



Getting more positive - FPI flows to improve?

October 16, 2025

Since the peak of the market in September 2024, we have witnessed prolonged time correction in line with our expectations. While the global picture looks cloudy, we are getting more positive on markets and expect high single digit to low double digit returns over the next 12-15 months.

5 reasons why we think FII flows will get better?

1. **Performance marks pessimism:** India is the worst performing market amongst EMs underperforming the benchmark by nearly 22%.
2. **Positioning also marks peak pessimism:** EM funds are nearly 250bps underweight on India, the most negative positioning over the past 20 years.
3. **Valuations are getting more reasonable:** While valuations are not cheap, they have become reasonable with Nifty trading at a PE of 20.4x in line with 5-year averages and slightly above 10-year averages. But in a relative context valuations look reasonable. India trades at around 60% premium to EM average on a PE basis, in line with historic averages.
4. **Earnings recovery could be a trigger:** While September 2025 will be the 6th consecutive quarter with single digit earnings growth, we feel it will mark the bottom of the earnings cycle and see earnings growing at 16% in FY27.
5. **Fed cuts may help EM flows:** The end of Quantitative Tightening and Fed cuts over the next few months may help flows to emerging markets including India which could offset partly concerns on a slowing economy.

Getting more positive on markets

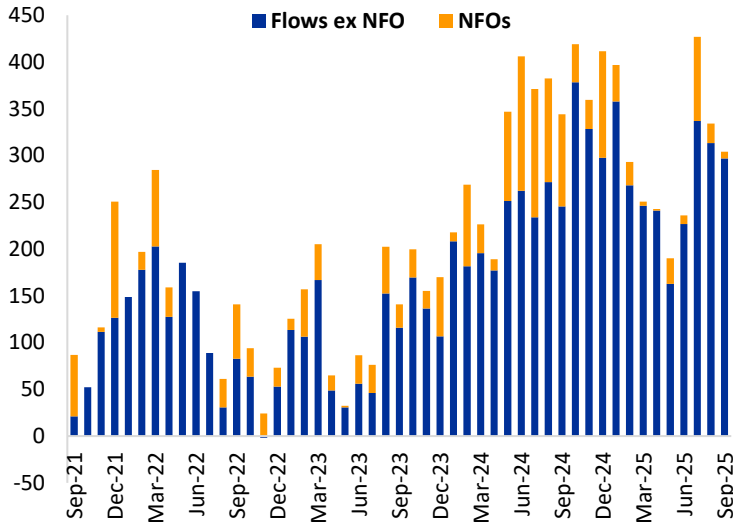
Since the peak of the market in September 2024, we have seen a prolonged time correction in line with our expectations. While the global picture looks cloudy, we are getting more positive on markets and expect high single digit to low double digit returns over the next 12-15 months. What is changing? First, the macros continue to be supportive of the market as detailed in our earlier report (<https://www.valentisadvisors.com>) and euphoria in the equity markets has reduced to a fair extent. Secondly, we think the earnings cycle is set to improve after 6 quarters of single-digit growth. Thirdly, valuations while still not cheap are getting a bit more reasonable, especially on a relative basis. Lastly, we think after massive selling by FIIs over the past year, we expect positive flows over next year.

Will domestic flows weaken?

Over the past 2 years, domestic flows to equities have been strong and offset the constant selling by FIIs. While the huge amount of IPOs/QIBs is absorbing part of the liquidity and indeed will likely continue, there is some concern that weakening domestic flows could put pressure on secondary markets.

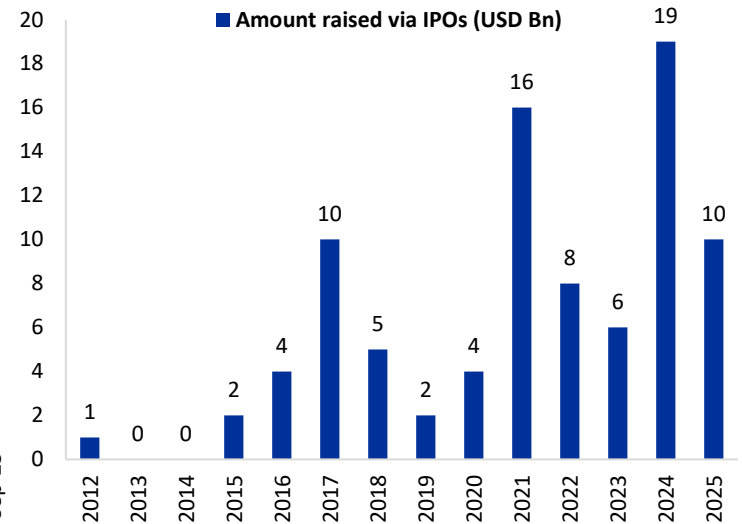


Chart 1: Net Equity Flows in MFs slowing? (Rs Bn)



Source: MOSL, Valentis Research

Chart 2: Supply of paper still strong

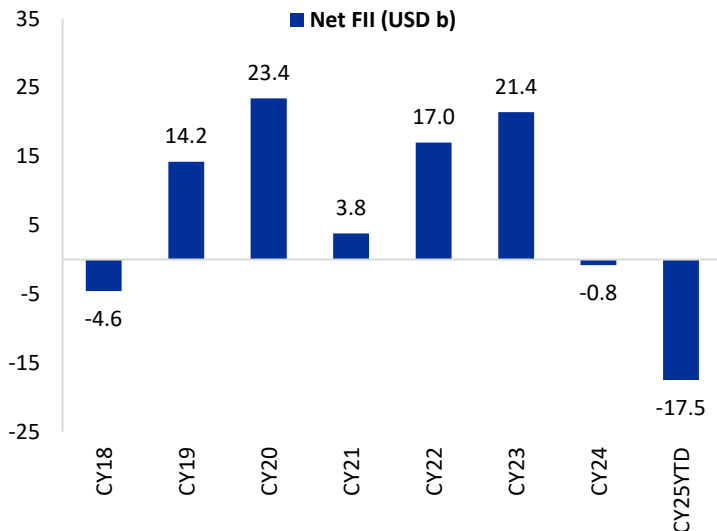


Source: Dam Capital, Valentis Research, Note: 2025 data is till Sept 2025

5 reasons why we think FII flows will get better

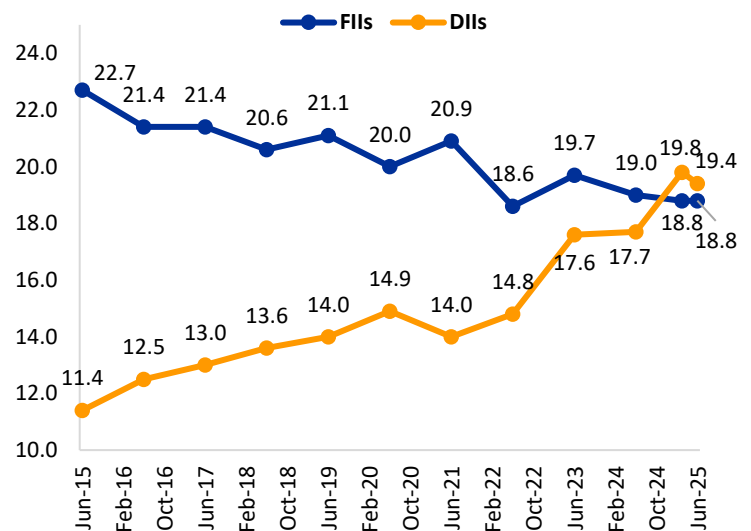
FIIs have been consistent sellers in the Indian market over the past 1 year with net sales of US\$29.3bn. With the global economy looking uncertain with a stagflation-like scenario in US possible, consensus is that FII flows are unlikely to improve. However, we think we have seen the worst of FPI outflows and expect FII outflows to slow and possibly even see positive flows.

Chart 3: Yearly Institutional flows (Rs Bn)



Source: MOSL, Valentis Research

Chart 4: Trend in FII/DII holdings for Nifty 500 (%)



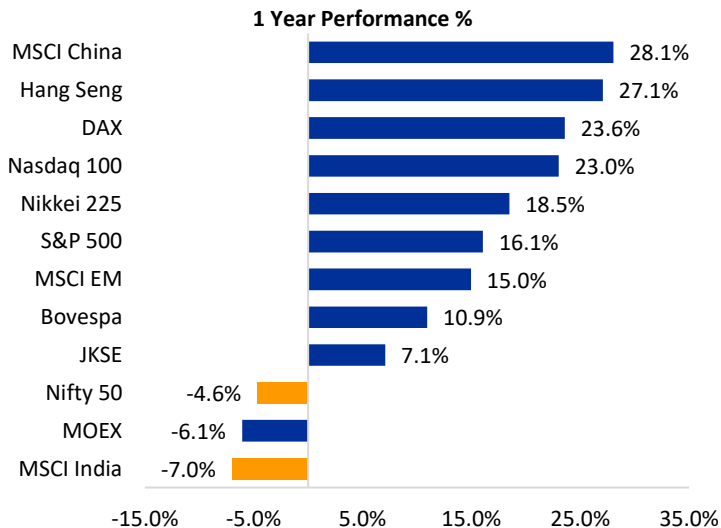
Source: MOSL, Valentis Research



#1: Performance – India is worst performing market

India has been the worst performing market amongst EMs over the past year underperforming the benchmark by nearly 22%. In fact, the index masks weakness in the broader market with nearly 2/3rd of the small-caps giving a negative return.

Chart 5 – India’s Performance continues to Lag



Source: MOSL, Valentis Research

Table 1 – Pain in Small caps much more than Large Caps

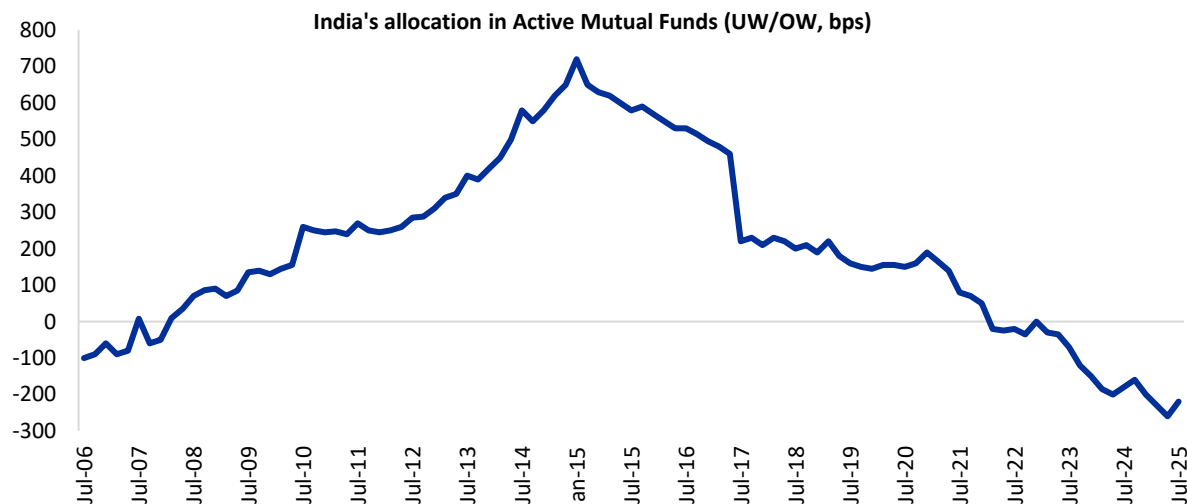
1 Year Returns	> 20%	10% to 20%	0% to 10%	0 to -10%	-10% to -20%	> -20%
BSE500	15%	8%	14%	14%	16%	32%
-Large Cap	12%	14%	17%	20%	18%	17%
-Mid Cap	21%	6%	21%	14%	9%	29%
-Small Cap	13%	8%	9%	11%	19%	40%
Nifty Smallcap 100	20%	7%	11%	14%	17%	32%
Nifty Midcap 100	20%	6%	23%	12%	13%	26%

Source: AceEquity, Valentis Research

#2: Positioning reflects extreme pessimism

EM funds are nearly 250 bps underweight India. This is the most bearish positioning on India on record. Any positive news could lead to buying in India to cut their underweight position.

Chart 6 – India’s allocation in active mutual funds globally is near a 2-decade low



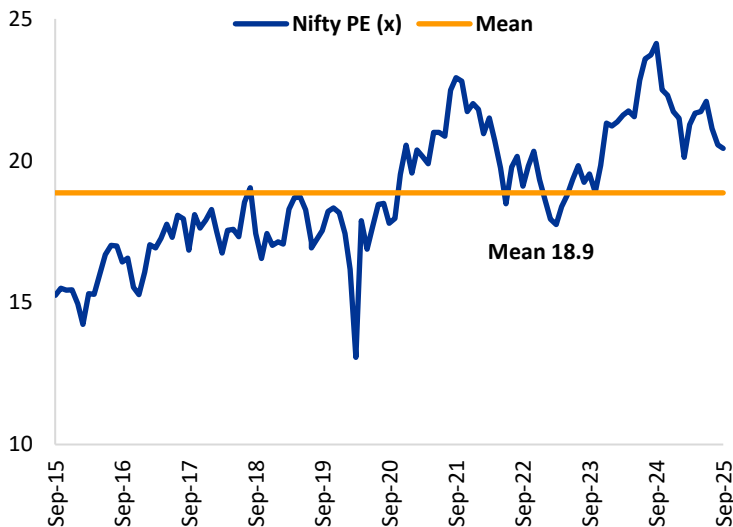
Source: Brokerage Reports, Valentis Research



#3: Relative valuations getting reasonable

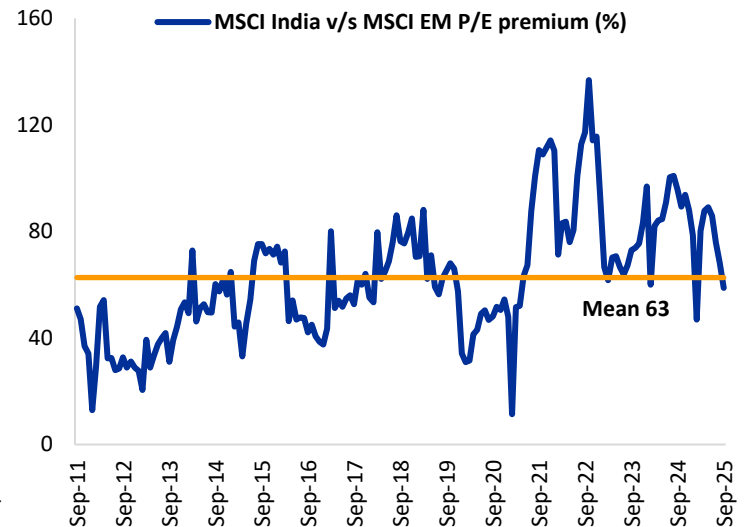
While valuations in India have improved, they are still not cheap. Nifty currently trades at 20.4x 1-year forward earnings, in line with its 5-year average of 20.7x and slightly above its 10-year average of 18.9x. However, in a relative context to emerging markets, India now trades at 60% premium on a PE basis, in line with its long-term averages.

Chart 7 – Nifty 12M Fwd P/E – getting more reasonable



Source: MOSL, Valentis Research

Chart 8 – Relative Indian valuations are reasonable



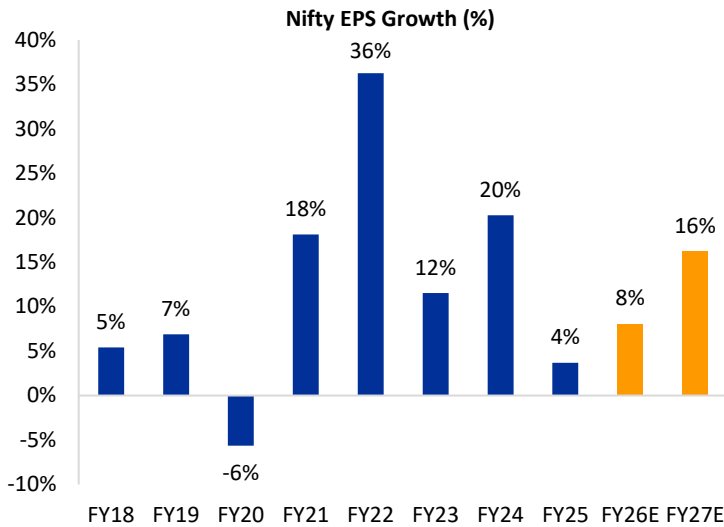
Source: B&K, Valentis Research

#4: Improving earnings can lead to improved FII sentiment

While Indian macro-economy parameters have been looking great with twin deficits under control, very low inflation and falling interest rates (we expect a further cut in December), earnings have been a weak spot (for details see our earlier note <https://www.valentisadvisors.com>). We think September quarter will be the 6th quarter of single-digit earnings growth but will also mark a turning point with the next few quarters seeing double-digit growth. Also, earnings downgrades will hopefully come to an end.

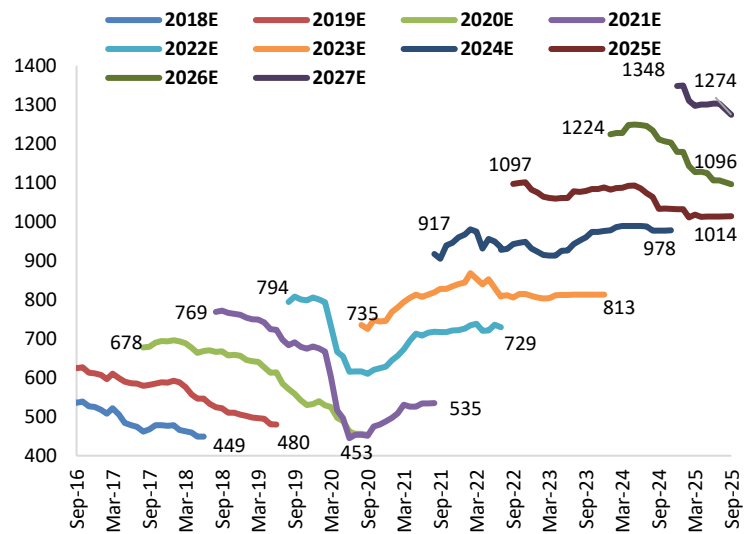


Chart 9 – Earnings forecast to rebound



Source: MOSL, Valentis Research

Chart 10 – Earnings downgrade spell ending?

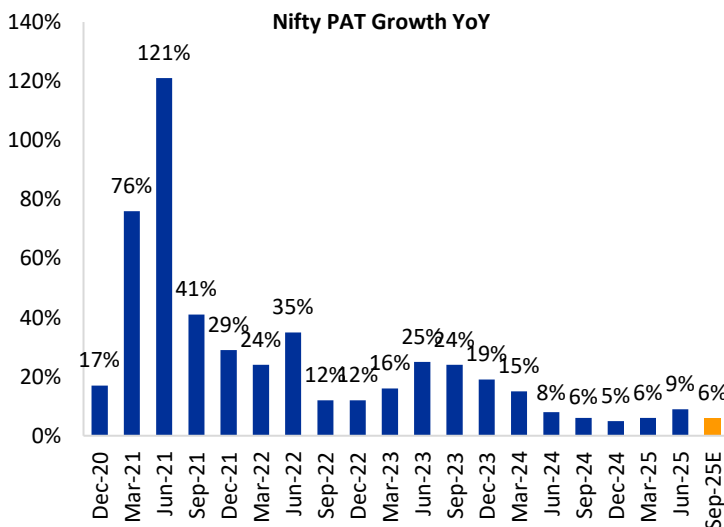


Source: B&K, Valentis Research

Q2FY26 will again be a weak set of earnings

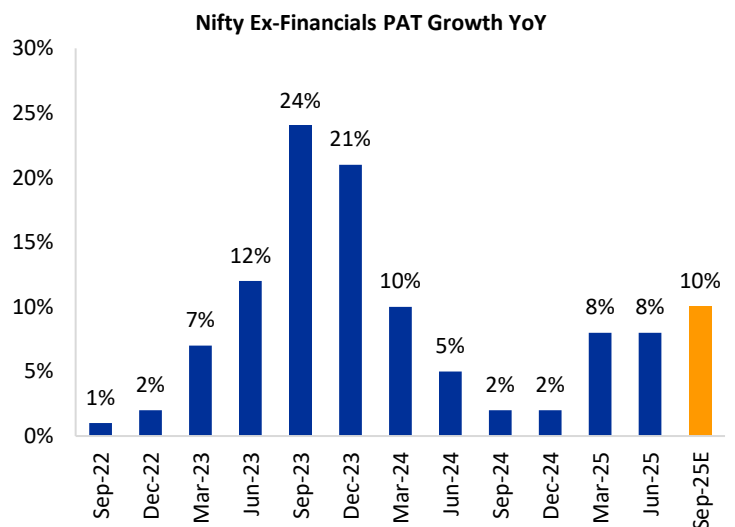
We expect Q2FY26 to be another weak quarter of earnings with Nifty earnings likely to grow 6% YoY. Excluding global commodities (metals and oil and gas), earnings growth drops further to 4%. However, the good news is that private and public sector banks are likely to see drop of 7% each in earnings. Excluding financials which will see a recovery in earnings from next quarter, the earnings for Q2 move to double digit at 10%. Another interesting highlight of the results is that small and mid-cap earnings are expected to grow much faster than large cap earnings – as per Motilal Oswal, large-cap/mid-cap/small-cap universe is likely to register a PAT growth of 7%/23%/14%, YoY.

Chart 11 – Nifty's PAT Growth anticipated only at 6% YoY



Source: MOSL, Valentis Research

Chart 12 – PAT to grow 10% YoY for Nifty Ex-Financials



Source: MOSL, Valentis Research

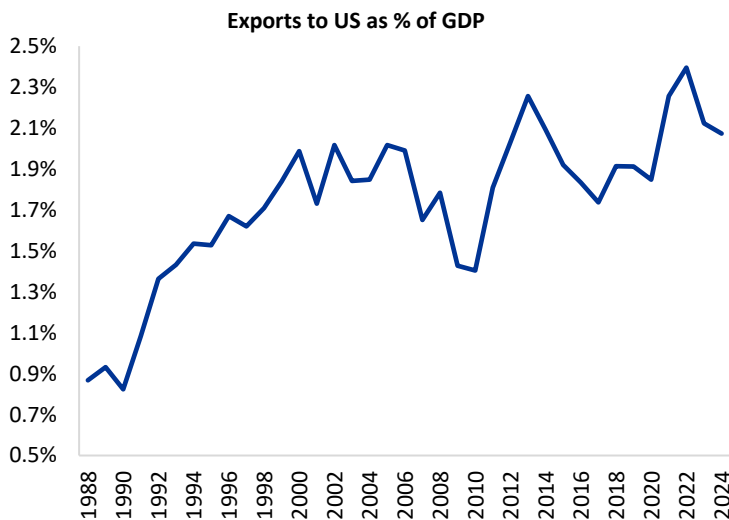


Indo-US trade deal could be sentiment positive; slow-down in US economy is a risk

We think one risk for earnings could be a major slow-down in the USA. Over one-third of our earnings come from global facing sectors (including commodities) which could see downgrades in case of any recession conditions in the USA.

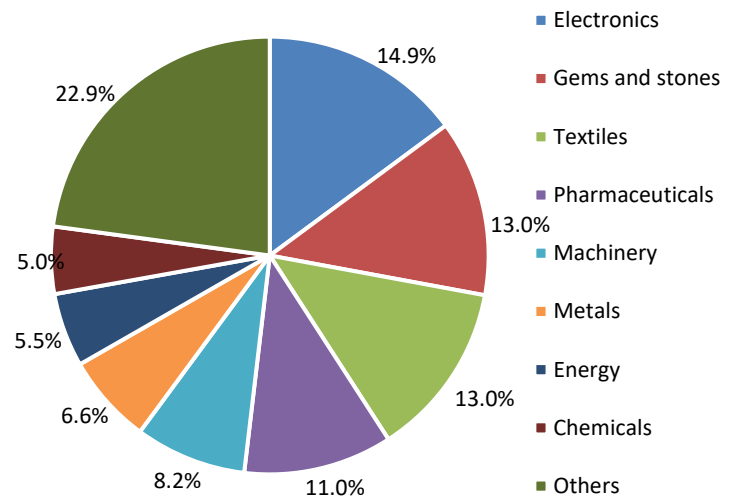
The US tariffs have a limited impact on earnings near term since (a) It impacts less than half of US exports that account for only 1% of GDP (b) the sectors most impacted are textiles, gems & jewelry and shrimps that are not a large part of the market. The big market impact will come if generic pharma sees a large tariff which appears unlikely currently. Meanwhile, any trade deal with the US will be sentimentally positive and ease the pain of some of these large sectors impacted by the tariff increase.

Chart 13: US exports as % of GDP is low for India



Source: IMF, World Bank, Niryat, Valentis Research

Chart 14: Composition of India exports to US



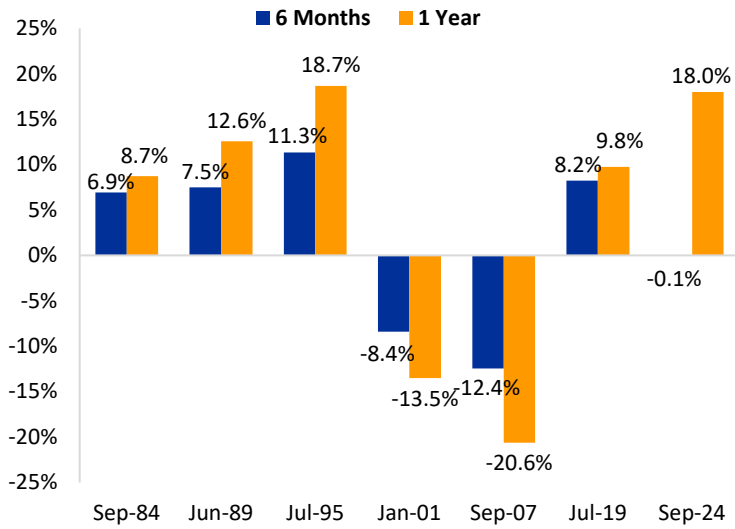
Source: Kotak IE, Valentis Research

#5: Fed cuts could help flow to emerging markets

While the US economy could weaken putting pressure on earnings and stock market, it will also lead to easier liquidity with Fed planning to stop quantitative tightening (QT) soon and Fed cuts are likely to continue. This will likely help flows to emerging markets and India will also be a beneficiary. At peak the Fed balance sheet was at US\$8.97 trillion (April 2022). The Fed has since reduced the size of their balance sheet by nearly \$2.4 trillion. With Fed giving indications that they are likely to stop the QT, the easy liquidity will be good for equity markets. We also expect 2 Fed cuts in the next few months which will help flows to equity.

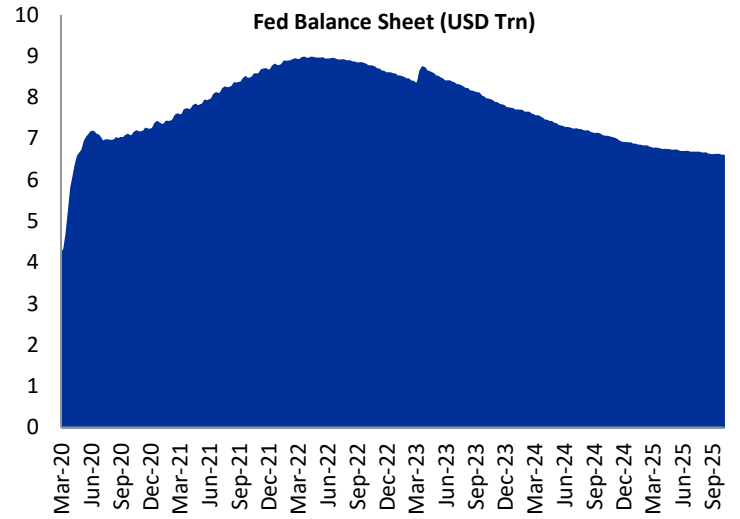


Chart 15: Fed cuts generally help markets



Source: Investing.com, Valentis Research

Chart 16: Fed Balance Sheet has reduced significantly



Source: Investing.com, Federal Reserve, Valentis Research



Portfolio Performance and outlook

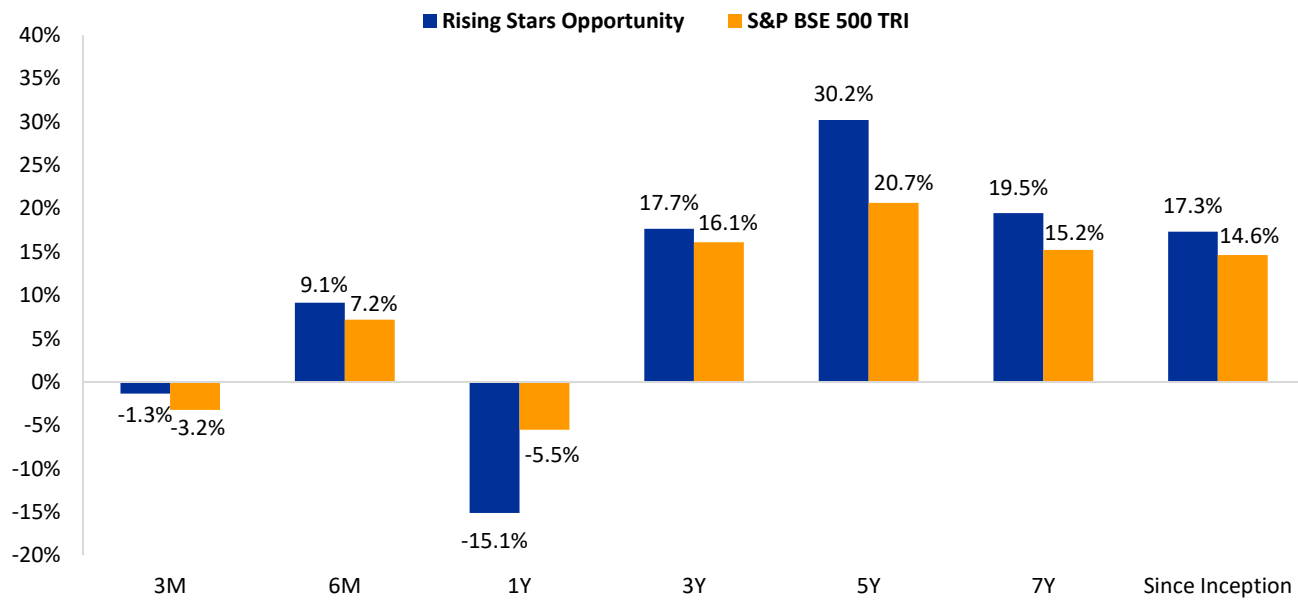
1. We continue with our theme of “buy local, avoid global”. In line with that theme nearly 80% of our portfolio has very minimal exposure to USA exports

US exports as % sales	Weightage	No. of stocks
Nil	74%	12
>0-10%	5%	1
10-20%	0%	0
20-40%	8%	2
40-50%	6%	1
Above 50%	0%	0

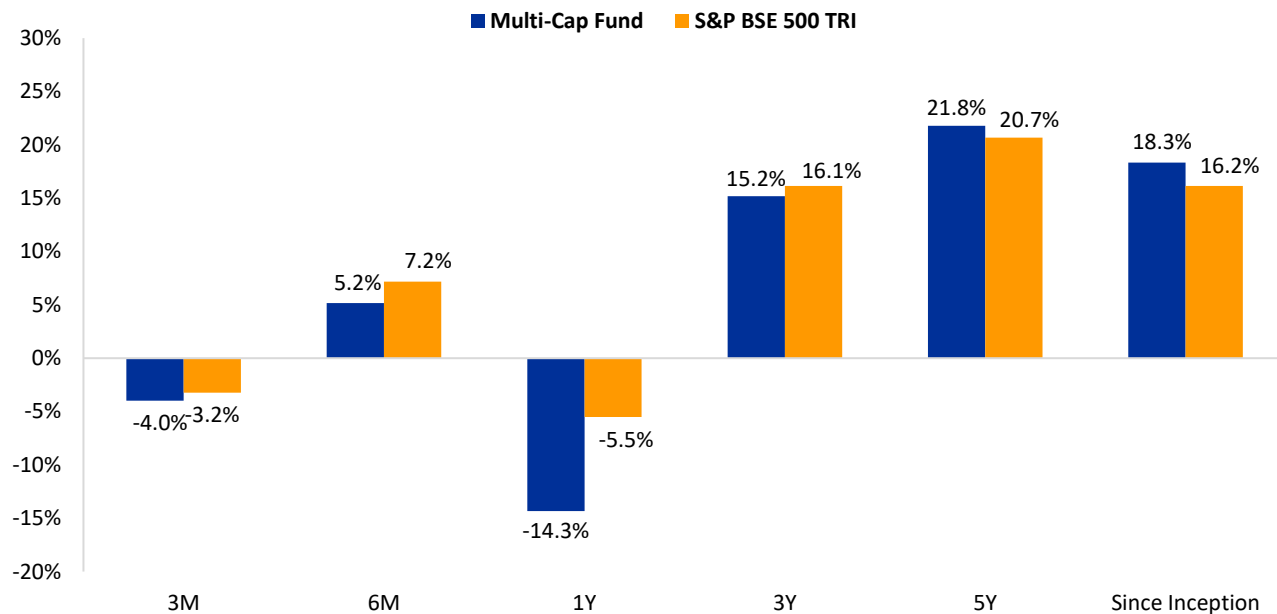
2. The high US export companies are in the pharma sector where tariffs are currently not applicable. We believe the tariffs on generics will not be onerous and indeed it may be zero going by current reports. If the tariffs on generics are confirmed at zero or low levels, we may add weight to pharma.
3. The other sector with US exposure is chemicals. We have stressed our earnings, assuming the 50% US tariffs remain for the next 2 years and are comfortable with the valuations in this company. We may look to add to our weight on any share price weakness post Q2 results.
4. Our overall theme remains buying growth at a reasonable price. Going forward we have tried to maintain a portfolio with high earnings growth of 21% while keeping valuations below the market at a PE of 16x. We think this will help us achieve a good return in the portfolio despite the likely volatility in the markets.
5. While we have been cautious on the markets, we think current positioning on India and likely Fed cuts mean we may see a year-end rally in markets. We have reduced cash in the portfolio and see better returns for small and mid-caps over next 15 months than the negative returns over past 15 months.



Valentis Rising Stars Opportunity Fund Performance (as on September 30, 2025)



Valentis Multi-Cap Fund Performance (as on September 30, 2025)



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