

“At heart ‘uncertainty’ and ‘investing’ are synonyms” – Benjamin Graham

Dear Investors,

We often keep hearing about the famous quote by Vladimir Lenin "There are decades where nothing happens; and there are weeks where decades happen". Last few weeks have been no different and the world at large has been facing extreme uncertainties around tariff imposed by Mr. Trump on every piece of land outside the borders of America, be it friendly state or enemy state or even uninhabited islands! The method and rationale of arriving at the obnoxious tariff rates on different countries itself had been a topic of discussion among think tanks. **With the speed at which Mr. Trump makes decisions and reverses or modifies them, volatility of global markets is a certainty.** As abruptly as he had announced the tariff rates on all countries including, with similar abruptness he has now announced a 90-days pause on those but a flat 10% arbitrary tariff would be charged on all countries barring China and a few more countries which retaliated with their own tariffs. **Volatility is bound to be there for the foreseeable future and there is no way of predicting with accuracy the extent of impact of his decisions from time to time. Also the old rule based globalization has been shelved and a new ad-hoc mutual agreement based trade agreement with US could become the new norm.** However, in the midst of all this uncertainty and global supply chain disruptions and economic trade relations getting altered dramatically, India remains a key market which is seeing lesser and lesser direct negative impact, and on the contrary this whole trade war could be a blessing in disguise for India in the medium to long run.

If you were to ask me, where do I see Indian markets in the next 3 months, 6 months and 1 year, amidst global uncertainties, absolute index performance is difficult to predict. **But India should emerge as a relative outperformer.** My confidence comes from various factors which are supportive of this theory. **Lesser dependence to US & China demand, relatively lower tariff incidence, lower crude oil prices, low FPI exposure in recent quarters, large domestic market and a pro-growth RBI stance are the key reasons.** I continue to believe that there is limited direct implication of the USA's reciprocal tariff (whether 10% or the earlier 26%) for India. When a comparison is made between the top 27 countries (based on their export to the US, reciprocal tariff rate, and overall exports) and India, product-wise exports to the US suggest that India may face limited impact. Moreover, **the bilateral trade discussion with the USA (if finalized) may be positive in the medium to long term.** Countries like India, Malaysia, Philippines, Thailand could benefit from very high tariffs in China as supply chain could shift to these new destinations which have better trading terms with US. We see limited risk of dumping from China into our markets given recent examples of policy intervention in the form of quality certification, Anti Dumping Duty (ADD), etc. **Despite limited direct impact of tariff on India, volatility may persist in the near term given United States accounts for ~26% of the global GDP, ~48% of the world's market cap, and ~43% of FPI equity asset under custody (AUC) in India.**

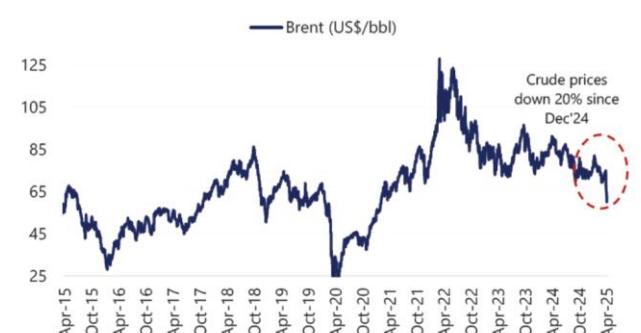
Some key factors that give confidence that India is relatively better off and its good time to increase India equity allocation for investors:

- **India's relatively low exposure to US markets is a boon:** Though the US is India's largest trading partner, yet it accounts for approximately 18% of total exports from India. The dependence on US looks meagre when we see that **India's goods exports and trade surplus with the US are at 2.3% / 1.2% of GDP** and are much lower in comparison to most emerging market counterparts. For example, Korea and Taiwan exports to US are 7% and 15% of GDP respectively, while their trade surpluses at 4% and 10% respectively are much higher compared to that for India.
- **Lower Crude oil prices nearly offset the tariff impact:** Brent Crude oil prices are down ~20% YTD to US\$60/bbl. India is a large net importer, so a decline in oil prices is a significant positive for the country's Balance of Payment / Fiscal / and Inflation (CPI) situation. The govt. already raised the excise duties on petrol & diesel by Rs2/ltr even as retail prices are constant. This adds 0.1%/GDP (Rs320bn) to government revenues. A US\$10/bbl decline in crude oil prices reduces India's Current Account Deficit (CAD) by ~0.3-0.4% of GDP, and **at US\$60/bbl (vs. US\$80/bbl avg. in FY25), the lower crude effectively more than makes up for potential reduction in US trade surplus.**

India has a low share of US exports as % to its GDP



Crude being India's largest import bill has positive impact on its trade deficit as oil prices fall



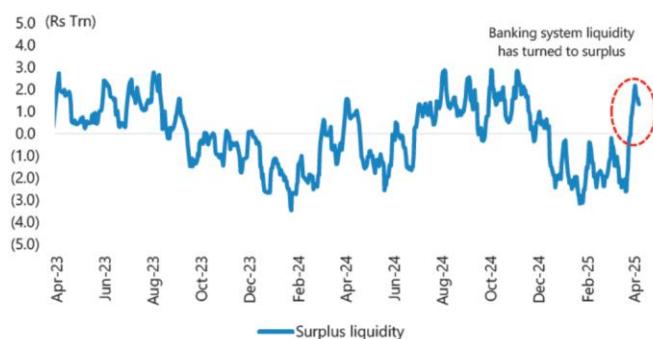
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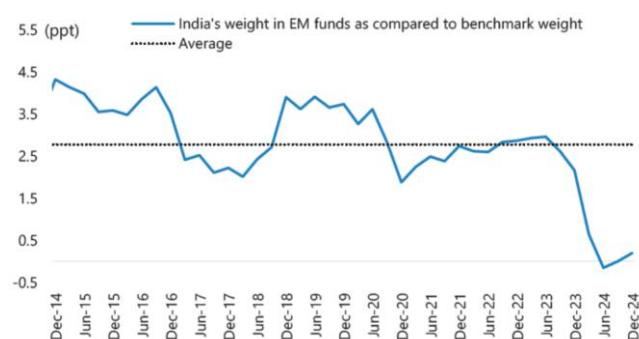
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Liquidity is no longer a concern for the banking sector



- **RBI actions on rate cuts and improved liquidity stance would support the domestic growth engine:** RBI's monetary policy in recent times after the new governor has taken charge, has shifted its stance on liquidity to 'accommodative' from 'neutral', implying RBI will maintain surplus liquidity in the banking system. Already, several steps worth Rs8.5trn (2.6% of GDP) have been taken by the RBI since Dec24 to inject liquidity, consequent to which liquidity has shifted to a surplus position (Rs1.3 trillion) vs. a deficit earlier in the year. **Relaxed liquidity stance should help in deposit rate cut transmission and support bank margins and credit growth whenever capex picks up.**

India has become underweight in most EM funds



- **Foreign Portfolio Investors (FPI) ownership is low and India allocation is underweight; room for equal weight to overweight:** FPIs have sold equity shares worth US\$27bn in India since Sep'24, partly as China rallied and post US elections when money also flowed back to the US markets. Few factors which drove this was weakening Indian Rupee, strengthening Dollar Index, strengthening US Bond yields, slowing corporate India earnings growth and better prospects of Corporate America profitability with tax cuts and strong economic recovery. Also as seen from the graph on the left, it shows that the majority of funds are carrying India weight at Neutral to Underweight when compared to the benchmark indices. **This underweight stance is seen reversing as March was the first month after almost months when there was a net buy figure from FII in Indian equities.**

So where do we go from here in Indian and Global markets and what should investors do?

Sharp swings in global markets depending on news flows around tariffs is the new norm. I believe no matter by how much the tariff rates get reduced to, it would be inflationary for US citizens and the same would have to be addressed through tax cuts and Fed rate cuts in US markets. Bond yields in US are again something which will be closely watched because that would also lead to dollar strengthening or weakening as a large amount of the T-bills are coming for maturity next year and is one of the major cause of concern for Mr. Trump and reducing the trillions of dollars of debt has been biggest election manifesto. Mr. Trump wants to bring back manufacturing to America but then this is good for discussion and impractical for implementation considering the high cost of manufacturing anything in the US. All this sounds good in theory but in reality, will not be easy to address. **The process of supply chain realignment would be painful and will keep global economy on the edge of slow growth and recession in different parts of the world.** India would also not be immune from the same but as mentioned in my above pointers, **India has all the ingredients to emerge as a major out-performer from all this noise.** US-China trade relations will surely not be the same again and someone large enough and who has better trade terms with US, has to fill the boots. India fits the bill, though the transition will be a long-drawn process because private capex in India is a slow process and replacing large Chinese capacities is not easy overnight.

I continue to believe that the **domestic slowdown in India is transient and not structural.** Domestic growth is likely to revive given multiple policy intervention in the form of monetary easing through 50 bps rate cut already delivered and another 50-bps expected in 1HFY26, banking liquidity turning surplus, lower risk weight for NBFCs & MFIs and Fiscal easing (tax sops in the form of higher rebates helping middle-income households and higher government capex spending). Management commentary in terms of the evolving demand situation is a key monitorable as we have just entered Q4FY25 earnings season. **It would be prudent for investors to use the current weakness and volatility in the market to gradually add onto their equity portfolios and continue the process of staggered investments into Indian markets because valuations have become relatively comfortable compared to the expected earnings growth in FY26 and FY27.** At the same time investors should keep in mind that the near-term returns could be volatile swinging from positive to negative territory and vice versa as the tariff noise and earnings recovery data will become the key drivers of the market in the near term.

Happy Investing!

Team Quest

Quest Investment Advisors

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