March 31, 2026

Geopolitical Volatility - A Structural Opportunity in Indian Equities

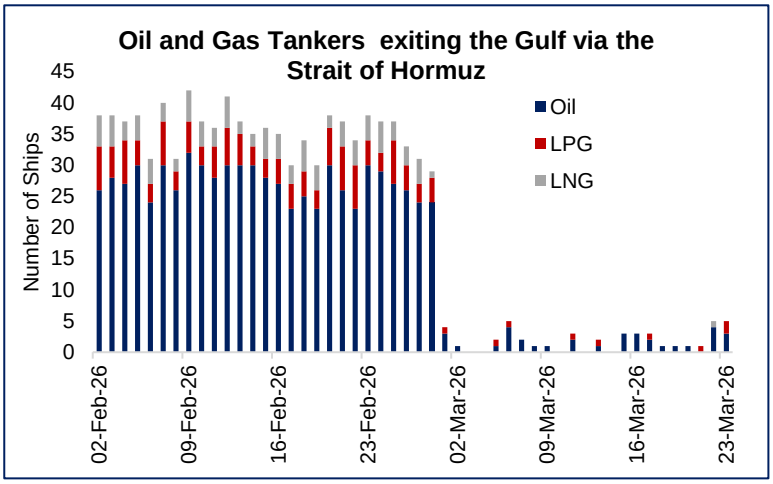
What's the Point?

- Geopolitical conditions remain fluid, with backchannel diplomacy underway; however, ongoing disruptions in the Strait of Hormuz continue to influence oil prices, pose inflation risks and impact market sentiments.
- Risk-off sentiment has weighed on emerging markets, including India, but valuation compression alongside resilient domestic inflows bodes well for the relative attractiveness of Indian equities.
- Moderating valuation indicators, such as the yield gap (10-year G-Sec vs. NIFTY earnings yield) and forward P/E, may provide opportunity to add to investments in a staggered manner with a long-term horizon.

Recently, geopolitical tensions between the US–Israel alliance and Iran have shifted from acute escalation to a more contained, yet uncertain phase. While hostilities persist, there are early, albeit inconclusive, signals of de-escalation through backchannel diplomacy. For now, markets continue to focus on the Strait of Hormuz, a critical conduit for global energy flows, where ongoing disruptions have influenced energy prices and broader risk sentiment. This has weighed on equity markets globally, including India.

Narrow Strait, Wide ranging implications

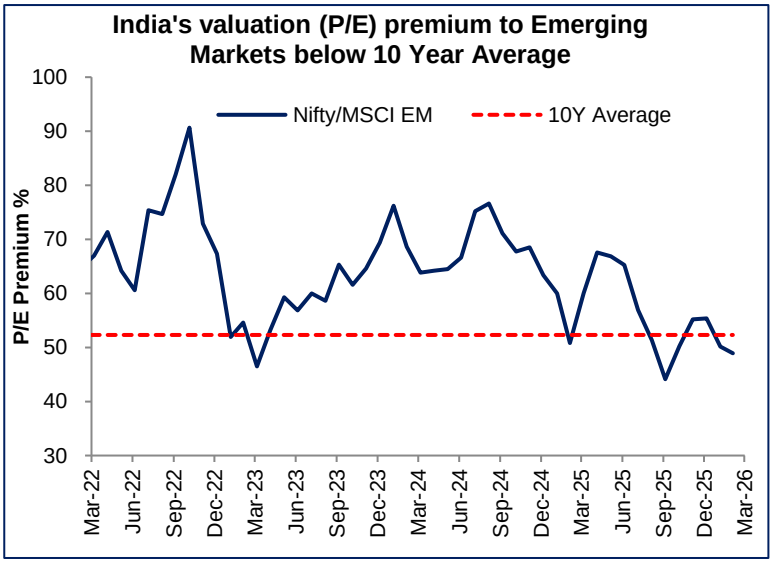
The Strait of Hormuz remains central to global markets, given its role in facilitating **~20% of global oil flows.** While flows have partially resumed, they remain well below normal levels, with selective access and elevated congestion indicating that risks are still present. Importantly, **Hormuz is not just about oil volumes, it influences freight costs, insurance premiums and overall confidence in global trade flows**, making it a key driver of the oil risk premium embedded in markets. Fertilizers, petrochemicals and industrial inputs too face delays, feeding into broader inflation risks.



Global Equities: Risk-Off Dynamics in Play

The geopolitical shock has triggered a classic risk-off environment across global markets. Developed markets, particularly the US, have shown relative resilience, while Emerging markets (EMs) have borne the brunt of outflows, reflecting higher sensitivity to global risk sentiment.

The correction in Indian equities has broadly mirrored emerging markets in the recent risk-off phase. Notably, India had already underperformed peer EMs through 2025 due to trade concerns and elevated valuations. The recent decline has further compressed India's valuation premium to EMs, bringing it below historical averages and improving its relative attractiveness.



Mission: To be the wealth creator for every Indian
Vision: To be the most respected asset manager in the world

Indian Equities: Narrowing gap between 10Y Gsec Yield and Earnings Yield

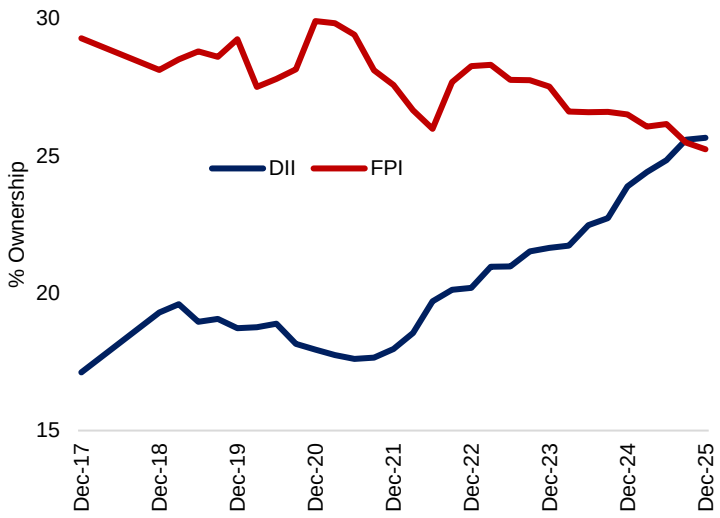
In spite of recent spike in bond yields, the gap between 10-year G-Sec yield and NIFTY 50 Index Earnings Yield (Trailing 12M) has narrowed (225bps as of 25-Mar-2026), reflecting a moderation in equity valuations. **Historical data suggests that when this spread approaches lower bands, forward equity returns tend to improve,** as the relative attractiveness of equities versus fixed income improves. **1 Year Forward P/E of NIFTY 50 too has moderated sharply from 20.7 as of 31-Dec-25 to 17.3 as of 27-Mar-26 (vs 10 Year Average of 18.7)**

Equally noteworthy is the resilience of domestic flows amid ongoing volatility, a trend evident over the past few years. **While CYTD 2026 has seen FPI outflows of ~$11 bn, DIIs have remained strong net buyers at ~$24 bn**, providing a meaningful counterbalance. Notably, **DIIs now hold a higher share in the NIFTY 50 Index than FPIs**, marking a structural shift in ownership. This growing domestic participation reduces reliance on foreign capital, enhances market resilience and strengthens the case for renewed foreign inflows once geopolitical headwinds subside.

Moderation of Yield Gap^ (10Y Gsec yield vs NIFTY 50 earnings yield) bodes well for equities

Yield Gap in bps (10Y Gsec Yield - NIFTY 50 TTM Earnings yield)	% of Instances (Apr'00 to Mar'26)	Average Subsequent 12M returns %
Below -100 bps	14%	48.3%
-100 to -50 bps	1%	34.7%
-50 to 0 bps	1%	32.0%
0 to 50 bps	2%	9.8%
50 to 100 bps	3%	19.1%
100 to 150 bps	5%	24.5%
150 to 200 bps	12%	24.8%
200 to 250 bps	**21%**	**12.3%**
250 to 300 bps	28%	7.8%
300 to 350 bps	11%	-5.4%
350 to 400 bps	2%	-0.5%
400 to 450 bps	0%	-6.3%

DIIs own more of NIFTY 50 than FPIs now, indicating a structural shift in ownership of Indian Equities



Conclusion: The current geopolitical environment remains fluid, but a prolonged conflict would carry adverse economic consequences for all parties, increasing the incentive for an eventual resolution. Historically, externally driven market corrections, in the absence of domestic macro weaknesses, have created investment opportunities. With valuations supportive and India relatively attractive versus other EMs, such corrections could offer investors a timely opportunity to add to their investments with a long-term horizon.

Sources: Bloomberg, ^ Avendus Spark, CMIE and other publicly available information.

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