

“Many investors seem to have forgotten a hard reality; there are frequent periods when stock markets don’t do much” – Jim Rogers

Dear Investors,

As we enter 2026, I would like to extend from all of us here at Equinova a very warm Season’s greetings to all readers and investors. It gives me immense joy as I pen down my thoughts on an eventful year that’s gone by and more importantly on the year that lies ahead, in my first investor letter at Equinova. 2025 will likely be remembered as a year that went by with a lot happening around us but then again seeming like nothing much was happening in our portfolios and equity markets. Yet, stepping back from the tape, **2025 may well prove to be one of the most consequential years for India’s economic architecture.** While markets were busy repairing excesses, the groundwork for the next phase of growth was being laid—quietly, deliberately, and structurally. If 2025 was about endurance, 2026 increasingly looks like a year of emergence.

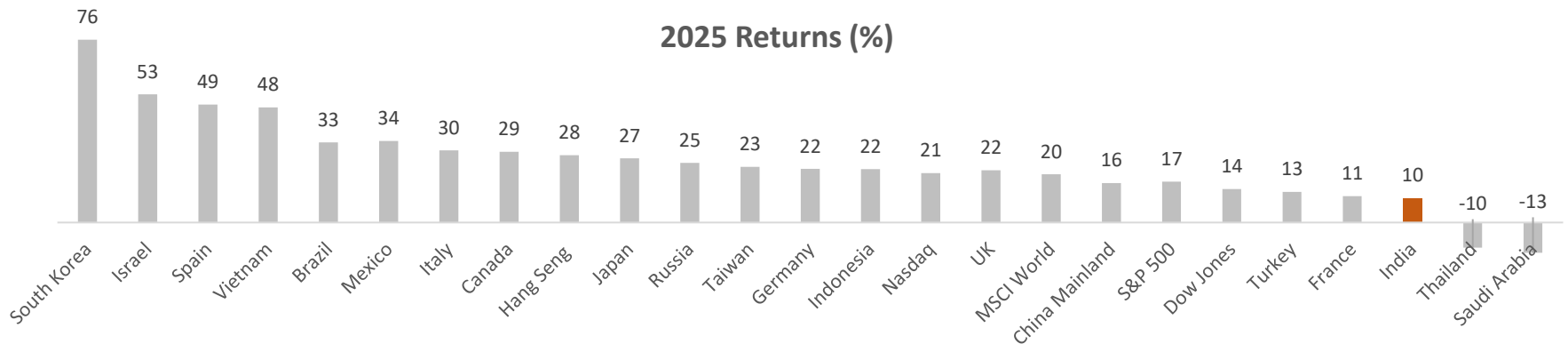
2025 in a Snapshot through the eyes of Equinova



Source: Equinova Research

As can be seen from above news-clips, there was a never-ending flow of geopolitical, local political and policy headlines and in midst of all the noise, some of the important reforms and news lost its impact among the investors as pessimism around equities took center stage. **Two of the major factors which led to the markets in India being on a weak footing were US Tariffs and India Inc. earnings weakness till Q1FY26.** Though a 50% tariff on Indian exports to the US didn’t impact our GDP or corporate earnings, but yes it did its damage on the sentiments among the Foreign Investor community who saw India as the ‘Most Tariffed’ nation. Also, **lot of flight of capital globally has been towards AI Trade** and India is not in anyway part of this AI Theme for investible opportunities. The other major factor was the **subdued mid-single digit earnings growth which was visible for the first 9 months of CY2025.** Indias rich valuations saw meaningful time correction and at the same time foreign ownership in Indian equities went down to the lowest level in decades to around 17% while at the same time domestic institutional ownership went up to its highest levels.

After several years of outsized returns, we saw normalization of returns in the year. **Indian equities became one of the worst performing markets globally** both among emerging and developed markets. It's a bit painful to see this phase considering that for prior almost 4 years, India used to feature among the top quartile in performance among global peers.



Source: Equinova research

Interestingly **there was huge divergence in stock price performances even within the same market capitalizations**. There is a common narrative which has been made popular that mid-caps and small-caps saw sharp underperformance to large-caps. However, let's look at some numbers which would show that whenever the markets look difficult to make money, it becomes a stock pickers market and that is where portfolio differentiation plays out.

Index	1 year return	Best performing stock	1 year return	Worst Performing Stock	1 year return
NIFTY 50	10.1%	Shriram Finance	72.7%	Trent	-39.2%
NIFTY NEXT 50	2.1%	TVS Motors	57.6%	REC Ltd	-37.3%
NIFTY MIDCAP 100	5.7%	L&T Finance	130.2%	Ola Electric	-46.7%
NIFTY SMALLCAP 100	-6.6%	Hindustan Copper	110.2%	Tejas Network	-61.7%

Source: Equinova research

Some interesting observations which comes out from the above table:

1. All Large cap Index have not fared well. **NIFTY NEXT 50** which is also a large-cap Index **has underperformed the NIFTY MIDCAP 100**
2. There is **huge divergence in returns** of more than 100% **between the best performing NIFTY 50 stock and the worst performing one**. Similarly, close to 100% divergence is seen between the best and the worst performing NIFTY NEXT 50 constituents.
3. The divergence in returns between the best and the worst performing constituent stocks becomes starker when we move to **NIFTY MIDCAP 100** and **NIFTY SMALLCAP 100**.

Another interesting data which emerges is regarding the proportion of companies in the respective indices which have outperformed the corresponding index, and it highlights the importance of stock picking which has now become key for alpha creation.

52% of NIFTY 50 companies have outperformed the Index return

43% of NIFTY MIDCAP 100 companies have outperformed the Index return

36% of NIFTY SMALLCAP 100 companies have outperformed the Index return

The Reform Canvas of 2025 – Quiet, Structural, and Powerful; Setting stage for 2026

Direct Tax Reforms: Restoring Incentives to Grow and Consume

The direct tax measures introduced in the Union Budget 2025 marked a meaningful shift in policy intent—from incremental tinkering to broad-based incentive realignment. By **rationalizing slabs, simplifying compliance, and improving post-tax income visibility**, the government reinforced the idea that growth is best achieved when households and entrepreneurs retain a higher share of incremental earnings. **Beyond the immediate boost to disposable incomes, these reforms improve behavioral confidence—encouraging consumption, risk-taking, and capital formation**. Importantly, the signal was clear: India is serious about making itself a competitive jurisdiction for both talent and enterprise over the long run.

Indirect Tax and GST Reforms: Efficiency as a Growth Lever

GST reforms in 2025 focused both on rate changes and on process, predictability, and trust. **Slashing GST rates across various industries helped in reducing consumer prices** across various good and services. Tighter input credit mechanisms, reduced litigation, and improved settlement timelines enhanced working capital efficiency across supply chains. Over time, GST has evolved from a disruptive tax reform into a formalization engine, nudging enterprises toward scale, compliance, and productivity. **The cumulative effect is often underappreciated in markets, but its impact shows up quietly—in margin stability, better cash flows, and improved return ratios.** As GST stabilizes further, it becomes less a tax and more an invisible enabler of organized growth.

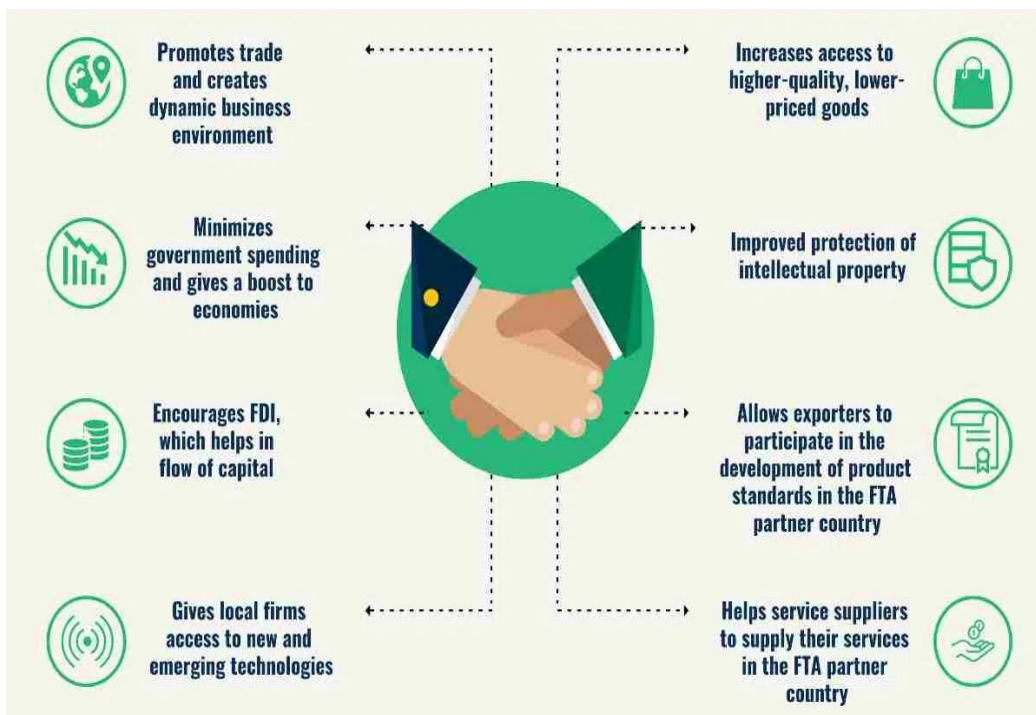
Labour Reforms: Preparing the Workforce for Scale

Labour reforms continued their gradual but deliberate rollout, with emphasis on flexibility, formal employment, and scalability. While the immediate market reaction is often muted, **these reforms are foundational for manufacturing, infrastructure, and services-led expansion.** India's 2025 Labour Code reforms **consolidated 29 laws into four codes (Wages, Social Security, Industrial Relations, Workplace Safety)** for simplified compliance and broader worker protection, covering gig/platform workers, mandating uniform wages, extending social security, among many other positive reforms. As enterprises gain the confidence to hire, invest, and expand without regulatory overhang, the virtuous cycle between employment and consumption strengthens.

Trade Agreements: Strategic Confidence Over Defensive Protectionism; Game changer for India

Perhaps the most underappreciated yet transformative pillar of India's reform agenda has been its new approach to global trade agreements. For years, trade policy was viewed through a defensive lens—fear of imports, anxiety around competitiveness, and protection of inefficient domestic capacity. That mindset has decisively shifted. India's recent trade agreements—with countries such as Australia, the UAE, the UK, and the EFTA bloc—reflect a confidence-led strategy rather than a fear-driven one. As articulated by the Commerce Minister, **India now follows a clear, standardized framework before entering any negotiation: agreements must be win-win, strategically aligned, and complementary rather than extractive.**

Benefits of FTA for India



Equally important is who India is choosing to partner with. **The focus is firmly on advanced economies with high per capita incomes, where competitive asymmetry works in India's favour.** These economies demand quality, scale, and reliability—areas where Indian industry has steadily improved. By engaging with markets that value standards over subsidies, **India is positioning itself as a trusted global manufacturing and services partner, not merely a low-cost alternative.** Crucially, India's decision to stay out of RCEP now looks prescient rather than conservative. Avoiding premature exposure to deeply asymmetric competition has preserved domestic manufacturing optionality, while bilateral and plurilateral agreements are opening targeted, high-quality export opportunities. Over time, **this approach should reduce volatility in trade balances and improve earnings visibility** for export-oriented sectors—something markets tend to reward only with hindsight.

What to expect in 2026: Time to change stance from Cautious Optimism to Selective Aggressive Optimism

Every bull market is born in skepticism, and every new cycle begins when narratives lag reality. 2025 may not have rewarded patience immediately, but it strengthened foundations. In 2026 the contours of a more confident, reform-driven, and globally integrated India are becoming clearer. For long-term investors, optimism need not be loud—it only needs to be well-reasoned. Below have summarized some of the key things to look out for in this year and which would drive equity returns during the year.

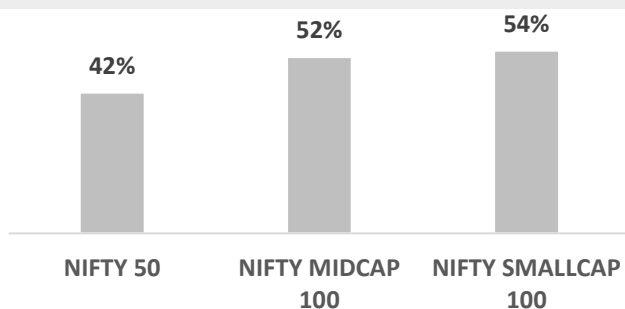
• EARNINGS DOWNGRADE CYCLE TO REVERSE TO UPGRADE CYCLE

After seeing earnings downgrades for almost four quarters since Q3FY25, the intensity of earnings cuts has been moderating. We have been highlighting since the last quarter that the bottom has been made on earnings weakness, and a round of earnings upgrades is around the corner. **Supported by both fiscal and monetary measures coupled with GST cuts and trade deals playing out, we see strong earnings revival in mid teens (14-16%) over CY2026.** A stable earnings floor is likely to lend support to the equity market which has been used to seeing single digit earnings growth for the last 18 months. Like always, **we are chasing companies which are beating their industry peers on earnings growth and accordingly portfolio positioning is being done.**

• MIDCAPS AND SMALLCAPS TO OUTPERFORM LARGE CAPS

We believe that many mid and small cap companies will post stronger earnings growth in the next 2-3 years given higher weightage of domestic and global cyclicals in mid and small cap space, pick up in capex activity, and lower inflationary pressures. While the Nifty-50 EPS is expected to grow at 16%, **Nifty Midcap 100, and Nifty Smallcap 100 is projected to grow at 22% and 25% (consensus) respectively over the next two years.**

Raw materials as a % of total cost is more in mid & smallcaps and hence they benefit more in low inflationary environment



Source: ACE Equity

Both domestic and global cyclicals have more weightage in Midcap & Smallcap Index hence they are expected to report stronger earnings growth

	NIFTY 50	NIFTY MIDCAP 100	NIFTY SMALLCAP 100
Financial	36.5	28.3	30.2
Domestic Cyclicals	20.7	37.4	30.8
Domestic non-cyclical	15.6	12.8	21.8
Global price takers	12.8	4.5	1.2
Global cyclicals	0.6	3.7	11.3
Global noncyclical	13.8	13.3	4.7
	100.0	100.0	100.0

Source: NSE

Accordingly, our portfolio positioning will remain **overweight on Midcaps and Smallcaps in 2026.**

• URBAN AND RURAL DISCRETIONARY CONSUMPTION TO REVIVE

We remain **optimistic about Urban consumption demand in 2026, supported by direct tax benefits, GST cuts, stronger retail credit growth, inflation under check and the sustained impact of multiple government initiatives.** While we had seen personal loan growth robust in post covid era of FY23 and FY24 (21% and 28%, respectively), consumption remained muted as credit was largely used to offset COVID-induced income stress. However currently, with a healthier income backdrop and improved credit availability, it is expected to translate into stronger consumption. **Segments that thrive on credit-driven demand could perform particularly well in 2026.**

On the **rural consumption growth we remain optimistic, due to impact from state welfare schemes, combined with easing inflation, improving wage growth and better MSP for crops.** The welfare schemes primarily target women, farmers, senior citizens, and the unemployed, with free or subsidized electricity and LPG are also becoming widespread. 14 states are offering unconditional cash transfers to women in FY26. We are not supportive of such welfare schemes which have the potential to ruin the fiscal balance of the government, because these schemes merely reallocate revenue expenditure and hence are not truly income supportive. They represent direct cash transfers and carry significant political visibility, making non-implementation difficult. Hence, even as there has been a mere rejuvination of revenue expenditure, **this is more direct in nature and enables better cash inflow to low-income households which ultimately ends up as increased discretionary consumption** in these rural households.

- **BANKS (BOTH PVT AND PSUs), NBFCs, MFI AND CAPITAL MARKET INTERMEDIARIES TO REGAIN GLORY**

The banking sector is entering a phase of earnings upcycle, with profit CAGR of +15% expected over FY26-FY28E, supported by improving growth visibility, NIM recovery, and operating leverage. Also supportive are strong domestic macro and the end of the rate cut cycle. Valuations too are attractive and institutional investor ownership is relatively low. **I continue to like PSU banks** (which has been my preferred bet over the last six years) **given similar loan/ deposit growth, RoE profile, credit cost, lower loan to deposit ratio, and they still trade at ~40-50% discount compared to private banks.** **MFI and NBFCs** which had gone through a painful process of delinquencies and NPA provision cycle, **seem to be out of the woods** and could report strong growth numbers in 2026. The last but not the least are the **capital market plays** like AMCs, Wealth Management, Broking firms and platform businesses, which **could see strong revival (+20% CAGR over FY26—28E)** supported by operating leverage playing out in an improved equity market environment.

- **INDUSTRIALS AND CAPEX TO PICK UP AFTER THE LULL**

Over the last two years, public and private capex has been weak due to elections, fiscal compulsions and domestic slowdown amidst trade uncertainty. 2025 has been a year of reforms with multiple intervention by both the government and the central bank to help revive growth. **Power generation, Transmission, Defence, Aerospace, EMS and Semiconductors** continue to see some of the highest capex outlay from both government and private companies. **Capacity utilization levels across most industries are above the long-term average** of 74% which is typically the inflexion point for fresh private capex. **Low interest rates, deleveraged balance sheets** for India Inc and **increased export and local consumption demand** are all falling in sync to build a case for strong capex pickup in the country thereby also spurring the corporate credit growth or banking sector.

- **FOREIGN PORTFOLIO INVESTOR FLOWS TO REVERSE BACK TO INDIA**

After seeing the highest ever FII outflow of around USD 17.5 billion from India in CY25, **we believe that CY26 could see a reversal of the flows** because of the following factors, which would also help to stem the Rupee from sliding:

- The six-month FPI equity flow as a percentage of market cap is at -1 Standard Deviation
- Lowest FPI ownership in India at 17% despite strong earnings growth and stable macro outlook
- Reasonable equity valuation relative to other emerging and developed markets
- Low market beta and counter AI trade

- **TRADE DEALS TO INCREASE INDIA'S SHARE OF GLOBAL TRADE**

As seen from the earlier trade deals, there is a significant increase in India's exports to global markets. **This is a virtuous cycle of more domestic capex, job creation and income generation.** The long pending and delayed **US India trade deal would also see the light of the day** sometime during the year and that would be a major sentiment booster for Indian economy as Indian exporters have found alternate markets to replace the loss of business to US and now with the US market re-opening it would be like an icing on the cake. **FTA with European Union, South Korea and some GCC countries are also in the advanced stages of finalization.**

In conclusion and in view of all the above factors, would like to reiterate our bullish stance on Indian equities for 2026. What truly distinguishes the current cycle is that both the major engines of growth—capex and consumption—appear unusually steady, a rarity over the last decade. We believe that Indian markets are well poised to retrace the underperformance of CY2025, supported by better earnings prospects, supportive domestic macros, and improved geopolitical situation. Valuations when seen from the eye of PEG ratio is not at all demanding and more so ever in case of Midcaps and Smallcaps. **NIFTY-50, NIFTY MIDCAP 100 and NIFTY SMALLCAP 100 PEG currently stands at 1.6x, 1.4x and 1.2x respectively** which is below their respective long-term averages. **Geopolitical turmoil and Tariff related news flow will keep the risk meter alive and kicking but that is the new normal for global equities and India.**

Happy Investing and a Happy New Year!!

Aniruddha Sarkar
Co-Founder

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