, reflecting the heightened sensitivity of FPIs to global yields, relative valuations, and domestic macroeconomic signals. In our view, this environment underscores a structural shift in market drivers, where domestic investor participation increasingly plays a stabilizing role, while foreign flows have become less of a dominant influence on overall market direction.

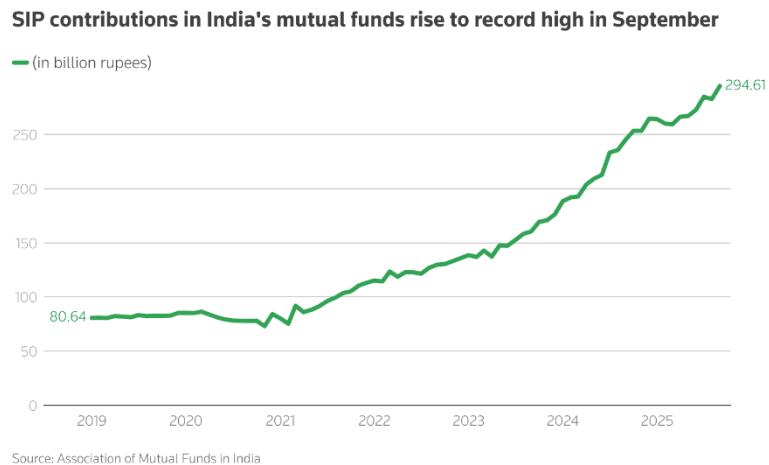
We also note that foreign flows continue to remain relevant, particularly in large-cap and high-beta segments, where they contribute to liquidity, price discovery, and episodic market momentum. In our assessment, these flows can amplify moves in index-heavy

stocks and influence market sentiment, but the overall market is now less dependent on FPI activity than in prior cycles. We see that the interplay between domestic and foreign participation creates a more diversified market structure, with domestic institutional investors providing structural support and foreign investors contributing episodic momentum and volatility.

On balance, we view the current FPI environment as one characterized by heightened selectivity and sensitivity to global conditions. We assess that while foreign participation remains an important component of market liquidity and pricing efficiency, domestic investors are now the primary anchors of Indian equity markets. We see that understanding the episodic nature of foreign flows, their sectoral concentration, and their interaction with domestic demand is critical for assessing market behaviour, managing volatility, and positioning portfolios effectively in 2026 and beyond.

Rise of Domestic Institutional Investors

We assess that domestic institutional investors have assumed an increasingly dominant and stabilising role in supporting the Indian equity market, a trend that has become especially pronounced in the context of volatile foreign portfolio flows. We observe that the surge in domestic inflows has been driven by a combination of sources, including mutual funds, insurance companies, pension funds, and systematic investment plan contributions from retail investors. In our assessment, this diverse mix of domestic participants has created a stable and predictable liquidity base that can absorb external shocks, mitigate episodic volatility, and support more orderly market functioning. We note that over the past twelve months, domestic institutions reportedly injected approximately ₹7.1 trillion into Indian equities, a record level of domestic capital deployment. In our view, this substantial contribution has significantly offset heavy foreign portfolio investor selling, helping to preserve relative market stability even amid challenging global macro conditions and episodic risk-off periods.



We further observe that this surge in domestic participation is not limited to occasional bursts of activity. We see that sustained monthly SIP inflows, often exceeding ₹25,000 crore, have established a reliable and recurring pipeline of capital, which

underpins mutual fund and insurance-linked buying and strengthens the structural liquidity profile of the market. In our assessment, this represents a marked shift from the historical reliance on foreign flows and reflects a broader trend of financialization of household savings in India, as households increasingly channel their savings into formal investment vehicles rather than traditional instruments such as bank deposits or physical assets. We view this trend as creating a more resilient equity market that is less sensitive to external shocks and global capital flow volatility.

We also observe that the growing dominance of domestic investors has implications for market structure, sectoral performance, and style dispersion. In our view, large-cap stocks, which typically comprise the bulk of domestic institutional holdings, are likely to benefit disproportionately from concentrated buying, supporting sustained valuation premiums in these segments. We see that mid-cap and small-cap equities, while attracting relatively less direct domestic participation, may experience selective support through portfolio rebalancing and spillover effects as domestic institutions diversify across sectors and market capitalizations. In our assessment, understanding the timing, composition, and structural nature of domestic flows is critical for evaluating relative performance, managing volatility, and making informed allocation decisions across styles and market segments.

On balance, we view the growing role of domestic institutional investors as a structural positive for the Indian equity market. We assess that DIIs provide a stabilising foundation for liquidity, reduce dependence on foreign capital, and enhance overall market resilience. We see that sustained SIP inflows, robust mutual fund activity, and growing participation from insurance and pension funds are likely to remain central to market functioning in 2026. In our view, monitoring domestic flows, their sectoral and capitalization bias, and their interaction with external shocks will be essential for portfolio construction, risk management, and capturing sustainable, risk-adjusted returns in the evolving Indian equity landscape.

Ownership Structure and Market Impact

We assess that the combined effects of persistent domestic buying and episodic foreign selling have materially reshaped the ownership landscape of Indian equity markets, reflecting a structural shift in market dynamics and capital allocation. We observe that data from major exchanges and research sources indicate domestic institutional investors have overtaken foreign portfolio investors in terms of equity ownership share, a trend that has been sustained over multiple quarters. In our assessment, this milestone reflects a structural redistribution of market power, with domestic institutions now holding a larger proportion of listed equities relative to foreign investors. For example, DIIs reportedly held approximately 17.6 percent of NSE-listed companies in a recent quarter,

compared with around 17.2 percent for FPIs, representing a significant reversal from historical norms and highlighting the growing influence of domestic capital in shaping market behaviour.

We further observe that the cumulative contribution of domestic investors over the past decade has been multiple times larger than that of foreign investors, underscoring a long-term reorientation of the equity capital base. In our assessment, research indicates that between fiscal 2015 and fiscal 2025, domestic investor contributions to equities were roughly 3.7 times greater than foreign inflows. We see this as evidence of a structural trend, where domestic savings are increasingly channelled into formal investment vehicles such as mutual funds, insurance-linked instruments, and systematic investment plans, enhancing the depth and resilience of Indian equity markets.

We also note that these ownership changes have meaningful implications for market dynamics, valuation behaviour, and volatility. In our view, domestic flows, particularly those driven by SIP-led mutual fund and insurance buying, tend to be more stable, predictable, and less correlated with global risk sentiment than foreign portfolio flows. We assess that this stability reduces market volatility, especially during periods of external uncertainty, and acts as a counter-cyclical force that cushions equity markets against episodic foreign outflows. We observe that as a result, benchmark indices have demonstrated resilience even amid significant FPI selling, marking a departure from historical patterns where foreign outflows often triggered sharp price declines.

In our assessment, the growing dominance of domestic investors also influences valuation behaviour across market segments. We see that sustained domestic participation supports large-cap and index-heavy stocks, contributing to structural valuation premiums, while mid- and small-cap segments continue to experience selective re-rating based on domestic investor attention and liquidity allocation. In our view, understanding the evolving interplay between domestic and foreign ownership, the timing and composition of flows, and the resulting effects on volatility and pricing is critical for portfolio construction and risk management.

On balance, we view the structural shift toward greater domestic ownership as a positive development for the Indian equity market. We assess that this trend provides a stabilizing foundation for liquidity, mitigates reliance on foreign capital, and enhances market resilience. We see that the evolving ownership landscape will continue to shape return dynamics, valuation patterns, and sectoral performance in 2026 and beyond, making domestic flows a central consideration for investors seeking sustainable, risk-adjusted returns.

Liquidity Conditions and Market Breadth

We assess that while domestic flows have provided substantial support to headline indices, liquidity dynamics and market breadth reveal a more nuanced market structure. We observe that heavy domestic buying has largely concentrated in large-cap and highly liquid stocks, supporting benchmarks such as the Sensex and Nifty. In our assessment, this concentrated participation has contributed to relative undercapitalisation in mid- and small-cap segments, resulting in a widening performance divergence within the broader market. We see that broader indices and smaller stocks frequently lag benchmark returns even as headline indices rally, reflecting the selective nature of domestic investor flows and the structural preference for high-liquidity, index-heavy names.

We further note that despite this concentration, domestic participation has meaningfully improved overall market liquidity. We observe that even during periods when foreign portfolio investors have been net sellers, DIIs have often offset these outflows through substantial net purchases, smoothing trading volumes and mitigating abrupt liquidity shocks. In our assessment, this capacity to absorb selling pressure enhances the resilience of Indian equity markets, supporting more orderly price discovery and reinforcing investor confidence during periods of heightened external uncertainty.

We also assess that these trends strengthen the depth and durability of the domestic investor base. We see that the combination of sustained SIP inflows, mutual fund and insurance buying, and pension fund participation creates a structural pipeline of capital that can support market activity across macroeconomic cycles. In our view, this structural depth not only cushions headline indices but also enhances the market's ability to absorb volatility and maintain stable trading conditions even in episodes of external stress.

On balance, we view the interaction between concentrated domestic flows and broader liquidity dynamics as a defining feature of the Indian equity market. We assess that while large-cap and liquid stocks benefit disproportionately from sustained domestic demand, mid- and small-cap segments remain vulnerable to episodic undercapitalisation and relative underperformance. We see that the overall strengthening of domestic investor participation provides a stabilising influence, improves liquidity resilience, and supports market functioning, making the evolving domestic investor base a critical factor in understanding volatility, breadth, and return patterns across market segments in 2026 and beyond.

Foreign Direct Investment (FDI) and Longer-Term Capital

We assess that beyond the dynamics of short-term portfolio flows; longer-term foreign direct investment continues to serve as a positive signal for India's capital markets and broader economic prospects. We observe that gross FDI flows into India have risen consistently, with recent data indicating approximately 15 percent year-on-year growth, reaching around \$58 billion over the April to October 2025 period. In our assessment, this reflects sustained investor confidence in India's structural growth potential, robust domestic demand, and the long-term attractiveness of key sectors, even as equity portfolio flows remain subject to volatility and episodic reversals.

We further note that FDI inflows play a critical role in supporting corporate investment capacity, enabling sectoral expansion, and driving broader economic growth. In our view, these inflows indirectly bolster equity valuations by strengthening earnings capacity and facilitating investment cycles that underpin corporate profitability. We observe that FDI tends to be directed toward sectors with growth potential, including technology, manufacturing, consumer goods, and infrastructure, which not only enhances capacity but also contributes to long-term productivity gains and competitive positioning in the global economy.

We also assess that FDI provides a structural counterbalance to shorter-term portfolio flows, which can be episodic and highly sensitive to global macro conditions. In our view, the predictability and durability of FDI make it a stabilizing factor for capital formation, reducing reliance on foreign portfolio investment for financing growth and supporting sustained corporate investment activity. We see that this trend enhances India's position as an attractive destination for diversified global capital, creating a more resilient funding environment for corporates and reinforcing confidence among domestic and foreign investors alike.

On balance, we view sustained FDI inflows as a constructive and stabilizing influence on India's equity markets and economic growth trajectory. We assess that continued structural investment supports corporate expansion, strengthens earnings potential, and complements domestic investor flows in creating a deep, liquid, and resilient capital market. We see that FDI will remain an important driver of long-term market fundamentals, helping to underpin valuations, encourage sectoral growth, and support risk-adjusted returns in 2026 and beyond.

Implications for Equity Markets in 2026

We assess that the evolving capital flow landscape indicates that domestic investor participation will continue to play an increasingly pivotal role in shaping Indian equity market outcomes in 2026. We observe that domestic institutional investors are acting as a structural anchor, providing a steady and predictable source of liquidity that reduces the market's susceptibility to abrupt sell-offs driven by shifts in foreign sentiment. In our assessment, this structural participation supports a more stable return environment and emphasizes the importance of quality and liquidity considerations in domestic investor allocations. We see that sustained inflows from mutual funds, insurance companies, pension funds, and retail systematic investment plans provide a durable foundation for market valuations and help smooth trading conditions, even when global volatility or macroeconomic shocks create episodic stress.

We further observe that foreign flows remain an important component of market liquidity and valuation discovery, even if they are more erratic and sensitive to global risk conditions. We assess that periodic reversals in FII sentiment, for example late-year buying activity amid broader sell-offs, demonstrate that foreign investors continue to respond to valuation resets, relative risk-return opportunities, and strategic reallocation decisions. In our view, these flows, while muted relative to domestic participation, can temporarily influence price discovery, particularly in high-beta or large-cap segments, and affect cross-border risk premia, creating episodic volatility that interacts with domestic positioning.

We also assess that the interaction between stable domestic capital and episodic foreign flows will be a key determinant of equity market behavior in 2026. We observe that domestic investors are likely to continue supporting core valuations and providing resilience to the market, whereas foreign flows may amplify sectoral or style-specific volatility in response to global monetary policy shifts, macro shocks, or changing risk sentiment. We see that this dual dynamic reinforces the need for active monitoring of ownership composition, sectoral exposure, liquidity conditions, and macro sensitivity to navigate market movements effectively.

In our assessment, the balance between domestic and foreign capital flows will shape not only headline index performance but also market breadth, style dispersion, and sectoral rotation. We see that large-cap, liquid, and index-heavy names are likely to continue benefiting from concentrated domestic flows, whereas mid-cap and small-cap segments may remain more sensitive to episodic foreign participation and broader risk sentiment. We assess that investors who integrate insights from flow composition, valuation metrics, and sector-level fundamentals are better positioned to manage volatility, identify relative opportunities, and optimize risk-adjusted returns.

On balance, we view the structural strength of domestic investor participation as a stabilizing foundation for Indian equities, supporting liquidity, reducing reliance on foreign capital, and underpinning core valuations. We assess that foreign flows, while more variable, remain a critical factor for episodic volatility, cross-border risk premia, and market-level repricing events. We see that active evaluation of this interplay, particularly in sectors with elevated foreign ownership or global demand exposure, will be essential for portfolio positioning, risk management, and capturing sustainable, risk-adjusted returns in 2026 and beyond.

Sector Strategy Overview

We assess that sector allocation for 2026 should be framed within the context of India's evolving macroeconomic backdrop, earnings momentum, and structural shifts in market participation. We observe that Indian equities have demonstrated resilience, underpinned by strong domestic demand, supportive policy continuity, and improving earnings revision trends. In our view, sector outcomes in 2026 are likely to be differentiated, reflecting both domestic and global demand dynamics, structural investment trends, and variations in profitability growth potential across industries.

1. Financials (BFSI) – Core Growth Engine

We see the BFSI complex as a central driver of equity performance in 2026. We observe that stronger credit growth, improving asset quality, and abundant liquidity support the sector's earnings potential. Domestic demand for credit is expanding alongside renewed consumer spending and corporate investment activity, providing a supportive backdrop for net interest income growth across both public and private banks. In our assessment, improved balance sheets, stronger capital buffers, and more disciplined provisioning enhance the resilience of leading banks, while growth in retail and SME lending provides sustained earnings visibility. Non-bank financial companies are also benefiting from fintech integration, rising insurance penetration, and broader financial inclusion efforts, which we view as incremental drivers of profitability. We maintain a pro-cyclical overweight stance on BFSI, emphasizing institutions with robust capital adequacy, clear loan growth trajectories, diversified fee income streams, and resilient operational profiles.

2. Consumption and Discretionary – Diffused Recovery

We assess that consumer-oriented sectors are positioned for selective recovery in 2026, reflecting normalizing demand patterns and structural income growth. We observe that durable and discretionary segments, such as automobiles, travel and leisure, consumer durables, and telecom services, are likely to benefit from pent-up demand, rising household incomes, and increased access to affordable credit. In our view, easing

financing costs, rural income recovery linked to agricultural performance, and favourable monsoon conditions further support discretionary consumption. Within autos, earnings growth is likely to be driven by volume recovery and export demand, while consumer durables benefit from urban premiumisation and expanding middle-class consumption. Telecom and entertainment sectors are supported by structural digital penetration and increasing adoption of online services. In our assessment, selective allocation is warranted, prioritizing companies with clear pricing power, operational discipline, and sustainable margin profiles, given that competitive pressures and input cost volatility may constrain broad-based consumption margins.

3. Technology and IT Services – Mixed Momentum

We observe that the IT and technology sector enters 2026 against a backdrop of uneven global demand, currency fluctuations, and variable enterprise IT spending. In our assessment, stabilizing enterprise IT budgets, heightened adoption of cloud infrastructure, increasing cybersecurity investment, and digital transformation initiatives provide tailwinds for selective companies. We see that traditional IT service providers may experience slower deal renewals, while specialised segments such as software-as-a-service, digital services, and cloud integration could outperform. Accordingly, we maintain a neutral-to-selective stance, focusing on firms with differentiated service offerings, strong deal pipelines, scalable business models, and demonstrated ability to capture secular digital transformation opportunities. We assess that valuation resets in parts of the IT universe create opportunities for selective exposure, particularly where earnings catalysts are evident and currency risk is well managed.

4. Healthcare and Pharmaceuticals – Defensive and Structural

We assess that healthcare and pharmaceuticals retain structural appeal due to India's demographic trends, rising domestic healthcare demand, and export potential in generics and biotech. In our view, the sector is positioned for moderate but steady earnings growth with defensive characteristics, making it suitable for core positioning and risk mitigation during cyclical downturns. Companies with strong research and development pipelines, scalable manufacturing platforms, diversified export revenues, and regulatory compliance advantages are well positioned to generate above-market returns. We see that domestic demand, including rising per-capita healthcare spend and increased penetration of private health services, provides a stable revenue base, while export-oriented pharmaceutical businesses benefit from global generics demand, regulatory arbitrage, and manufacturing scale advantages.

5. Infrastructure, Capital Goods, and Industrials – Capex-Linked Exposure

We observe that infrastructure and capital goods sectors are poised to benefit from revived investment activity, government-backed capital expenditure programs, and

renewed public-private partnerships. In our assessment, construction and engineering firms with strong order books and robust execution capacity will have clear revenue visibility, while industrial machinery and capital goods producers are positioned to capture upside from domestic capex acceleration. We also see structural tailwinds from renewables and power equipment, aligned with national energy transition goals and increasing capacity build-out. In our view, this thematic provides cyclical exposure that is linked to the mid-cycle phase of economic expansion, and a diversified approach across subsectors can help capture revenue and earnings growth while managing project execution and regulatory risks.

6. Real Estate and Materials – Selective Prospects

We assess that real estate and materials offer selective opportunities based on valuation and structural demand trends. In our view, residential real estate is supported by strong housing demand, government incentives, and improving financing availability, while materials companies such as cement, steel, and basic metals benefit from ongoing infrastructure activity and industrial production growth. We observe that companies with clear balance sheet strength, scalable operations, disciplined capital allocation, and pricing power are better positioned to capture cyclical upswings. In our assessment, the sector is not uniformly attractive, and a selective approach focusing on quality, earnings visibility, and structural growth drivers is warranted.

7. Energy Transition and Renewables – Long-Term Structural Potential

We assess that the energy transition and renewable energy sectors represent a long-term thematic opportunity aligned with national decarbonisation policies, capacity expansion, and declining cost curves for solar and wind generation. In our view, government incentives, renewable infrastructure build-out, and structural shifts in energy consumption provide a foundation for long-term earnings growth. While we acknowledge that near-term earnings may experience volatility due to project execution cycles, regulatory adjustments, and commodity-linked costs, we see this sector as a strategic thematic allocation rather than a core cyclical exposure, suited for investors seeking long-term structural growth aligned with energy transition objectives.

8. Small and Mid-Caps – Dispersion Plays

We observe that small and mid-cap segments continue to exhibit elevated dispersion and heterogeneity. In our assessment, certain cyclical small-cap companies can outperform during a broad economic recovery, whereas others face earnings volatility, liquidity constraints, and structural risks. We see that rigorous bottom-up selection, with emphasis on balance sheet quality, sustainable earnings growth, and liquidity, is critical for capturing alpha in these segments. We assess that small and mid-cap investments remain opportunities for disciplined investors willing to navigate higher volatility and focus on earnings quality, sector positioning, and structural competitive advantages.

Conclusion

Sector	Stance	Rationale
Financials (BFSI)	Overweight	Strong credit growth, capital resilience
Consumption & Discretionary	Selective Overweight	Demand recovery, pricing power focus
Technology & IT	Neutral-Selective	Valuation reset, selective earnings catalysts
Healthcare & Pharma	Strategic Core	Defensive growth, export potential
Infrastructure & Capital Goods	Cyclical Exposure	Capex momentum, order book strength
Real Estate & Materials	Selective Overweight	Housing demand, construction activity
Energy Transition / Renewables	Thematic	Long-term structural trend
Small & Mid Caps	Selective Alpha	Dispersion, bottom-up focus

On balance, we assess that sector allocation for 2026 should balance structural growth sectors with cyclical exposures, leveraging domestic macro momentum, evolving investor participation, and earnings-driven market conditions. We see financials as the core engine of equity returns, while consumer discretionary, infrastructure, and thematic areas such as energy transition provide differentiated growth opportunities. Technology and healthcare maintain strategic importance amid uneven global demand, and small and mid-caps offer selective alpha opportunities in a more earnings-focused market regime. In our view, active sector rotation, disciplined valuation assessment, and rigorous bottom-up selection will be essential to capture next-cycle leadership, manage volatility, and navigate external headwinds effectively.

Financials

We assess that the financial sector will remain a central anchor of India's equity landscape as we move into 2026. We observe that the sector is benefiting from evolving credit dynamics, including strengthening retail and SME lending, improving corporate credit demand, and broadening penetration of financial services across urban and rural markets. In our view, these trends, combined with improving balance sheet fundamentals, strong capital buffers, and disciplined risk management, provide a structural foundation that supports sustainable earnings growth and underpins investor confidence.

We see that the sector is transitioning from the post-pandemic balance sheet clean-up phase into what is likely to become a more differentiated and structurally driven earnings cycle. In our assessment, this reflects the maturation of the credit cycle, with non-performing assets now largely under control and asset quality across banks and non-bank financial institutions showing significant improvement. We observe that stronger capital adequacy ratios, prudent provisioning policies, and improved governance frameworks are enabling banks to expand lending selectively while maintaining risk discipline.

In addition, we note that non-bank financial companies and fintech-linked lenders are increasingly contributing to the sector's growth through targeted lending solutions, insurance distribution, and niche credit products. We assess that these developments, together with broader financial inclusion initiatives and rising penetration of formal credit in rural and semi-urban markets, provide incremental earnings opportunities that are less correlated with traditional large-bank portfolios.

We also observe that macroeconomic conditions remain supportive of the sector's growth trajectory. Stable inflation, moderating interest rates, and improving consumption and investment activity are creating an environment conducive to credit expansion and fee income generation. In our view, these factors provide tailwinds to net interest income, support cross-selling opportunities, and allow for continued growth in retail and corporate lending segments.

On balance, we view the financial sector as not only a stabilizing anchor for the equity market but also a potential driver of differentiated returns in 2026. We assess that selective exposure to well-capitalized institutions with strong balance sheets, diversified revenue streams, visible loan growth, and disciplined risk management will provide investors with a combination of resilience, earnings visibility, and attractive risk-adjusted returns. We see that the sector's positioning at the intersection of domestic demand growth, credit cycle maturation, and structural improvements in asset quality underscores its critical role in shaping market outcomes and overall portfolio performance in the year ahead.

Credit Cycle Dynamics

We assess that credit growth in the Indian banking system has moderated from the elevated levels seen in prior years but continues to remain healthy relative to long-term historical norms. We observe that after a period of rapid expansion, aggregate credit growth was reported at approximately 11.4 percent in FY2025, with momentum gaining traction into the first half of FY2026. In our view, while the early months of FY2026 exhibited a soft start, incremental lending activity regained strength by mid-year, driven by renewed demand across both retail and corporate segments. We see that retail demand has been supported by improving household incomes, moderating interest rates, and growing access to formal credit, while corporate credit has benefitted from investment activity, working capital requirements, and selective refinancing.

We note that near-term forecasts for credit growth are somewhat mixed, reflecting both macro and structural considerations. In our assessment, ICRA's downward revision of FY2026 credit growth to a range of 9.7 to 10.3 percent underscores banks' prudence in improving credit-to-deposit ratios and reining in higher-yielding unsecured exposures. Conversely, we observe that other analysts, including CareEdge, continue to project a stronger 11.5 to 12.5 percent growth trajectory, assuming a rebound in consumer spending and corporate capital demand later in the fiscal year. In our view, these differing projections highlight a broader theme: underlying credit demand remains robust, but banks are prioritizing portfolio quality and secured lending over aggressive growth, reflecting a structural shift in risk appetite and lending strategy.

We also assess that structural factors are influencing the pace of credit expansion. We observe that competition from non-bank financial institutions, increasing adoption of corporate bond financing, and alternative lending channels are reshaping how borrowers access credit. In our view, this has prompted banks to be more selective, favouring secured lending, higher-rated corporate exposure, and disciplined risk management, which is likely to result in a slower but more sustainable credit trajectory relative to prior boom cycles.

On balance, we see that credit growth in 2026 is expected to remain at a healthy, moderate pace, sufficient to support domestic demand and economic activity without undermining asset quality. We assess that banks that effectively balance portfolio expansion with risk management, capital adequacy, and targeted lending strategies will be well positioned to capture both growth and earnings stability. We further note that this calibrated approach to credit deployment reinforces the broader resilience of the BFSI sector, providing a foundation for sustainable returns and acting as a stabilizing force in the Indian equity market as macro and global conditions evolve.

Asset Quality Trends

We assess that asset quality metrics in the Indian banking system have improved markedly from the stressed conditions observed in earlier cycles. We observe that both gross non-performing assets (GNPAs) and net NPAs have trended lower in recent years as banks completed legacy portfolio cleanups, wrote off stressed loans, and strengthened provisioning buffers. At the aggregate system level, we note that gross NPAs declined to multi-year lows of approximately 2.5 percent by FY2025, while net NPA ratios settled near 0.5 percent. We view these trends as reflecting both improved borrower performance and proactive risk management practices by banks across retail, corporate, and priority lending segments.

We see that the Reserve Bank of India's Financial Stability Report projects that the gross bad loan ratio could edge up modestly to around 3 percent by March 2026 under a baseline scenario. In our assessment, even if this moderate increase materializes, capital ratios across the banking system are expected to remain comfortably above regulatory minimums, and no bank is projected to breach the required capital floor, even under adverse stress scenarios. We view this as a strong signal of sector resilience, reflecting improved balance sheet strength and risk buffers built over multiple quarters of disciplined provisioning and legacy asset resolution.

Nevertheless, we observe emerging pockets of stress in specific segments such as unsecured personal loans, microfinance, and small business exposures. In our assessment, smaller-ticket unsecured lending has experienced higher slippage rates, prompting banks to tighten underwriting standards, implement risk-based pricing, and adopt stricter collection practices. We also note that microfinance portfolios continue to exhibit structural vulnerabilities, with asset quality pressures expected to persist into the early part of FY2026 before normalizing. We see that these higher-risk pockets underscore the importance of granular monitoring, portfolio segmentation, and proactive credit risk management, particularly in environments where macro conditions soften or interest costs increase.

Overall, we view the banking sector's asset quality as broadly sound and well-provisioned, underpinned by legacy cleanups, disciplined lending, and strong regulatory oversight. At the same time, we assess that vigilance is warranted in targeted segments where higher slippage risk persists. In our view, banks that maintain conservative underwriting, robust provisioning practices, and dynamic risk monitoring frameworks will be best positioned to sustain asset quality, protect capital adequacy, and support earnings stability in 2026. We believe that this combination of broad-sector resilience and selective risk awareness reinforces the financials sector's role as a stabilizing anchor in Indian equities.

Return on Equity and Profit Sustainability

We assess that Return on Equity (ROE) remains a central measure of financial sector performance, reflecting the interplay of net interest margins, credit costs, and capital leverage. We observe that after a period of compressed profitability in earlier fiscal years, Indian banks have experienced a modest improvement in ROE, supported by stable net interest income, declining provisioning requirements, and enhanced operational discipline. In our view, these factors have helped the sector regain structural profitability, even as credit growth moderates and competitive pressures persist.

Looking ahead to FY2026, we expect ROE and Return on Assets (ROA) metrics to exhibit moderate moderation, reflecting a combination of margin pressure, competitive repricing, and evolving macro conditions. We note that ICRA projects sector-wide ROE in the 12.1 to 13.4 percent range, with ROA around 1.1 to 1.2 percent. In our assessment, while these levels represent a slight decline from cyclical peaks observed earlier in the decade, they remain healthy in a historical context and reflect continued structural resilience.

We also observe that net interest margins may experience some compression as deposit costs remain elevated and lending rates adjust downward in response to monetary easing. In our view, this could weigh on profitability for FY2026; however, we see that banks' strong capital positions, reflected in robust Tier-1 ratios, provide a buffer against unexpected credit shocks and allow for selective growth deployment. In addition, we assess that diversified revenue streams, including fee income from wealth management, insurance, and transaction banking, along with operational efficiencies achieved through digital adoption and cost rationalization, are likely to support sustainable ROE levels despite cyclical pressures.

Overall, we view the financial sector as structurally well-positioned to sustain profitability in FY2026. We assess that banks which effectively balance prudent margin management, disciplined risk-taking, and operational efficiency will maintain ROE above global emerging market peers. In our view, these dynamics reinforce the financials sector's role as a core anchor of India's equity market, providing both resilience in periods of macro uncertainty and the potential for differentiated returns through selective exposure to well-capitalized, operationally efficient institutions.

Non-Bank Financial Companies and Broader Financial Sector Trends

We assess that India's financial ecosystem extends well beyond traditional commercial banks, with Non-Bank Financial Companies (NBFCs) playing an increasingly important role in credit intermediation and sectoral diversification. We observe that NBFCs have become critical providers of financing in specialised segments, including consumer finance, vehicle loans, affordable housing, and lending to underserved or semi-formal segments of the economy. In our view, this expanded role reflects both evolving borrower needs and the capacity of NBFCs to deploy targeted, nimble credit solutions where traditional banks may be constrained by regulatory limits or balance sheet priorities.

We see that NBFC balance sheets have strengthened over recent years through improved risk management, higher capital buffers, and enhanced governance frameworks. In our assessment, after an uneven performance in FY2025, growth in the NBFC sector is expected to resume in FY2026, supporting overall credit expansion and complementing banking sector lending. We view this as a stabilising factor for the broader financial ecosystem, enabling continued credit flow to high-demand segments without placing excessive pressure on bank balance sheets.

In addition, we observe that strategic foreign institutional investment in NBFCs highlights global investor confidence in India's diversified financial landscape. For example, the acquisition of a sizeable minority stake in Shriram Finance by Japan's MUFG for \$4.4 billion illustrates both the depth of foreign capital interest and the sector's capacity to attract governance expertise, capital infusion, and strategic oversight. In our assessment, transactions of this nature not only provide growth latitude to individual companies but also signal confidence in the structural prospects of India's financial sector more broadly.

Overall, we view NBFCs as a complementary pillar of India's financial system, supporting retail and SME lending, enabling financial inclusion, and providing alternative avenues for capital deployment. In our assessment, NBFCs' continued growth, coupled with stronger balance sheets, prudent risk management, and strategic foreign investment, is likely to enhance sector resilience, diversify credit channels, and contribute to sustainable earnings growth in the financial ecosystem through FY2026.

Implications for 2026 Positioning

We assess that the credit cycle in India is entering a phase of more disciplined expansion, in which banks are likely to grow their loan books selectively while placing strong emphasis on asset quality, prudent underwriting, and capital conservation. In our view, this reflects a shift from prior rapid-growth phases toward a more sustainable, quality-driven credit expansion. We see that while overall credit growth may be moderate relative

to the elevated rates observed in earlier cycles, it remains healthy in absolute terms and continues to underpin earnings power across the financial sector, particularly for well-capitalized institutions with diversified portfolios.

We observe that asset quality is expected to remain broadly stable, supported by elevated provisioning coverage, improved risk management practices, and a cautious approach to high-risk or unsecured lending segments. In our assessment, while pockets of stress may persist in specific segments such as microfinance, unsecured personal loans, or smaller SME exposures, the overall banking and NBFC landscape is structurally resilient. We see that proactive monitoring, risk-based pricing, and portfolio segmentation will remain key tools for sustaining asset quality as the cycle progresses.

In terms of profitability, we assess that ROE sustainability will depend on the interplay of net interest margins, loan mix, and continued diversification of fee-based and non-interest income streams. In our view, banks and financial institutions that can balance margin management with prudent credit deployment and operational efficiency are best positioned to maintain healthy returns while navigating competitive and macro pressures.

For investors, we see that this environment supports a quality-tilted allocation to the financial sector. We recommend prioritizing institutions with strong capital buffers, superior asset quality metrics, and diversified, stable earnings profiles. In our assessment, these attributes will enable banks and financial companies to deliver sustainable performance in 2026, provide resilience against external shocks, and act as a stabilizing anchor within broader equity portfolios. We also note that selective exposure to well-managed NBFCs can complement banking allocations by providing targeted growth opportunities in specialised lending segments and supporting overall portfolio diversification.

Industrials and Capital Goods

We assess that the industrials and capital goods sector is entering a pivotal inflection point as we approach 2026, driven by a broadening and more sustained capex cycle, strengthening order books, and the potential for improving operating leverage across companies. In our view, this phase marks a transition from a prolonged period of subdued investment in fixed assets toward an environment where both public and private sector capital expenditure are gaining meaningful traction. We observe that government infrastructure programmes, increased industrial spending, and private sector project announcements are collectively contributing to higher demand for machinery, industrial equipment, and construction-related services, which in turn should support revenue growth and margin improvement across the sector.

We note that order books for major capital goods firms have expanded, reflecting both renewed bidding activity for public infrastructure projects and rising private sector investment in manufacturing, energy, and transport sectors. In our assessment, this provides visibility into near- to medium-term revenue streams, while also enabling companies to achieve better operating leverage as fixed costs are absorbed over higher volumes of production. We see that sectors linked to industrial machinery, engineering services, and energy infrastructure are particularly well positioned to benefit from this upturn, with sequential improvement in utilisation rates, project execution, and cost efficiency contributing to earnings resilience.

In addition, we observe that structural factors such as government incentives for manufacturing, renewable energy investments, and strategic initiatives to enhance domestic production capabilities are likely to reinforce long-term growth trajectories for the capital goods and industrials space. In our view, these initiatives not only provide cyclical tailwinds but also support sustainable profitability for companies that can capitalise on both public and private sector demand.

Overall, we assess that the industrials and capital goods sector presents a combination of cyclical and structural opportunity as we move into 2026. We see that selective exposure to companies with strong order books, execution capabilities, diversified client bases, and scalable operational platforms can provide investors with attractive risk-adjusted returns. In our view, the convergence of a broadening capex cycle, improving operating leverage, and supportive policy measures positions the sector as a key beneficiary of India's domestic investment recovery, making it an important thematic allocation for portfolios seeking cyclical upside with structural growth support.

Capex Cycle Revival - Metrics and Drivers

We assess that capital expenditure by Indian corporates has entered a meaningful growth phase, providing a strong foundation for industrials, capital goods, and broader economic expansion. In our view, aggregate capex rose approximately 11 percent year-on-year in FY25 to around ₹9.4 trillion, reflecting a diversified mix of sectors including oil & gas, power, telecom, automobiles and their ancillaries, iron & steel, and non-ferrous metals. We see this as indicative of broad-based investment momentum rather than reliance on isolated sectors. In addition, order books for capital goods companies expanded sharply, exceeding 20 percent growth in FY25 and continuing into the first half of FY26, which in our assessment underscores a robust execution pipeline and rising visibility of future revenues.

We observe that multiple structural drivers are supporting this capex revival. Capacity utilisation rates across manufacturing industries have climbed toward decade highs, creating both the need and incentive for capacity additions and modernization. In our

view, as plants operate closer to full productive levels, companies are motivated to deploy fresh capital to expand and upgrade capacity rather than risk operating near constraint. This dynamic, in our assessment, reinforces sustained investment activity across cyclical and strategic sectors.

Policy frameworks have further bolstered the capex environment. Government-led initiatives, such as Production Linked Incentive schemes and strategic manufacturing pushes in sectors like electronics, pharmaceuticals, and textiles, are designed to attract large-scale private investment, enhance domestic industrial capacity, and upgrade technology adoption. In our view, these policy measures have catalyzed investment, particularly in sectors linked to global supply chain diversification, energy transition, and export-oriented growth strategies, providing both cyclical stimulus and structural support for capital allocation.

Looking further ahead, we see that long-term projections suggest capex momentum may continue well into the latter half of the decade. According to ratings agencies such as S&P Global Ratings, top Indian corporates could invest approximately \$800 to \$850 billion over the next five years, effectively doubling historic investment levels. In our assessment, infrastructure, power transmission, renewable energy, and technology-driven manufacturing are likely to account for a significant portion of this spending, which should provide sustained revenue visibility and growth opportunities for industrials, capital goods, and ancillary sectors.

Overall, we view the current capex cycle as both broad-based and structurally supported. We assess that companies with strong order execution capabilities, diversified sector exposure, and scalable production platforms are well positioned to capture the benefits of rising capital investment. In our view, this sustained capex momentum provides a supportive backdrop for earnings growth in FY26 and beyond, underpins operating leverage gains for capital goods players, and reinforces the industrials sector as a key beneficiary of India's domestic investment recovery.

Order Books and Revenue Visibility

We assess that firm order books in the industrials and capital goods sector provide a meaningful forward revenue cushion and underpin earnings growth forecasts for FY26 and beyond. In our view, the substantial increase in order backlog observed in FY25 and the first half of FY26 reflects broad-based demand across sectors such as infrastructure, energy, power transmission, and core industrial investment, signalling that growth drivers are both cyclical and structural in nature. We see that this strong project pipeline offers visibility for multi-quarter revenue recognition, supporting sustainable earnings expansion for key capital goods and engineering firms rather than representing a short-lived cyclical spike.

We observe that the performance of leading engineering, procurement, and construction (EPC) firms exemplifies these trends. In our assessment, these companies have reported robust order inflows, with diversification across project types, geographies, and client segments, enhancing revenue stability and reducing dependence on single-sector or single-region exposures. We see that the widening geographical footprint of these firms, including overseas project participation, provides both risk mitigation and growth potential, while also allowing companies to capitalise on global industrial and infrastructure investment trends.

In addition, we assess that the quality of order backlogs has improved, reflecting higher margin projects, stronger contractual structures, and better execution timelines. We note that structural investment demand, driven by government initiatives, private sector capex, and global supply chain realignment, is increasingly supplementing traditional cyclical flows, creating a more resilient earnings base. In our view, companies that demonstrate strong project execution, disciplined cost management, and diversified client exposure are best positioned to convert this order visibility into sustainable profitability.

Overall, we see that industrials and capital goods firms with robust and diversified order books are likely to benefit from a multi-quarter earnings runway, improved operating leverage, and enhanced cash flow generation. In our assessment, this provides investors with a degree of earnings certainty in an otherwise cyclical sector, while highlighting the structural growth opportunities emerging from India's ongoing investment revival and infrastructure expansion.

Operating Leverage and Profitability Dynamics

We assess that operating leverage in the industrials and capital goods sector has materially improved as firms benefit from rising scale, stronger capacity utilisation, and longer-duration order books. In our view, extended order visibility allows companies to absorb fixed costs more efficiently, enabling revenues to grow faster than incremental operating expenses and thereby supporting margin expansion. We observe that key return on capital metrics, including ROCE and asset turnover, have strengthened, reflecting both improved asset utilisation and, in certain niches, enhanced pricing power. In our assessment, this combination of structural scale gains and selective pricing strength underpins a more sustainable earnings profile for well-positioned industrial and capital goods companies.

However, we note that the operating leverage improvement is uneven across the sector. In our view, profitability and margin outcomes vary significantly depending on company size, project mix, competitive positioning, and cost structure. Some firms continue to face headwinds from rising commodity input costs, execution delays in legacy orders, or

intense competitive pricing pressures, which in our assessment can partially offset the benefits of operating leverage. We observe that margin trends within sub-segments of the capital goods universe remain mixed, with larger, well-diversified firms generally exhibiting stronger resilience, while smaller or highly specialised players are more susceptible to cost and pricing volatility.

We also assess that broader cost dynamics, particularly commodity price fluctuations and freight cost pressures, represent secular risks to margin sustainability. In our view, companies with robust pricing power, long-term contracts, or localisation strategies for raw materials and supply chains are better positioned to maintain or expand margins despite these pressures. Conversely, players operating in highly competitive or input-intensive niches may face ongoing margin compression until cost and pricing conditions stabilise.

Overall, we see that operating leverage remains a key driver of earnings growth in industrials and capital goods. In our assessment, firms that combine strong order books, disciplined cost management, pricing power, and efficient asset utilisation are best positioned to deliver sustainable margin expansion and attractive risk-adjusted returns. We view these dynamics as central to understanding sectoral performance in 2026, highlighting both opportunities for well-capitalised leaders and the potential variability across sub-segments within the capital goods and industrials universe.

Sectoral and Private Capex Distribution

We assess that capital expenditure growth across Indian industries is neither uniform nor evenly distributed, with structural patterns emerging that are critical for investors to consider. In our view, energy-related sectors, including conventional electricity generation and renewables, particularly storage solutions, are likely to maintain elevated capital intensity over the medium term. We observe that projected annualised capex growth in these energy segments is expected to outpace broader industrial capex trends, reflecting both policy support for the clean energy transition and increasing domestic and global demand for energy infrastructure.

We see that telecom and the automobile and ancillary sectors have also contributed meaningfully to corporate capex, driven by domestic demand recovery, rising household incomes, and export opportunities. In our assessment, investments in telecom infrastructure, 5G rollout, and network expansion are reinforcing structural revenue streams, while automobile and ancillary investments in new models, electric vehicle production lines, and supply chain upgrades highlight the role of private sector capex in enhancing competitive positioning and technological capability.

Private sector investment announcements have risen sharply, particularly in manufacturing, as corporate India increasingly allocates funds toward capacity expansion, process modernisation, and forward integration strategies. In our view, while this private capex is more unevenly deployed than public sector investment, it signals growing business confidence in domestic growth drivers and anticipated demand streams. We see that private companies are increasingly willing to commit capital to projects that generate medium- to long-term revenue visibility, enhancing industrial resilience and supporting earnings growth in capital goods suppliers and related sectors.

Public sector capex continues to play a foundational role in shaping the broader industrial cycle. We observe that government funding for transport infrastructure, energy sector enhancements, and strategic industrial projects has accelerated project execution, improved cash flow absorption for suppliers, and catalyzed private capital deployment. In our assessment, the public sector impetus not only supports structural growth but also improves macroeconomic confidence, lowers execution risk, and often encourages private sector participation in capex-intensive projects.

Overall, we view the uneven but strategically concentrated nature of capex as a key driver of sectoral differentiation in 2026. Industries with sustained investment momentum, whether from public initiatives or private confidence, are likely to exhibit stronger revenue growth, improved operating leverage, and enhanced earnings visibility. In our assessment, understanding the distribution and drivers of capex is critical for positioning in industrials, capital goods, energy, telecom, and manufacturing-related equities, as it directly informs forward earnings potential and relative sectoral performance.

Risks and Headwinds

We assess that while the indicators for India's capex cycle remain broadly favourable, meaningful risks persist that could influence sector outcomes and investment returns in 2026. Uneven domestic demand recovery is a key consideration, as regional or sector-specific variations in economic activity may affect corporate investment decisions and slow the pace of project initiation. In our view, global economic uncertainty, including slower growth in advanced markets, shifts in trade patterns, and rising policy unpredictability, can also temper investment enthusiasm or delay project execution timelines, particularly for export-oriented or import-dependent sectors.

We observe that disruptions in global supply chains, such as input shortages, logistics bottlenecks, or raw material price volatility, have the potential to influence procurement cycles, project scheduling, and order inflows for capital goods and industrial firms. In our assessment, these factors can create short-term variability in revenue recognition and operating leverage, even for companies with structurally strong order books. Ratings agency commentary emphasizes the importance of monitoring these external variables

closely, as they represent potential headwinds despite the overall structural optimism surrounding India's investment landscape.

Execution risk remains an inherent feature of large-scale capital projects. We note that delays, cost overruns, and financing bottlenecks can materially dampen the expected benefits of capex, particularly for firms without strong balance sheets, diversified revenue streams, or robust risk management frameworks. In our view, companies with disciplined project governance, diversified client bases, and strong financial flexibility are better positioned to navigate these challenges, while firms with concentrated exposure or weaker execution capabilities face greater downside risk.

For investors, these observations underscore the need for active monitoring and selective positioning within the industrials and capital goods universe. In our assessment, understanding both structural growth drivers and potential execution or external risks is critical for differentiating between firms likely to deliver sustainable earnings and those more susceptible to project-related or macro shocks. Overall, while the capex cycle offers significant opportunity, we view disciplined analysis, risk management, and sectoral differentiation as essential to capturing upside while mitigating downside exposures.

Implications for Equity Returns

We assess that in 2026 the industrials and capital goods sector is positioned to benefit from a combination of structural and cyclical tailwinds, which together create a supportive backdrop for earnings growth and selective outperformance. In our view, the broadening capex cycle across India, encompassing both private and public investment initiatives, provides a durable driver of demand for industrial and capital goods companies. This expansion, coupled with healthy and well-diversified order books, offers a forward earnings runway that underpins revenue growth while also allowing companies to leverage operating scale to improve margins. We see that firms operating in infrastructure, power equipment, renewable energy, and key manufacturing supply chains are particularly well-placed to capture the benefits of expanding investment activity and structural industrial demand.

From an equity allocation perspective, we observe that improving fundamentals in the sector suggest attractive opportunities for investors with a multi-quarter investment horizon. In our assessment, companies with high-quality backlog, disciplined project execution, efficient cost structures, and diversified client exposure are likely to deliver more consistent earnings and demonstrate resilience against execution or commodity-related shocks. We note that these attributes support not only revenue growth but also operating leverage and return on capital, reinforcing the potential for sustained value creation.

However, we emphasise that selectivity remains critical in this sector. In our view, the heterogeneity of the industrials and capital goods universe means that not all companies will benefit equally from capex growth or structural tailwinds. Firms with weaker balance sheets, concentrated order flows, limited pricing power, or exposure to volatile input costs could underperform even in a generally supportive environment. We see that active monitoring of project execution, margin trends, and order book quality is essential for identifying firms capable of converting macro tailwinds into tangible earnings growth.

Overall, we assess that the industrials and capital goods sector presents a compelling allocation opportunity in 2026, particularly for investors focused on structural growth drivers, cyclical recovery, and multi-quarter performance visibility. In our view, disciplined stock selection, emphasis on execution quality, and evaluation of balance sheet strength are key to capturing upside while mitigating the uneven risks inherent in a highly heterogeneous sector.

Consumption and Discretionary

We assess that India's consumption landscape is entering a structurally supportive phase, underpinned by improving macroeconomic conditions, stronger household balance sheets, and more diversified demand drivers across geographies and income segments. In our view, this marks a meaningful shift from prior periods of volatility, which were influenced by elevated inflation, discretionary spending moderation, and policy adjustments that constrained certain segments of consumer activity. We observe that consumption growth has gained renewed traction, supported both by urban demand resilience and a pronounced recovery in rural markets. The rural rebound is being driven by rising agricultural incomes, stable monsoon outcomes, and increased penetration of formal financial instruments that bolster purchasing power across smaller towns and villages.

We see that aggregate private final consumption expenditure has expanded robustly, contributing to consumption growth rates approaching multi-quarter highs. In our assessment, this strength reflects not only higher household spending but also broader participation across diverse sectors, including consumer staples, discretionary goods, automobiles, electronics, and services. We note that consumption patterns are becoming more evenly distributed across income segments, with middle-class households driving durable goods purchases while rural and lower-tier urban consumers support staples and fast-moving consumer goods volumes.

From an investor perspective, we view this structural improvement in consumption as a supportive backdrop for equities linked to domestic demand. Companies with strong brand positioning, pricing power, and broad distribution networks are better positioned

to capture incremental volume growth and convert it into sustainable revenue and earnings gains. We also see that rural-linked demand represents a meaningful diversification driver, reducing concentration risk and enhancing resilience against localized macro shocks or urban-focused consumption slowdowns.

Overall, we assess that the combination of macro stabilisation, income growth, and broadening consumption participation creates a durable foundation for Indian consumer-facing companies in 2026. In our view, monitoring sectoral exposure, pricing power, and geographic distribution will be essential for identifying businesses that can benefit most from this structural consumption upswing while managing potential risks from input cost pressures, policy changes, or demand volatility.

Broad Consumption Trends

We assess that private consumption continues to be a primary engine of India's GDP growth, with structural improvements in household incomes, price stability, and credit access underpinning broader demand expansion. In our view, economists' observations of a rising consumption share of GDP reflect both higher disposable incomes and the easing of price pressures across key staples and discretionary categories. We note that in the second quarter of FY26, private consumption expenditure accelerated to approximately 7.9 percent year-on-year, signaling a meaningful broadening of demand across multiple sectors. This growth is particularly notable given the preceding period of moderate demand, during which consumption had lagged as urban households faced elevated food inflation and slower discretionary spending.

In our assessment, both urban and rural markets are contributing to this recovery, albeit with differing dynamics. Historically, urban demand has driven headline consumption growth, supported by higher incomes, modern retail penetration, and service-oriented spending. However, we observe that rural consumption has shown sustained momentum, outpacing urban segments in volume growth for successive quarters. We see this trend as being supported by rising real wages, improved farm incomes, better access to formal and informal credit channels, and targeted policy measures, including tax rationalisation and regulatory reforms. These factors have enhanced purchasing power at the household level and facilitated a more broad-based recovery in consumer categories ranging from essential staples to aspirational discretionary goods.

From an equity perspective, we view this broadening of consumption as creating differentiated opportunities across sectors and companies. Firms with strong rural distribution networks, resilient supply chains, and category leadership are better positioned to benefit from the sustained expansion in both rural and urban demand. In our assessment, companies that can capture growth across multiple geographies while

maintaining pricing discipline and margin resilience are likely to outperform peers in an environment of more evenly distributed consumption growth.

Overall, we see private consumption as a structural driver of economic and corporate growth in 2026, providing a foundation for revenue stability and earnings visibility. In our view, monitoring the evolution of urban-rural demand, discretionary versus essential spending, and policy support will be critical for investors seeking to allocate capital effectively in India's consumption-linked equities.

Rural Demand and Consumption Depth

We assess that rural India's consumption resurgence in 2025–26 is both significant in scale and consistent in momentum, making it a key pillar of the broader domestic demand recovery. In our view, rural consumption growth has outpaced urban demand in recent quarters, with data indicating an increase of approximately 7.7 percent year-on-year in Q2 FY26, marking one of the strongest performances in several years. We see this upturn as being supported by a confluence of factors, including favourable agricultural outcomes, improved wage dynamics in non-farm rural sectors, and relatively stable input costs. Collectively, these factors have enhanced disposable incomes and spending power in smaller towns, semi-urban areas, and hinterland markets, creating a more balanced and broad-based consumption environment across the country.

In our assessment, the structural significance of rural consumption is reinforced by shifts in demand patterns and manufacturing integration. Packaged goods penetration in rural areas has expanded meaningfully, and local manufacturing, particularly among MSMEs and regional brands, has increasingly catered to the evolving needs of rural consumers. We note, for example, growth in rural manufacturing linked to agricultural tools and allied products, reflecting deeper integration of rural households into formal supply chains and value networks. This trend highlights the potential for long-term structural demand that extends beyond traditional staples toward semi-durable and aspirational categories.

From a sectoral perspective, we observe that rural demand is particularly critical for staples, fast-moving consumer goods, two-wheelers, and basic discretionary items. In our view, the two-wheeler segment has benefitted directly from rural traction, with year-on-year volume growth projected in the high single digits, supported by policy measures such as tax rationalisation, strong seasonal demand, and improved financing access. We also see that rural consumers are increasingly participating in aspirational purchase decisions, signaling an evolving consumption profile that is expanding beyond basic necessities to include lifestyle and aspirational products.

Overall, we assess that rural consumption will remain a durable driver of revenue and earnings growth for companies with broad rural reach and category relevance. In our

view, investors should prioritise firms with established rural distribution networks, scalable supply chains, and brand recognition capable of capturing this sustained growth. The combination of structural income gains, expanding manufacturing integration, and evolving purchase behaviour makes rural India a critical and growing contributor to the domestic consumption story heading into 2026.

Premiumization and Shifts in Consumer Preferences

We observe that consumption trends in India are increasingly characterized by a structural shift toward premiumization, a phenomenon that is becoming evident across both urban and rural markets. In our assessment, premiumization reflects consumers' willingness to trade up to higher-quality, branded, or aspirational products, driven by rising household incomes, evolving lifestyles, and greater exposure to global consumer culture. Within the Indian context, we see this trend manifesting prominently in premium FMCG segments, fashion and lifestyle categories, personal care, and selective durable goods. In rural markets, the uptake of premium FMCG products has grown significantly, with research indicating that the proportion of premium products consumed by rural households has increased sharply over recent years. This demonstrates that aspirational purchasing behavior is no longer confined to urban centers and that rural households are gradually shifting from value-oriented to higher-quality consumption patterns.

We also note that FMCG companies have adapted strategically to this trend by offering smaller, more affordable pack sizes of premium products. In our view, this approach balances aspirational positioning with affordability constraints, allowing brands to penetrate rural geographies more effectively while capturing incremental volume growth. Within this framework, premium categories such as branded personal care, beauty and wellness products, and discretionary packaged foods have gained disproportionate share relative to staples in certain rural clusters. This indicates that the premiumization trend is not only broadening geographic penetration but also reshaping category consumption hierarchies in favor of higher-margin products.

Digital adoption and e-commerce penetration are further reinforcing the premiumization trend. In our assessment, platforms such as UPI for payments, expanding internet access, and organized retail and direct-to-consumer channels are lowering traditional barriers to purchase. These developments enable consumers across income levels and geographies to access premium assortments more conveniently, supporting aspirational buying in both urban and rural segments. In particular, we see that digital channels facilitate incremental penetration in categories where convenience, variety, and product differentiation drive purchase decisions.

Overall, we assess that premiumization represents a durable structural theme for Indian consumption in 2026. Investors and corporates should consider companies with strong

brand equity, scalable distribution networks, and product portfolios that can capture both urban aspirational demand and the emerging rural premium segment. In our view, the combination of rising incomes, evolving lifestyle preferences, and enhanced digital access positions premium categories for continued growth and margin expansion across the consumption landscape.

Sectoral Implications and Consumption Subthemes

We assess that the FMCG and retail sectors remain a core pillar of India's consumption story heading into 2026, underpinned by resilient volumes, expanding premiumization, and the broadening reach of organized retail. In our view, reported volume and value growth have been particularly strong in rural markets, reflecting both structural income gains and an expansion of product penetration. We note that industry forecasts point to high single-digit volume growth for FMCG in 2026, supported by moderating input costs and rising adoption of premium categories. Organized retail and modern trade continue to capture incremental share from traditional channels, while e-commerce accelerates category diversification and expands geographic reach. In our assessment, the combination of these dynamics supports not only volume growth but also margin expansion for well-positioned FMCG and retail companies.

Within automobiles and consumer durables, we observe a recovery that aligns closely with broader household demand improvements. Two-wheeler volumes have shown meaningful traction in both rural and urban markets, benefitting from improved financing availability, stable commodity pricing, and policy support. We also note that demand for consumer durables, including appliances and electronics, is expected to correlate strongly with income growth and financing access, particularly as urban consumption normalizes. In our view, these sectors are benefiting from both cyclical recovery and structural shifts in household expenditure, with a select set of companies positioned to capture outsized gains due to brand strength, distribution reach, and cost discipline.

We further observe that lifestyle and services segments are increasingly contributing to discretionary spending, particularly among younger cohorts such as Millennials and Gen Z in urban centres. In our assessment, rising incomes and digital engagement are driving premium consumption in categories such as fashion, hospitality, personal care, and experiential services. We see that brand proliferation and ease of access through digital channels amplify this trend, although discretionary spending remains sensitive to macro volatility, pricing pressures, and external shocks. Companies that can deliver differentiated experiences, scale digitally, and maintain price discipline are best positioned to benefit from this ongoing structural shift.

Overall, we assess that consumption across FMCG, retail, automobiles, durables, and lifestyle services is entering a phase of sustainable growth, with rural demand,

premiumization, and digital access serving as key drivers. In our view, investors should focus on companies with strong brand equity, scalable distribution networks, and exposure to both urban and rural consumption growth, as these firms are likely to outperform in a structurally supportive and increasingly earnings-driven market environment in 2026.

Risks and Moderating Factors

We assess that while the overall consumption environment in India remains constructive, the trajectory of discretionary demand in 2026 is likely to be uneven and influenced by several critical variables. In our view, urban discretionary spending is closely linked to employment growth, wage trajectories, and policy confidence. Sustained improvements in these metrics would support continued demand in sectors such as consumer durables, lifestyle services, and discretionary retail. Conversely, we note that any volatility in commodity prices, residual inflationary pressures, or unexpected policy shifts could constrain real disposable incomes, particularly among lower- and middle-income urban households, thereby tempering discretionary spending momentum.

From a rural perspective, we see that demand is fundamentally supported by improved agricultural incomes and credit access, yet it remains sensitive to monsoon outcomes and fluctuations in crop pricing. In our assessment, weaker-than-expected agricultural performance or sharp swings in input costs could reduce rural consumption propensity, delaying adoption of discretionary or premium products.

We also observe that the pace of premiumization across consumption segments may differ materially. While aspirational spending is rising, a substantial proportion of the population continues to prioritize value-oriented purchases. In our view, categories that fail to balance aspirational appeal with affordability and flexible pricing are at risk of slower adoption, particularly in price-sensitive rural or semi-urban markets. Conversely, companies that combine brand positioning with affordability and incremental product innovation are better positioned to capture this emerging preimmunized demand.

Overall, we assess that the consumption outlook for 2026 is positive but nuanced. Investors and corporates should consider both structural drivers, such as rising incomes, digital penetration, and rural expansion, and near-term risks including inflation volatility, input cost pressures, and weather-related shocks. A selective approach that differentiates between resilient, high-margin, and well-distributed consumption businesses versus those vulnerable to cyclical or price pressures will be critical in navigating the evolving demand landscape.

Outlook Summary

We expect that consumption and discretionary demand in India will strengthen meaningfully in 2026 as macro conditions stabilize and rural recovery continues to gain traction. In our view, the rural economy will remain a central driver of private consumption, with growth in rural demand outpacing urban growth in recent quarters and contributing materially to overall household expenditure. This sustained rural momentum is supported by improving farm incomes, greater access to credit, and structural policy measures that enhance disposable income, enabling households to spend across staples, semi-durables, and discretionary categories.

We also observe that premiumization is becoming increasingly pervasive across both urban and rural markets. Rising incomes, greater brand awareness, and expanding digital penetration are driving consumers toward higher-value purchases, particularly in categories such as personal care, premium FMCG, durable goods, and lifestyle services. In rural markets, this trend is amplified by targeted product strategies, including smaller premium pack sizes, localized distribution, and aspirational positioning, which allow households to trade up without sacrificing affordability.

The evolving retail ecosystem further supports this consumption expansion. Organized brick-and-mortar retail and digital channels continue to deepen reach, broaden choice, and reduce friction in purchase behaviour. E-commerce platforms, mobile payment adoption, and integrated logistics networks facilitate access to premium and discretionary products even in smaller towns and semi-urban markets, accelerating category penetration and reinforcing demand growth.

Taken together, we assess that these factors position consumption as a critical pillar of India's GDP growth trajectory in 2026, with broad implications for sectoral performance across consumer staples, discretionary goods, automobiles, and lifestyle services. In our view, successful navigation of this environment will require careful attention to evolving income patterns, pricing dynamics, and distribution reach, while proactively monitoring macro risks, including inflationary pressures, commodity volatility, and rural income shocks, which could influence consumer confidence and spending behaviour. Companies that can combine brand strength, flexible pricing, and broad distribution are likely to capture the most sustainable upside in this increasingly consumption-driven market environment.

Technology and Digital Services

We view technology and digital services as a critical bellwether for India's equity landscape in 2026 because the sector serves as both a major engine for export revenues and a key driver of domestic digital transformation. After several years of muted growth, indicators now point to a structural recovery supported by robust global demand for digital services, expanding deal pipelines particularly in AI-centric solutions, and an evolving margin environment as companies adjust pricing models to align with new client expectations and business realities.

Global demand for technology services including digital transformation, cloud computing, and artificial intelligence solutions is rising steadily. Industry forecasts suggest that India's IT spending could reach approximately \$176.3 billion in 2026, representing a 10.6 percent year-on-year increase and outpacing global average growth. This expansion is being driven by investments in data centres, software, cybersecurity, and AI-enabled applications. Enterprises are increasingly focused on modernising legacy applications, enhancing customer experience, and strengthening digital infrastructure. Indian technology firms continue to capture value from global outsourcing and project delivery opportunities, with AI, machine learning, and automation now forming a majority of new contract wins, highlighting a transition from traditional transformation work toward higher-value digital mandates. Growth remains uneven across subsegments and geographies, with traditional outsourcing moderating and firms prioritising consulting, cloud migration, and outcome-based service models that embed measurable business impact.

Deal pipelines for Indian IT services illustrate a shift toward complex, AI-led, and outcome-oriented engagements. Nearly three-quarters of recent contract wins among leading Indian firms are AI-focused, indicating strong enterprise prioritisation of next-generation digital capabilities across sectors including BFSI, manufacturing, retail, healthcare, and high tech. Large mid-cap companies are also securing high-value deals, such as LTIMindtree's \$580 million contract with a global media client, underscoring the ability of Indian firms to compete in substantial transformation projects that go beyond legacy outsourcing. Private equity and strategic investments in cloud, SaaS, cybersecurity, and automation are increasing, reflecting deepening deal activity and a growing investment ecosystem for AI and specialised digital services.

Margins in the sector are evolving as firms adapt from traditional time-and-material pricing toward outcome-based and value-oriented models, particularly for AI and cloud engagements. This transition supports long-term pricing power but places near-term pressure on profitability due to investments in talent reskilling, solution development, and go-to-market transformation. Companies are responding with cost-control measures such as delaying pay hikes, trimming administrative expenses, and

reallocating resources toward high-value solution delivery. Wage inflation and continuous upskilling requirements, particularly in AI, cloud, and cybersecurity domains, further contribute to margin pressure. Despite this, firms with strong intellectual property, specialised offerings, and automation capabilities are better positioned to sustain and potentially expand margins over time.

Structurally, the Indian technology ecosystem is decentralising beyond traditional urban hubs. Locations such as Udaipur, Vizag, Coimbatore, and Nagpur are reporting rapid growth in hiring and delivery activity, reflecting both cost optimisation and talent diversification. These developments are critical for scaling delivery capacity, supporting global capability centres, and responding to enterprise demand for both domestic and international services. The domestic technology market itself is expanding as enterprises increasingly invest in in-house digital transformation, cloud adoption, and infrastructure modernisation. The combination of export-driven revenues and a growing domestic market enhances sector resilience and reduces reliance on any single demand source.

Looking into 2026, we expect the technology and digital services sector to enter a recovery and transformation phase characterised by robust revenue growth, strengthening deal pipelines focused on AI and digital transformation, and ongoing margin adjustment. Key implications include revenue upside from digital and AI investment, a shift toward value and outcome-based deals supporting sustainable margins over time, near-term margin pressure from strategic investments in talent and solutions, and differentiation for firms capable of attracting high-quality talent and scaling digital practices efficiently. Overall, 2026 is expected to mark a transition where revenue expansion is complemented by more disciplined and sustainable margin profiles informed by strategic investments and global client partnerships.

Energy, Utilities, and Materials

We assess the energy, utilities, and materials complex as a strategically significant segment of the Indian equity market in 2026, capturing core elements of economic growth, industrial activity, energy security, and the nation's transition toward cleaner energy. The sector is deeply interconnected with global commodity dynamics, domestic industrial demand, and policy frameworks supporting renewable energy expansion, yet it also faces considerable volatility due to pricing cycles, regulatory evolution, and capital intensity. These structural characteristics mean that performance within the sector is likely to be heterogeneous across subsectors, with companies navigating commodity cycles, transition risks, and capital allocation decisions in different ways.

Commodity pricing continues to be a major determinant of revenue and margin outcomes. Global oil and coal markets have softened, with supply overhangs and weaker

demand growth exerting downward pressure on pricing. In contrast, global LNG markets remain tight, with constrained supply driving year-on-year price increases of around 21 percent in recent benchmarks. This divergence illustrates the complexity of the fuel cost environment in India, where oil, coal, and gas interact across generation and industrial applications, creating opportunities for companies with flexible cost structures and hedging capabilities. Base metals such as copper, zinc, and nickel remain relatively supported due to structural demand from renewable energy infrastructure and electric vehicle supply chains, even as broader industrial activity moderates. The combination of cyclical pressures and strategic demand creates a nuanced environment in which pricing volatility can generate both upside and downside for participants, depending on portfolio diversification and operational flexibility.

Energy and utilities companies are simultaneously navigating the national energy transition, which seeks to expand renewable capacity while maintaining reliable, affordable electricity supply. India's power mix is evolving with rapid additions of solar and wind capacity, yet coal and natural gas continue to provide essential base-load stability. Transition risks manifest in multiple ways, including grid integration challenges, distribution company health, and regulatory execution gaps that can delay project completion or increase operational costs. Carbon pricing and international regulatory developments, such as the European Union's carbon border adjustment mechanisms, also impose incremental compliance costs for high-emission metals and energy exporters, necessitating capital allocation toward emissions reduction and technology upgrades. Companies that manage these transition risks effectively can benefit from improved access to capital and investor confidence, while those that lag may face higher capital intensity without commensurate returns.

Cash flow dynamics across the sector remain closely tied to pricing cycles, capital expenditure, and asset utilisation. Integrated energy producers and refiners face substantial investments in refinery upgrades, renewable capacity, and transmission infrastructure. These capital commitments support long-term growth but can suppress free cash flow in the near term if project phasing or execution is delayed. Utilities continue to contend with circular debt, tariff under-recovery, and the financial health of distribution companies, which can constrain liquidity and working capital efficiency. Materials companies, particularly in steel and mining, experience inherently cyclical cash flow patterns where high commodity prices temporarily enhance cash generation while downturns tighten spreads. Strategic investment in value-added capacity such as battery storage, cold rolling, and renewable-linked inputs offers the potential to smooth cash flow volatility and differentiate returns, provided execution is disciplined and aligned with structural demand trends.

Subsector differentiation is a critical lens for understanding risk and return. Energy producers with diversified operations across refining, petrochemicals, gas, and

renewable assets are positioned to smooth earnings volatility and better manage cash flow cycles. Power utilities benefit from long-term growth in electricity demand, though earnings depend on grid reliability, distribution efficiency, and the timing of renewable integration. Materials and metals producers face price and demand cyclicalities, yet strategic exposure to infrastructure, electrification, and renewable energy supply chains can provide a price floor and support mid-term profitability. Export-oriented producers must navigate additional pressures from carbon compliance, cross-border regulations, and global supply chain dynamics, making risk management and operational agility central to sector performance.

Looking toward 2026, sector performance is likely to reflect a balance of cyclical pricing conditions, transition pressures, and cash flow discipline. Global commodity price normalization may reduce revenue volatility while enabling better input cost management and margin predictability. Companies that combine credible energy transition strategies with disciplined capital allocation are likely to benefit from lower perceived risk and improved access to capital markets. Firms with diversified operations, flexible cost structures, and robust project execution capabilities are expected to maintain resilient cash flows and support shareholder returns through dividends or buybacks. Overall, the energy, utilities, and materials sector presents a complex but structurally important opportunity for investors seeking exposure to India's industrial and energy growth story, provided that selection emphasizes execution, balance sheet strength, and strategic positioning relative to both pricing cycles and transition risk.

Healthcare and Pharmaceuticals

We assess healthcare and pharmaceuticals as a strategically important and structurally growth-oriented segment of India's equity market in 2026. This sector occupies a dual role, addressing fast-rising domestic healthcare demand driven by demographic shifts and chronic disease prevalence while simultaneously serving as a cornerstone of India's global pharmaceutical exports. The combination of expanding domestic consumption, regulatory evolution, and export diversification provides a multi-year runway for volume growth and earnings expansion, although regulatory, competitive, and policy dynamics require careful monitoring.

Domestic demand for healthcare and pharmaceuticals continues to grow at a robust pace, underpinned by rising access to medical services, an ageing population, increasing prevalence of chronic illnesses, and an expanding middle-class population with higher discretionary healthcare spending. Total pharmaceutical consumption, estimated at approximately \$23.5 billion in FY24, is expected to expand steadily over the next two

years, supported by increased penetration in Tier-II and Tier-III cities and the expansion of hospital and outpatient networks. Analysts forecast growth in the range of 7 to 9 percent for the sector in FY26, with domestic revenues expanding by 8 to 10 percent as companies strengthen rural distribution networks, scale sales forces, and introduce differentiated products across both acute and chronic therapy areas. Healthcare services, including hospitals, diagnostics, and outpatient care, are also witnessing strong volume expansion, with hospital market valuations projected to grow significantly over the coming decade, reflecting capacity additions and structural demand for healthcare infrastructure.

The regulatory landscape plays a pivotal role in shaping sector dynamics. Policy reforms are intended to improve drug quality, streamline approval processes, and enhance competitiveness in global markets. Initiatives to digitalize export licensing and reduce administrative bottlenecks are expected to facilitate faster access to regulated markets for Indian exporters. Domestic policy measures, including customs duty waivers and incentives for production within Special Economic Zones, aim to encourage local manufacturing and reduce costs for essential medicines, thereby supporting both domestic affordability and industry competitiveness. Production Linked Incentive schemes for active pharmaceutical ingredients, bulk drugs, and advanced manufacturing continue to accelerate investment and reduce import dependency, providing a structural boost to the sector. Regulatory pressures remain relevant for smaller players, especially micro, small, and medium enterprises, as compliance costs rise due to enhanced testing requirements and quality standards, necessitating careful operational and financial management.

India's pharmaceutical export market remains robust, with FY25 exports exceeding \$30 billion. India continues to play a critical role in global generic and vaccine supply chains, accounting for roughly 20 percent of global generic volumes and more than 55 percent of certain vaccine requirements. Growth is increasingly concentrated in biologics, advanced formulations, and vaccines, with year-on-year expansion outpacing traditional bulk drug shipments. Patent expiries between 2024 and 2026 present a material opportunity, with Indian firms well positioned to capture an estimated \$3.5 to \$4 billion in generics demand. Strategic investments by multinational companies, including over \$1 billion in Indian manufacturing for high-growth therapeutic categories, underscore India's growing importance in global biologics and contract research and development manufacturing. Trade agreements, such as preferential access through the UK-India Free Trade Agreement, further support export diversification and reduce reliance on individual geographies.

The sector is also witnessing structural transformation with emerging segments such as biosimilars, biologics, and CRDMO services gaining traction. India's position in outsourced development and manufacturing is expanding, particularly in complex

therapies and specialty molecules, providing higher-margin opportunities and stronger integration into global R&D ecosystems. Companies with diversified portfolios that balance domestic demand with regulated export exposure are better positioned to sustain growth, while those concentrated in low-margin generics face more muted earnings expansion. Pricing pressures in developed markets, particularly the United States, alongside regulatory scrutiny, remain important variables affecting profitability.

Looking ahead, we expect healthcare and pharmaceuticals to deliver steady volume growth underpinned by structural demographics, government policy support, and global demand expansion. Revenues are projected to expand in the mid- to high single-digit range in FY2026, with domestic consumption growth strengthened by rural distribution penetration and tiered market expansion. Export opportunities are broadening into biologics and specialty molecules, even as traditional generics face competitive and regulatory headwinds. Regulatory reforms, tariff incentives, and Production Linked Incentive schemes will continue to shape competitive positioning and investment activity across the sector.

Overall, healthcare and pharmaceuticals are positioned as a defensive yet structurally growing component of India's equity market in 2026. The sector provides resilience in slower macro periods and exposure to secular growth driven by global health demand, rising chronic disease prevalence, and expansion of healthcare infrastructure. For investors, careful selection based on portfolio diversification, regulatory compliance, and exposure to higher-growth therapeutic and export segments will be essential to capturing sustainable performance in this evolving landscape.

Small and Mid-Caps

Small and mid-cap equities represent a heterogeneous segment of the Indian market that offers potential for high returns but comes with elevated risk and dispersion. Heading into 2026, these segments exhibit stretched valuations, uneven earnings visibility, and wide performance differentiation across companies and sectors. While historically a source of alpha, small and mid-caps now require a selective and research-intensive investment approach, particularly relative to the large-cap universe.

Valuation Risk Across the Segment

Valuations in small and mid-caps remain above long-term averages, reflecting a period in which multiple expansion has contributed materially to past returns. Forward price-to-earnings multiples for small-cap and mid-cap indices are significantly higher than their historical norms, suggesting elevated risk if earnings growth does not meet expectations.

Small-cap valuations, in particular, command a premium relative to large caps, increasing vulnerability to multiple compression in periods of macro uncertainty or tighter liquidity conditions. Analysts note that while mid-caps typically benefit from relatively stronger balance sheets, small caps are more exposed to swings in sentiment, making broad-based exposure riskier without earnings support.

Earnings Visibility and Growth Challenges

Earnings visibility continues to differentiate performance within small and mid-caps. Mid-cap companies generally participate in aggregate upward revisions in earnings forecasts alongside large caps, whereas many small-cap companies face slower recovery and muted profit momentum. This divergence creates an earnings-valuation mismatch, leaving certain small-cap stocks vulnerable to underperformance despite favourable macro fundamentals. Recent market activity illustrates this dynamic: after strong returns in 2023 and 2024, small caps underperformed in 2025 relative to mid and large caps, reflecting moderate earnings growth, liquidity constraints, and high valuation levels.

Liquidity limitations amplify the challenge of earnings predictability. Smaller companies typically exhibit lower trading volumes, which can lead to heightened volatility and less efficient price discovery. This illiquidity magnifies idiosyncratic risk and necessitates careful due diligence and conservative forecasting assumptions for portfolio construction.

Market Structure and Fund Flow Considerations

Domestic fund flows into small and mid-caps have historically been episodic but can provide strong support during periods of structural growth optimism. Mutual funds and domestic investors often target small and mid-caps with exposure to secular growth themes such as healthcare services, niche manufacturing, and technology-oriented segments. Despite these flows, the segment remains sensitive to shifts in risk appetite, macroeconomic developments, and global investor sentiment. Foreign institutional investors tend to favor large-cap, high-liquidity equities during periods of external uncertainty, leaving smaller stocks more exposed to volatility in global capital flows.

Stock Selection and Factor Dispersion

Given the high dispersion within these segments, stock selection is critical. Companies that combine strong balance sheets, secular growth drivers, robust cash flow generation, and transparent governance stand out relative to peers reliant on cyclical demand or leverage-driven expansion. Factor analysis indicates that quality metrics, earnings momentum, and operational resilience are particularly informative in identifying outperforming small and mid-caps. Empirical research suggests that elevated valuation environments without corresponding earnings acceleration can extend the breakeven

horizon for returns, emphasizing the importance of fundamental discipline in stock selection.

Risk Premia and Sector Exposure

Small and mid-caps generally carry a higher risk premium than large caps due to earnings uncertainty, liquidity constraints, and greater sensitivity to economic cycles. Elevated valuations can amplify downside risk if market sentiment shifts. Sector composition further accentuates this risk profile: small and mid-caps are often concentrated in cyclical industries such as construction, industrials, and consumer discretionary, which are sensitive to macroeconomic fluctuations. However, pockets of opportunity exist in niche sectors such as specialised technology, healthcare services, and targeted industrial segments, where secular growth improves earnings visibility and reduces reliance on cyclical tailwinds.

Implications for 2026 Positioning

For 2026, return outcomes in small and mid-caps are likely to be shaped by valuation discipline, earnings quality, and liquidity considerations. Broad-based exposure carries risk in an environment of stretched multiples, while a targeted, bottom-up approach emphasizing high-quality businesses offers a pathway to alpha. Key considerations include:

- Valuation discipline: Avoid indiscriminate allocation without adjusting for relative valuation risk.
- Earnings quality: Prioritize companies with visible, structurally supported earnings growth and pricing power.
- Tactical allocation: Employ smaller, measured positions for broad small/mid exposure while concentrating higher conviction positions in selected names.
- Liquidity management: Stress test portfolios for illiquidity and maintain disciplined entry and exit thresholds.

In summary, small and mid-caps remain an important source of potential outperformance, but elevated valuation risk and mixed earnings visibility demand a selective approach. Investors should emphasize rigorous fundamental analysis, disciplined stock selection, and active risk management to navigate the heterogeneity and volatility inherent to these market segments in 2026.

Themes and Structural Opportunities

We identify structural themes that extend beyond cyclical market drivers and anchor longer-term growth in Indian equities through 2026 and beyond. These themes include manufacturing expansion, infrastructure build-out, and financial deepening. Each theme is supported by policy frameworks, rising domestic demand, and evolving global competitiveness, making them key lenses for strategic allocation and thematic positioning.

Manufacturing: Capacity Expansion and Value Chain Integration

We view manufacturing as an increasingly important pillar of India's growth strategy. After years of lower relative contribution to GDP, industrial activity and output have strengthened, driven by both domestic demand and exports. Reports indicate robust momentum in manufacturing output, with growth exceeding broader economic expansion in recent quarters, suggesting genuine recovery in production capacities.

We expect India's GDP growth for FY26 to remain robust, with multiple agencies projecting expansion in the mid-to-high 6 percent range, supported by strong industrial output, corporate investment, and policy continuity. Growth estimates range from 6.3 to 6.9 percent, reflecting confidence in domestic demand and industrial performance.

We see the government's Production Linked Incentive schemes as a key enabler for manufacturing growth. These incentives attract large-scale investments in strategic segments such as electronics components, automotive parts, pharmaceuticals, and advanced materials. We expect these schemes to enhance domestic capacity, integrate Indian firms into global value chains, and foster higher value addition and export competitiveness. Electronics PLI incentives, for example, have already generated substantial investment commitments and are projected to create meaningful manufacturing output and employment.

We also observe that broader policy initiatives to improve ease of doing business, reduce bureaucratic obstacles, and incentivize capital goods procurement are reinforcing manufacturing momentum. We believe these structural shifts, if maintained, could gradually raise manufacturing's share of GDP and improve resilience to external demand shocks, providing strategic equity exposure in machinery, industrials, and technology-enabled manufacturing firms.

Infrastructure: Build-Out, Connectivity, and Economic Integration

We view infrastructure as both a growth engine and structural enabler across sectors. Government focus on infrastructure development remains strong, supported by sustained capital expenditure and long-term public investment programs. Recent data

show positive growth in core infrastructure output, including cement, steel, coal, and fertilizer segments, reflecting ongoing execution despite global headwinds.

We see the National Infrastructure Pipeline and related monetization initiatives as key drivers of public and private investment. The NIP targets over 1,11,00,000 crore in projects by the mid-2020s, spanning roads, rail, ports, and energy infrastructure. The National Monetisation Pipeline introduces private capital into core assets, including highways and airports, unlocking efficiency and value for investors.

We believe the infrastructure theme has broad multiplier effects. Improved logistics and connectivity reduce business costs, enhance market access, and enable regional economic integration. These improvements support manufacturing competitiveness, rural development, and services sector expansion. Infrastructure development also creates deep supply chain linkages for cement and steel producers, construction equipment suppliers, and engineering contractors, providing multi-year earnings visibility for publicly listed firms.

We note that infrastructure extension into digital and utility frameworks, including broadband, water, and power distribution, aligns with broader economic goals of inclusive growth and technological adoption. We see infrastructure-linked equities as strategic exposures for 2026, with earnings visibility derived from long-duration project pipelines and predictable policy prioritization.

Financial Deepening: Capital Markets, Credit Access, and Inclusion

We view financial deepening, defined as the expansion of financial markets, institutions, and instruments, as a core structural theme supporting India's equity opportunity set. A deeper financial system enhances access to capital, improves risk sharing, and supports efficient allocation across sectors and enterprises.

We observe strong expansion in capital markets, including record-breaking initial public offering activity and participation from small and mid-sized enterprises. In 2025, the IPO market achieved historic fundraising levels, reflecting robust capital formation and investor appetite.

We also note that liquidity has improved due to growing mutual fund assets under management, rising retail participation through systematic investment plans, and increasing pension and insurance penetration. Broader participation supports valuation discovery across market capitalisations and dampens volatility.

We see credit markets as another pillar of financial deepening. Recent reports highlight historically elevated growth in MSME credit, improving access for smaller firms. This expansion supports entrepreneurial activity, job creation, and sectoral diversification beyond large corporate balance sheets.

We also observe that financial inclusion has strengthened through digital banking, rural credit expansion, and microfinance growth. Increased access to financial services supports household consumption, savings, and investment behaviour, enhancing long-term economic resilience and equity market participation.

Interplay and Investment Implications

We see strong interconnections among manufacturing, infrastructure, and financial deepening. Manufacturing growth enhances domestic value creation and export competitiveness, supporting corporate earnings and capital flows. Infrastructure build-out reduces bottlenecks, expands market access, and reinforces manufacturing and consumption growth. Financial deepening ensures efficient allocation of capital, supporting investment cycles and reducing financing frictions.

We expect these structural dynamics to reinforce India's macro-outlook, which points to robust economic expansion supported by strong domestic demand and investment growth. We believe these themes support a multi-year investment lens that focuses on structural growth rather than short-term cyclical swings. Portfolios incorporating industrial growth, infrastructure firms, capital goods providers, financial intermediaries, and high-quality manufacturing companies are positioned to capture long-term value creation as India's economy evolves.

Risks and Execution Considerations

We recognize that structural themes carry execution risks. Infrastructure projects may face delays, cost overruns, and regulatory bottlenecks. Manufacturing expansion depends on sustained policy support and global competitiveness amid trade uncertainties. Financial deepening can be constrained by macro shocks or changes in bank credit cycles. We recommend continuous monitoring of policy delivery, credit conditions, and firm-level execution to harness these themes effectively.

Risks to the Outlook

Even as we see strong structural drivers supporting the India equity case for 2026, a range of macro, policy, earnings, and global shock risks could materially affect market performance. These risks may materialize individually or together, leading to volatility, valuation repricing, and compression of returns if we do not anticipate and manage them carefully.

1. Macro Risks

Currency and External Sector Pressures

We note that the Indian rupee has shown significant volatility, with forward premiums rising amid dollar strength and weaker investment flows. A weaker currency can raise import costs, increase inflation expectations, and reduce real equity returns, particularly for sectors that rely on imported inputs.

Capital Flow Volatility

We observe that foreign portfolio investor flows have been uneven, with extended periods of net selling linked to global risk sentiment and valuation sensitivity. Prolonged outflows can exert pressure on equity valuations and liquidity, especially if global monetary conditions tighten or yield differentials widen.

Moderation in Private Capex and Manufacturing

While capex revival underpins growth narratives, we see indicators pointing to moderation in private sector capital spending and manufacturing expansion. A slowdown in these areas could reduce growth momentum and dampen consumption demand over time.

Inflation and Growth Surprises

We recognize that unexpected spikes in inflation or slower economic growth could force policy trade-offs, erode real earnings and tighten financial conditions.

2. Policy and Regulation Risks

Trade Policy Uncertainty

We monitor rising tariffs and trade tensions, particularly with the United States, which could affect export volumes and sentiment toward manufacturing-linked sectors. Higher trade barriers could reduce competitiveness and affect GDP growth.

Geopolitical Tensions

We note that regional geopolitical risks, including India-Pakistan tensions, remain significant. Such uncertainty can influence macro forecasts, investor sentiment, and foreign investment flows.

Regulatory Overreach or Reform Fatigue

We see that rapid policy changes, while potentially improving long-term frameworks, may create short-term compliance costs, uncertainty, or investor caution if implementation is not smooth.

3. Earnings and Valuation Risks

Earnings Growth Inconsistency

We recognize that despite positive earnings momentum, structural risks around uneven earnings delivery persists. Earnings disappointments, especially in cyclical or export-dependent sectors, could significantly impact valuations and sentiment, particularly in mid- and small-cap segments where multiples are stretched.

Valuation Sensitivity

We note that valuations in some market segments are extended relative to historical norms. Elevated valuation risk means that even modest earnings misses or macro headwinds can trigger significant corrections.

Liquidity and Credit Conditions

We observe that weak credit growth, rising non-performing loans, or contraction in banking sector lending can tighten financing for corporates. This can slow capital expenditure and constrain earnings prospects for investment-linked sectors.

4. Global Shock Scenarios

Global Market Corrections

We recognize that the Indian market is connected to global trends. Corrections in major economies, particularly the United States, can cascade into emerging markets, pressuring equities and triggering sentiment-driven sell-offs.

Commodity and Energy Price Shocks

We see that geopolitical disruptions affecting commodity supply routes, such as conflicts in the Middle East, could increase input costs, raise inflation, and squeeze corporate margins.

Policy Divergence and Capital Flows

We monitor global policy divergence, such as uneven interest rate trends or delayed easing in major economies, which can create volatility in capital flows, currency markets, and risk premia, complicating return expectations for India.

5. Sentiment and Structural Market Risks

Retail Investor Behaviour

We note that expanded retail participation, particularly among newer entrants, may

amplify drawdowns during periods of market stress. Behavioural responses in weak market conditions can cause outsized price moves relative to fundamentals.

Dependence on External Demand

We recognize that India's export-linked sectors remain sensitive to global demand cycles. A prolonged slowdown in developed markets or trade disruptions could reduce export volumes, affecting corporate earnings and investor confidence.

Summary of Key Risk Scenarios

Risk Category	Primary Concern	Potential Impact
Macro	Currency volatility and weaker demand	Earnings downgrades, inflation pressure
Policy	Trade and regulatory uncertainties	Sector-specific disruption, rerating risk
Earnings	Earnings delivery mismatches	Valuation corrections
Global Shocks	Commodity, geopolitical, global slowdown	Broad market volatility

Assessing the Outlook

We believe that while structural fundamentals and domestic growth drivers remain supportive, the risk spectrum for 2026 is broad and multi-dimensional, spanning macro imbalances, policy uncertainty, earnings sensitivity, and global external shocks. We recommend monitoring currency trends, global policy shifts, and corporate earnings closely, and building scenario-based risk frameworks that capture both tail events and base case outcomes.

Portfolio Implications

We believe the outlook for Indian equities in 2026 reflects a combination of structurally supportive growth drivers and localized valuation risks, particularly across market segments and styles. This environment places greater emphasis on disciplined portfolio construction, thoughtful style allocation, and active risk management. We see merit in balancing cyclical opportunity with defensive resilience while remaining selective and valuation aware.

1. Strategic Positioning Across Market Capitalisation

Balancing Large-Cap Stability with Selective SMID Exposure

We view large-cap equities as providing relative stability through better earnings visibility, stronger balance sheets, and more reasonable valuations compared with smaller peers. These characteristics make large caps suitable as core portfolio holdings, particularly in an environment where valuation dispersion remains elevated.

At the same time, we acknowledge that mid-cap equities offer higher structural growth potential over the cycle. Select exposure to mid-caps can enhance portfolio returns if earnings recovery broadens in 2026, especially in sectors where operating leverage and demand visibility are improving. We favour a selective approach rather than broad-based exposure.

Cautious and Disciplined Small-Cap Allocation

We see small-cap equities as the most valuation sensitive segment, with multiples in many cases running ahead of earnings delivery. Without a meaningful and sustained acceleration in earnings, downside risk remains elevated. As a result, we recommend a measured and disciplined allocation to small caps, focused on high-quality businesses with strong balance sheets, scalable business models, and clear earnings visibility rather than broad index exposure.

Rotation and Diversification Signals

We observe that investor flows increasingly reflect selective rotation rather than broad market positioning. This suggests opportunities exist outside large caps, but success depends on careful sector and stock selection rather than market-wide exposure.

2. Style Bias and Factor Positioning

Quality and Earnings-Led Growth

We expect quality stocks with strong return metrics, consistent cash generation, and prudent capital allocation to outperform in an environment where valuation expansion

is limited. We favour earnings-led growth over momentum-driven strategies, particularly where pricing power and balance sheet strength support downside protection.

Value and Lower Volatility Exposure

We see value-oriented segments as providing defensive ballast within portfolios. Certain financials, utilities, and industrial leaders offer stable cash flows and relatively attractive valuations, which can help reduce portfolio volatility during periods of market stress.

Thematic Allocation

We recommend targeted exposure to structural themes such as consumption upgrading, manufacturing expansion, infrastructure development, and financial deepening. Allocating capital to companies aligned with long-term economic transformation can improve return durability, provided valuations remain reasonable and execution risk is well managed.

3. Risk Management Framework

Valuation Discipline and Entry Selectivity

Given elevated valuations in parts of the mid and small-cap universe, we emphasise valuation-aware entry strategies. We prefer allocating capital to companies trading closer to historical valuation bands or where earnings growth is sufficient to justify premium multiples.

Diversification Across Styles and Geographies

We view diversification as extending beyond market capitalisation. A measured global allocation can complement domestic equity exposure by reducing concentration risk and providing access to sectors and technologies that are underrepresented in the Indian market.

Tactical Rebalancing and Portfolio Maintenance

We believe periodic rebalancing is essential, particularly in volatile segments. Actively trimming overextended positions and reallocating toward higher conviction or undervalued opportunities can improve risk-adjusted returns over time.

Liquidity and Position Sizing

We remain mindful of liquidity risk, especially in smaller stocks. We recommend conservative position sizing, clear exit thresholds, and sufficient liquidity buffers to manage drawdowns during risk-off periods.

4. Preparing for Risk Scenarios

Downside Protection and Asset Allocation Flexibility

We see merit in maintaining tactical flexibility through exposure to defensive assets such as fixed income or gold during periods of heightened uncertainty. These allocations can help preserve capital and smooth portfolio volatility.

Stress Testing and Scenario Analysis

We recommend stress testing portfolios against adverse scenarios such as global market corrections, currency shocks, or sector-specific earnings downgrades. Scenario analysis improves preparedness and supports more informed allocation decisions under uncertainty.

5. Investment Horizon and Implementation

Core Holdings Versus Tactical Positions

For long-term investors, we favour maintaining core exposure to large-cap and quality franchises aligned with structural growth themes. Tactical allocations to higher-risk segments, including small caps or sector-specific opportunities, should be time-bound and actively monitored.

Systematic Investment Discipline

We continue to view systematic investment approaches as effective tools for managing volatility, particularly in mid and small-cap segments. Systematic allocation helps smooth entry points and reduces the behavioural impact of market fluctuations.

6. Summary of Portfolio Imperatives

Dimension	Strategic Implication
Positioning	Balanced exposure with emphasis on large-cap quality and selective growth
Style Bias	Preference for quality, earnings visibility, and selective value

Risk Management	Valuation discipline, diversification, and active rebalancing
Implementation	Tactical allocation with disciplined position sizing
Diversification	Inclusion of global and defensive assets where appropriate

We believe that the Indian equity market in 2026 increasingly rewards fundamentals, earnings delivery, and disciplined capital allocation over momentum-driven strategies. Portfolios that combine core stability with selective growth exposure, supported by valuation awareness and robust risk management, are better positioned to navigate market dispersion and capture long-term value creation.

Closing Thoughts

We conclude our India Equity Outlook for 2026 with a constructive but measured view on the opportunity set for Indian equities. The investment landscape is supported by durable structural drivers that extend well beyond the near-term cycle, yet it is also characterised by elevated valuation dispersion, uneven earnings visibility, and a broader set of macro and global uncertainties than in recent years. This combination reinforces the need for discipline, selectivity, and active portfolio management as investors position for the year ahead.

India enters 2026 with a relatively strong macro foundation compared with most major economies. Domestic demand remains resilient, supported by rising incomes, rural recovery, and improving consumption breadth. Private consumption continues to act as a central pillar of growth, aided by easing inflation pressures and greater financial inclusion. At the same time, investment activity, particularly in infrastructure and manufacturing, provides an important counterbalance to consumption-led growth and strengthens medium-term earnings potential across multiple sectors.

We see the ongoing recovery in rural consumption as a meaningful structural development rather than a short-lived rebound. Improving agricultural outcomes, better wage dynamics, and deeper access to credit are expanding the spending capacity of rural

households and supporting demand across staples, discretionary goods, and entry-level durables. This rural momentum is also reshaping consumption patterns, with premiumisation gradually extending beyond urban centres and into smaller towns and hinterland markets. Over time, this broadening of demand should support more balanced and resilient earnings growth across consumer-facing sectors.

Structural themes continue to anchor the longer-term equity narrative. Manufacturing expansion, infrastructure build-out, and financial deepening represent interconnected pillars of India's economic transformation. Policy continuity, public capital expenditure, and private sector participation are reinforcing these trends, creating multi-year visibility for select companies across industrials, capital goods, logistics, financials, and enabling services. We believe that portfolios aligned with these structural forces, while remaining valuation conscious, are better positioned to capture sustained value creation.

At the same time, we remain cautious on areas where valuations have outpaced fundamentals. Small and mid-cap equities illustrate this tension most clearly. While these segments offer long-term growth potential and alpha opportunities, they also exhibit heightened sensitivity to earnings disappointment, liquidity shifts, and changes in risk appetite. We expect 2026 to be a year where differentiation within these segments is pronounced, rewarding bottom-up stock selection and penalising indiscriminate exposure. Quality, balance sheet strength, and earnings visibility are likely to matter more than narrative-driven momentum.

Large-cap equities continue to play an important role as anchors of portfolio stability. Relative valuation comfort, stronger governance standards, and deeper liquidity make them well suited to a core allocation, particularly in an environment where global volatility and policy uncertainty remain elevated. We see value in blending this stability with selective exposure to mid-cap growth and thematic opportunities, calibrated carefully to risk tolerance and investment horizon.

Risk considerations remain central to our outlook. Currency volatility, capital flow sensitivity, global policy divergence, and geopolitical risks all have the potential to influence market sentiment and valuation multiples. In addition, domestic risks related to inflation surprises, policy execution, and earnings variability warrant close monitoring. We believe investors should approach 2026 with robust risk frameworks, including diversification across styles and assets, conservative position sizing in less liquid names, and regular portfolio stress testing.

From a portfolio construction perspective, we emphasise the importance of fundamentals over momentum. Earnings quality, return on capital, cash flow generation, and pricing power should be prioritised over short-term performance trends. Systematic investment approaches and disciplined rebalancing can help manage volatility and behavioural biases, particularly in segments prone to sharp drawdowns.

In summary, we believe India remains one of the most compelling long-term equity markets globally, underpinned by favourable demographics, policy-driven reform, and a growing domestic investor base. However, the path through 2026 is unlikely to be linear. Returns are expected to be more selective and more closely tied to earnings delivery than in previous phases of broad-based market expansion. Investors who combine a long-term structural lens with near-term valuation discipline and active risk management are best positioned to navigate this environment.

As we look ahead, we remain confident that Indian equities can deliver attractive risk-adjusted returns over time. Success in 2026, however, will depend less on broad market direction and more on thoughtful allocation, rigorous research, and the ability to adapt portfolios as macro conditions, earnings trajectories, and market sentiment evolve.

Personal Closing Note from the Authors

While writing this report, we set out to build a framework that goes beyond near-term market narratives and instead reflects how we, as aspiring professionals, think about risk, return, and long-term capital allocation. Our objective was not only to assess where Indian equities may head in 2026, but also to understand why different outcomes are possible and how investors can position thoughtfully across them.

For us, this exercise brought together three complementary perspectives. As an aspiring asset manager, Aditya approached the market through the lens of portfolio construction, valuation discipline, and long-term compounding. As an aspiring investment banker, Soham focused on earnings visibility, sectoral drivers, capital flows, and how businesses translate macro and structural trends into financial outcomes. As an aspiring risk manager, Laith emphasised downside scenarios, volatility, liquidity, and the importance of stress testing assumptions in an uncertain global environment.

While writing this report, we were repeatedly reminded that markets are rarely defined by a single narrative. India's growth story is powerful, but it is not immune to cycles, valuation excesses, or external shocks. Balancing optimism with caution became a recurring theme throughout our analysis. We aimed to reflect this balance by highlighting structural opportunities while also being explicit about the risks that could challenge consensus expectations.

This report also reflects our shared belief that successful investing is ultimately about discipline. Discipline in valuation, discipline in understanding earnings quality, and discipline in managing risk when markets become complacent or overly pessimistic. We believe these principles matter regardless of market conditions, and even more so as participation broadens and volatility becomes a defining feature of equity markets.

Finally, this work represents an important step in our own learning journeys. Writing it forced us to question assumptions, reconcile differing viewpoints, and ground our conclusions in evidence rather than conviction alone. We hope that readers find value not only in the insights presented, but also in the structured and balanced way the outlook has been framed.

We thank you for engaging with this report and hope it contributes meaningfully to your understanding of India's equity landscape as 2026 approaches.

To close, we leave you with a line that captures the long-term, conviction-driven nature of investing:

"When I die, put my money in the grave."

— Drake, Money In The Grave (ft. Rick Ross)

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Disclaimer

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