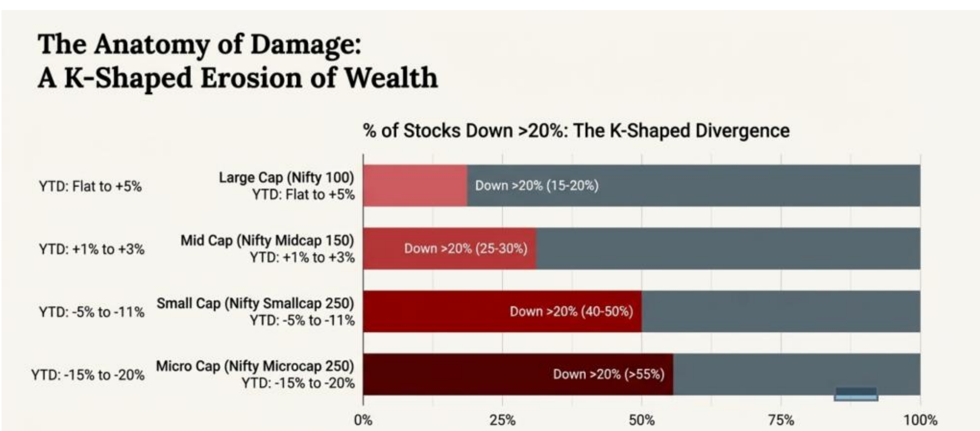
As we close the books on 2025, I find myself reflecting on a year defined by distinct phases. If 2023 and 2024 were years of "Momentum," 2025 will be remembered as the year of **"Consolidation" and "Realism."**

It was a year where the market took a pause to digest valuations, geopolitical alliances were tested, and the "easy money" era for retail traders came to a halt.

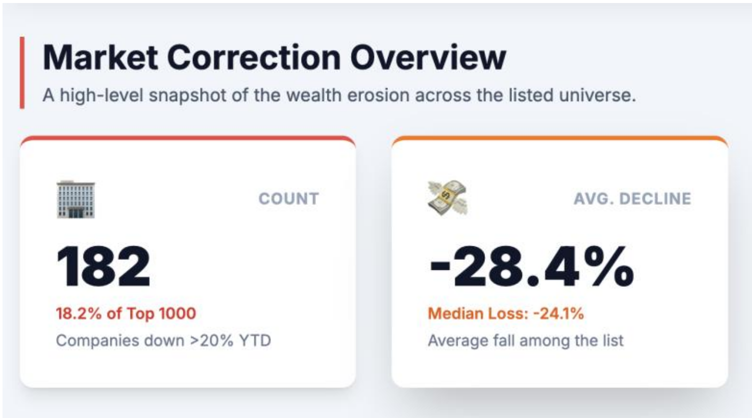
I want to take this opportunity to share my thoughts on what we saw, the changes within our firm, and why our conviction in the "India Story" for 2026 is stronger than ever.

2025: The Year of Divergence

Consolidation often brings divergence. For the first time in three years, the "rising tide lifts all boats" phenomenon ended. We witnessed a sharp contrast where the headline index was held up by heavyweights, while the broader market underwent a necessary health check. Consequently, from its September 2024 peak, the market witnessed a sharp correction.



Source: Quest Internal Research



Source: Quest Internal Research

This data confirms a "K-shaped" divergence where the top 100 companies have largely insulated portfolios from total ruin, while the bottom 500 companies (the microcap segment) have become wealth destructors for late entrants.

Data indicates that **89%** of the Nifty Smallcap 100 constituents delivered negative returns in 2025 YTD. This is not a stock-picker's market; it is a systemic wash-out. The median Price-to-Earnings (P/E) ratio of the Smallcap Index contracted from a lofty 45.3 in late 2024 to approximately 37.7 by late 2025.

The Political "Hat-trick"

The year began with anxiety following the General Elections, where the BJP returned with a thinner margin. However, the political narrative consolidated in late 2025 with a "Hat-trick of Stability" - winning Haryana, Maharashtra, and Bihar decisively. This has effectively re-rated India's political risk premium, ensuring policy continuity for the next four years.

Market Dynamics: The Tug-of-War

Behind the index numbers, 2025 was defined by a historic battle between foreign outflows and domestic resilience.

- The Global AI Vacuum: Global allocators temporarily tagged India as an "Anti-AI" trade. This led to an FII exodus of ~$18 billion (as of end Nov 2025). At the same time global inflows into EM equities have been around $60-70 billion with Chinese equities making up the bulk at $50 billion (as of end Nov 2025).

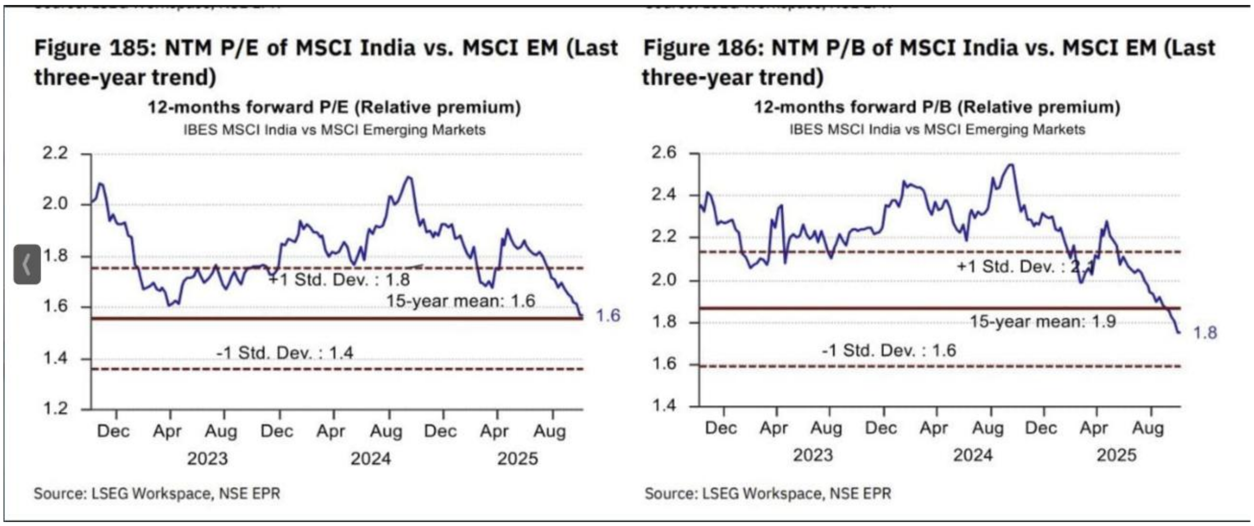
- The Retail Wall in SIP: Domestic investors absorbed this shock. Monthly SIP inflows hit a record ₹29,500 crore+ in Q3, proving that the Indian equity cult is structural, not cyclical.

- The Supply Glut: The market was also weighed down by heavy paper supply. 2025 saw record IPO fundraising of ₹1.6 lakh crore, with over ₹1 lakh crore coming from Promoter/PE exits. This naturally sucked liquidity out of the secondary market. The result was that individual traders pulled out over

₹20k crore from public equities in the December quarter alone. Some of these could be offloading from the investments made in the IPO for quick gains.

- Indian markets have severely underperformed overall EM indices this year. A departure from recent years. Nifty valuations, relative to EMs, are one of the lowest in the last 3yrs and below their 15 yrs.

- India has also seen its weightage going down in the MSCI EM index. Currently it stands at 15% vs 29% for China.



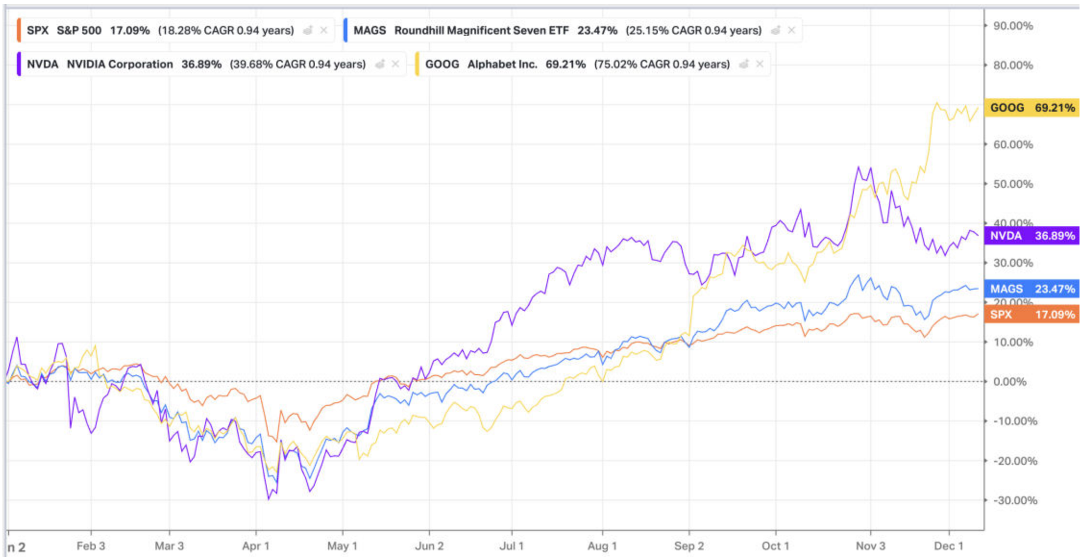
Source: LSEG workspace; NSE EPR

The Global Landscape: A "Narrow" AI Rally

To understand *why* liquidity left India, we must look at where it went. 2025 was dominated by the Global AI Super-Cycle, but the rally was dangerously narrow.

- The Index Illusion: The S&P 500 is up ~17% YTD, but this headline number masks a deeper polarisation. The rally was almost entirely driven by the "Magnificent 7" tech giants. The equal-weighted global indices actually remained muted.
- The "Mag 7" Premium: Capital concentration reached historic extremes. Stocks like Nvidia (up ~30% YTD) and Google (up >69% YTD) sucked oxygen from the rest of the world.
- The Valuation Risk: This exuberance has a price. The "Magnificent 7" cohort is now trading at a weighted forward P/E of ~30-35x, a massive premium over the broader market (S&P 500 ex-Mag 7 is at ~17x).
- Our View: Global AI trades are priced for perfection. Any earnings miss will be punished severely. In contrast, India’s "real economy" banks and manufacturers are trading at far more reasonable

valuations after the 2025 correction. We expect a "Sanity Rotation" in 2026, i.e., capital moving from expensive global tech back to visible earnings growth in India.



Source: Quest Internal Research

The Geopolitical Reality: Sovereignty over Deals

The much-anticipated India-US Trade Deal has been delayed beyond expectations, and it is important to understand why.

- The Stick Point: The deal seems to be stalled not just on tariffs, but on sovereignty. From the news reports it seems that the US' insistence on the F-35 jet came with "black box" restrictions that India, now the world's second-largest arms importer, could not accept.
- Strategic Autonomy: Instead of succumbing to pressure, India doubled down on its own interests. We saw Russian President Putin visit Delhi with offers of Su-57 co-development and cheap oil, driving India-Russia trade to $68.7 billion in FY25.
- The result: While lots of chatter that the US India tariff deal was in horizon, it seems now that the timelines have got extended. The impact of the same seems to be limited for now. Having said that, any US India tariff deal will bring extra upside to Indian markets once that happens.

The Macro View: The "Goldilocks" Pivot

While headlines focus on the Rupee, the real story of 2025 was the dramatic shift in India's monetary landscape. The RBI didn't just watch the data; they acted on it.

A. The Trigger: Inflation Collapsed

- The Reality: CPI has been trending lower and November 2025 CPI printed at a low 0.71%. This wasn't just base effect; we saw genuine deflation in food prices and the tangible impact of the GST rate cuts.
- The Implication: With inflation near zero, the "Real Interest Rate" became restrictively high, risking a growth slowdown and RBI pivoted.

B. Higher GDP growth

- In Q2 FY26, we saw GDP growth coming in higher at 8.2% underpinned by stronger domestic demand. This prompted the RBI, in its December Monetary policy, to raise the GDP forecast by 50bp for 2025-26 to 7.3% and by 30bp for Q1 2026-27 by 30bp to 6.75%.
- But lower nominal growth: A rare anomaly where Real GDP growth (8.2%) nearly converged with Nominal GDP growth (8.7%). A low nominal GDP doesn't bode well for our economy and for corporate results.
- Given the fact that the 10-year average for GDP deflator is around 5%, any ensuing RBI rate cuts and liquidity infusion is likely to accelerate India's nominal GDP growth.

C. The Action: Rate Cuts & Liquidity Recognising that the battle against inflation has been won, the RBI shifted gears from "price stability" to "growth support" in the second half of 2025.

- Breaking the Pause: The RBI has delivered a cumulative rate cut of 125 basis points (1.25%) in 2025, bringing the repo rate down to 5.25%. This signals the start of a structural easing cycle, directly reducing the cost of capital for our portfolio companies.
- The "Invisible" Stimulus: Equally important was the liquidity management. To address tight liquidity and to ensure monetary policy transmission, RBI has infused massive amounts of liquidity throughout the year. This included a CRR cut by 1% announced in June and a massive ₹1.5 lakh crore infusion (via OMOs and FX swaps) in December alone.

D. The Currency as a Shock Absorber

- Yes, the Rupee breached 90/$ in December and there is a lot of noise about it. We view this differently—not as a crisis, but as a necessary calibration.
- The Rupee had appreciated significantly in real terms (REER) during the pandemic. Letting it slide is now "inevitable and desirable" to restore export competitiveness against China.
- The Deficit Reality: While the Current Account Deficit (CAD) is expected to widen to ~1.2% of GDP ($50 billion) in FY26, this is well within manageable limits. The depreciation acts as a natural shock absorber, discouraging non-essential imports without the need for blunt tariff wars.

Source: Quest Internal Research

Overall, Indian macros seem to be decently placed. The bulk of adjustments in the Rupee have happened, rates are lower, and liquidity infusion has been comfortable. This should result in higher nominal GDP growth.

Evolution at Quest: Leadership & Continuity

Just as the market evolves, so do institutions. I want to share an important update regarding our investment leadership.

Our CIO, Aniruddha Sarkar, has decided to move on to pursue his entrepreneurial journey. We are grateful for his contribution over the last 5.5 years in strengthening our institutional framework.

However, at Quest, we have always believed that investment excellence is a result of process and research and not just people. To that end, I am pleased to announce that Rakesh Vyas, who joined us as Co-CIO in January 2024, is taking the helm.

Why this transition is seamless:

- It's not new: Rakesh has already been managing our "Flagship" PMS strategy since April 2024
- Deep Experience: Rakesh brings 20 years of experience, including nearly 15 years at HDFC Mutual Fund, where he successfully managed the HDFC Infrastructure and Housing Opportunities Funds.
- Institutional Memory: He is supported by Bharat Sheth, a Founding Member of Quest since 1994, and five other analysts ensuring our core investment philosophy remains the bedrock of our decisions.

The Road to 2026: From Consolidation to Earnings

As we look toward 2026, the narrative shifts from "Valuation Consolidation" to "Earnings Delivery." With the earnings trajectory projected to grow at 14-16% in FY27, we are positioning the portfolio around four high-conviction themes:

A. Consumer Discretionary: The "Disposable Income" Boost

We are structurally bullish on consumption due to a "triple engine" of support:

- Fiscal Stimulus: Recent GST rationalization and new income tax slabs (exempting up to ₹12 lakh) have put cash back in consumers' hands.

- Monetary Easing: With the RBI cutting rates and infusing liquidity, borrowing costs for homes and autos are set to fall.

B. Financials: The Sweet Spot

While we like large banks, the alpha lies in Small Banks and NBFCs. The credit cycle remains healthy, and falling interest rates will expand their margins. We are positioned in agile lenders with strong underwriting standards. Additionally, capital-market–linked businesses remain structural long-term bets, supported by rising financialisation of savings and increasing investor awareness that continues to drive strong flows.

C. Manufacturing & CRDMO

We are actively evaluating the Contract Research & Manufacturing (CRDMO) space. As global pharma giants diversify beyond China ("China Plus One"), India is moving up the value chain from generics to complex research. This is a multi-year trend. During 2023 & 2024 Government spent was largely focused on Infra spending, despite this Private Capex being not picked up due to slow growth of Consumption. By reducing Income Tax slab, reduction in GST with lower interest rate a revival of Pvt capex is expected from Q4 FY26.

D. Private Capex

Capacity utilisation is rising. Once it crosses the critical threshold, we expect the long-awaited private capex cycle to trigger, benefiting capital goods and industrial enablers. During 2023 & 2024 Government spent was largely focused on Infra spending, despite this Private Capex being not picked up due to slow growth of Consumption. By reducing Income Tax slab, reduction in GST with lower Interest rate it is expected revival of Pvt capex from Q4 FY26.

Final Thoughts

Quest was founded in the late 1980s and has thrived through multiple market cycles. Over the three decades+ our core values of discipline, research, and long-term compounding have remained constant.

The setup for 2026 remains constructive, though as usual risks remain—global tech exuberance unwind, renewed geopolitical tensions or delays in the US–India trade framework, weaker Rupee or volatile commodities challenging earnings stability. Yet, with valuations healthier, policy continuity assured, domestic liquidity intact, and the government's focus on growth, India enters 2026 far better positioned than it began in 2025.

Thank you for your continued trust in us.

Rajkumar Singhal

CEO, Quest Investment Managers