"Volatility tests conviction, but it also creates opportunity for disciplined investors."

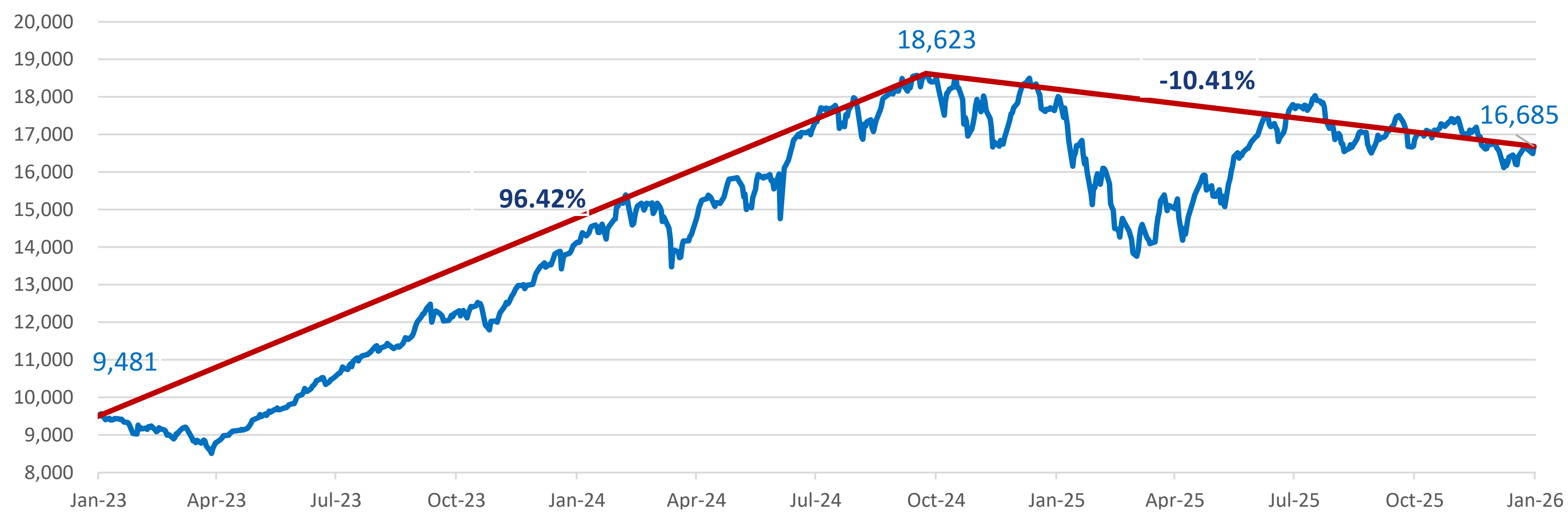
2025: Beneath the Headline Indices

2025 was not a straight-line market. Beneath the appearance of stability in headline indices, a broad-based valuation reset unfolded across the equity landscape.

At the surface, benchmark indices suggested continuity. However, this masked the intensity of challenges investors encountered in the early part of the year. Market stress was less visible in index levels and more apparent in breadth, valuation compression, and sharp drawdowns across a wide universe of stocks.

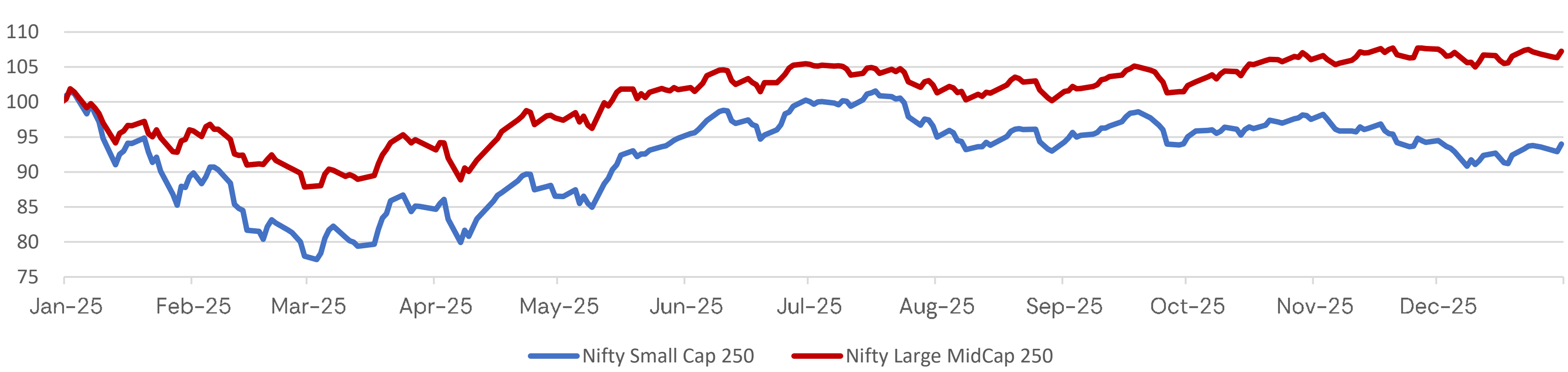
The adjustment was most pronounced in the small-cap segment. Following a prolonged phase of valuation expansion through 2023 and 2024, small caps entered a correction phase in 2025. Over both the trailing three-month and one-year periods, the small-cap index corrected meaningfully, reflecting tighter liquidity conditions, earnings normalisation, and declining tolerance for speculative premiums.

Exhibit 1 – Index Performance – Nifty Smallcap (3 –Year – 31/12/2022 to 31/12/2025)[1]



Nifty Smallcap – 3 Year Performance highlights the arc of the small-cap cycle over the last three years. After a strong post-pandemic rally and a sharp acceleration through 2023–24, the index entered a corrective phase in 2025. This correction was not abrupt, but persistent—signalling fatigue after an extended period of valuation expansion.

Exhibit 2: Nifty Smallcap 250 vs Nifty Largemidcap 250[1]



1 https://www.niftyindices.com/reports/historical-data

Nifty Smallcap 250 vs Nifty Largemidcap 250 sharpens this narrative through relative performance. While large and mid-cap indices showed greater resilience, small caps underperformed meaningfully, particularly over the last three months and on a one-year basis.

The correction in small caps is less about market stress and more about market discipline. It marks a transition from narrative-driven expansion to fundamentals-driven differentiation, setting the stage for healthier participation as earnings catch up with prices.

Market breadth data reinforces this trend. Within the BSE 500 universe, substantial number of stocks are trading well below their peaks, with many down in the 20%–40% or higher range, pointing to a broad market correction. One-year returns are largely negative, indicating weak medium-term performance despite some short-term rebounds.

Key to note that median return of BSE500 during CY25 was -4% compared to Nifty50 return of ~10%. Almost ~47% of the stocks fell more than 20% from the 52W high during CY25 and almost one-fourth of the BSE500 stocks fell more than 30% from peak during this period.

Exhibit 3: Market Breadth – BSE 500 Drawdowns

Fall from 52WH	No. of Stocks
> 40%	39
30% < - > 40%	76
20% < - > 30%	121
Median return of BSE 500 in CY25	-4%

2025 began as a year of recalibration, where valuations set the tone.

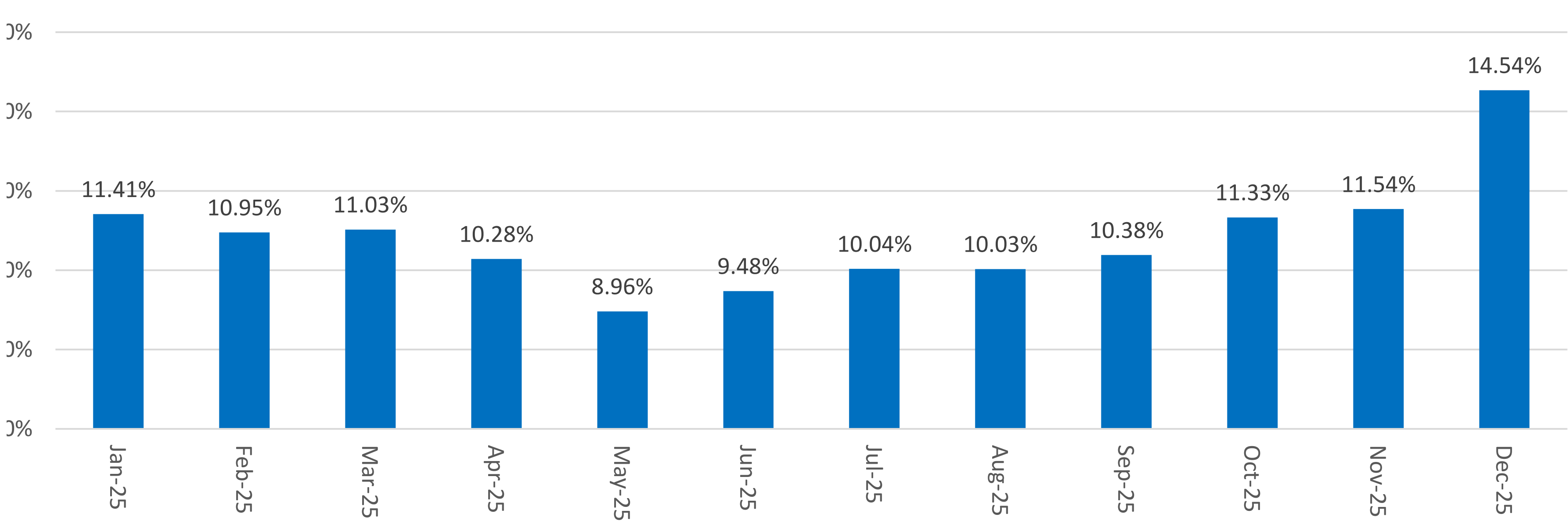
Policy Anchors, Credit Transmission, FDI Flows and Consumption Recovery

As markets adjusted, policy stability emerged as a critical anchor. Government initiatives and RBI measures through 2025 were aimed less at stimulating excess demand and more at preserving macro balance, ensuring adequate liquidity without compromising inflation control or fiscal discipline.

The impact of these measures was gradual but observable. Rather than sharp inflection points, the economy showed incremental improvement across sectors. Policy transmission worked through credit availability, consumption sentiment, and business confidence, laying the foundation for recovery rather than delivering an immediate surge.

Total bank credit stood at ₹203.2 lakh crore as of 31 December 2025 and has seen gradual improvement as credit growth improves from low of ~9% yoy during CY25 to ~14% yoy in last fortnight of Dec-25.

Exhibit 4: YoY Bank Credit Growth[2]



2 https://www.rbi.org.in/

Two segments continue to demonstrate sustained growth; MSME segment, which is around **8% of total credit**, has remained steady, supported by digitalisation, formalisation, and improved risk-adjusted returns and Retail credit, accounting for roughly **40% of loans**, is expected to accelerate further, aided by GST rationalisation, lower interest rates, benign inflation, and income tax relief announced in the Union Budget.

Consumption, Credit & a Clearer Outlook

RBI embarked on an aggressive deregulation path in 2025, mainly by cutting risk weights and removing lending restrictions at multiple levels. This has benefited cyclical recovery in two ways: i) banks are more confident of lending and have shed some of the extreme risk-aversion, and ii) this has helped shore-up capital bases of several banks also through capital infusion by strategic investors, which has given them the space to step up loan growth.

Financial Institution	Strategic Investor	Investment ($mn)
Yes Bank	SMBC	1,800
RBL Bank	Emirates NBD	3,000
Federal Bank	Blackstone	700
Shriram Finance	MUFG	4,300
Sammaan Capital	IHC	1,000

A pre- and post-festive lens provides a useful view of economic momentum in 2025. Sectoral data indicates that growth strengthened in the last quarter of CY25, i.e., from October to December, driven by festive demand, improved cash flows, and healthier inventory cycles.

The GST rationalisation in September 2025 (GST 2.0) played a key role in boosting retail credit demand by improving affordability. This uplift reflects strong alignment between policy reforms and consumer behaviour.

Credit growth seems to have picked up post implementation of GST 2.0 with gradual improvement through October 2025 to December 2025.

Exhibit 5: Monthly credit growth of retail sector

Period	YoY		
Sector	**Consumer Durables**	**Vehicle**	**Gold**
Jan-25	-2.70%	6.58%	75.47%
Feb-25	2.23%	6.47%	86.61%
Mar-25	-1.31%	8.61%	103.52%
Apr-25	-1.26%	6.00%	119.63%
May-25	-3.92%	5.89%	115.26%
Jun-25	-3.10%	8.02%	123.81%
Jul-25	-6.06%	8.91%	121.95%
Aug-25	-6.04%	8.74%	117.83%
Sep-25	-6.25%	7.28%	114.88%
Oct-25	0.02%	9.89%	118.81%
Nov-25	-5.94%	12.38%	125.35%

Festivals continued to act as a demand anchor. Automobiles led big-ticket consumption, supported by tax relief and EMI schemes. Consumer electronics and appliances saw strong traction via e-commerce discounts and financing. Apparel, footwear, and textiles benefited from wedding-related demand, while jewellery remained resilient despite price volatility. FMCG and packaged foods saw volume-led growth, aiding inventory turnover.

Credit growth is translating into real consumption, strengthening the outlook for sustained demand.

Manufacturing, Exports and the CAPEX Question

Manufacturing is expected to see continued growth over next few years. While the sector has expanded over the past decade, the current phase marks a shift toward deeper global integration, supported by policy incentives, rising FDI, and improving export competitiveness.

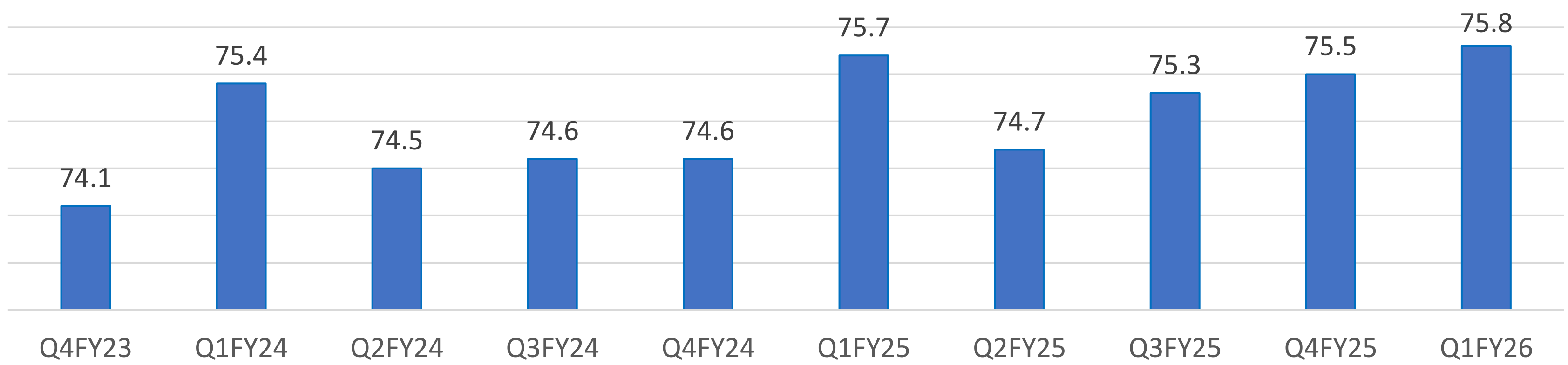
The sector contributes **16–17% of GDP** and employs over **27 million workers**, with electronics, chemicals, defence, automotive, engineering, and textiles driving momentum. Technology adoption - automation, digitalisation, and process-led manufacturing, is reshaping competitiveness.

Export competitiveness improved as rupee depreciation aided pricing advantages and India integrated deeper into global value chains. Domestic value addition in electronics rose from 30% to 70%, with a target of 90% by FY27. Smartphone exports increased to 22.9 million units in H1 2025, from 15 million a year earlier. India is also positioning itself as a key supplier in wind-energy components, with potential to meet 10% of global demand by 2030.

Policy support remains strong. The National Manufacturing Mission announced in Budget 2025–26 focuses on ease of doing business, MSME growth, technology access, workforce readiness, and quality manufacturing, with a parallel push toward clean-tech ecosystem.

FDI inflows into manufacturing have risen 69% over the past decade to ₹14.3 lakh crore, while PLI-linked investments have crossed ₹1.76 lakh crore.

Exhibit 6: RBI Quarterly Seasonally Adjusted Capacity Utilization

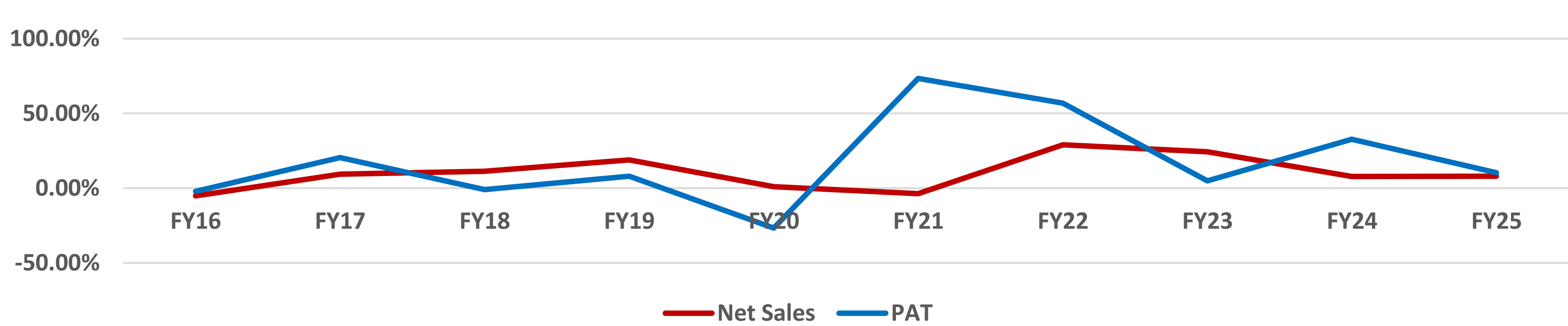


Source: Reserve Bank of India Order Books, Inventories and Capacity Utilisation Survey

Capacity utilisation has improved incrementally across sectors. While a broad-based private CAPEX cycle has yet to emerge, early signs of selective investment, capacity expansion, technology upgrades, and backward integration, are visible.

Manufacturing is structurally better positioned than in past cycles. With strong policy backing, rising exports, improving utilisation, and sustained investment flows, it represents one of India's most powerful long-term growth levers, though the pace of private CAPEX remains the key variable to watch.

Exhibit 7: BSE 500: Trends in Revenue Growth and Profitability Across Business Cycles



Exceptionally strong PAT growth during FY21-24 was driven more by pricing power/improved realisations, cost optimisations and deleveraging of balance sheets. However, as is evident from FY25 onwards earnings trajectory, the growth will likely be driven more by volume growth and consequently requiring the private capex to pick up to meet the increasing demand.

Current portfolio construct and performance

As highlighted earlier, CY25 has been a challenging year, marked by muted earnings momentum and subdued broader market returns. The October–December 2025 period was particularly difficult for small-cap stocks, driven by earnings disappointments following GST rate rationalisation–led demand deferment, heightened geopolitical uncertainties, valuation derating, and persistent FII outflows.

Our portfolio performance was impacted primarily due to our relatively higher allocation to small- and mid-cap stocks, which together account for nearly two-thirds of the portfolio.

Month Ended	Large Cap	Mid Cap	Small Cap	Cash
31st Dec 2025	31.18%	29.64%	33.13%	6.05%

Exhibit 8: Portfolio in FY terms

Financial Year Returns as on 31-12-2025						
	FYTD 26	FY 25	FY 24	FY 23	FY 22	FY 21
Quest Multi	14.29	5.57	52.96	-7.08	26.32	87.40
BSE 500 TR INR	12.57	5.96	40.16	-0.91	22.26	78.63

Exhibit 9: Portfolio performance

Trailing Returns as on 31-12-2025								
	1 Month	3 Month	6 Month	1 Year	2 Years	3 Years	5 Years	Since Inception
Quest Multi	-2.69	0.22	-3.46	-4.80	16.44	19.76	18.52	15.84
BSE 500 TR INR	-0.24	5.02	1.63	7.63	11.64	16.4	16.82	13.96

Over the past three months, stock-specific corrections in select small-cap holdings such as SH Kelkar, Eternal, Techno Electric, ITC Hotels and Oracle Financial Services have been key contributors to underperformance. We will discuss the investment rationale and forward outlook for these names in the subsequent section (Annexure) to address concerns arising from the sharp price corrections.

Our sector-focused, rotation-driven investment philosophy continues to form the bedrock of portfolio construction. This is reflected in our constructive stance on consumer discretionary, lending businesses (banks and NBFCs), capital-market plays, power transmission & distribution (T&D), and the broader manufacturing theme.

In CY25, the front-loading of interest-rate cuts compressed lending margins, while elevated stress in unsecured lending meaningfully impacted earnings growth across the sector. However, we believe the medium-term outlook remains compelling, supported by strong credit growth driven by a consumption recovery, improving margins from moderating funding costs, and normalisation of credit costs. Accordingly, we remain positive on the space.

From a positioning perspective, we exited ICICI Bank—an institution with a strong franchise but fairly valued in our view—and redeployed capital into City Union Bank, which offers strong growth in the core MSME segment with an improving margin profile, and Tata Capital, where robust growth and moderating credit costs provide earnings visibility. We also increased our allocation to capital-market plays by adding ICICI Prudential AMC.

Exhibit 10: Last 3 months changes

Entry	Exited	Reduce exposure	Increase exposure
City Union Bank	ICICI Bank	Eternal	Cohance
Tata Capital	ABB	Trent	
Swiggy		Hitachi Energy	
ICICI Pru AMC			
LG Electronics			

We remain constructively inclined towards the consumer discretionary space, particularly following significant policy interventions by the Government of India and the RBI during CY25, which are expected to enhance disposable incomes. That said, demand softness through most of CY25 weighed on earnings and valuations across the sector. Our exposure through retail, hospitality, and real-estate-linked businesses has consequently underperformed. While festive demand and December 2025 data indicate some recovery in mid- to large-ticket discretionary spending, a broad-based rebound in small-ticket consumption remains elusive.

Our investment in a leading big-box value retailer catering to middle- and lower-middle-income households, supported by its "opening price point" strategy, has delivered in-line operational performance in terms of same-store sales growth and store expansion. Nevertheless, the stock corrected by approximately 20% from its peak during CY25, which adversely impacted portfolio returns.

The slowdown in government capex and the continued absence of a meaningful private-sector capex cycle prompted us to reduce exposure to this theme. We exited ABB and partially pared our position in Hitachi Energy. Despite these actions, we remain structurally positive on the power T&D capex opportunity.

Our conviction in a sustained consumption-led growth cycle underpins our belief that improving capacity utilisation across industries will eventually translate into a revival in private capex, most likely towards the latter part of CY26.

Exhibit 11: Sector-wise exposure

BFSI and Capital markets	28.57%	**IT and ITES**	4.18%
Consumer discretionary	17.04%	**Chemicals**	3.98%
Auto and Auto Ancs	11.26%	**Energy and Utilities**	3.77%
Industrials	6.77%	**Metals and Materials**	2.83%
Cash	6.05%	**Lifestyle and consumption**	2.68%
Pharma and Healthcare	5.6%	**Hospitality**	2.68%
Telecom	4.60%		

Market Outlook and Portfolio Strategy Ahead

We expect CY26 to mark a revival in growth, driven by (1) a recovery in corporate earnings and (2) an improvement in domestic consumption, supported by GST and income-tax rate cuts alongside lower interest rates. A potential conclusion of the India–US trade deal could further strengthen the macro environment, especially following the recent INR depreciation caused by a sharp deterioration in India's trade balance despite otherwise resilient fundamentals. This should also aid the improving outlook for export-oriented sectors.

After two fiscal years (FY25 and FY26E) of single-digit corporate earnings growth, FY27 is likely to witness a normalisation to the 12–14% range. This recovery is expected to be led by BFSI, which is coming off a low base, as net interest margins normalise following the upfront impact of RBI rate cuts. Discretionary consumption should also be a key contributor, with the full-year benefit of post-GST volume recovery and operating leverage driving stronger growth. In addition, the investment cycle is likely to gain traction, led by central government spending, with corporate capex providing incremental support as capacity utilisation continues to improve.

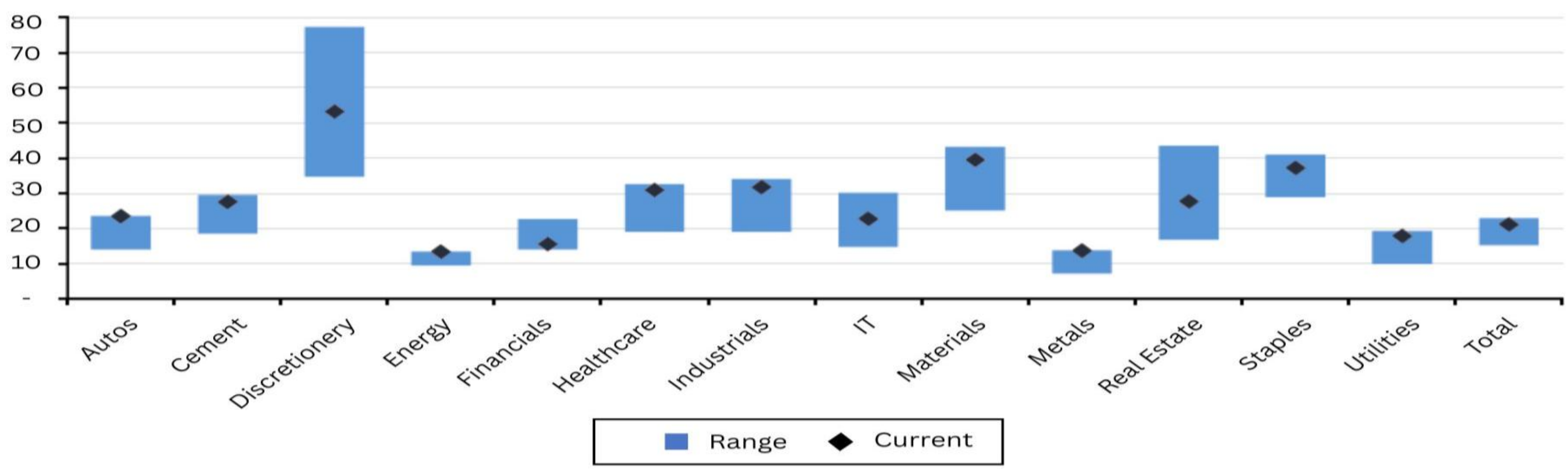
We expect sectors such as Technology and Staples to act as a drag on aggregate earnings growth; accordingly, the portfolio remains underweight in these segments. Unlike the past two fiscal years—when consensus expectations of double-digit earnings growth were followed by meaningful downgrades—the recent trend suggests that the downgrade cycle is now moderating, with revisions beginning to stabilise.

FPIs sold equities worth USD 18.9 billion in CY25 and have largely stayed underweight India over the past three years, primarily due to subdued earnings growth, elevated valuations, and India's limited participation in the AI-led global rally. However, with Nifty FY27 valuations at ~20x P/E—only marginally above the long-term average—we believe valuations are reasonably supportive. Coupled with an expected normalisation in earnings growth, India could re-emerge as an attractive destination for FII allocations over the next 4–6 quarters.

Despite a muted year for markets, most sectors continue to trade higher than average valuations, largely because forward earnings have failed to grow at the pace anticipated a year ago. Meaningful valuation moderation has been observed primarily in IT, Communication, Discretionary, and Industrials, while Staples and Healthcare have seen only a mild cooling from the record-high levels.

Our portfolio construct biased around discretionary, financials are better placed as the asking valuations are broadly inexpensive despite expected meaningful improvement in earnings trajectory.

Exhibit 12: Sector-wise historical P/E Range (taken end of year since 2016)



Constructed bottom up from 229 companies - 200 from NSE200 and few others. Forward PE at the end of each year is taken for last 10 years - eg P/E based on March 2024 earnings is taken as on December 2022. Based on all collated P/E values this range is taken. Source: Bloomberg, Bernstein Analysis

We believe small- and mid-caps are well positioned to outperform over the next 4–6 quarters, supported by higher earnings growth and a lower valuation premium relative to large caps. Smaller companies are delivering superior growth across multiple sectors, including staples, financials, and technology, offering greater scope for alpha generation. The portfolio is well positioned to benefit from this trend.

Annexure

Investment Rationale on some portfolio companies which have seen some sharp corrections in recent month

1. **S H Kelkar & Co. Ltd.** – A softer demand environment in India and Europe has constrained growth in recent quarters. However, growth momentum is expected to improve in the second half of the year, supported by new capacity additions, GST rate cuts, improving market sentiment, and better traction in global MNC accounts. Management remains confident of delivering a 12–15% CAGR over the medium term. Margins were adversely affected by high-cost inventory, incremental expenses related to new creative centres, and certain one-time costs. Normalization of these factors, along with the benefit of lower-cost inventory and operating leverage, is expected to drive margin expansion and earnings recovery going forward.

2. **Eternal Ltd.** – Eternal's food delivery business (Zomato) in 2QFY26 delivered a YoY NOV growth of 14% reflecting persistent macro and demand headwinds. Its move to lower minimum order value through Gold membership program to capture budget users and drive sustainable growth is yet to be demonstrated. Meanwhile, the quick commerce (BlinkIt) business has shown a robust YoY NOV growth of 137% during Q2FY26. The path to EBITDA breakeven has been pushed to FY27E (not specifically guided by the company) as it currently focuses on increasing store count from 1,816 to 2,100 by March-26 and 3,000 stores by March-27. The competitive intensity continues to remain high from multiple players through lowering down of AOV thresholds and negligible delivery fee. That said, we view this moderation as transitory in nature. We believe Blinkit continues to demonstrate superior growth quality, supported by a large, engaged transacting user base and stable ordering behaviour. Importantly, there has been no material dilution in average order values or ordering frequency, underscoring the resilience of demand. Blinkit's Adj. EBITDA loss remains meaningfully lower than peers, reinforcing its structural advantage in unit economics.

3. **Techno Electric & Engineering Co Ltd.** – The company continued to report strong growth, driven by healthy operational momentum across both EPC and smart metering segments. While margins moderated in Q2FY26, they are expected to remain within the guided range for FY26. The order book remains robust at over ₹10,000 crore. Delays in customer onboarding at the Chennai Data Centre pose a near-term concern; however, strong demand tailwinds and proven execution capabilities are expected to result in meaningful contribution from this segment starting FY27. A strong base business, combined with the emerging Data Centre opportunity, is likely to drive robust earnings growth over the medium term.

4. **ITC Hotels Ltd.** – ITC Hotels delivered healthy growth in H1FY26, accompanied by modest margin improvement, driven by strong growth in ARR and occupancy levels. Growth could have been stronger in the absence of geopolitical disruptions and an unusually heavy monsoon. H2FY26 is expected to witness stronger sequential and YoY performance. The structural uptrend in the hospitality sector remains intact, supported by robust demand and limited supply additions in the branded segment. Improved occupancy at newer properties and continued improvement in ARR are expected to drive growth, aided by new signings in the managed properties segment. Additionally, stabilization of the recently opened Sri Lanka hotel will meaningfully add to revenues and EBITDA in the coming quarters. Proceeds from the sale of adjoining Sapphire Luxury Residences are also expected to further enhance cash flows and earnings.

5. **Oracle Financial Services Software Ltd.** – OFSS reported a subdued topline and the seasonal impact of wage hike had a downward pressure on the margin during Q2FY26. The wins included 6 for its core banking platform and 8 for its digital and payments modules, underscoring continued demand for its product suite. 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.

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