

Monthly Newsletter

JANUARY 2025

- One of the largest Digital Platform for Alternative Investment Fund.
- Portfolio Management Services.
- A Process Driven Investment.
- Most Knowledgeable and Experienced team.
- Fully Process Driven.
- Experts in AIF & PMS.

**Process - Driven Platform For
AIF, PMS & Gift City Fund Investments**

January 2025



Indian Equity Market Outlook 2025:

Dear Valuable Investors,

Can Valuations and Investor Sentiment Continue to Drive Returns?

As we move into 2025, the Indian equity market faces a similar conundrum to its global counterparts: valuations are high, investor sentiment is strong, but can multiples continue to expand from already elevated levels, or will earnings growth become the primary driver of returns?

In last few years Indian equity market experienced a solid rally, with major indices reaching record highs. Valuation multiples for the Indian market have risen to levels above the long-term historical average. The Nifty 50 currently trades at a P/E ratio of around 22-23x, significantly above its historical average of about 18-19x. This presents a key question for investors in 2024: given already stretched valuations, can multiple expansion continue to drive returns, or will earnings growth take centre stage?

Historical Performance: How Earnings, Multiples, and Dividends Have Contributed to Returns in India?

Historically, earnings growth has been the dominant driver of returns in the Indian equity market, just as it has been in global markets like the S&P 500. Over the past few decades, earnings growth has accounted for the majority of returns, with multiple expansion and dividends contributing to a smaller extent. From 2000 to 2023, Indian equities have seen average annual returns of around 12-15%, with earnings growth accounting for roughly 60-65% of these returns, while multiple expansion has contributed 20-25%, and dividends have bridged the gap.

However, much like in global markets, there have been periods where multiple expansion drove returns beyond what earnings alone could provide. A deeper dive into these periods reveals that multiple expansion was often fuelled by one of three factors:

January 2025

- **Earnings Contraction:**

During periods of economic slowdown, earnings growth often stagnated or contracted, leading to negative returns from earnings. However, in these years, multiple expansion occurred due to an improving economic environment or market recovery, where valuations rebounded after periods of contraction (e.g., 2003 post the tech-bubble crash, or 2020 after the pandemic-induced market crash).

- **Multiples Recovery:**

In certain years, after periods of earnings stagnation or contraction, multiples themselves rebounded, often driven by a change in macroeconomic conditions, such as lower interest rates, economic stimulus, or a shift in investor sentiment. Notably, in 2013, 2017, and 2020, the market saw strong multiple expansion even as earnings growth was modest.

- **Optimistic Investor Sentiment:**

Strong bull markets, fuelled by investor optimism, often led to a significant rise in multiples. These years typically coincided with strong macroeconomic fundamentals and/or the excitement surrounding specific sectors (e.g., technology, infrastructure). The market's enthusiasm about India's future growth potential led to significant valuations expansion, often irrespective of current earnings performance.

2025 Outlook: Can Multiple Expansion Continue?

In 2025, the Indian equity market faces a situation where multiples are already stretched. The Nifty 50 is trading at about 22-23x P/E, which is more than one standard deviation above the 10-year average of 18x. This brings us to a key question: can multiples continue to expand from such elevated levels, or will earnings growth be the primary driver of returns?

1. Global and Domestic Macroeconomic Environment

The macro backdrop is generally supportive of the Indian equity market in 2025. While there are global uncertainties looming, such as geopolitical risks and global inflation trends, India's domestic growth prospects remain relatively strong. The Indian economy is expected to grow at around 6-6.5% in 2025, supported by a resilient consumption story, government infrastructure spending, and strong agricultural output. Additionally, monetary policy in India is expected to remain accommodative, as inflation is expected to gradually recede from its peak in 2022, allowing for potential rate cuts in the second half of 2025.

January 2025

This supportive backdrop could provide a boost to investor sentiment, potentially leading to multiple expansion in the short term. However, the Indian market's P/E ratios are already at historically high levels, which suggests that the potential for further multiple expansion from here may be limited, especially in a global environment where central banks are cautious about inflation and interest rate hikes.

2. Earnings Growth in 2025: A Key Driver

In 2025, earnings growth is expected to accelerate after being flattish year in 2024.

Banking and Financials: The Indian banking sector is poised for strong growth, driven by rising credit demand, particularly in the retail and SME sectors. Additionally, improving asset quality and a shift towards digital banking should provide tailwinds for profitability.

Consumption and FMCG: Consumption is expected to continue its recovery, with strong growth in rural demand and continued urbanization. Additionally, rising incomes in India, coupled with government support for affordable housing and infrastructure, will likely benefit the consumer goods and FMCG sectors.

Infrastructure and Construction: The government's focus on infrastructure spending remains a critical growth driver, with capital expenditure in the construction and energy sectors expected to rise. Moreover, the demand for affordable housing continues to support the real estate sector.

Technology: Despite global economic uncertainties, India's IT sector is expected to see moderate growth driven by continued demand for digital transformation, cloud computing, and artificial intelligence. However, growth in the sector is likely to moderate from the high levels seen in recent years.

3. Valuations: The Risk of Multiple Contraction

While earnings growth is expected to accelerate in 2025, valuation risk prevails. The Nifty 50's P/E ratio is already stretched, and should earnings growth not meet expectations, there is a risk that multiple contraction could occur. In such a scenario, the market's P/E ratio could shrink even if earnings grow, leading to lower total returns despite a positive earnings growth trajectory.

January 2025

4. Investor Sentiment: A Double-Edged Sword

Investor sentiment in India is currently optimistic, with equities receiving strong inflows, buoyed by the country's strong growth story, the continued rise in retail investors, and positive macroeconomic signals. However, this optimism has the potential to morph into overconfidence, as seen in past years (e.g., 2014 or 2017), potentially driving stock prices even higher irrespective of earnings performance.

In 2025, market sentiment could be influenced by factors such as:

- **Global inflation and interest rates:** A return of inflationary pressures or higher interest rates globally could dampen sentiment, causing multiple contraction.
- **Geopolitical risks:** Potential disruptions, especially related to trade, supply chains, or tensions in neighbouring regions, could impact investor sentiment.
- **Speculation in risk assets:** Cryptocurrency and other speculative investments could pose a challenge to equity markets, as investors may shift funds from traditional equities to these high-risk assets.

Conclusion: Earnings Growth Will Likely Drive Returns in 2025

While positive sentiment and macroeconomic factors could support multiple expansion in the short term, the market's already elevated valuations suggest that earnings growth will likely be the key driver of returns. Earnings growth is expected to accelerate, especially in sectors like Banking, Consumer Goods, and Infrastructure.

For investors, this means that focusing on sectors with solid earnings growth potential, as well as keeping a close eye on macroeconomic trends, will be critical. While multiple expansion could continue in the near term if investor sentiment remains strong, investors should be cautious of the valuation risks that come with already high P/E ratios. Ultimately, earnings growth will likely be the cornerstone of equity returns, as it has been in the Indian market's long-term history.

Thanks & Regards

Vikas Agrawal

Founder & CEO

AIF & PMS Experts India

January 2025



VISIT OUR WEBSITE FOR MORE INFORMATION

aifpms.com 

AIF & PMS Experts India Pvt. Ltd.

**1st Floor Office No.111, Ajmera Sikova, LBS Marg, Opp, Damodar Park,
Nr Ashoka Mill, Ghatkopar West, Mumbai - 400086**

DISCLAIMER:

Investing Involves Risk. This document is for information purposes only and should not be viewed as a legal offering document or solicitation. Offers to invest in these fund are made only by the Asset Management companies . Past performance does not guarantee future results and there is no assurance that the managed accounts will necessarily achieve its objectives. Any forward-looking information and/or opinions contained in this document are based on the market information available at the time of publication and are subject to a number of known and unknown risks, uncertainties, assumptions as to future events and other factors that could cause the actual results to differ materially from those implied by the information set forth herein. This information is confidential and is intended for only the person or entity to whom it was sent and in no circumstances may this material be shown, copied, transmitted, or otherwise given to any person other than the authorized recipient. The holdings shown do not represent all of the securities purchased, sold, or recommended for any particular advisory client and in the aggregate may represent only a small percentage of an account's portfolio holdings. Actual portfolios may differ as a result of account size, client-imposed investment restrictions, the timing of client investments and market, economic, and individual company. Considerations. Securities are shown for illustrative purposes only and are not a solicitation to buy or sell any particular security or invest in a particular sector. AIF & PMS Experts India Pvt Ltd may act as an intermediary who coordinates with either a discretionary investment manager or a non-discretionary model provider in a variety of separately managed accounts. Any performance information included herein represents the performance achieved by the various product manufacturers as a discretionary or non-discretionary investment manager with trade implementation responsibility for accounts included in a performance. We at AIF & PMS Experts does not guarantee any returns in the hand of investors not we take any sort of accountability of performance of the scheme. The Company reserves the right to make modifications. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness.