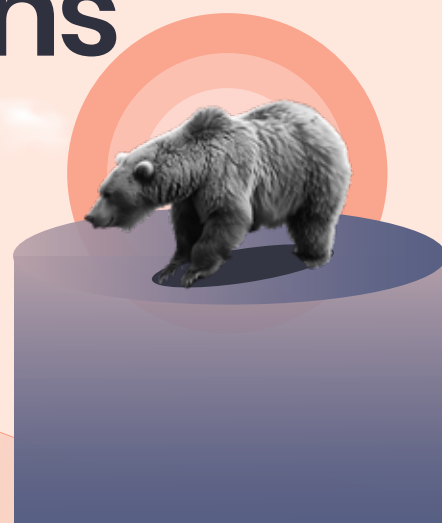


6th March, 2025

What the market correction means for investors

Why this correction is different — and why it isn't



Executive Summary

Market corrections are normal, not aberrations: Since 2005, Indian markets have corrected almost yearly, yet always recovered. Current correction shows large, mid, and small caps down ~11%, ~20%, and ~25% respectively.

Four key factors driving this correction: Earnings growth slowing down to pre-COVID levels, unsustainable valuation especially in mid/small caps, US tariff uncertainties impacting exporters, and competitive US bond yields attracting foreign capital.

India's long-term investment thesis remains solid: Despite the correction we are witnessing, India's long term growth story looks promising. Key positives include upcoming monetary easing, fiscal deficit reduction to 4.4% by FY26, tax relief boosting consumption, and healthier banking sector balance sheets.

Investments through Dezerv: While it is extremely difficult and counter productive to time the market, in anticipation of the market fall, we have been taking precaution by moving capital to ensure your portfolios are large cap heavy. We believe the valuations in the large-cap space are still reasonable and are expected to yield good returns over the next 3 years. This has played out well for our clients.

Recommendation for clients:

- Review all your external assets and **assess your asset allocation**. We continue to have a large cap bias in the equity space and suggest diversifying through **exposure to gold**.
- For investors with steady income streams, this is a **good time to benefit from Dezerv's SMART Systematic Investment Plans (SIP)**. Our dynamic SIP benefits investors by allocating to segments where there are opportunities based on the current market environment.
- If you have small cash reserves (<5% of your total equity portfolio), it is a **good time to deploy money now**. You can connect with your investment expert for more information.
- If you have large capital to invest, we recommend **55% deployment through 6 tranches of 7.5%** each fortnightly in the next 3 months.

What’s happening?

The Indian equity markets have experienced a significant correction since September 2024. This correction has spared no segment of the market, though it has been more pronounced in the small-cap segments.

A Benchmarks

All major equity indices have fallen ~ **11% - 25%**. While large-cap indices have seen a moderate correction, mid and small-cap segments have suffered a significant decline.

Index	26-Sep-24	5-Mar-25	Change
Nifty 100	27,256	24,271	-10.95%
Nifty Midcap 150	22,368	19,996	-20.60%
Nifty Smallcap 250	18,435	16,104	-24.90%
Nifty Midcap Momentum	67,493	58,460	-24.70%

Source: Niftyindices

B Mutual funds

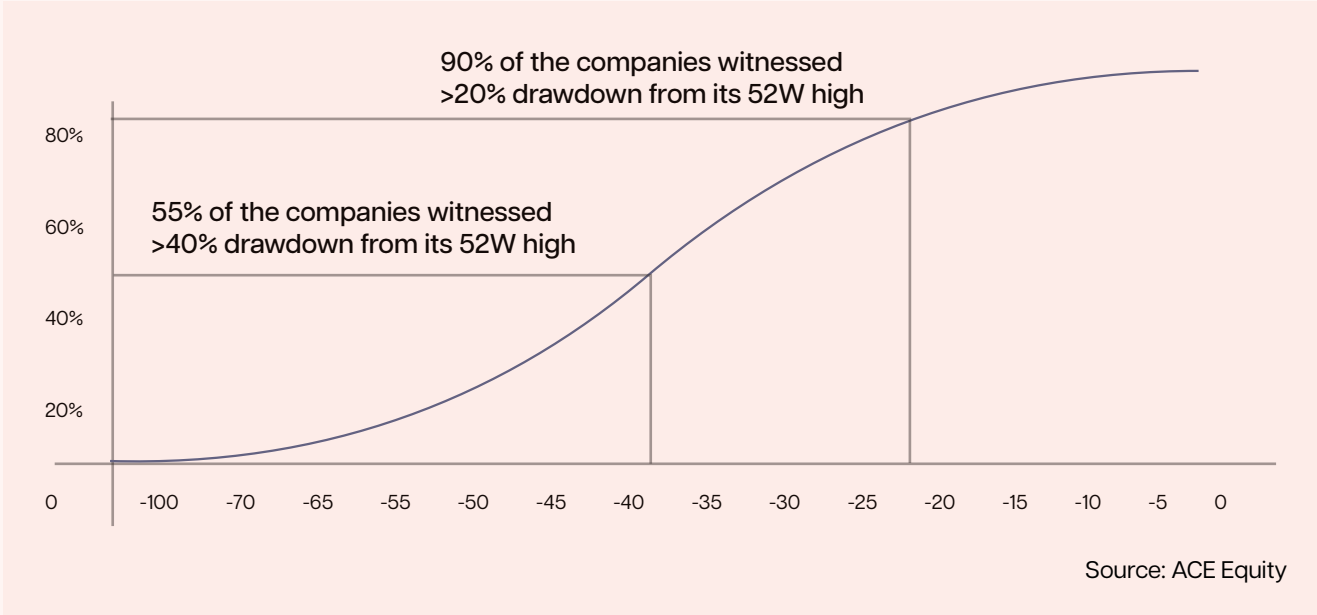
Across mutual fund categories, we've seen similar declines, with large-cap funds down **19%**, mid-cap funds down **21.2%**, and small-cap funds down **23.5%** from their peaks.

Category	Average drawdown since Sep 2024
Large Cap	-19%
Mid Cap	-21%
Small Cap	-23%

Source: Niftyindices

C Direct equity

This broad-based correction has affected more than just the indices. Direct equity investors have witnessed significant pain in individual stocks, with 90% of listed companies experiencing a drawdown of more than 20% from their 52-week highs. Even more concerning, 55% of companies have fallen by over **40%** from their recent peaks.



This correction has unfolded in line with our analysis—concerns we highlighted in our client communication last month signaled these precise vulnerabilities ([You can read our previous assessment here](#)).

But as seasoned investors know, corrections are a natural and recurring feature of equity markets, not an anomaly. History shows us that markets rarely move in straight lines. The current scenario, while uncomfortable, is neither unique nor unexpected when viewed through the lens of historical market behavior.

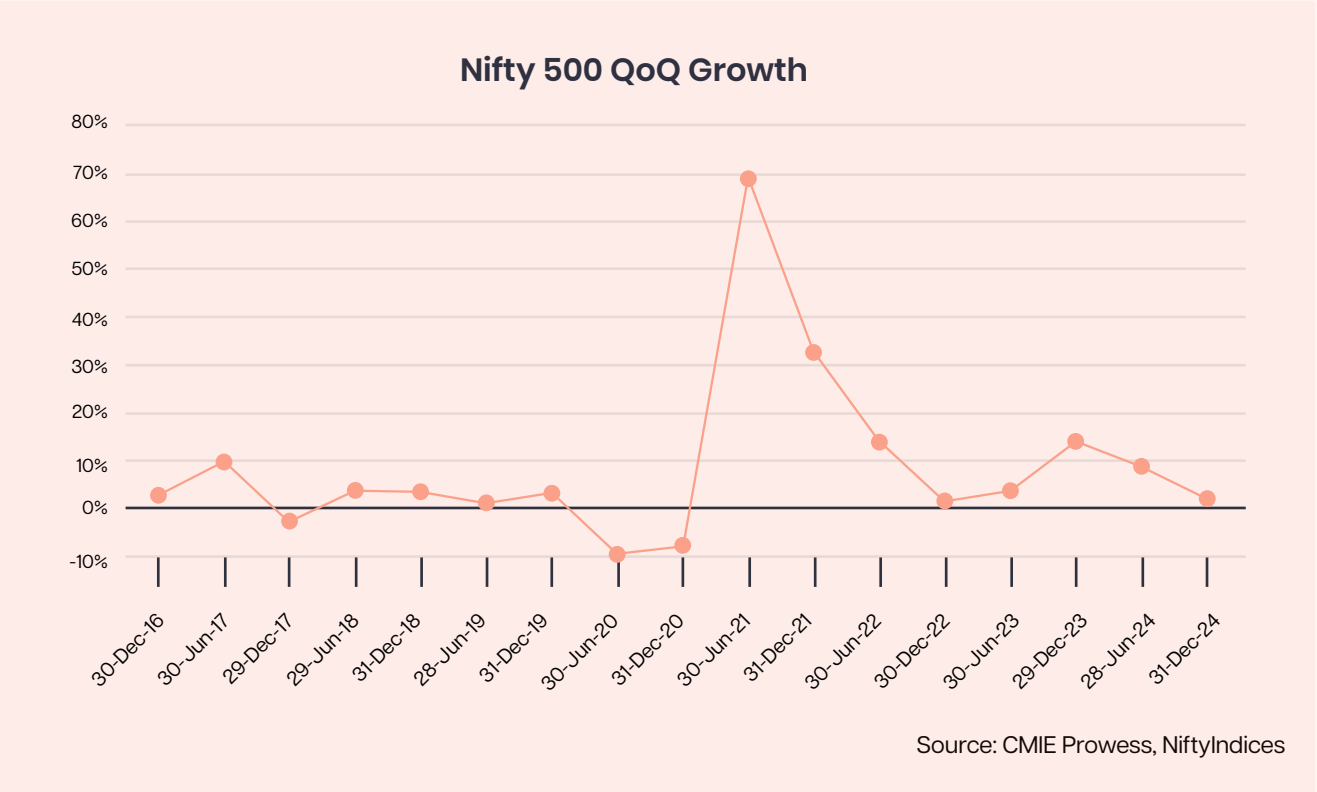
What's driving the market correction?

Market corrections rarely have a single cause, and the current scenario is no exception. Our analysis identifies four primary drivers behind the present market correction:

01 Slowing down of earnings growth

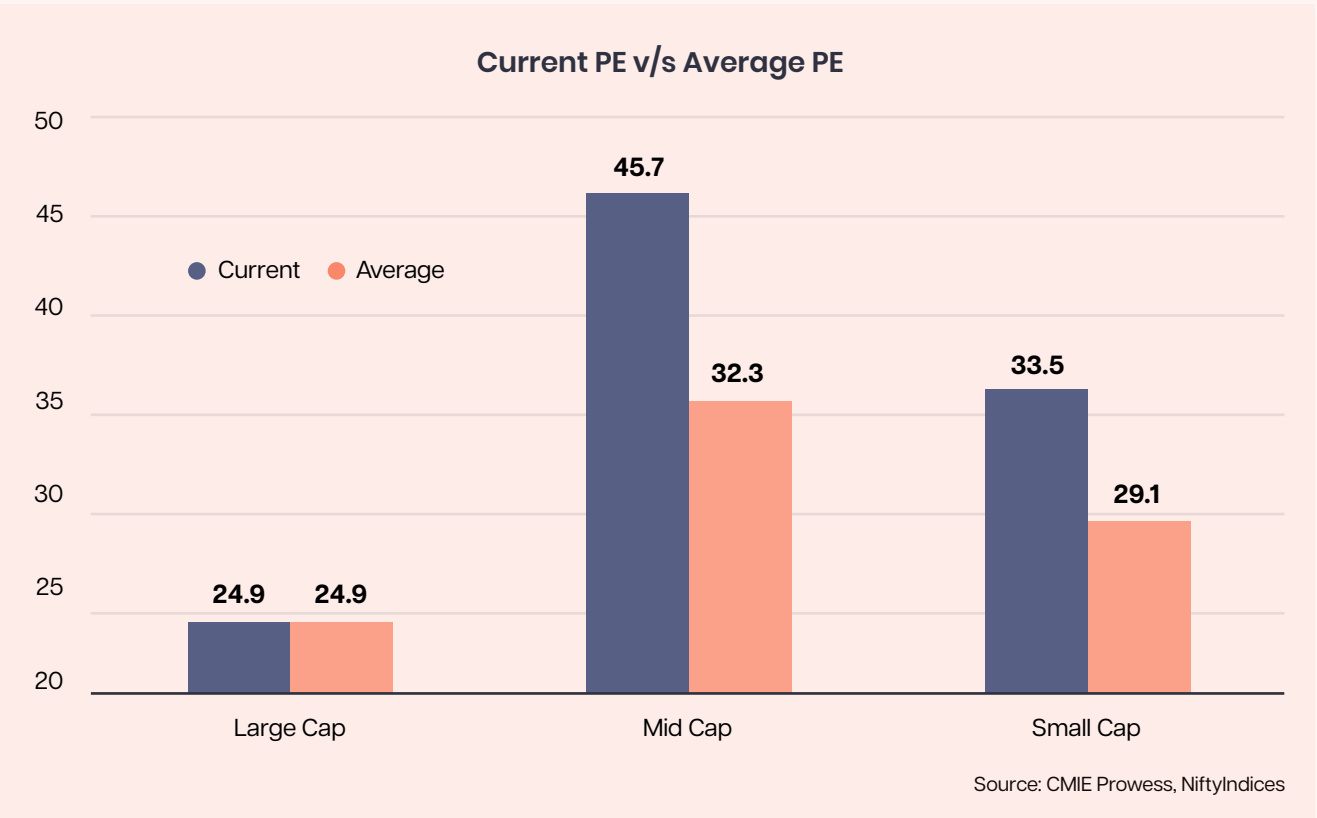
Post-pandemic corporate earnings have normalised after experiencing extraordinary growth (up to 70% quarter-on-quarter). We have seen earnings growth slow down in the last two quarters, and combined with the high valuations, a correction was the natural consequence.

Earnings growth has reverted to pre-covid levels



02 High valuations in the small and mid-cap space

We believe the current market correction was overdue and we anticipated it, especially in the small and mid cap space as they were trading at a **30-40% premium** to historical averages. Our analysis highlighted this and since October 2024, we have consistently increased our large cap allocation and reduced small and mid cap allocation, benefiting clients.

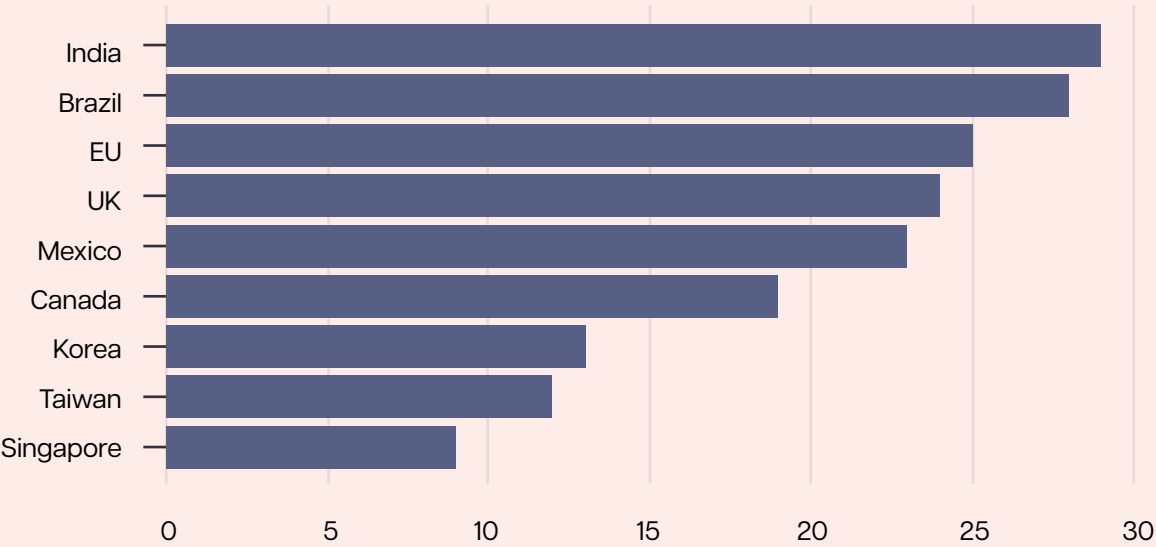


03 Geopolitical uncertainty: Risks due to trade tariffs

The US is India’s largest exporter and the recent uncertainty due to trade tariffs imposed by the Trump administration have spooked investors and in turn the equity markets. Recent analysis suggests India may face the highest reciprocal tariff rates globally under proposed US trade policies, potentially **approaching 30%** - creating significant uncertainty for export-oriented sectors that form a crucial component of India's economic growth story.

India and Brazil to be most affected by Trump’s reciprocal tariff plan

Reciprocal tariff rates, %, selected nations would be subject to under US reciprocal levies*



*Reciprocal tariffs calculated by combining value added tax rates and most-favoured nation rates
Source: Capital Economics

04 US bonds offer a similar yield without the volatility or currency risk

US bonds currently offer attractive yields without the volatility or currency risk associated with emerging market equities. In addition, US interest rates have risen. This has played an integral role in the factors that led FIIs withdrawing nearly **INR 1,50,000 crore** from Indian equities in the last six months. When the Nifty 50 earnings yield relative to US bond yields narrows, as it has recently, international capital tends to reallocate to the US and other emerging markets.

Nifty 50 Earnings Yield v/s US Bond Yield



Source: CMIE Prowess, FRED

Market corrections: Expected, not exceptional

One of the most important realities for equity investors to internalise is that market corrections are an expected part of the investment journey, not exceptional events. The historical data makes this abundantly clear.

Since 2005, Indian equity markets have witnessed corrections almost every year

Large Cap		Mid Cap		Small Cap	
Year	Drawdown	Year	Drawdown	Year	Drawdown
2005	-13.3%	2005	-13.5%	2005	-18.2%
2006	-30.8%	2006	-38.0%	2006	-37.7%
2007	-15.3%	2007	-16.7%	2007	-16.8%
2008	-61.1%	2008	-72.9%	2008	-75.6%
2015	-20.6%	2015	-18.4%	2015	-23.3%
2016	-11.8%	2016	-14.6%	2016	-15.8%
2018	-14.9%	2018	-43.1%	2018	-59.8%
2021	-16.8%	2021	-21.1%	2021	-9.2%
2022	-11.4%	2022	-10.3%	2022	-26.6
2024	-14.2%	2024	-18.3%	2024	-23.3%

Note: Data since April 2005. Returns are CAGR | Source: Nifty Indices

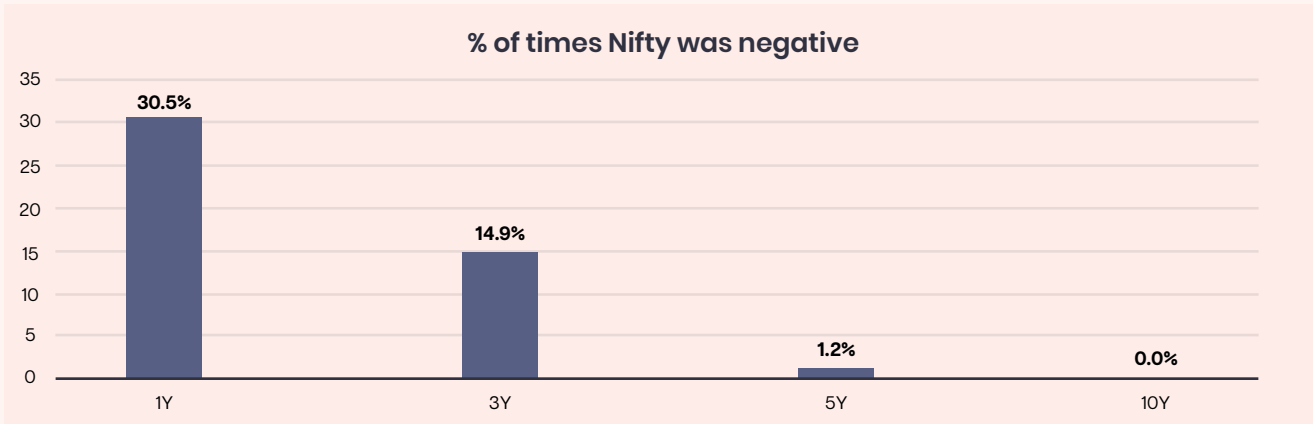
Yet despite these regular corrections, the long-term trajectory of Indian markets has been upward. Perhaps most reassuringly, the data shows that after significant drawdowns (15%+), the median 3-year forward returns have been between ~14-16%.

3Y forward returns after 15% drawdown	NIFTY 100	NIFTY 50	NIFTY 500	NIFTY Large Midcap 250
Median	15.9%	15.2%	14.1%	15.4%

Source: Niftyindices

This pattern of correction and recovery is the market's natural rhythm. In fact, over a 10-year investment horizon, the probability of experiencing a negative return in a diversified equity portfolio drops to zero, based on historical data.

Chances of losses in a diversified equity portfolio reduces over the long-term



This data underscores a fundamental principle: time in the market matters more than timing the market. It also highlights the importance of diversifying your investments to reduce risk across market cycles.

Positive long-term factors amidst market volatility

While short-term volatility commands attention, the structural growth drivers for the Indian economy remain robust. Several positive catalysts warrant attention:

01 Government focus on consumption driven growth

Over the past 3-4 years, government capital expenditure has driven economic growth while private consumption slowed. However, this is changing now, which is evident through various moves.

A Easing in monetary policy

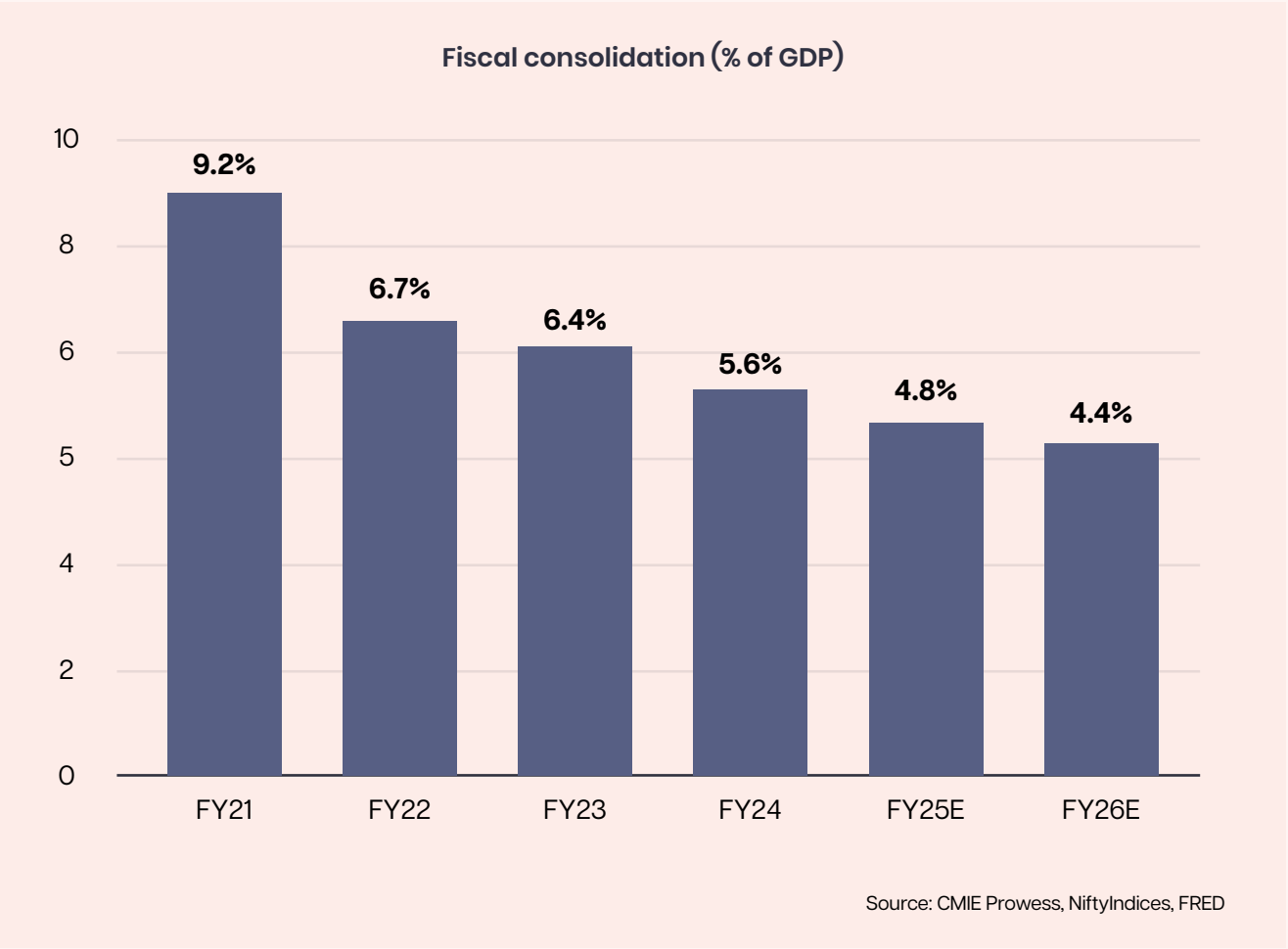
In last month’s Monetary Policy Committee meeting, the RBI slashed rates for the first time in 5 years. It reduced the repo rate from **6.5% to 6.25%** and in the upcoming meeting, we expect a further cut which can boost liquidity and spending.

B Tax relief to boost consumption

Recent tax reforms have delivered substantial relief to taxpayers across income brackets, with cumulative tax savings estimated at **₹1 lakh crore**. This additional disposable income is likely to boost consumption, particularly benefiting sectors like consumer discretionary, automobiles, and retail.

02 Fiscal discipline and consolidation

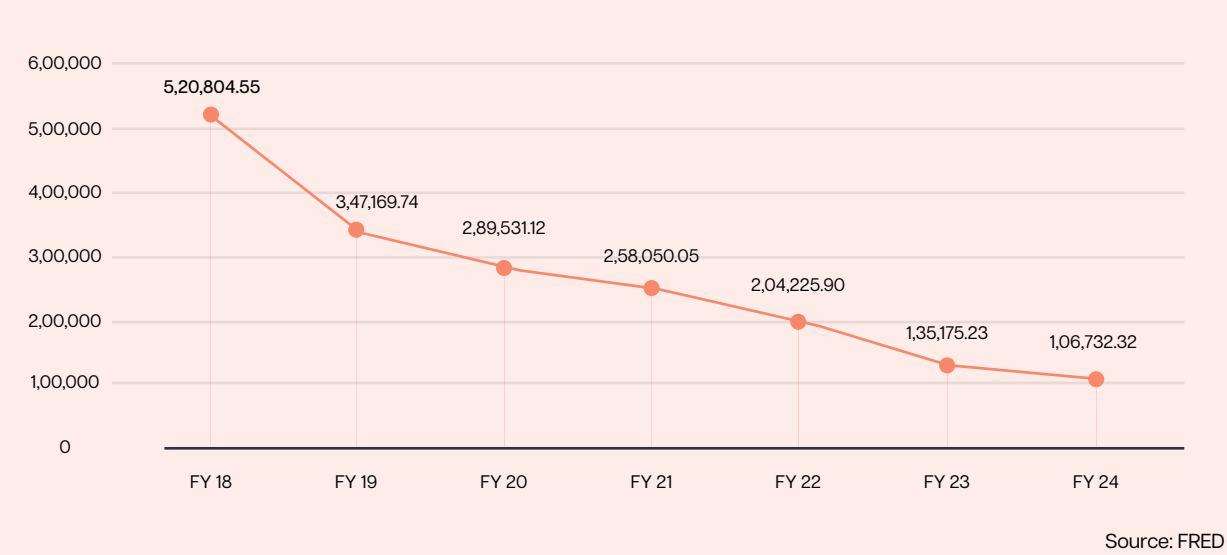
India has made significant progress in fiscal consolidation, with the fiscal deficit decreasing from **9.2% of GDP in FY21 to 5.6% in FY24**, with projections of further **reduction to 4.8% in FY25E** and **4.4% in FY26E**. This disciplined approach to public finances enhances macroeconomic stability, and in turn propel the equity markets.



03 Bank NPAs on the decline

Indian banks have significantly improved their balance sheets, with non-performing assets (NPAs) showing a steady decline since FY18. This improvement in asset quality positions the banking sector to support economic growth through increased lending. A healthy financial system is a prerequisite for sustainable economic expansion and ultimately, benefiting the equity markets.

Bank NPAs on decline, a sign of healthy bank balance sheet



These positive fundamentals suggest that the current market correction, while painful in the short term, does not undermine the long-term structural growth story for India. The correction is more a valuation reset than a fundamental deterioration in India's economic prospects.

We expect earnings to rebound within the next six months, driven by strong private consumption and positive trends in both the manufacturing and services sectors.

SECTION 5

What should investors do?

In periods of market volatility, the decisions made by investors determine long-term outcomes more than market movements themselves. Here are the key actions investors should consider:

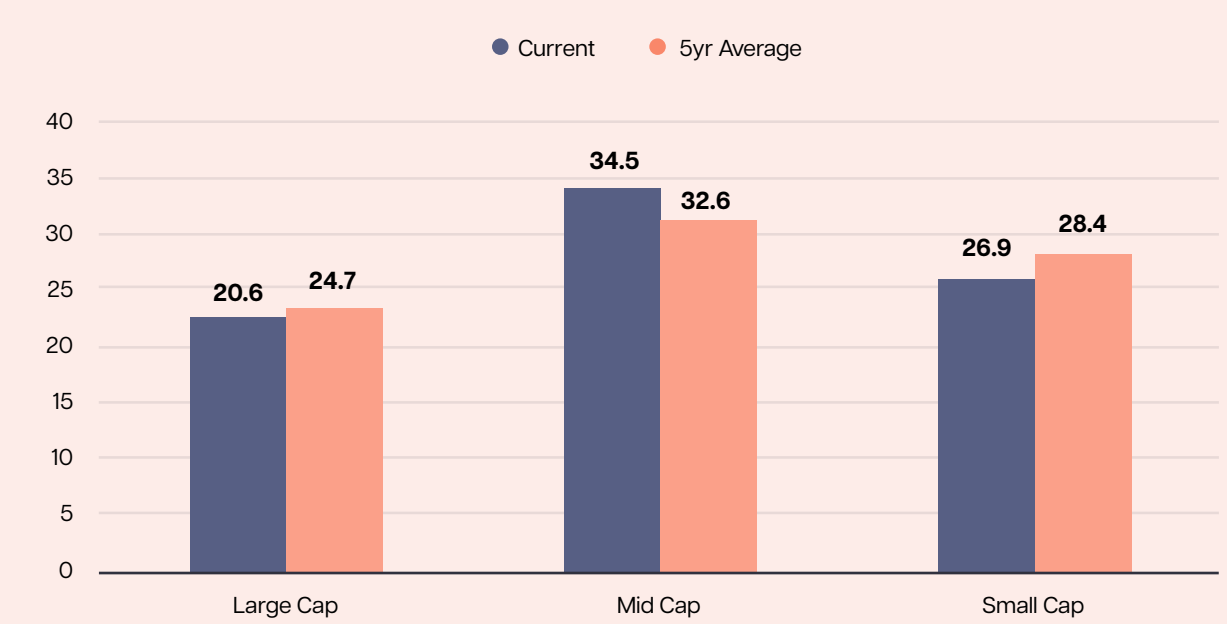
01 Instead of focusing on small and mid-caps, invest in large caps

Post-COVID, the small and mid cap segments have seen significant returns and investors have over-allocated to these segments. However, these two segments have also seen the steepest corrections in the last 6 months.

When we look at the elevated valuations in the last 6-9 months, it is obvious that this correction was long overdue.

The good news is that this market correction offers an opportunity to investors. Based on the current PE ratio compared to the 5 year average, the large cap segment is much more reasonably valued compared to the small and mid cap segments.

PE ratios by market capitalisation



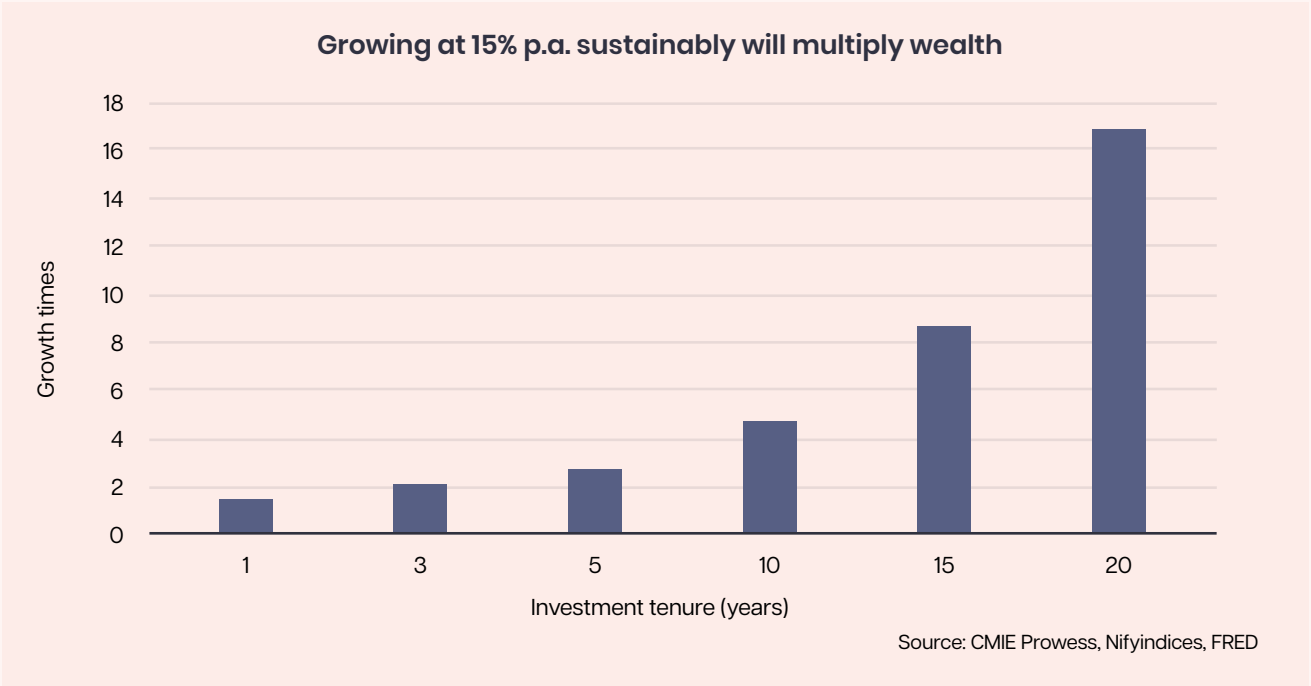
02 Have realistic expectations

In the post-covid period, investors have seen a constant growth in the equity markets with returns ranging 20-22%. This is probably the first time since then that investors are experiencing a market correction. It is time for investors to rationalise their expectations and expect the equity markets to yield returns of 13–15% per annum in the long run.

Long term returns have been ~15% p.a. from April’05 to February’25

	Large Cap	Mid Cap	Small Cap
Since inception	15%	17%	16%
Average 3Y rolling	13%	16%	14%
Annual volatility	21%	21%	22%
Max drawdown	-61%	-73%	-76%

Based on recent years' returns, 13-15% may seem modest. However, as shown below, compounding at 15% per annum can generate substantial wealth over the long term.



03 Focus on asset allocation

Market corrections offer a valuable opportunity to reassess your asset allocation and capitalise on emerging opportunities.

As you can see below in this illustrative example, a blended approach with asset allocation to equity, fixed income and gold can reduce the risk of your portfolio and reduce the average days it takes for your portfolio to recover during a market downturn.

Drawdown	5-10%	10-15%	15-20%	>=20%
Equity				
No. of drawdowns	13	6	5	7
Chance of drawdown	5.8%	2.7%	2.2%	3.1%
Avg days to recovery	22	86	155	642
Blended (60% Equity 30% Debt 10% gold)				
No. of drawdowns	11	5	0	3
Chance of drawdown	3.9%	1.8%	0.0%	1.1%
Chance of drawdown	67	270	0	233

04 Be cautious with direct stock picking

The post-2008 experience offers a sobering reminder of the risks in direct equity investing. Of the 1,055 listed companies in January 2008:

- 70 companies (2% of market cap) ceased to exist
- 205 companies (22% of market cap) lost capital even after 17 years
- 206 companies (21% of market cap) failed to generate even 8% p.a. return
- Only 463 companies delivered satisfactory returns

This underscores the challenge of stock selection and the importance of professional expertise, particularly during market corrections when distinguishing between temporary price declines and permanent capital impairment becomes crucial.

SECTION 6

Recommendations for investors

In the current market environment, it is normal for investors to be concerned about their investments. We have the following recommendations.

Portfolios managed by Dezerv

At Dezerv, our approach to portfolio construction and management is guided by data, discipline, and a long-term perspective. Our strategies reflect our views shared above in the note.

- A** We have already made our equity portfolios large-cap heavy given we see valuation comfort in this space. We believe large-cap heavy portfolios will continue to create wealth for investors over a 3-year time horizon.
- B** If we look at historical market corrections of ~15-20%, the markets have delivered a median return of ~ 15% over the next 3 years. This presents a good opportunity for investors to generate returns in actively managed portfolios.
- C** We recommend our clients to continue with their existing Systematic Transfer Plan (STP) as scheduled.
- D** We continue to monitor the markets and your portfolios and we will reach out to you proactively if your scheduled transfer (STP) needs to be expedited or slowed down due to market conditions.

Beyond Dezerv assets

- A External portfolio:**
 - It is extremely important to be cautious in such a market and investors need to be mindful of valuations. Mid and small-cap stocks have experienced a significant correction, and investors holding onto these stocks directly or through PMS should re-assess their allocations.
- B Cash holdings:**
 - **If you have regular cashflows:** For investors with steady income streams, this is a good time to benefit from Systematic Investment Plans (SIPs). Market corrections allow you to accumulate more units at lower prices - effectively lowering your average purchase cost. Considering Dezerv's SMART SIP approach, this disciplined investing method not only helps minimise the impact of market volatility but also transforms market downturns into opportunities for long-term wealth creation.
 - **If you have small cash reserves (Less than 5% of your total equity portfolio):** We are closely monitoring the markets and we will notify you when an investment opportunity arises.
 - **Large cash deployment:** If you have a significant cash holding, we recommend 55% deployment through 6 tranches of 7.5% each fortnightly in the next 3 months.

Fixed Income

In our last note, we recommended investors to lock-in yields by investing in bonds. If you haven't yet, you should invest in high-yielding medium term bonds of 2-3 year duration, to lock-in returns right away. These assets currently offer attractive interest rates, and their value is likely to increase with interest rate cuts. We anticipate a gradual reduction in the interest rates in the next few MPC meetings. By investing now, you can secure these high rates before they potentially decrease in the future.

Gold

We believe gold is beneficial for diversification and a natural hedge against inflation and currency depreciation. Given the current market environment, we believe investors will benefit from investing in gold by allocating 5-10% to it.

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