

## “Compounding is hard because a bad month can feel longer than a good decade” – Morgan Housel

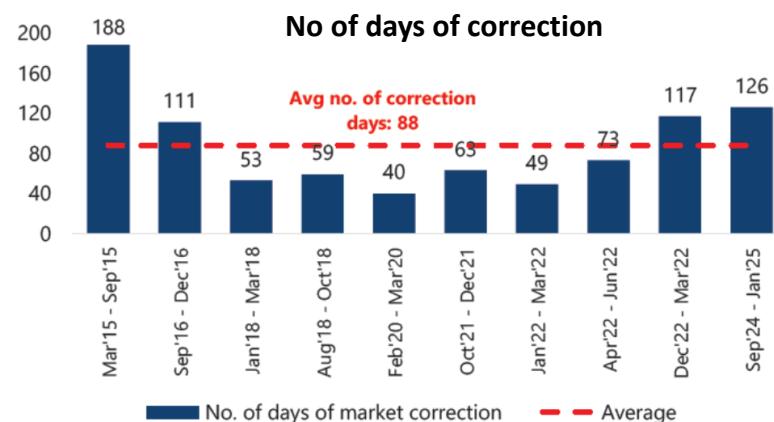
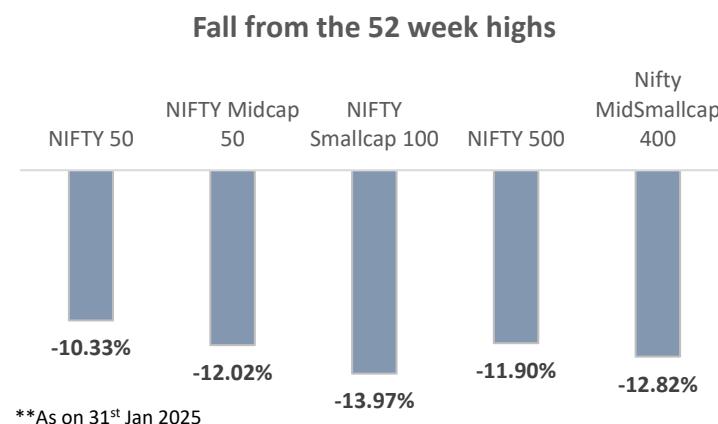
Dear Investors,

After a decent year for Indian equities in 2024, markets have started 2025 on a soft footing amidst heightened fears from all fronts. Most people wanted a correction for last several months on the back of valuations being rich and earnings slowing down. But like they say, expecting something bad to happen is one thing, but its always painful when it actually happens. **Sharp cuts in headline index has eroded some part of the gains seen for the whole of last year** as can be seen from the table below. But excesses happen on both sides in the market and the current situation is of extreme pessimism. Also, what is evident is that even within Largecaps, Nifty NEXT 50, which did better than NIFTY-50 last year, saw higher correction accordingly in Jan’25.

INDEX	CY 2024 Returns	1 month return as on 31st Jan'25
NIFTY 50	8.8%	-0.6%
NIFTY NEXT 50	27.4%	-7.1%
NIFTY MIDCAP 50	21.5%	-6.4%
NIFTY SMALLCAP 100	23.9%	-9.9%
NSE 500	15.2%	-3.6%

*Sharp drawdowns in Jan'25 have led to 6 months return turning negative for all indices*

In Rupee terms the different headline indices have corrected between 10-14% from the peak levels over the last 3-4 months. Infact **the current correction in the market is the second longest correction we have seen in Indian markets in the last 10 years** and is already 126 days long.



What was seen in the month of January’25 were bouts of extreme panic selling on the back of fears around FII selling, further deep cuts happening in markets due to economic slowdown, fear around Budget 2025 surprises and fear that Q3FY25 earnings would be weaker than estimates. Most of these fears had little logic to it which will try to address.

### FII continue to sell in secondary though primary market show a different picture; INR weakening

*FII continue to invest in Primary market while taking off from the secondary market on valuation concerns*

Interestingly FIIs have been net sellers in the secondary market for the whole of CY2024 totaling a Net Sell figure of USD 13.78 bn for the year. However, **they have shown strong participation in the Primary market and have been net buyers of USD 14.49 bn** there thereby taking the full year figure to a small net buy of USD 0.71 bn in Indian equities. **January’25 was a different picture wherein FIIs sold almost USD 9.5 bn in secondary market** thereby being the second highest sell figure in the last 12 months. Lack of much IPOs in a weak environment also did not see any FII flows hence we saw the impact on India’s Forex reserves and Rupee touched the lowest levels in its history. However, we get comfort from the DXY index which has seen some moderation in recent times and if one goes by the history, as can be seen from the graph below, **Dollar has depreciated significantly in the first 14 months of Mr Trump’s first term as President.**

(USD bn)	Equity		
	Secondary	Primary	Total
Dec-24	0.30	2.12	2.42
Nov-24	-4.66	2.10	-2.56
Oct-24	-13.55	2.36	-11.19
Sep-24	5.55	1.33	6.88
Aug-24	-0.66	1.53	0.87
Jul-24	3.12	0.75	3.87
Jun-24	2.92	0.27	3.19
May-24	-3.67	0.60	-3.06
Apr-24	-2.80	1.76	-1.04
Mar-24	3.52	0.72	4.24
Feb-24	-0.38	0.57	0.19
Jan-24	-3.47	0.38	-3.10
<b>Total for 2024 (\$bn)</b>	<b>-13.78</b>	<b>14.49</b>	<b>0.71</b>

## Dollar Index had depreciated in first 14 months of Trump's last presidency



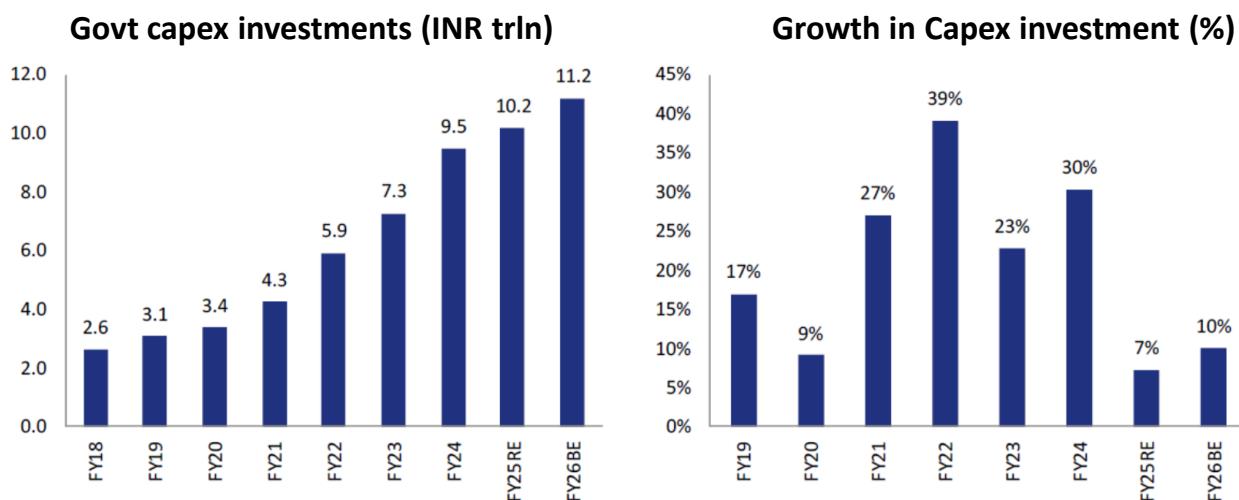
*Trump's Make in America and Tariff wars could make Dollar Index weaker as seen in his last term as President*

The strengthening of the USD amidst an improved macroeconomic environment in the US remains the major cause of concern for the Rupee. US job growth unexpectedly accelerated in December while the unemployment rate fell to 4.1% as the labor market ended the year on a solid footing, indicating the low chances of a rate cut from the Fed. However, we would have to wait and watch how Mr. Trump's make in America policy and increased Tariffs on various countries impacts inflation in America. **A depreciating dollar is good for emerging market equities like India.**

## Earnings slowdown was real; weak Capex to be blamed; recovery in FY26 to be seen post Budget 2025 push though short-term weakness to continue

The Union government's Capex has missed the FY2025 target of INR 11.1 trillion (~3.4% of GDP), due to lower-than-expected spending in the first eight months of the fiscal year. General elections led to government capex slowing down which happens in almost every election year. Further, strong monsoons in 2QFY25 disrupted supply chains. Market expectation however was of a pickup in government spending post the election season but that did not materialize. **Capital expenditures in the Budget for F2026 are pegged at INR 11.2tn, growing 10.1% YoY vs. 7.4% YoY in F2025RE.** As such, the share of capital spending in GDP is estimated at a healthy rate of 3.1% of GDP in F2026BE, similar to F2025RE. The central government continues to push states to increase capex, as it Budgeted INR 1.5tn for 50-year interest-free loans to states to be treated as capex, vs. INR 1.25tn in F2025RE.

*Capex which has been below the budgeted estimates in FY25, could see 10% growth in FY26*



## Budget 2025 provides much needed boost to sagging domestic consumer demand and sentiments

**Wage growth was outpaced by inflation, leading to declines in real wages which then impacted the consumption** from the middle class population. RBI's regulatory action on unsecured loans, non-banking finance companies (NBFCs), and digital lending further impacted credit growth and consumption. This led to a deceleration in GDP growth in 2QFY25 to 5.4% YoY (sharply lower than market expectations of 6.5% YoY). However now RBI has addressed liquidity issue in the system over the last 3 months.

The government has made significant increase in the tax exemption limits for the middle classes raising the exemption limit from Rs 7 lakhs to Rs 12 lakhs. This would make almost more than 80% of the taxpayers currently registered, as beneficiaries saving anywhere between Rs 30,000 to Rs 1,10,000 per annum in tax savings. **This would spur in consumption demand for discretionary items which had seen some slowdown in recent quarters due to rising inflation and lower income growth.** Retail would be the biggest beneficiary since elasticity of demand is the highest in retail on account of lower price points. **Other sectors to benefit from increased demand would be consumer durables and automobiles.** The government's focus on job creation and support for MSME continues. This segment is the biggest job creator in India and also plays crucial role in raising income levels of households. The finance minister rolled out various measures to boost domestic production, support MSMEs, and improve ease of doing business: (1) Revised classification criteria for MSMEs by raising their thresholds to at least 2x, to help them achieve better efficiency and capital access; doubled credit guarantee cover for them. (2) Additional Rs 100bn government contribution for start-up AIFs. (3) New scheme for 500,000 first-time entrepreneurs from disadvantaged sections.

## Current Portfolio construct & Performance

Our exposure to consumption, manufacturing, and capex-driven stocks has contributed to strong portfolio performance in CY24, as we believe these sectors benefit from structural tailwinds, despite occasional short-term fluctuations. However, the slowdown in government capex and weaker economic momentum impacted portfolio returns over the past three months, particularly in the last month

Since the last update, we've enhanced our retail exposure by adding a leading big-box value retailer. This company, which targets middle and lower-middle-income households with its 'Opening Price Point' strategy and competitively priced private label products, is well-positioned to benefit from an expanding footprint, strong value proposition, and growing consumer discretionary spending.

The portfolio has also been repositioned by reducing exposure to certain mid and small-cap stocks, where growth prospects are slowing or valuations are approaching fair value. As a result, cash levels have been slightly increased over the past month.

Month Ended	Large cap	Midcap	Small cap	Cash
31-Jan-24	46.6%	10.4%	36.4%	6.7%

In the past couple of months, there has been some unexpected weakness in both consumption and capex-driven companies. In fact, in January 2025, six out of the seven top contributors to negative performance in the portfolio (namely **Zomato Ltd, Trent Ltd, Voltas, Kalpataru Projects, SH Kelkar, and ABB India**) were from these sectors. However, following the Budget 2025 announcements, we are confident that our consumption-focused investments will recover and begin making positive contributions to the portfolio. While the capex allocation in the budget was lower than expected, we believe strong consumption growth will drive private sector capex apart from the ongoing Govt capex, positioning our exposure to benefit from this trend.

Regarding the performance of the portfolios, what one month of sharp cut can do to overall returns can be seen in below table:

(As on 31 <sup>st</sup> Dec'24)	1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years	Since inception
<b>Quest Flagship PMS</b>	-0.08%	-2.63%	10.42%	37.89%	29.66%	16.29%	21.58%	17.46%
<b>BSE 500 TRI</b>	-1.50%	-7.79%	-0.74%	15.81%	21.03%	15.35%	19.04%	11.03%

(As on 31 <sup>st</sup> Jan'25)	1 Month	3 Months	6 Months	1 Year	2 Years	3 Years	5 Years	Since inception
<b>Quest Flagship PMS</b>	-11.53%	-9.95%	-6.90%	15.98%	24.80%	11.94%	17.87%	16.54%
<b>BSE 500 TRI</b>	-3.45%	-4.84%	-8.25%	9.68%	20.96%	14.15%	18.24%	10.75%

(Returns for periods more than 1 year are annualized returns. Base month changes as we move from 31<sup>st</sup> Dec'24 o 31<sup>st</sup> Jan'25)

The Fund maintains a positive outlook on consumption-driven sectors such as platforms and retail, aiming to capitalize on India's expanding middle class, increasing disposable income, rising aspirations, and the shift toward discretionary spending and convenience. It is well-positioned to benefit from recent government efforts to boost consumption led by Rs 1 trillion in income tax relief.

The Fund's current exposure to the financial sector is focused on lenders, including private banks and fast-growing housing finance company (HFC), which are poised to benefit from India's economic growth. These institutions are expected to gain from their strong liability franchises and sound underwriting practices. Furthermore, the additional Rs 1 trillion in taxpayer relief from the recent budget is likely to translate into increased savings and household balance sheet deleveraging, benefiting lenders with better deposit growth and reducing credit quality concerns for unsecured loans.

While the budget announcements have been slightly underwhelming for the overall Government capital expenditure, we maintain a positive view on India's long-term growth in capital expenditure and manufacturing. This growth trajectory is driven by the push for infrastructure development and manufacturing aimed at both domestic consumption and exports. Our portfolio holds significant exposure to real estate and infrastructure development companies that stand to benefit from India's rapid urbanization, rising housing demand, and infrastructure expansion, which are less reliant on government capex. The real estate market in India is still highly influenced by micro-market trends, and our stock selection is focused on those regions with the best growth potential. Key suppliers of building materials to real estate companies form a core part of the portfolio, providing a pan-India investment opportunity. Additionally, we have investments in companies that are leading India's industrial expansion, particularly those specializing in electrification, automation, mobility and robotics. These companies are set to benefit from the transition to smart manufacturing, improved mobility and sustainable energy solutions.

Our investments span a broad range of sectors, including financials, consumer goods, healthcare, industrials, real estate, infrastructure, capex-driven industries, and technology. This diversified approach is designed to capture the opportunities arising from India's ongoing economic transformation, fuelled by strong domestic consumption, infrastructure development, and digitalization across key industries.

## Sector allocation

Sector	Weightage	Sector	Weightage
Consumer	18.3%	Telecom	2.9%
Private Banks	16.7%	Hospitality	2.4%
Pharma & Healthcare	11.3%	Insurance	2.2%
Chemicals	8.8%	Housing Finance	2.0%
Industrials	8.7%	Logistics & Shipping	1.4%
Real Estate & Ancillaries	7.8%	Textile	0.4%
IT & ITeS	7.4%	Cash & Cash Equivalent	6.7%
Cement	3.1%		

Despite the weak performance over the past month, we believe the portfolio is well-structured and poised to recover much of the underperformance in the coming months and quarter. The recent decline in stock prices appears to be driven more by panic than by any fundamental issues. We have outlined our investment thesis (Annexure 1) for some of the top underperforming companies this month and continue to hold strong conviction in all of our portfolio holdings.

As mentioned previously, the portfolio is strategically positioned to benefit from several key drivers, including the liquidity injected by the RBI, stabilizing asset quality, the expected increase in capital expenditure from both the government and private sector in FY26 (after a weak base), a more favorable outlook for export-driven sectors due to the declining INR, and personal tax benefits for middle-class households from the recent budget.

*Tariffs have been the biggest concern under Mr Trump and that remains a overhang now for globalization*

### Market outlook and Portfolio strategy ahead

Indian equity markets could remain lackluster for the next couple of months as market absorbs news flow around Trump tariffs on various countries and their impact on India and global supply chains. However **I see limited price correction from current levels and more of a time correction in the market.** The recent imposition of tariffs by US President Donald Trump on imports from China, Mexico, and Canada has significant implications for the global economy. It would import inflation into US thus making rate cuts difficult. On the other hand, there is a possibility that some manufacturing could shift to countries like India which have low tariff barriers now, however that too seems a bit tricky as US companies would be hesitant to put capital into a new geography not knowing when that country could face the wrath of Trump tariffs. There is a high likelihood that Trump uses the tariffs more for striking a deal and might not be long term in nature. Also, **how China, Canada and Mexico retaliate would also change the course and intensity of the tariffs.**

In midst of all the market volatilities and market noise, we continue to focus on our core strength of finding pockets of earnings strength which is supported by the right valuations. We continue to remain fully invested in the market and have not taken any aggressive cash calls in our portfolio. **We believe the current downturn in the market is more temporary and not a structural downfall which warrants any major risk aversion. There is a high probability of earnings upgrades over the next 4-6 months.**

We remain confident of H2FY25 being better than H1FY25 and see strong recovery in earnings for India Inc. in FY26. Among the consumer facing companies **we see strong recovery in earnings for Autos and Consumer discretionary companies.** Q3 is of major importance due to concentration of the festive and wedding season and hence lot of improvement in the numbers could be seen in the next two quarters with further aid from the budget 2025 tax incentives. **In the capital goods sector most companies have indicated that 2HFY25 will see an uptick in revenues** and order inflows following the state elections and they have maintained their full year growth targets. **Cement companies expect profitability to improve in 2HFY25,** led by positive operating leverage, favorable fuel prices, and cost-saving initiatives. Even in Pharma and healthcare space we expect earnings growth momentum to sustain in the coming quarters, led by ongoing niche launches and improved operating leverage.

*Index valuations have seen decent corrections from the peak and provide opportunity for investors to build portfolio over the next few months*

After the recent correction **Nifty-50, currently trades at 19x P/E for FY2026 earnings and 17.5x P/E for FY2027 earnings.** We don't see these valuations being expensive from a standalone perspective as its very close to historical average valuations. However, when seen on a relative basis to China it looks expensive because China has massively under-performed India in the last 5 years due to its own structural problems. If we look at **NSE-500 which is more broad based, it currently trades at 20.2x P/E on FY2026 earnings and 18.2x P/E for FY2027 earnings.** Again, a sharp drop from the recent 25x and 22x respectively it was trading just a few quarters back. With most commentary highlighting a stronger H2FY25, our view is that we would see some recovery in earnings from Q3FY25 and meaningful recovery from Q4FY25. **From now till the end of the FY25 I see good opportunity for investors to pick quality companies at reasonable valuations during the volatile period.**

Happy Investing!

Team Quest PMS

## Annexure 1: Investment Rationale on some portfolio companies which have seen some sharp corrections in recent month

### Zomato Ltd

- ❖ The food delivery segment is witnessing a consumption slowdown once again, similar to H2FY23. We maintain our growth assumptions of 20% growth over medium term while factoring the near term slowdown. Budget'25 tax incentives would see discretionary spends increasing thereby supporting its GMV.
- ❖ Blinkit continues to ramp up ahead of expectations, albeit competitive pressure and rapid store addition will drive higher near-term costs. We believe the network may have to carry a greater load of underutilized stores, which will impact near-term profits in the next few quarters. However, once it comes out from this period of expansion, the business is likely to turn meaningfully profitable, as a larger part of the business starts comprising mature stores compared to newly added ones as can be seen from the current cohort shared by the management.
- ❖ We derive comfort from strong execution history of management in the past. With a strong cash balance (~Rs.192bn) post QIP, we believe Zomato is well-positioned to invest in and expand its offerings across both the quick commerce and Going-out (District) business segments, which should drive near-term growth. We have been holding Zomato for several Quarters now & believe the current correction is only a blip in the long-term journey.

### Trent Ltd

- ❖ After a lower-than-expected revenue growth of 40% in the September quarter, Trent's stock has corrected sharply from recent highs. Additionally, concerns have emerged regarding the relatively slower pace of store openings in the last few months, putting pressure on the growth hypothesis that has driven the stock since we added it to our portfolio several quarters ago.
- ❖ However, we are looking at this from a different lens—square footage addition rather than store count. As per a recent note from Bernstein Research, over the past six quarters, the average Zudio store size has increased by 23%, from ~7.7K sq. ft. in Q1FY24 to ~9.5K sq. ft. in Q1FY25. While the company defines a Zudio store as ranging between 7,000-10,000 sq. ft., we observe that each new store is becoming even larger. The average size of an incremental Zudio store has surged by 70%, from ~10K sq. ft. in Q3FY24 to ~17K sq. ft. in Q2FY25. This suggests that despite a moderation in store openings, overall retail space expansion remains robust.
- ❖ Another concern has been potential cannibalization, with multiple stores opening in close proximity. While this is a valid point, we believe it is premature to assume it will materially impact Trent's growth trajectory, at least in the near term. The company's expansion strategy appears to be focused on deepening penetration in key markets rather than saturation.
- ❖ Moreover, Zudio continues to add new adjacent categories, including:
  - Beauty (with an expanding assortment),
  - Fashion Jewellery (such as LGD), and
  - Innerwear (via its JV with MAS from Sri Lanka).
- ❖ These categories offer higher gross margins and higher store throughput compared to value apparel, strengthening Zudio's positioning while creating natural adjacencies for both Zudio and Westside.
- ❖ Despite occasional short-term blips, Trent remains on a strong long-term growth trajectory. Management has demonstrated exceptional execution, creating globally recognized retail formats with improving profitability. We have held Trent for several quarters and believe the current correction presents a temporary pause rather than a structural issue in its long-term growth journey.

### Oracle Financial Services Software Ltd (OFSS)

- ❖ This quarter witnessed the lumpy nature of the business with Products segment declining by 7% on a YoY basis but still growing by 9% YoY during the 9MFY25 period. The other negative surprise came in from a sharp increase in employee cost which formed 49.7% of sales during the quarter vs 46.9% QoQ and 41.70% YoY. However, over a nine-month period employee cost is stable at 46.7% of sales vs 47.0% last year. During 9MFY25, the License and Cloud revenue grew 20% YoY as the demand for cloud-based products increases.
- ❖ The deal signing continues to perform well with 21 deals signed during the quarter of which 12 deals had Oracle Core Banking application. These deals are spread across geographies which reduces concentration risk, and the complex nature of deals makes it a high entry barrier for the competitors. Overall deal pipeline also continues to remain robust. We remain confident of company delivering steady growth going forward as share of license and cloud-based deals starts increasing.

## Annexure 1: Investment Rationale on some portfolio companies which have seen some sharp corrections in recent month

### SH Kelkar & Company Ltd

- ❖ In a challenging environment due to multiple factors such as fire incident at Vashivali plant (key unit for domestic fragrances) and volatility in key raw material prices, the company has been able to navigate H1FY25 with 18.3% revenue growth. Amidst all these headwinds, the management continues to do growth investments in form of new creative development centers (CDCs) in Europe and the US which is affecting the profitability margins in FY25.
- ❖ The medium-term growth outlook for the company remains positive with scale up in Unilever contract, market share gains in global market, revival in domestic FMCG demand and ramp-up in recent and . On margins, we expect SHK to be able to largely pass along input cost fluctuations and extract operating leverage on recent growth investments.
- ❖ Insurance claim and cash flows from operations should help the company par down the debt and acceleration of the same should start happening from FY27 onwards.

### Kalpataru Projects International Ltd (KPIL)

- ❖ KPIL ended 2QFY25 with a robust order book of ~INR 606bn, supported by record-high order inflows of INR 84bn, marking a 74% YoY growth. While execution picked up despite heavy monsoons, delivering 9% YoY growth in Q2, management has indicated a potential shortfall in its 20% revenue growth guidance as H1 was impacted by election-related disruptions and slower government spending. Especially in the water segment, collections were slow due to multiple state elections, leading to a moderation in execution.
- ❖ We continue to remain positive on KPIL as it remains a strong beneficiary of multiple macro triggers, including:
  - Government's continued investment in transmission connectivity capex for renewable energy projects.
  - Strong real estate momentum, driving demand for urban infrastructure.
  - Increased spending on water supply projects, particularly under Jal Jeevan Mission.
  - A large order from Saudi Aramco, reinforcing its international growth trajectory.
- ❖ Moreover, KPIL's strategic initiatives, such as the divestment of non-core assets and improved subsidiary performance, enhance confidence in sustained growth with improving RoEs. The company's strong execution capabilities, diversified order book, and improving financial metrics position it well to capitalize on these macro tailwinds.



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