



Market Outlook

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Preview:

If you step back and look at the last three months in one frame, a single chain of causation ties everything together: the West Asia conflict sparked a crude oil shock, the crude shock hammered the Balance of Payments, the BOP stress drove the rupee lower, the weaker rupee led to imported inflation, and the inflation fear has kept the RBI anchored at 5.25%, which was once expected to be lowered but we expect 2 rate hikes in this year. We will not be surprised to see 10-year G-Sec going to 7.5% in 2 years. This, in turn, has made FII re-entry into Indian equities conditional on global factors resolving themselves, rather than Indian macros improving.

1. The West Asia Conflict: Where we Stand

The conflict between the US/Israel and Iran, which began on February 28, is now in its ninth week. An uneasy ceasefire has been extended indefinitely and peace talks remain unsure right now. What started as a military operation aimed at regime change has evolved into something more consequential for global markets: a dual blockade of the Strait of Hormuz.

Before the conflict, approximately 3,000 vessels passed through the Strait every month, amounting to a ~20% of the total oil supply globally. In March, just 154 crossings were recorded which is barely 5% of the pre-war average. Today, the Strait is effectively paralysed from both ends: Iran has mined approaches from within the Persian Gulf, while the US Navy has blockaded Iranian ports from the Oman Sea side. An Indian commercial vessel was attacked near Oman, and war-risk insurance premiums have surged to levels that have made routine shipping commercially unviable for many operators.

The IMF has warned that if the conflict persists, a global recession is possible. Oil prices have reflected this fear, with Brent Crude touching \$123/bbl at its peak, roughly 70% above pre-war levels. As of the time of writing, Brent has pulled back toward ~\$100/bbl on tentative signals of negotiations, but the Indian rupee, which is paid for oil procured through alternative routes, means the effective cost India is paying is considerably higher, estimated to be ~\$114/bbl.

India imports about 85% of its oil and 80% of its gas from West Asia. The conflict has affected not just crude, but LPG, helium, API ingredients for pharma, and the shipping lanes through which a material portion of our exports and imports move. Over 2.22 lakh Indian nationals have returned from the Gulf region since the conflict began. The human dimension of this crisis is real and significant.

The Oil Price Outlook

The key question for the market is not what oil prices are today, but where they settle over the next 6 to 12 months. Three scenarios broadly frame the range of outcomes:

- **Short resolution (2–4 weeks):** Conflict ends, Strait re-opens, OPEC spare capacity (estimated at 4.6 mbpd, led by Saudi Arabia's 2.4 mbpd) fills the gap, and Brent reverts to the \$80–90/bbl range by the second half of 2026. This is the 'relief' scenario the market briefly priced in when Brent fell below \$100.
- **Prolonged conflict (2–3 months):** Disruption persists, non-OPEC alternatives ramp slowly, and Brent trades in the \$85–100/bbl range through most of FY27. This is our base case.
- **Structural damage scenario:** Oil infrastructure in Saudi Arabia or the UAE is compromised, or the Hormuz blockade continues beyond a quarter. In this case, Brent remains above \$100 and the economic damage to India becomes materially worse.

One critical nuance: The physical oil market was actually in surplus before the conflict began. Global supply had been growing faster than demand throughout 2025, with non-OPEC supply the primary driver. This surplus has buffered the immediate supply shock from Iran's exit from effective export markets. But it does not insulate us from freight disruption, insurance surcharges, and longer shipping routes which are adding \$10–15/bbl in effective cost even when the commodity itself is available. Slowly, Venezuela has become India's third largest oil supplier, overtaking Saudi Arabia and the US. India is importing around 4.17 mbpd from Venezuela, representing a 47% month-on-month increase for May 2026

Russia, Turkey, and some other countries have sold gold recently to fund their economies, signalling they may pump more oil to support their fiscal positions. This would lead to an increase in oil supply and hence reduce the prices in the future. This dynamic when combined with Venezuela beginning to stabilise (though Venezuelan oil is now India's second-largest import source, which itself shows how radically supply chains have reoriented) indirectly suggests that oil could come down meaningfully within 2 - 3 months if geopolitics permits. Venezuela has been able to supply heavier oil that bridges part of India's sourcing gap, and this manageable supply-log situation is a genuine relief amid all the noise.

With UAE opting out of OPEC, it would also lead to an increase in the supply of oil from the country. An approximate 5 mbpd output would increase from their country, which shows positive signs for a reversal in the price of crude, if the war ends in the short term.

2. The Balance of Payments (BOP): India's Real Stress Point

The BOP is the most important framework to understand India's current macro stress. Let us look at the numbers plainly, because they tell a clear story.

India's trade deficit, which used to run at around \$10 billion a month in prior years (on an average), has expanded sharply. For FY 2025–26, the numbers look approximately as follows:

BOP Component (FY25–26)	Approximate Figures
Trade Deficit (net of service exports)	(\$32 billion)
ECB (External Commercial Borrowings)	\$15 billion
FDI inflows	\$7 billion
FPI outflows (bonds + equity)	(\$18 billion)
Net Trade Deficit	(\$28 billion)

India's forex reserves, which stood at approximately \$723 billion at the peak, have declined by roughly \$33 billion since the conflict began due to RBI intervention. They now stand at approximately \$683 billion. The RBI net sold a record \$53 billion in FY26, the largest-ever intervention in a single fiscal year. While reserves remain comfortable at approximately 11 months of import cover, the depletion rate is worth watching.

The FY27 CAD estimate has been revised to 2.3% of GDP, up sharply from 0.9% in FY26. For context, at the 2013 'taper tantrum' when India faced a balance-of-payments crisis, the CAD was running at more than 4.5% of GDP. We are not there yet, but the direction is uncomfortable, and the speed of deterioration bears watching.

Finance Minister Nirmala Sitharaman has flagged what she calls the '3 Fs' risk: Fuel, Fertiliser, and Foreign Exchange. This is an accurate summary of the external sector challenge. OMCs are losing approximately ₹590 crore per day in under-recoveries (after all rate hikes). Gold and silver import duties were sharply raised (gold from 6% to 15%) to reduce forex outflows. PM Modi publicly urged citizens to reduce energy consumption and delay gold purchases, marking an unusual public appeal that itself signals the degree of official concern.

India benefited from a strong **pull factor** for foreign capital in FY22 and FY23, when U.S. bond yields were relatively low at around 1.5–2%, making emerging markets such as India more attractive to global investors. However, with U.S. yields now in the 4–4.5% range, the attractiveness of dollar-denominated assets has increased, creating a **push factor** for capital away from India and other emerging markets. At the same time, Taiwan and South Korea have emerged as key beneficiaries of the global AI investment theme, attracting significant global capital flows and contributing to FII outflows from India. Further, India's gold imports rose over 24% to a record USD 72 billion in FY2026; however, following the government's decision to increase the duty on gold to 15% from 6%, imports have moderated sharply.

Hence the only option left is saving forex reserves. Currently net FDI is zero and negative FII flows in India have made the BOP situation precarious. Growing opportunities for Indians to acquire assets in Europe have driven a significant increase

in outward FDI. Meanwhile, global FDI activity remained weak due to geopolitical uncertainties, with high oil prices and a depreciating rupee further weighing on the investment environment.

Critically, the capital account has emerged as a separate area of concern beyond the current account. Economists have flagged that FPI repatriation and weak net FDI inflows, rather than just the trade deficit are adding a deeper structural pressure on the rupee.

There is one notable bright spot: net FDI rose sharply to \$7.65 billion in FY26, suggesting that long-term investors remain confident in the India story even as short-term portfolio players have been cautious.

3. The Path to Resolution: Five Things That Would Fix the BOP

Five things, working in sequence, would move India from where it is today to a meaningfully better place:

- **Address the BOP problem directly:** If trade deficit trends improve (either through lower crude or better export performance), currency stability follows naturally. The government's gold duty hike, export promotion through the RELIEF scheme, and energy diversification partnerships (such as the new India-UAE strategic oil reserve and LPG agreements, and Canada positioning itself as an alternative oil and LNG supplier) are all steps in this direction.
- **Currency stabilisation → market rerating:** If the rupee stabilises, FII flows should improve because the breakeven for foreign investors improves. Currency stability with time correction of market valuations (currently at 18-19x trailing P/E) plus improving earnings growth creates the conditions for re-entry.
- **FPI incentivisation:** India is one of the few emerging markets that still levies withholding tax on FPI in their capital gains and there is a withholding tax on the debt income too. If that decision is taken in investors' favour, it would be a meaningful pull factor for foreign capital beyond just equities.
- **Government actions:** GST rationalisation is already done, PLI support are in place to boost exports, and energy security investments are being made. Each of these, individually, is not transformative. Together, they are building the foundation for a re-acceleration in the economy.
- **Currency stabilised → FII inflows → earnings recovery → market up-move:** If policymakers are able to stabilize the rupee through measures such as revisiting LRS outflows, discouraging non-productive imports such as gold, curbing speculative activity in precious metals and foreign exchange markets, accelerating repatriation of export proceeds, utilizing government forex balances efficiently, and controlling excessive speculative currency positions, many of the current macro challenges could begin to ease. A stable currency would improve investor confidence and bring back the FII flows, and probably a favourable environment for earnings growth.

Iran: Likely to remain restrained given the severe inflationary and currency pressures. The country is facing approx. 50% inflation and currency collapse. Its ability to sustain a prolonged confrontation is limited. This is perhaps the most underappreciated aspect of the geopolitical calculus. Iran's stock market was closed for a total of 80 days, and has recently opened again.

USA: We fail to acknowledge a big factor for US is its refinancing of debt in the current year. Out of the \$40T of debt, there is an approx. \$10T, which needs refinancing/rollover as it is reaching its maturity. The inflation in US has reached its peak of 3.8% in April highest since 2023 due to the crude price shock. There are mid term elections in the US in November, and for that the US President would not want the inflation number to not be by his side. With losing popularity in the house, the US President has more to lose than to gain from this ongoing crisis.

Overall, due to these reasons we foresee the crisis to end soon, unless new information comes to light.

4. The Indian Macros, Currency and FPI Flows

A. Indian Macros

Indian market valuations had risen to nearly 22x earnings in 2025, placing them in the overvalued zone. Following the recent market correction, valuations have moderated to around 18–19x trailing P/E, which appears reasonable when viewed alongside the expected earnings growth of 12–15% (with nominal GDP growth projected at 11–12%, supported by inflation of around 5–6%).

We expect the RBI to maintain status quo in the June policy meeting, with the possibility of 1 or 2 rate hikes during FY27 depending on the inflation trajectory. However, the RBI is likely to look through a large part of any inflation arising from supply-side disruptions, particularly given the significant contribution of crude oil prices to the recent rise in inflation.

Whereas, on the consumption side, the picture is more reassuring. GST collections have been consistently robust: ₹2.08 lakh crore in March 2026 and ₹2.43 lakh crore in April 2026. This shows economy is resilient.

The public investment thesis is also supported by the RBI transferring a record ₹2.87 trillion surplus to the government which is the largest-ever such transfer aimed at giving the government meaningful fiscal flexibility even as the external account tightens.

B. Currency:

The rupee is down approximately 10% against the dollar in FY 2026 and 7% in CY26 alone, marking it as the worst performing currency among Asian countries and the second-worst overall, since the onset of the Iran conflict.

The USD/INR pair has traded as high as 96.83, and the RBI has been forced to announce a \$5 billion USD/INR buy-sell swap to inject durable liquidity while managing exchange-rate volatility.

For an FII sitting in New York or London, investing in Indian equities involves two distinct bets: one on the Indian market, and one on the currency.

C. FPI / FII Flows

FII/FPI inflows are likely to turn decisively positive only if one or more of the following conditions materialize:

1. The AI-driven investment narrative moderates, prompting a reallocation of capital away from markets such as Taiwan, South Korea, and Japan and back into India.
2. India's macroeconomic fundamentals strengthen meaningfully, accompanied by a recovery in corporate earnings growth to the 15–18% range, thereby improving the attractiveness of Indian valuations relative to peers.
3. A sharp decline in U.S. 10-year Treasury yields, which would revive global dollar carry trades and encourage greater capital flows into emerging markets, including India.

The growth story for India is currently not driven through the advent of AI, which is another reason why FIIs are finding better opportunities in other countries than India.

An important factor behind FII selling in India was its allocation within the broader emerging markets basket. As there are no India-specific funds in dollar terms, any redemption from emerging market funds results in automatic selling of Indian equities. Additionally, MSCI-related rebalancing led to further outflows, as India's weight in the index declined amid the sharp rerating of markets such as Taiwan, South Korea, and Japan. Despite these headwinds, Q4 FY26 earnings remained encouraging; however, markets were unable to fully reflect the positive results due to the West Asia conflict and prevailing global uncertainties.

D. SIP Flows

There is a fear of SIP flow inflows slowing, we expect it to increase which are at around ₹31 thousand crores per month currently. The age wise bifurcation of the SIP inflows in the markets shows that the youth, popularly known as the Gen Z and the millennials, are inclined towards investing in SIPs as they have the financial understanding and want the compounding of money in their lives.

Over the last 24 months amid challenging market conditions, the SIP trend has been quite the opposite. The SIP contributions have remained resilient and continued to grow, reflecting the increasing financial awareness and long-term investment discipline among retail investors. This growing investor maturity has ensured that market volatility has not translated into a meaningful decline in SIP flows.

Nearly 48% of the investors in the SIPs are in the age bracket of 18-30. We expect that this number will only go on increasing and hence is a huge positive sign for the Indian markets. This structural domestic liquidity is the primary reason markets have not collapsed despite the FII exit.

5. Capex: Private Investment Is the Missing Link

One of the central tensions in India's current economic landscape is between consumption, which remains resilient and capex, where the private sector has been a laggard.

To understand why this matters, consider India's BOP challenge through a different lens. Our trade deficit is partly a function of the fact that China has massive excess capacity in many goods that India either cannot produce at scale or produces at significantly higher cost. Rather than being able to export competitively, India ends up importing from China,

as it is essentially cheaper to import than to manufacture here. This is the 'capex issue' from an export and consumption point of view: without scale manufacturing, the import bill stays high and the export potential stays limited.

Even though the private capex has come in, there has been an equal amount of outflow from the country, on account of IPO listings (by which we gave an exit route to FPIs), acquisitions of M&Cs by Indian companies and lesser repatriation due to the ongoing West Asia crisis.

The government has understood this, and has been doing the 'heavy lifting' through public investment by introducing PLI schemes, infrastructure capex, semiconductor missions, the RELIEF scheme for export logistics.

The semiconductor mission's outlay of ₹76,000 crore is being deployed, with 12 plants now operational and 38,000+ GPUs deployed for AI infrastructure. Andhra Pradesh has approved a ₹1 trillion Reliance AI data centre investment. Coal India is investing ₹1 trillion over five years across energy and critical minerals. These are meaningful, real investments. The challenge is that their multiplier effects take time to filter through to private sector confidence and ultimately to employment and consumption.

6. Sectoral Themes: Where the Action Is

Consumption

Consumption is holding up, but the nature of it is changing. FMCG companies have already raised prices 3–5% and are preparing further hikes, with HUL facing 8–10% material inflation and some input costs up 40–50%. Volume growth in FMCG is expected at 4–4.5% if crude remains elevated which is technically, not a disaster, but not the recovery many were hoping for. Premiumisation in general remains the brighter story. Consumers have not disappeared; they are simply prioritising spending more carefully.

IT and Technology

IT remains under structural pressure. Mutual fund exposure to the sector has fallen to an 8-year low of around 6.7% of equity holdings. The threat from Anthropic, OpenAI, and other AI players moving directly into enterprise execution rather than just enabling IT companies is real. HCLTech itself has estimated a 2–3% annual deflationary impact from AI on traditional services revenue. That said, IT companies are distributing record shareholder payouts (₹1.3 trillion in FY26, including Infosys's ₹18,000 crore buyback), signalling a mature cash-return phase. The transition is difficult, but the balance sheets are strong. GCCs continue to add employment in large numbers even as traditional outsourcing demand softens.

Power and Renewables

Power is perhaps the cleanest structural story in the market today. Peak demand hit a record 270.82 GW in May due to heatwaves, and the government is evaluating 1,150 kV ultra-high-voltage transmission as only the second country in the world to deploy such technology after Kazakhstan. REC has floated tenders for 21.5 GW of transmission projects. Suzlon, Inox Wind, and Adani Power are all reporting strong growth. Union Budget capex and India's 500 GW renewable target by 2030 keep policy tailwinds firmly in place.

Defence and Strategic Manufacturing

Defence budgets are rising globally, and India is no exception. The semiconductor mission is scaling, with ISM 2.0 tenure possibly extended to 12 years with an ecosystem push of up to ₹1.5 trillion. India's share in Apple AirPods production has risen from 1% to 4%, signalling a genuine China+1 shift rather than just rhetoric. Toyota is setting up a 1 lakh vehicle capacity plant in Maharashtra. Bajaj Group is investing ₹2,000–2,500 crore in healthcare. The manufacturing story is building, but it requires patience.

EV and Energy Transition

Ironically, one beneficiary of the crude shock is the EV sector. Electric PV sales are up 75.1% YoY, E2W sales up 60.7%, and Tata Motors reports EV bookings up 25–30% with volumes crossing 92,000 units and approximately 40% market share. As petrol and diesel prices rise (they went up ~₹5/litre in May), the total cost of EV ownership looks better relative to petrol. The government is also preparing CAFE-3 norms with a possible E25 base fuel standard and evaluating flex-fuel incentives which are all pointing to a structural acceleration in alternate fuel adoption.

Gold and Commodities

Gold has been a surprisingly muted story given the conflict, and the reason is instructive. Several Gulf countries including Turkey, Russia, Eastern European countries have been selling gold to fund their economies amid the geopolitical stress. Substantial official-sector selling has capped prices even as retail and central-bank demand remains strong. While gold remains a long-term hold (with moderate gains) given the macro backdrop, but near-term entry at current domestic prices (with the new 15% import duty raising costs) needs careful evaluation. The duty hike in India has also killed the demand of Gold and Silver, and hence we expect the demand to be muted in the near term future.

7. Market View - Where does Nifty go from here?

We expect the Finance Minister to address the BOP issue first, and expect some kind of a tax concession for the FPIs and a few changes in Capital Gain tax, to revive debt market and support equities. Looking at FPI's continued selling the Nifty range according to us will be between 22,800 – 25,500, which represents strong support and resistance from a valuation and historical context. At 18-19x trailing P/E, the market is not cheap, but it is below the 10 year average, particularly when you strip out the large-cap sectors under stress (OMCs and PSU banks adjusted for provisioning) and look at mid-cap and small-cap earnings growth, which has been strong.

The Nifty Midcap 100 is already at all-time highs at more than 62 thousand, up approx. 17% in FY27 so far.

From here, the market's near-term trajectory depends on three things:

1. Oil prices (the most decisive single factor),
2. The monsoon (El Nino conditions add uncertainty to food prices and rural consumption), and
3. Q1 FY27 earnings (where the full impact of the oil shock will be visible for the first time in corporate results).

If oil settles toward \$90 and continues its decline toward \$70–75 as additional production comes to support affected economies, the equity market will respond quickly and positively. In that scenario, a move toward 24,500 becomes very achievable.

SIP investments should not stop, and the data shows they are not as its composition has shifted toward Gen Z and millennials who instinctively understand systematic investing. Lump-sum investors should continue using market dips to deploy capital, keeping a 3–5 year horizon firmly in mind.

As Warren Buffett famously observed: If you know you will buy a product repeatedly over the next decade, you want to buy more of it when prices are lower, not less.

We expect markets to gradually improve as valuations normalize and fundamentals continue to strengthen. If earnings remain resilient, supported by rising consumption and favourable demographic trends, the NIFTY could potentially reclaim its previous highs before the end of FY27. In this environment, staggered investments over the next 4–5 months could prove beneficial. We believe the market will continue to reward a bottom-up stock-picking approach. Of the 916 companies that have reported Q4 results, aggregate PAT growth stands at 14.1%, indicating that earnings momentum has increasingly shifted towards the broader market, particularly the mid-cap segment. However, large-cap stocks are beginning to appear attractive from a valuation perspective and could see renewed interest if foreign portfolio investors return to India.

Investors should avoid basing their investment strategy solely on NIFTY index levels. Instead, focus on the underlying earnings growth and opportunities across the broader market, while maintaining a balanced allocation between large-cap and mid-cap segments based on individual risk appetite and investment objectives.

What is needed now is resolution of the external shock, and for that, time is an ally.

8. Points to Ponder

Valuations & Market Performance

- NIFTY is currently trading at an **8% discount to its historical average valuation** and remains **11% below its previous peak**, providing a relatively favourable entry point for long-term investors.
- The market witnessed a **7% rally in April**, reflecting improving sentiment despite global uncertainties.
- The **NIFTY Midcap 100 Index is at an all-time high**, highlighting continued strength in the broader markets.
- Over the last two years, **Banks have delivered an 8.10% CAGR**, significantly outperforming **FMCG (1.1%)** and **IT (0.5%)**.

Liquidity & Flows

- The ongoing **IPO market slowdown could support secondary market liquidity**, as capital that would otherwise be allocated to primary issuances remains available for listed equities.
- Domestic participation remains robust, with **Equity Mutual Fund inflows of ₹38,400 crore in April**, providing a strong cushion against foreign capital volatility.
- **Gold imports have declined following the duty hike**, helping moderate pressure on the external account.

Macroeconomic & Geopolitical Watchpoints

- The **Iran-US conflict has removed nearly 40 million barrels of oil supply** from the system, creating upward pressure on energy prices globally.
- **WPI has touched 8.3%**, primarily driven by higher fuel prices.
- **El Niño could impact India's GDP growth by 40–60 bps**, making it an important macro variable to monitor.

Structural Growth Drivers

- **EV demand now accounts for nearly 50% of new bookings**, reflecting the accelerating pace of adoption in the mobility sector.
- **Peak power demand has reached 270.82 GW**, underscoring the continued expansion of economic activity and energy consumption.
- **Coal India has announced a capex plan of ₹1 lakh crore** to support India's long-term energy sufficiency objectives.
- India is targeting **USD 1 trillion in exports by 2027**, after closing the previous year at **USD 813.11 billion**, reinforcing confidence in the country's long-term growth aspirations.

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