PL Capital
PRABHUDAS LILLADHER

EQUITY MARKET OUTLOOK
A BALANCING ACT

Vikram Kasat
Head - Advisory

Nifty 50 is down 15% from its all-time high of 26,277 in September 2024. The correction has come on the back of **global uncertainty, weak earnings growth, and high valuations.** Mid and smallcap indices are seeing deeper correction, with Nifty Midcap 150 down ~21% from its 52-week high and Nifty Smallcap 250 down ~26%.

Despite the correction, **midcap and smallcap stocks continue to be more expensive** than their 5-year averages. The decline in largecap stocks (below their 5-year average P/B) and the higher P/B ratios of mid & smallcaps (above their 5-year averages) suggest a normalization of valuations.

Category	Current Valuation PB (Price to Book)	5-year Mean PB	5-year Median PB	Premium/ Discount to 5-year Avg (%)	Premium/ Discount to 5-year Median (%)
Nifty 100	3.43	4.02	4.19	-14.59	-18.14
Nifty Midcap 150	4.93	3.74	3.61	31.81	36.57
Nifty Smallcap 250	3.5	3.26	3.38	7.29	3.55

Data as on 31st Jan, 2025

Now, what could influence markets from here?

THE BIG POSITIVE — DOMESTIC CONSUMPTION

Unlike previous budgets that were heavy on infrastructure, in this year's Union Budget the government has put money directly into people's hands. The idea is simple: more disposable income means more spending, which benefits businesses and, in turn, the stock market.

Key Budget Highlights That Favor Equities

Tax Reliefs for the Middle Class
Higher exemption limits and rebates mean more cash in urban India's pockets. This can benefit sectors like FMCG, retail, autos, and real estate the most

Rural Boost
Increased Minimum Support Prices and direct cash transfers to revitalize rural demand, positively impacting agriculture, consumer durables & 2-wheelers

Credit Support for MSMEs
Easier access to loans for small businesses will likely lead to higher credit growth for banks and NBFCs, while also stimulating job creation

Healthcare & Insurance Expansion
Tax benefits for health insurance and pharma R&D make these sectors attractive investment opportunities

Sectors Poised to Win in a Consumption-Driven Market

- Autos & Two-Wheelers
- Banking & NBFCs
- Retail & FMCG
- Healthcare & Pharma

THE BIG NEGATIVE — FII SELLING

Foreign institutional investors have sold stocks worth ~INR 3 lakh crore so far, since September 2024. The major reasons are:

Attractive US 10-Year Yields
Yields of 4.5-5% in the US offer a compelling alternative to emerging markets

Indian Currency Depreciation
Depreciation of 3-4% reduces the dollar returns for foreign investors

Indian Tax on Foreign Capital
The 12.5% tax levied by India on foreign capital further diminishes returns

Earnings Slowdown & Valuations
Concerns about current earnings growth and valuations are also driving FII selling

For FIIs to return, we need a confluence of factors: **higher domestic earnings, a lower US 10-year yield, a weaker dollar, and stronger emerging market growth.**

How much can FIIs sell?

Some back of the envelope calculations:
India's Market Cap = INR 450 lakh crore (at peak)
FII Holding = INR 80 lakh crore (at peak)

Based on previous cycles of 2008 or 2022, FIIs could sell **~1% of India's total market cap or 5-5.5% of their peak holding.**

FII selling could amount to **INR 4 - 4.5 lakh crore.** FIIs have already sold INR 3 lakh crore so far.

Can DIIs counter this selling?

SIP: INR 26,000-27,000 crore a month is equal to INR 3 - 3.25 lakh crore per annun
EPFO: INR 25,000-50,000 crore a year (investments through ETFs)
LIC and other insurance companies: INR 50,000-1,00,000 crore
Existing Cash: INR 1,00,000 - 1,25,000 crore

DII buying worth INR 4.5 - 6 lakh crore is possible in a year, assuming no redemption and continuation of flows.

DII inflows does not mean markets will not fall! It just gives a buffer to make the fall more gradual as per the changing fundamental scenario.

THE BALANCED CASE — ARE WE HEADED FOR A MARKET CONSOLIDATION?

So, despite strong domestic demand, global uncertainties like tariff wars, delayed interest rate cut suggest that market consolidation is the most likely scenario, rather than a sustained rally or a sharp correction. Persistent FII outflows and valuation concerns can limit upside gains. Sector rotation is evident, with cyclical stocks likely to outperform defensive stocks in the coming months.