
EBONY WEALTH

MONTHLY MARKET UPDATE MAY 2026

Markets in Focus

“Interest rates are to asset prices what gravity is to the apple. When there are low interest rates, there is very low gravitational pull on asset prices. For higher rates, the opposite is true.”

— Warren Buffett

The views in this document are inherently **provisional**, poised for rapid evolution amid fluid oil and market dynamics, the ultimate pivot for global assets. Lower oil prices could **unleash a brisk rally** in equities and bonds, trigger a USD sell-off, and deliver tailwinds to worldwide equities (including EM) and bonds; conversely, upward oil pressure would reverse those dynamics, fostering equity/bond headwinds and dollar strength.

OIL

Oil remains the single most important geopolitical variable for equity market positioning in H2 2026. The Iran conflict and the associated disruption risk around the Strait of Hormuz have materially altered the global macro backdrop. The IEA has characterised the disruption as one of the largest supply shocks in the history of the global oil market, with an estimated 10-13mn barrels per day of Gulf production affected. With WTI trading above USD105 and Brent above USD109 as of mid-May, elevated oil prices have become the primary driver of supply-side inflation globally, constraining the Federal Reserve’s ability to ease policy while simultaneously weighing on consumer demand and corporate margins. **As a result, the trajectory of oil prices is likely to play a decisive role in determining whether equity valuations expand or compress during the second half of the year.**

Table 1: Likely impact of Oil on different asset classes

Variable	SCENARIO 1 Full Diplomatic Resolution Probability: Low-to-Moderate Oil: Brent → \$80–85	SCENARIO 2 - BASE CASE Fragile Ceasefire Probability: Moderate-to-High Oil: Brent \$90–110	SCENARIO 3 - TAIL RISK Full Strait Disruption Probability: Low Probability, High Impact Oil: Brent > \$150
INFLATION	Moderates gradually; supply shock unwinds	Stays sticky; above central bank comfort levels	Surges - severe stagflationary episode globally
GROWTH	Stabilises; earnings expectations improve	Slows modestly; margins compress on input costs	Deteriorates materially; recession risk rises sharply
EQUITIES	Broadly constructive — no major PE re-rating given elevated valuations & bond yields	Range-bound; limited scope for multiple expansion	Significantly negative; broad-based correction
BONDS	Yields drift lower; Fed easing expectations re-emerge	Elevated & volatile; duration unattractive; accrual preferred	Long-end yields spike; curve volatility; easing only later
KEY RISK	Structural supply tightness limits return to pre-conflict levels	No durable settlement; geopolitical premium stays embedded	Biggest challenge to soft-landing consensus; no easy policy response

Source: StatLane

U.S. Equities

For equities, H2 2026 increasingly marks the beginning of a new market era, one where indiscriminate **liquidity-driven multiple expansion is no longer the dominant driver of returns**. In an environment characterised by structurally higher interest rates, elevated geopolitical uncertainty, and greater dispersion in earnings quality, equity investing is likely to become far more selective and fundamental driven. The investment approach must therefore shift from broad market participation toward a more deliberate focus on earnings durability, balance sheet strength, cash flow visibility, and reasonable valuations.

Table 2: Long-run index performance

The constructive view on US largecap quality is anchored in a long run return record that is exceptional by any historical standard. The table below sets out annualised total returns for the major US equity indices and key global comparators across six time horizons, as of early May 2026 (pre the 15 May pullback).

Index	1 yr	3 yr p.a.	5 yr p.a.	10 yr p.a.	15 yr p.a.	20 yr p.a.
S&P 500	+30.6%	+21.7%	+13.2%	+15.2%	~+13.5%	~+11.8%
Nasdaq Composite	+42.7%	+27.9%	+13.2%	+18.7%	~+16.0%	~+13.0%
Dow Jones Industrial Avg	+23.5%	+15.3%	+9.9%	+13.1%	~+11.5%	~+10.5%
Russell 2000 (US small cap)	+44.2%	+18.3%	+5.8%	+11.0%	~+9.0%	~+8.5%
MSCI EAFE (Dev. ex-US)	+26.0%	+15.4%	+8.9%	+8.9%	~+6.5%	~+5.0%
MSCI Emerging Markets	+45.6%	+20.3%	+6.3%	+9.2%	~+7.5%	~+7.0%

Annualised total returns (%) by index and time horizon, as of early May 2026. US indices shown in dark; international comparators in grey. 15yr and 20yr figures marked ~ are approximate. Source: Bloomberg, Wespath, TradeSwing, FinanceCharts.

Three conclusions stand out from this data and are directly relevant to H2 2026 positioning.

First, the primacy of US largecap equities across every time horizon is unambiguous. The S&P 500's 20-year annualised total return of approximately 11.8% is well above its very long-run historical mean of around 10%, and its 10year return of 15.2% is exceptional in absolute terms. The Nasdaq's 10year annualised return of 18.7% - driven by the disproportionate contribution of megacap technology to index level performance - illustrates the structural earnings advantage that the US market has accumulated over the AI cycle. No other major equity market comes close to matching this record across all time horizons simultaneously.

Second, the magnitude of US outperformance over international developed markets is both striking and persistent, and it compounds in a way that is easy to underestimate. MSCI EAFE has returned approximately 5% p.a. over 20 years versus the S&P 500's 11.8% - a gap of nearly 7% annually. Compounded over two decades, this gap is transformative in wealth terms: USD100 invested in EAFE 20 years ago would be worth roughly USD265 today; the same USD100 in the S&P 500 would be worth approximately USD900. European and Japanese markets have periodically outperformed over shorter windows - as in early 2026 but these episodes reflect valuation mean reversion rather than a structural shift in earnings power. The underlying drivers of US dominance, primarily technology sector profitability, corporate earnings dynamism, and depth of capital markets, remain intact. MSCI Emerging Markets present a more complex picture: the 1-year return of 45.6% and 3-year return of 20.3% p.a. are strong, benefiting from the AI supply chain rally and selective China trade re-engagement, but over 5 and 10 years the compounded returns of 6.3% and 9.2% respectively fall well short of US largecap performance, reflecting structural fragility, geopolitical risk, and more volatile earnings cycles.

Third, the Russell 2000's data exposes structural disadvantage of smaller, more leveraged businesses in a higher-rate environment, where refinancing costs bite harder and access to cheap capital - which sustained many small-cap business models in the zero-rate era is no longer available.

AI Capital Expenditure: Structural Earnings Driver, but Execution Risk Is Rising

The scale of AI infrastructure investment being undertaken by the hyperscalers remains one of the most important earnings and market developments in US equities since early 2025. Microsoft, Alphabet, Amazon, and Meta have collectively guided to capital expenditure of more than USD300 billion this year alone, with the majority directed toward AI infrastructure, data centres, networking, and compute capacity.

Importantly, these investments are increasingly being supported by visible commercial demand rather than purely speculative deployment. Microsoft has continued highlighting strong AI adoption across Azure and Copilot offerings, while Alphabet and Amazon have both reported sustained acceleration in cloud demand driven by AI workloads. Meta has similarly positioned AI infrastructure spending as central to both monetisation and long-term platform competitiveness.

The broader implication is that the current capex cycle is strategic rather than discretionary. The key beneficiaries continue to be semiconductor companies, data centre operators, power and cooling infrastructure providers, and select software platforms embedded within enterprise AI deployment.

However, the scale of investment is also beginning to pressure free cash flow generation across the hyperscaler ecosystem. Rising depreciation costs, elevated infrastructure spending, and higher financing requirements are likely to Chaweight on margins and cash flows over the next 12–24 months. Markets have so far remained focused on revenue growth and AI adoption, but investor attention is gradually shifting toward the pace and sustainability of AI monetisation.

The core investment debate is therefore becoming increasingly clear: whether AI-driven revenue growth can scale quickly enough to justify the unprecedented level of capital deployment currently underway. While the long-term structural opportunity remains compelling, the risk is that infrastructure investment temporarily runs ahead of realised demand. This reinforces the importance of distinguishing between companies with durable earnings power and those benefitting primarily from speculative AI related re-rating.

Chart 1: AI-Related Exports from Taiwan and Korea to the World, USD Bn, 3-month Annualized



Sources: Taiwan Ministry of Finance, Korea Ministry of Trade, Industry and Resources, Haver Analytics. AI-related exports include household electronics, semiconductors, automatic data processing machines, telecommunications equipment, electrical machinery and parts. Data as of May 19, 2026.

Valuation: Markets Are Priced for Strong Execution

The S&P500 is entering H2 2026 trading at historically elevated valuation levels, with a trailing P/E ratio of approximately 27x. The current valuation is placed within the top decile of historical observations and above 90% of readings since 1950. Forward valuations also remain demanding, with the S&P500 trading at nearly 21-22x forward earnings broadly in line with the peak multiples reached during 2021 and approaching, though still below, the extremes witnessed during the 2000 technology bubble.

At the same time, market concentration has reached historically elevated levels. A small group of large technology companies accounted for more than half of S&P 500 returns during 2025, while the equal-weight index has significantly underperformed the cap-weighted benchmark over the past three years. In effect, index-level performance has become increasingly dependent on the ability of a handful of AI-linked companies to deliver sustained revenue growth and profitability expansion. To some extent, these premium valuations can be justified by the quality of earnings, the structurally higher profitability of technology heavy indices, and the transformative potential of AI led productivity gains.

However, our view is that markets are already pricing in a substantial portion of the AI-driven earnings growth that is still yet to be fully delivered. In an environment characterised by structurally higher interest rates and elevated bond yields, equity markets may become increasingly intolerant of even modest earnings disappointments. Unlike the ultra-low-rate regime of the previous decade, where liquidity often absorbed weaker execution, the current environment is more likely to punish disappointment through multiple compression.

Additionally, passive exposure to broad US equity indices no longer provides the same degree of diversification that investors historically assumed, given the rising concentration within index returns and market capitalisation. As a result, the case today is less about broad-based index exposure and more about maintaining selective exposure to high quality structural growth businesses at reasonable valuations, while avoiding speculative re-rating trades where expectations already appear fully priced in.

Table 3: World Stock Market Returns

2017	2018	2019	2020	2021	2022	2023	2024	2025	YTD	May'26
MSCI Asia ex-Japan 42.1%	US S&P 500 -4.4%	US S&P 500 31.5%	MSCI Asia ex-Japan 25.4%	US S&P 500 28.7%	UK FTSE All-Share 0.3%	Japan TOPIX 28.3%	US S&P 500 25.0%	MSCI EM 34.4%	MSCI Asia ex-Japan 27.9%	MSCI Asia ex-Japan 11.3%
MSCI EM 37.8%	UK FTSE All-Share -9.5%	MSCI Europe ex-UK 27.5%	MSCI EM 18.7%	MSCI Europe ex-UK 24.4%	Japan TOPIX -2.5%	US S&P 500 26.3%	Japan TOPIX 20.5%	MSCI Asia ex-Japan 33.0%	MSCI EM 25.7%	MSCI EM 9.7%
Japan TOPIX 22.2%	MSCI Europe ex-UK -10.6%	UK FTSE All-Share 19.2%	US S&P 500 18.4%	UK FTSE All-Share 18.3%	MSCI Europe ex-UK -12.2%	MSCI Europe ex-UK 17.3%	MSCI Asia ex-Japan 12.5%	Japan TOPIX 25.5%	Japan TOPIX 17.3%	Japan TOPIX 6.2%
US S&P 500 21.8%	MSCI Asia ex-Japan -14.1%	MSCI EM 18.9%	Japan TOPIX 7.4%	Japan TOPIX 12.7%	US S&P 500 -18.1%	MSCI EM 10.3%	UK FTSE All-Share 9.5%	UK FTSE All-Share 24.0%	US S&P 500 11.3%	US S&P 500 5.3%
MSCI Europe ex-UK 14.5%	MSCI EM -14.2%	MSCI Asia ex-Japan 18.5%	MSCI Europe ex-UK 2.1%	MSCI EM -2.2%	MSCI Asia ex-Japan -19.4%	UK FTSE All-Share 7.9%	MSCI Europe ex-UK 8.1%	MSCI Europe ex-UK 20.1%	MSCI Europe ex-UK 7.5%	MSCI Europe ex-UK 4.1%
UK FTSE All-Share 13.1%	Japan TOPIX -16.0%	Japan TOPIX 18.1%	UK FTSE All-Share -9.8%	MSCI Asia ex-Japan -4.5%	MSCI EM -19.7%	MSCI Asia ex-Japan 6.3%	MSCI EM 8.1%	US S&P 500 17.9%	UK FTSE All-Share 6.5%	UK FTSE All-Share 1.2%

Source: FTSE, LSEG Datastream, MSCI, S&P Global, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency, except for MSCI Asia ex-Japan and MSCI EM, which are in US dollars. Past performance

U.S. Bonds

For fixed income, the current environment offers one of the most attractive entry opportunities in over a decade. That is a statement worth substantiating carefully, because it runs counter to the instincts of a generation of investors trained in a world where bonds paid almost nothing and served primarily as a portfolio diversifier of last resort.

The income case

The rate-hiking cycle, whatever its economic costs, has produced a structural shift in the attractiveness of fixed income as an asset class. Intermediate-duration, investment-grade instruments - the five-to-ten-year segment of the high-quality credit curve - now offer yields in the range of 4.5% to 5.5% in USD terms, levels that provide genuine risk-adjusted competition to equities for the first time since the pre 2008 era. This is not a marginal improvement; it is a qualitative change in what fixed income can contribute to a portfolio. "Income generation" is once again the primary driver of fixed income returns, as it was for most of the twentieth century before the experiment with zero interest rate policy distorted the calculus.

The significance of this shift cannot be overstated for long-term investors. When bond yields were near zero, the expected return from a high-quality bond portfolio over a five-year horizon was negligible. At current yield levels, the expected return from the same portfolio - assuming no major shift in the rate environment - is meaningful and largely predictable. Predictability of return is itself a valuable portfolio characteristic in an environment of elevated macro uncertainty. The global bond selloff of 15 May, which pushed US 10year yields above 4.5% (their highest level in a year) and 2year yields back above 4%, reinforces rather than undermines this case. Japan's 30year yield hit 4% for the first time; UK long-bond yields reached a 28year high. At these levels, the income argument for high-quality bonds is more compelling than at any point before the rate cycle began, and the entry point for intermediate investment-grade credit has improved further still.

The portfolio construction case

Beyond income, the portfolio construction argument for fixed income has been strengthened by the normalisation of the equity-bond correlation. The defining anomaly of 2022 was that equities and bonds fell simultaneously, stripping diversified portfolios of their hedge. That episode reflected the specific combination of supply-shock inflation and an aggressive tightening cycle - conditions that forced both asset classes to re-price together. As monetary policy transitions from tightening to holding and eventually easing, the traditional negative correlation between equities and high-quality bonds is reasserting itself.

This matters because it restores the fundamental logic of multi-asset portfolio construction. The asymmetry here is favourable: if the soft-landing holds, bond investors earn the income; if growth falters, they earn the income plus price appreciation. That optionality is not available elsewhere in the portfolio at comparable risk.

Quality preference within credit

The preference within credit markets is to remain firmly higher in the quality stack. Investment grade spreads continue to offer adequate compensation relative to the underlying default risk. High-yield credit warrants more caution. Spreads have compressed materially from their 2023 wides as risk appetite recovered, and in our assesment they no longer adequately compensate for the default risk that is building as the vintage of cheap debt issued during 2020 and 2021 approaches maturity and must be refinanced at substantially higher rates.

Indian Economy

GDP

India's economy demonstrated remarkable resilience in FY2025-26, estimated to have grown at 7.6% maintaining its position among the fastest-growing major economies globally. Growth in FY2026-27 is projected at 6.9% since the pandemic, India has recorded an average growth of 8.2% during 2021-25. Domestic demand continued to be supported by strong consumption and public investment.

Table 4: High Frequency Indicators – Demand & Payment Indicators (YOY Growth)

Indicator	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26
GST E-way Bills – Volume	23.4	18.9	19.3	25.8	22.4	21.0	8.2	27.6	23.5	15.8	18.8	12.9	11.8
GST Revenue	13.3	17.3	6.5	8.2	6.9	10.0	7.6	0.7	6.1	6.2	8.1	8.8	8.7
Toll Collection – Volume	16.6	16.4	15.5	14.8	12.7	4.5	4.6	2.9	0.4	-1.8	-8.7	-4.0	-6.4
Electricity Demand – Volume	2.8	-4.8	-2.3	2.6	3.8	3.5	-5.8	-0.6	5.8	3.8	1.0	0.9	3.7
Petroleum Consumption – Vol	0.2	1.1	0.5	-4.4	4.8	7.0	-1.5	0.6	4.5	0.3	4.5	3.2	-4.6
Petrol	5.0	9.2	6.8	5.9	5.5	8.0	7.4	2.6	7.1	6.1	6.1	7.6	6.8
Diesel	4.2	2.1	1.5	2.4	1.2	6.5	-0.3	4.8	5.2	3.3	4.3	8.1	0.9
Aviation Turbine Fuel	3.9	4.4	3.3	-2.3	-2.9	-0.8	2.1	5.4	0.3	5.5	4.0	0.7	-0.1
Digital Payments – Volume*	30.0	29.2	28.3	30.9	31.1	28.1	21.5	30.2	26.8	22.3	23.5	21.0	19.7
Digital Payments – Value*	18.4	12.6	17.4	16.6	5.3	13.4	8.8	14.7	15.2	11.5	17.9	12.6	14.6

* Apr-26 digital payments data provisional. Sources: GSTN; RBI; CEA; NPCI; Ministry of Petroleum & Natural Gas, GoI.
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Table 5: High Frequency Indicator – Activity and Trade Indicators (YOY Growth)

Indicator	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26
PMI Services (>50=Expansion)	58.7	58.8	60.4	60.5	62.9	60.9	58.9	59.8	58.0	58.5	58.1	57.5	58.8
Intl Air Passenger Traffic	13.0	5.0	3.4	5.5	7.7	7.3	9.7	7.5	6.0	7.1	3.0	-18.5	-16.7
Domestic Air Cargo	16.6	2.3	2.6	4.8	7.1	2.8	-2.3	20.5	4.3	8.7	18.5	10.8	—
International Air Cargo	8.6	6.8	-1.2	4.2	4.5	2.3	-2.3	12.7	12.6	8.4	17.5	-6.0	—
Port Cargo Traffic	7.0	4.3	5.6	4.0	2.5	11.5	11.9	14.5	12.7	7.6	5.1	0.6	2.4
Retail Commercial Vehicle Sales	-1.0	-3.7	6.6	0.2	8.6	2.7	21.1	17.0	24.6	15.1	28.9	15.1	15.0
Steel Consumption	6.0	8.1	9.3	7.3	10.0	8.9	2.4	6.0	5.4	4.9	12.8	13.7	8.1
Cement Production	6.3	9.7	8.2	11.6	5.4	5.0	5.2	14.6	13.7	11.3	8.9	4.7	9.4

— = data not available for Apr-26. Sources: FADA; Indian Ports Association; AAI; JPC MoSteel; OEA MoCI; S&P Global.
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Table 6: High Frequency Indicator – Industrial Production and Manufacturing (YOY Growth)

Indicator	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Feb-26	Mar-26	Apr-26
IIP – Headline	2.6	1.9	1.5	4.3	4.1	4.6	0.5	7.2	8.0	5.1	5.1	4.1	—
PMI Manufacturing (>50=Expansion)	58.2	57.6	58.4	59.1	59.3	57.7	59.2	56.6	55.0	55.4	56.9	53.9	54.7
PMI Export Order	57.6	56.9	60.6	57.3	56.1	56.5	54.7	54.1	54.0	54.1	53.2	55.0	56.3
PMI Mfg: Future Output	64.6	63.1	62.2	57.6	60.5	64.8	62.3	57.1	56.9	56.4	57.9	67.3	65.5
Index of Eight Core Industries	1.0	1.2	2.2	3.7	6.5	3.3	-0.1	2.1	4.7	4.7	2.8	1.2	1.7
Elec Gen: Conventional Vol	-1.8	-8.2	-6.1	-0.8	1.0	0.8	-10.6	-5.0	4.4	2.2	-1.5	-1.1	2.4
Elec Gen: Renewable Vol	28.0	18.2	28.7	26.4	22.7	16.4	21.4	22.9	18.0	22.9	25.3	11.7	—
Automobile Production Vol	-1.7	5.2	1.2	10.7	8.1	10.8	-2.8	22.3	37.1	15.0	22.1	20.2	26.0
Passenger Vehicle Production Vol	10.8	5.4	-1.8	0.1	-4.1	16.1	9.8	22.8	23.1	5.6	9.8	9.0	12.8
Tractor Production Vol	20.5	9.1	9.8	11.5	9.4	23.0	13.0	37.5	57.9	14.6	80.0	28.6	18.1
Two-Wheelers Production Vol	-4.1	4.7	1.4	12.3	10.0	9.8	-5.6	20.9	39.9	16.1	24.4	22.0	28.1
Three-Wheelers Production Vol	4.1	16.9	8.6	24.0	15.8	15.9	15.9	55.4	39.6	33.2	29.9	34.0	41.6
Crude Steel Production Vol	9.3	11.0	12.6	13.8	12.8	13.7	8.9	11.1	10.8	11.5	11.4	9.4	5.8
Finished Steel Production Vol	6.6	7.0	10.9	13.8	13.8	14.0	7.2	12.4	10.9	12.5	8.6	6.9	3.4

PMI values are index form (>50=expansion, <50=contraction). — = not yet available. Sources: MoSPI; S&P Global; CEA; SIAM; OEA GoI; JPC; DGCIS&S; TMA. RBI Bulletin May 2026

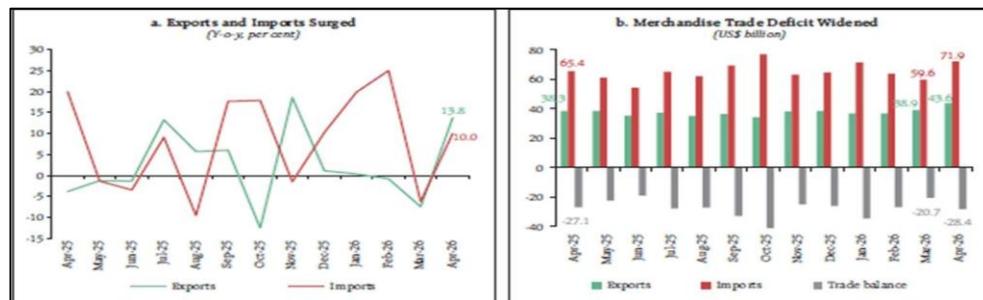
Inflation: CPI & WPI

CPI headline inflation edged up to 3.5% (y-o-y) in April 2026 from 3.4% in March, driven mainly by food prices. Core inflation (CPI excluding food and fuel) remained steady at 3.7%. WPI inflation surged to 8.3% in April 2026 a 42month high, driven primarily by the fuel and power group due to the West Asia conflict. The RBI has projected average CPI inflation at 4.6% for FY2026-27

Trade

The merchandise trade deficit widened to USD28.4bn in April 2026 from USD27.1bn in April 2025, primarily due to a surge in imports of electronic goods, gold, and machinery. Merchandise exports grew 13.8%yoy to USD43.6bn, while imports grew 10%yoy to USD71.9bn.

Chart 2: Trade data

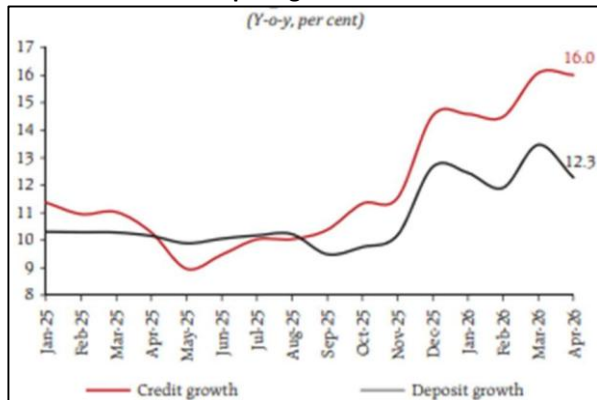


Source: RBI, PIB and DGCIS&S

Credit & Deposit Growth

Scheduled commercial bank (SCB) credit growth remained robust at 16% yoy as on April 30, 2026, while deposit growth decelerated to 12.3%, widening the credit-deposit gap to 3.7%. The credit-deposit ratio stood at 81.4%. Total outstanding credit to the commercial sector grew 15% in FY2025-26 to Rs.314 lakh crore.

Chart 3: Credit and Deposit growth



Source: RBI

FOREX

India's foreign exchange reserves stood at USUSD688.9bn as on May 15, 2026, providing import cover of approximately 11 months of imports. Gold holdings of 880.52 metric tonnes have appreciated significantly in value to over USUSD 120bn.

Table 7: Key Interest Rates

Rate / Ratio	FY24-25 Q3	FY25-26 Q3	Current
Policy Repo Rate (%)	6.25	5.25	5.25
Cash Reserve Ratio (%)	4.00	3.00	3.00
Statutory Liquidity Ratio (%)	18.00	18.00	18.00
10-Yr G-Sec Yield – FBIL (%)	6.62	7.11	7.11
91-Day T-Bill Primary Yield (%)	6.52	5.33	5.33
INR-USD Spot (Rs./USD)	85.58	94.60	94.60
Credit-Deposit Ratio (%)	80.8	81.4	81.4

Chart 4: System Liquidity

Liquidity conditions eased in April 2026 as tax-related outflows waned and government spending rose. The daily average net LAF absorption stood at Rs.3.94 lakh crore in April. In May (up to 21st), surplus liquidity moderated to Rs.2.11 lakh crore as currency in circulation picked up and government spending stabilised.

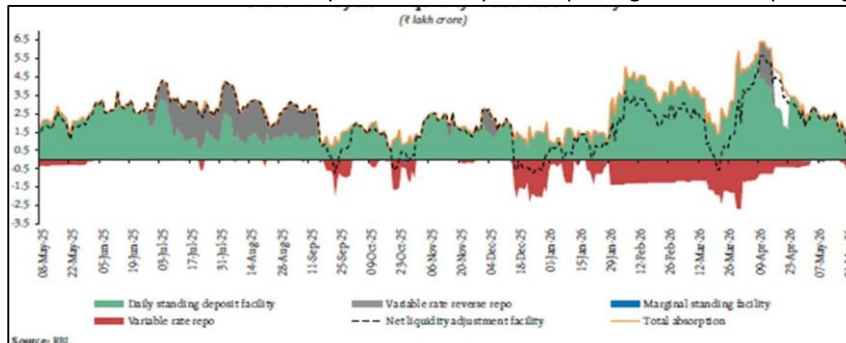


Chart 5: India Forex Reserves (USD Bn)

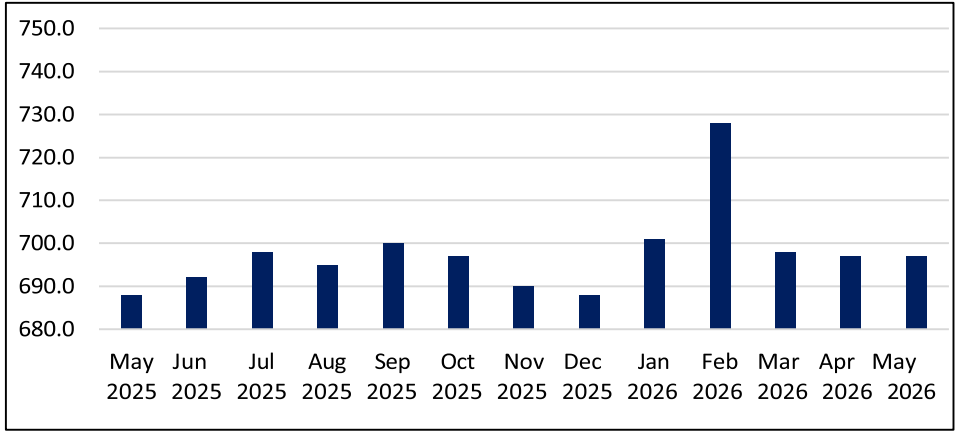
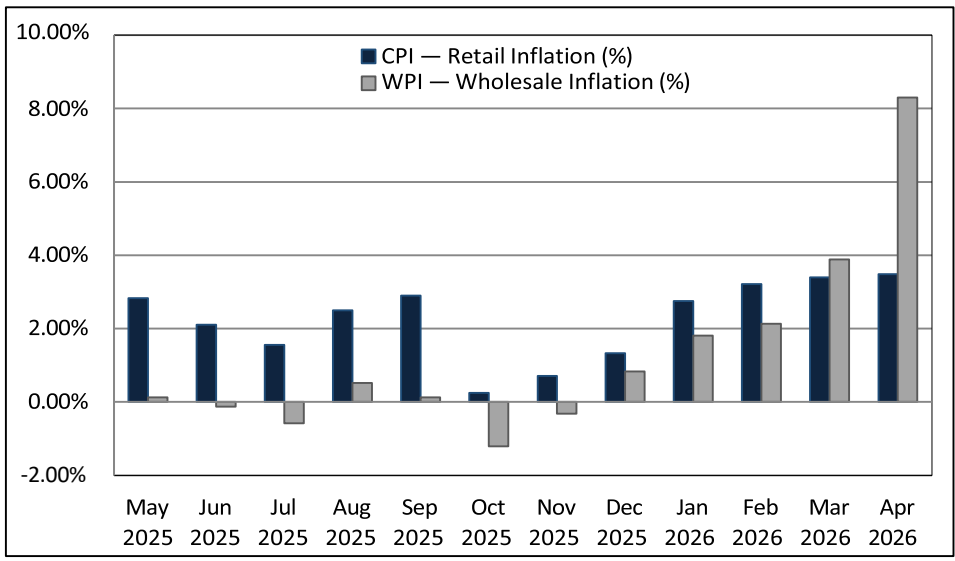


Chart 6: CPI and WPI Inflation YOY



Source: RBI

Indian Equities

Indian equities have undergone a meaningful correction in early 2026, with the Nifty 50 trading near 24,000, ~ -9% lower year to date and well off its late 2025 highs. The drawdown has been driven by a record monthly foreign outflow in March, escalating geopolitical tensions in West Asia, Brent crude trading above USD110 per barrel, and an Indian rupee that has weakened to a record near 95 against the US dollar. We continue to view this as a valuation reset rather than a structural breakdown. Domestic macro stability, the resilience of household savings flows into equities, and the Reserve Bank of India's policy credibility remain in place, and the under-ownership of Indian equities by foreign investors has built up meaningful optionality on any improvement in oil and global risk appetite.

Our central call is that the asymmetry remains skewed: upside from here is likely to be earnings-led and gradual, while downside, if it materialises, will be sharper and macro-driven, with crude oil now confirmed as the single most important swing variable. We stay constructive on India over 2-3 years horizon, with a preference for Large and Midcaps relative to small and microcaps despite stronger performance YTD from Mid, Small and Microcaps.

1. Domestic Growth Model Remains Intact

India continues to stand out among emerging markets because its growth architecture is overwhelmingly domestic. Unlike export-heavy economies in North Asia, the Indian GDP base is anchored in private consumption, the financialization of household savings, and government-led infrastructure spending. With an export to GDP ratio close to 20%, India is structurally less exposed to the slowing developed market trade cycle than its EM peers, which means global demand shocks tend to translate into growth moderation rather than outright contraction. The RBI's revised FY27 GDP growth forecast of 6.9%, while lower than the 7.4% projected in February, still places India among the fastest-growing large economies globally and is consistent with a slowdown rather than a stall.

2. Capex Cycle and Defence: Multi-Year Tailwinds

India's public capital expenditure push remains one of the strongest visible among large economies and continues to provide a structural floor under both growth and corporate earnings. Central government capex has expanded from roughly INR1.97trn in FY15, or about 1.6% of GDP, to around INR11.1trn in FY25, or about 3.4% of GDP, and the FY27 budgeted envelope sits in the range of INR12 to 12.5trn. Roughly 70 to 75% of this spending continues to flow into roads, railways, defence, and logistics, and private capital expenditure is gradually crowding in, particularly in manufacturing and the energy transition.

Geopolitical fragmentation, the ongoing West Asia conflict, and accelerating supply-chain realignment are also reinforcing the case for defence indigenisation. Domestic defence manufacturers continue to benefit from rising budget allocations, growing export opportunities, and supportive policy frameworks such as the Production Linked Incentive scheme and import substitution targets, and this remains one of the more durable thematic exposures within the Indian equity universe.

3. Macro Stability: Policy Credibility as the Anchor

India's macro framework is materially stronger than in previous cycles, and that strength is being tested rather than broken by the current external shock. On the fiscal side, the central government deficit has glided from

around 4.8% of GDP in FY25 toward the 4.4% in FY26, with the FY27 budget targeting roughly 4.3%. Slippage risk is real if crude remains elevated and subsidy or duty cushioning is required, but the starting point is one of genuine consolidation rather than fiscal stress.

On the monetary side, the Reserve Bank delivered 125bps of cumulative rate cuts through 2025, taking the policy repo rate down to 5.25%, and has now held rates at that level for three consecutive meetings, most recently on 8 April 2026. The Monetary Policy Committee retained a neutral stance, citing the unprecedented uncertainty introduced by the West Asia conflict and the disruption to global energy and commodity prices. Headline CPI inflation came in at 3.4% in March 2026, comfortably below the 4% target, but the RBI has revised its FY27 average CPI projection up sharply to 4.6%, with core inflation projected at 4.4%. The government has also reaffirmed the 4% inflation target with a 2 to 6% tolerance band, which keeps the inflation targeting regime credible. The clear takeaway is that the bar for further rate cuts has risen materially, while a hike remains a low probability scenario reserved for a sustained crude shock.

The banking system is in arguably its strongest shape in more than a decade. Gross non-performing assets have moved into the low single digits and net NPAs are around or below 1%, capital adequacy is comfortable, and credit growth is improving. This combination of fiscal discipline, monetary credibility, and a healthy financial system meaningfully reduce the probability that the current external shock translates into systemic stress.

4. Valuations: Moderate, Not Attractive

The Nifty 50 trailing P/E stands at 20.45x as of May 18, 2026, broadly in line with its post-2021 long-run average of 20–21x. On a forward basis, the Nifty trades at approximately 19.3x FY27 earnings, also broadly in line with the long-term average of 19.5x. Optically, headline Bloomberg multiples suggest the Nifty is trading below one standard deviation of its historical PE. However, we estimate ~5% downside risk to Bloomberg FY27 EPS. On that basis, valuations are broadly fair rather than genuinely cheap.

5. US Bond Yields: An Additional Headwind

US Treasuries have sold off sharply since the onset of the Middle East escalation on February 28, 2026. The U.S. 10year yield has risen approximately 65 basis points to around 4.6%. The latest leg of the bond sell-off was driven by a combination of a high CPI print, Stable labour growth, rising crude prices, the appointment of a new Federal Reserve chair, and a synchronised global sell-off in government bonds.

This has three distinct negative implications for Indian equities. First, the US-India 10year yield differential has narrowed sharply to around 244bps, well below the historical average of approximately 450bps. This weakens the relative attractiveness of Indian fixed income, reduces the incentive for debt oriented foreign flows, and adds incremental pressure on the rupee. Second, higher US yields provide FPIs with an additional reason to reallocate equity capital toward developed markets, compounding the existing pressure from the Iran conflict and crude prices. Third, higher global discount rates are negative for PE multiples.

The partial silver lining is that US financial conditions have remained resilient despite the rise in bond yields, limiting second-order damage to the US economy and credit markets. An early resolution of the Iran conflict would provide some relief for US Treasury yields, though other structural factors including a rising US fiscal deficit and continued AI-driven capital expenditure are likely to limit how far yields can fall even in a resolution scenario.

6. Domestic Flows: Structural Support to the Market

The single most important reason the Indian market correction has been more orderly than the underlying macro shock would suggest is the depth of domestic flows. Monthly systematic investment plan inflows have continued to print at record or near record levels, with March 2026 collections at roughly INR32087 crores, and equity-oriented mutual fund schemes attracted around INR40500 crores in net inflows in the same month.

Insurance and pension flows are steadily rising in parallel, and domestic institutional investors absorbed roughly 1.28 lakh crore rupees of foreign selling in March alone. This structural domestic bid is the principal reason why drawdowns at the index level have remained shallow relative to the scale of the foreign outflow, and we expect it to continue acting as a counter-cyclical stabiliser through the remainder of FY27.

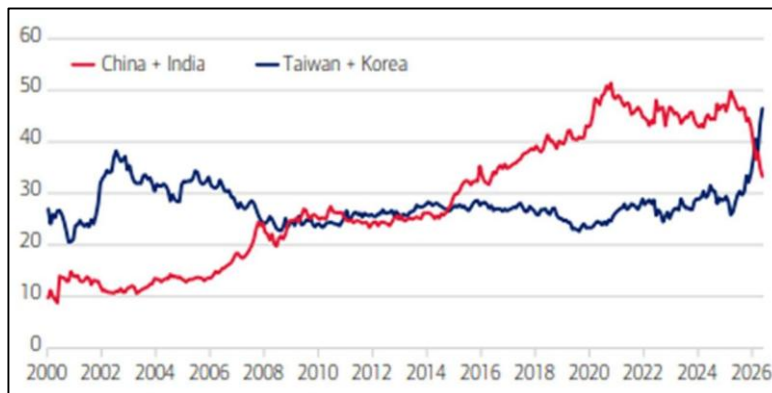
7. FII Positioning: Under-Ownership Has Built Optionality

Foreign investor positioning has corrected sharply and quickly. Calendar-year-to-date outflows are now in the range of USD18 to 20bn. India's weight in major emerging-market indices has compressed from a 2024 peak of 20 to 21% down to roughly 14%, and active EM funds remain underweight India by an estimated 200 to 300bps. Any combination of a credible de-escalation in West Asia, a stabilisation or fall in crude, dollar weakness against the broader EM complex, or a Federal Reserve pivot toward easing would create a low base from which incremental flows could return rapidly. Under Ownership at this scale is a source of upside convexity rather than further selling pressure.

8. Valuations: Meaningful Normalisation Under Way

The correction has produced a broad-based reset in Indian equity valuations. The Nifty 50 currently trades at a trailing twelve-month consolidated price-to-earnings ratio of around 20.9, which is roughly in line with its long-run average of 20 to 21X and well below the 23 to 24X level that prevailed in late 2024. On a 1 year forward basis the index trades closer to 18 to 19X. Midcaps, which had reached forward multiples above 30X in 2024, have re-rated down and small caps have seen sharper multiple compression on the back of drawdowns of 25 to 35 % from their highs. Relative to emerging markets, India still trades at a premium, but that premium has compressed from a peak of 90 to 100 % in early 2025 to roughly 30%. India remains a premium market and we believe it deserves to, given its growth differential, demographic profile, and policy stability but the relative starting point is now far more attractive than it was twelve months ago. With consensus FY27 Nifty earnings growth in the 10 to 12 % range, the combination of more reasonable multiples and a credible earnings path is the foundation for our constructive medium-term call.

Chart 7: Weight in MSCI EM Index (%)



Source: BOFA,FactSet. Data as of May 19, 2026

Key Risks to the Outlook

Crude oil is the dominant variable in the risk picture and warrants treatment ahead of every other factor. India imports roughly 85 % of its crude requirement, and Brent has now traded above USD110 per barrel as the US-Iran conflict enters its ninth week and traffic through the Strait of Hormuz remains effectively halted. Goldman Sachs has flagged the possibility of crude approaching USD120 per barrel if the stalemate continues. A sustained Brent print in the USD100 to 115 per barrel range would widen the current account deficit toward or upward of 2% of GDP, pressure the fiscal balance through subsidies and excise adjustments, keep the rupee under stress, and risk a further round of macro-driven multiple compression. Conversely, a credible ceasefire and reopening of the Strait could pull crude back by USD10 to 15 per barrel almost immediately and would be the single most powerful catalyst for a re-rating of Indian equities.

Inflation and the policy reaction function are the second-order risk. Domestic CPI is still inside the RBI's tolerance band, but the central bank's own FY27 forecast of 4.6% reflects a meaningful upward shift. If crude remains elevated and feeds through into transport, aviation, restaurant, and manufacturing input costs, the door to additional rate cuts effectively closes, real rates stay elevated, and equity multiples lose one of their key supports.

The third risk is **external sector** sensitivity. Oil shocks transmit into India through a familiar channel: a wider import bill, a weaker rupee, imported inflation, and pressure on foreign exchange reserves as the RBI smooths volatility. The rupee has already weakened to around 95 against the US dollar, the RBI is intervening selectively, and FX reserves have been drawn down modestly. None of this is destabilising at current levels, but the channel becomes more powerful the longer crude stays above USD100.

The fourth risk is **slower global growth**, which would weigh on India's export-oriented sectors particularly information technology services and parts of the chemicals and auto-component complex and on broader risk appetite for emerging market equities.

The fifth risk is **structural inflation driven by deglobalisation, supply chain realignment, and resource nationalism**, which together may keep global commodity prices structurally higher and limit the disinflation tailwind that supported equity multiples through much of the previous decade. The final risk is higher global borrowing and elevated developed-market bond yields, which can crowd out emerging market capital flows and place a ceiling on equity valuations even when domestic earnings are healthy.

The Sixth risk is **further rise in U.S. interest rates** as differential between U.S. and Indian rates is narrow relative to past and can add further pressure on INR and lead to further uptick in domestic rates.

Table 8: Indian Equities - Scenario Analysis

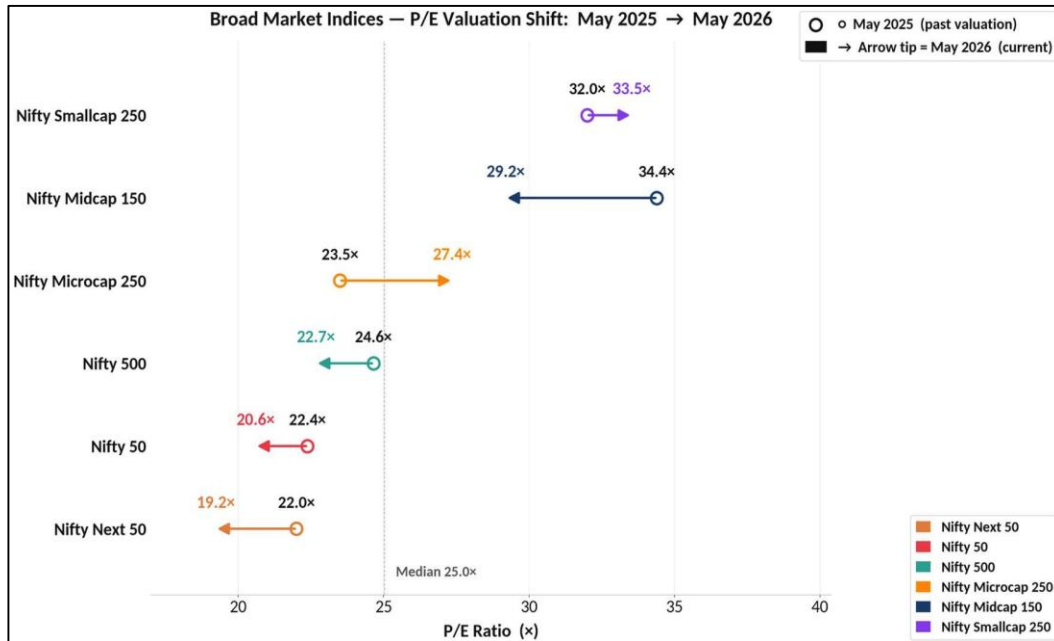
Variable	Base Case (FY27)	Bear Case (FY27)	Current Reading (Apr 2026)
West Asia situation	De-escalation by June	Conflict extends through FY27	Strait of Hormuz blockade in place; US-Iran talks stalled
Brent crude (USD/bbl)	USD80-95	Sustained > USD100	~USD118-120 (above bear-case trigger)
RBI repo rate	5.25%, with optional cut in H2 FY27	Easing bias dropped; possible defensive hike	5.25% (held Apr 8, 2026; neutral stance)
Real GDP growth	6.5-6.9%	< 6.0%	RBI projects 6.9%
Average CPI inflation	4.5-5.0%	> 5.0%	RBI projects 4.6% for FY27
Fiscal deficit (% of GDP)	4.2-4.4%	> 4.6%	Pending; risk skewed higher on oil subsidy / revenue drag
CAD (% of GDP)	1.2-1.5%	~2.0%-2.25%	Tracking wider on oil import bill
FII positioning	Drifting underweight → neutral	Structurally underweight	
Nifty forward P/E	18-19x	17-18x	~19x (near top of base-case band)
FY27 Nifty EPS growth	10-12%	5-7%	
Nifty 12M range	22,000-26,000	20,000-24,000	
USD/INR	92-94	Weaker than 94	~94.86

Source: StatLane

Bottom Line

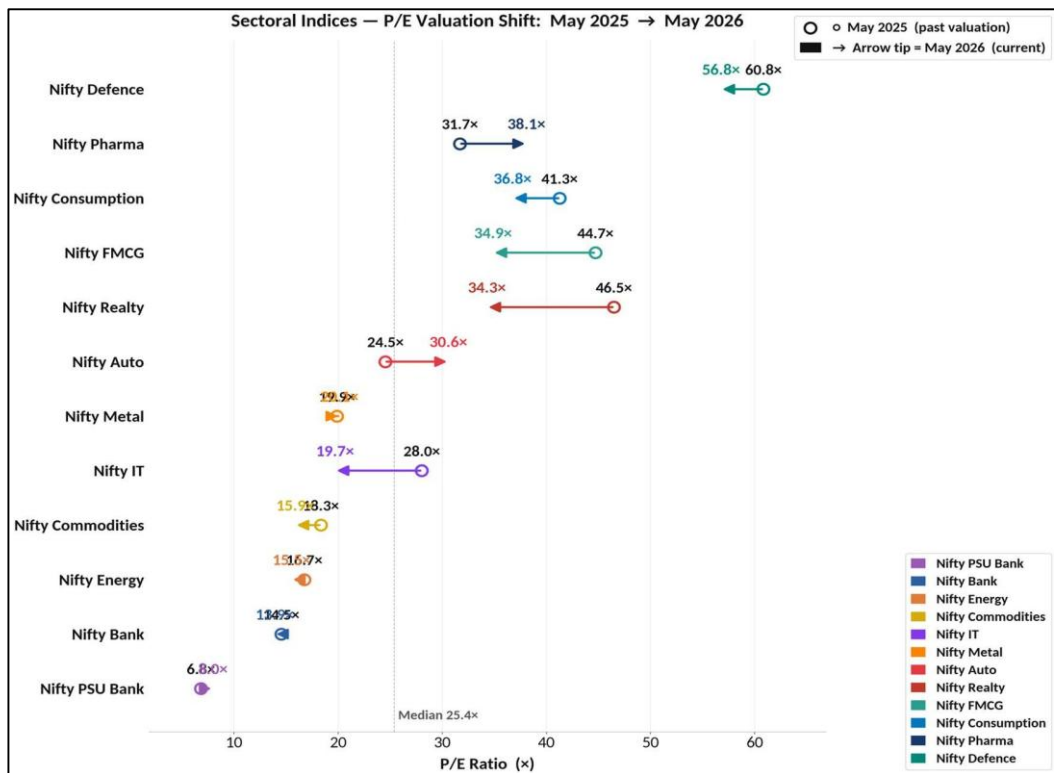
Indian equities are transitioning into a more balanced phase. Valuations have normalised to roughly long run averages, foreign positioning has cleaned up sharply, domestic flows remain robust, and the macro framework fiscal, monetary, and financial has proved durable through a genuine external shock. The setup is one of earnings led upside that is likely to be gradual, paired with a sharper but less probable macro-driven downside scenario centred on crude. We remain constructive on India over a 2-3year horizon, with crude oil and the trajectory of the West Asia conflict identified as the single most important variables to monitor. The current phase is best characterised as a healthy consolidation rather than a structural downturn, and we believe patient, earnings anchored exposures will be rewarded as the cycle clears.

Chart 8: Broad Market Indices - P/E Valuation shift– May 2025 vs. May 2026



Source: NSE, Nifty Indices. P/E is trailing PE

Chart 9: Sectoral Indices - P/E Valuation shift– May 2025 vs. May 2026



Source: NSE, Nifty Indices. P/E is trailing PE

Chart 10: Broad Market Valuation Re-Rating Map

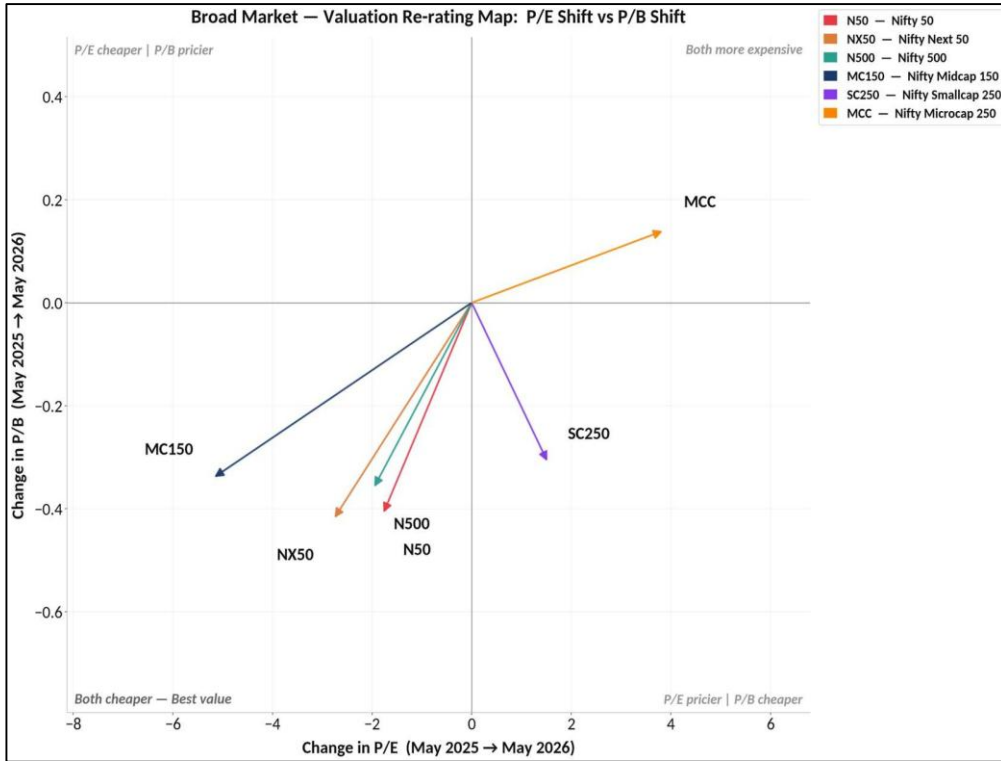
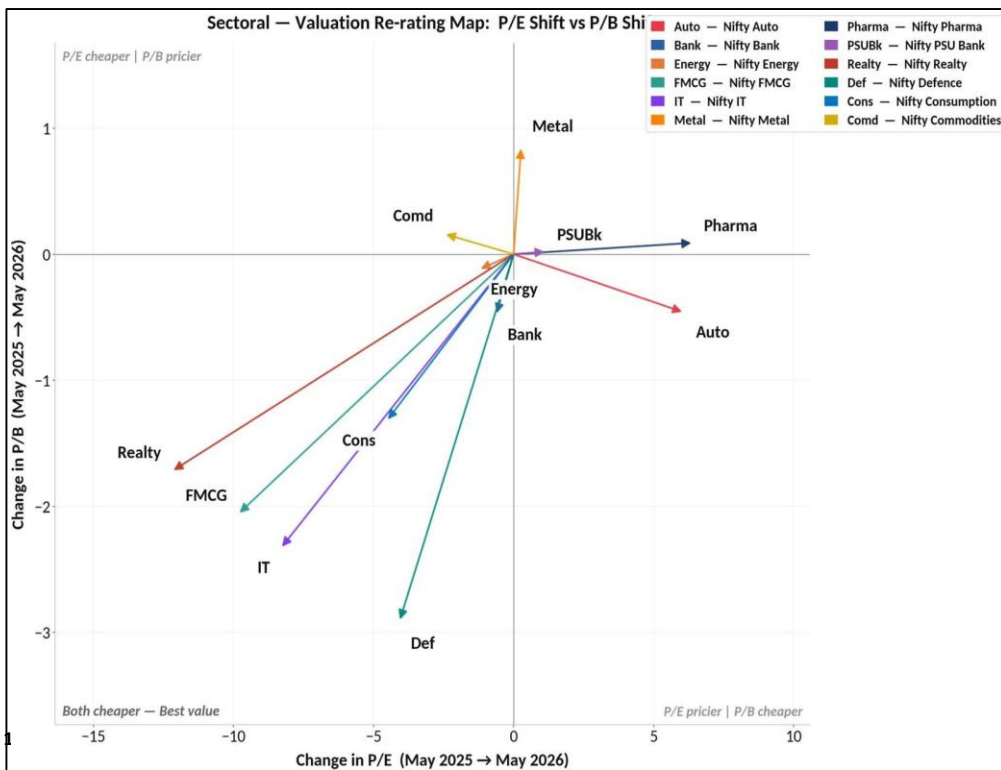


Chart 11: Sectoral Valuation Re-Rating Map



Indian Bonds

The RBI has delivered a cumulative 1.25% of rate cuts in the current easing cycle, taking the repo rate to 5.25%. At this stage, the easing cycle appears largely complete, and the scope for any meaningful decline in bond yields from current levels looks limited.

A combination of domestic and global factors is likely to keep yields elevated over the coming quarters. Domestically, India continues to face a large government borrowing programme, which is expected to keep supply pressures elevated across the bond market. At the same time, higher crude oil prices pose risks to inflation, disposable incomes, and overall consumption demand. Globally, the interest rate environment has also become less supportive, with both the **US Federal Reserve and the ECB shifting towards a prolonged pause following the escalation of geopolitical tensions in West Asia**, compared to the more accommodative expectations that prevailed earlier.

Higher crude oil prices, along with elevated gold imports, are also contributing to a widening current account deficit (CAD). A higher CAD typically increases depreciation pressure on the rupee. The Indian rupee has already weakened materially over the past year, making it one of the weaker-performing emerging market currencies during this period. **Currency weakness, in turn, feeds imported inflation**, reduces the RBI's flexibility to ease monetary policy further, and can potentially trigger additional foreign portfolio outflows. This external vulnerability is likely to remain one of the key risks for the Indian bond market over the next 12 months.

Liquidity conditions within the banking system have also become increasingly volatile in recent months. Strong credit growth of nearly 16% YoY continues to significantly outpace deposit growth, which remains closer to 12–13%. This widening credit-deposit gap has increased reliance on wholesale funding, pushed up funding costs, and created periodic pressure across money market rates.

In addition, RBI dollar sales aimed at stabilising the rupee, tax outflows, and intermittent government cash balances have contributed to tighter liquidity conditions despite the cumulative policy easing undertaken so far. Reflecting these pressures, short term money market yields and Certificate of Deposit (CD) rates have moved sharply higher over recent weeks, suggesting that financial conditions remain tighter than what the policy rate alone may indicate.

On the inflation front, the outlook is becoming increasingly challenging. The sharp rise in crude oil prices, coupled with the possibility of a below-normal monsoon, could push inflation above the RBI's comfort range over the coming quarters. **Against this backdrop, bond yields are expected to remain broadly range-bound, albeit with a mild upward bias, especially as markets have already begun adjusting to higher inflation expectations since the start of 2026.**

In this environment, the case for duration, which performed well during the initial phase of the easing cycle, has weakened considerably. With most of the policy easing now behind us and long-end yields facing pressure from elevated supply, global uncertainty, tighter liquidity conditions, and external vulnerabilities, the probability of meaningful capital appreciation from duration exposure has reduced materially. At current levels, duration risk appears asymmetrically skewed to the downside. **We expect the 10year government bond yield to trade in the 6.9%-7.3% range over the coming quarters and support from RBI if the yields rise sharply above 7.5% through OMOs and other such instruments.**

In contrast, the short to medium end of the yield curve continues to offer attractive accrual opportunities. The 2-4year segment, in particular, provides favourable carry, with spreads having widened relative to the repo rate due to the macro concerns highlighted above. Over the next 12 months, accrual strategies are therefore likely to offer a superior risk-reward profile compared to duration strategies.

On the credit side, selective exposure to high-quality issuers remains favourable. AA+ and AAA-rated corporate

where tighter global financial conditions could lead to spread widening and weaker liquidity in lower-rated segments.

For investors, short term funds, corporate bond funds, and medium term debt funds focused on the 2-4year maturity bucket remain suitable vehicles for building a robust accrual-oriented fixed income portfolio. **From a tax efficiency perspective, investors with a minimum investment horizon of over two years may also consider income plus arbitrage strategies as part of their allocation mix.**

“Overall, Indian bonds are best viewed as a carry + tactical duration opportunity”

Table 9: Yield Matrix

Category	29-May	1 Week Ago	1 Month Ago	3 Month Ago
AAA PSU				
1 Year	7.85%	7.82%	7.17%	6.85%
3 Year	7.84%	7.93%	7.62%	7.08%
5 Year	7.80%	7.90%	7.65%	7.28%
10 Year	7.90%	7.90%	7.67%	7.37%
Corporate Bond				
1 Year	7.93%	7.86%	7.23%	6.95%
3 Year	7.76%	7.85%	7.54%	7.01%
5 Year	7.72%	7.82%	7.57%	7.20%
10 Year	7.90%	7.90%	7.67%	7.37%
Government Bond				
1 Year	6.06%	6.25%	5.93%	5.54%
5 Year	6.82%	6.93%	6.75%	6.38%
10 Year	7.00%	7.09%	6.99%	6.66%
30 Year	7.64%	7.68%	7.57%	7.34%
SDL				
1 Year	6.50%	6.35%	5.95%	5.80%
5 Year	7.39%	7.36%	7.23%	6.70%
10 Year	7.73%	7.75%	7.64%	7.37%
15 Year	7.78%	7.83%	7.72%	7.57%

Source: Bandhan MF, ICRA Analytics

Market Data

India Index Performance % 30 May 26	1M	3M	1Yr	3Yr
Nifty 50	-1.7	-6.3	-3.8	9.5
Nifty Next 50	2.1	2.2	7.5	20.1
Nifty 200	-0.2	-3.1	-0.0	13.1
Nifty 500	-0.0	-2.1	0.3	13.9
Nifty Midcap 150	2.6	3.4	7.5	22.1
Nifty Smallcap 250	1.6	7.1	1.5	20.4
Nifty Microcap 250	3.0	11.1	1.1	25.7
Nifty Total Market	0.1	-1.6	0.3	14.3
Thematic/Sectoral Index				
Nifty Auto	1.8	-6.3	14.2	24.0
Nifty Bank	-1.0	-10.2	-1.9	7.9
Nifty Chemicals	2.7	5.3	-2.5	7.8
Nifty FMCG	-3.2	-3.3	-9.9	0.4
Nifty IT	-0.6	-4.5	-20.3	2.0
Nifty Metal	4.8	10.1	47.6	32.6
Nifty Oil & Gas	-4.2	-8.6	-0.8	15.7
Nifty Pharma	4.7	6.1	14.4	25.2
Nifty PSU Bank	-3.3	-16.4	17.7	27.4
Nifty Realty	-1.4	0.3	-17.3	18.2

Source: NSE India, StatLane Research, Index = Total Return Index, Performance over 1 year is CAGR

India Index valuations 30 May 26	P/E	P/B	Div Yield
Nifty 50	20.3	3.2	1.4
Nifty Next 50	19.3	3.8	1.4
Nifty 100	20.1	3.3	1.4
Nifty 200	21.5	3.5	1.2
Nifty 500	22.5	3.6	1.1
Nifty Midcap 150	28.9	4.8	0.7
Nifty Smallcap 250	33.7	3.6	0.7
Thematic/Sectoral Index			
Nifty Auto	30.4	4.5	1.3
Nifty Bank	13.7	1.9	1.1
Nifty FMCG	34.0	8.6	0.9
Nifty IT	19.8	5.4	3.9
Nifty Metal	20.0	3.5	1.5
Nifty Pharma	37.6	5.3	0.7
Nifty PSU Bank	7.9	1.3	2.4
Nifty Realty	34.3	3.8	0.4
Nifty India Consumption	36.2	7.6	0.8
Nifty Commodities	15.7	2.5	1.6
Nifty Infrastructure	21.0	3.1	1.1
Nifty PSE	10.6	2.1	2.8
Nifty India Defence	55.7	12.1	0.5
Nifty Capital Markets	48.2	13.8	0.9
Nifty Chemicals	47.1	4.3	0.6
Nifty Oil & Gas	9.0	1.6	2.3

Global Index Performance (%) 30 May 26	1M	QTD	12M
S&P 500	5.3	11.3	29.8
Dow Jones Industrial Average	2.8	6.2	20.7
S&P Europe 350	2.7	7.3	21.2
S&P Asia 50	18.8	48.4	100.6
S&P EM BMI	2.9	10.5	29.3

Note 1: Source: S&P Dow Jones Indices LLC and/or its affiliates. 2 Index performance based on total return (USD)

U.S. Smart Beta Index Performance (%) 30 May 26	1M	QTD	12M
S&P 500 Momentum	12.6	26.6	44.4
S&P 500 Equal Weight	2.7	9.5	20.4
S&P 500 Growth	8.1	14.0	36.1
S&P 500 Value	2.0	8.0	22.7
S&P 500 Low Volatility	-2.8	2.2	0.6

Note 1: Source: S&P Dow Jones Indices LLC and/or its affiliates. 2 Index performance based on total return (USD)

Table 9: Commodities	31 May 26	Month Ago
Oil (Brent)	93.4	111.2
Gold	4492	4595

Source: StatLane Research

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