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AN EXPENSIVE INDEX, YET RICH IN ALPHA OPPORTUNITIES : OUTLOOK 2026

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From The CEO's Desk

Reading the signals…

"Within the Top 500 stocks by market cap, around 170 companies are potentially undervalued, and for the full market more than 400 companies provide a large universe for an active portfolio creation."

Whether viewed by market capitalization or by sector, market continues to offer ample opportunities for active investors to generate alpha.

As we started to assess the potential outlook for Indian markets in 2026, we wanted to follow the Scientific Investing Framework. That required understanding the global and Indian economic backdrop, especially on the debt side. This includes government debt, corporate debt and household debt across major developed economies and India.

Next, we looked at the GDP growth rates, inflation and interest rate expectations for 2026 with a focus on US and India. With this macroeconomic backdrop, we looked at the earnings growth expectations for the Indian markets. The expected return from the markets is dependent not only on the earnings growth but also on the starting and ending valuation ratios.

On the global debt issue, for the last several years there is consistent noise about the fragility of the global financial system with US government debt at $38 trillion and the Japanese and Chinese debt-to-GDP ratio above 200% and 300%, respectively. On YouTube podcasts and mainstream media, the discussion turns to the how the world is over leveraged and could collapse at any time. Discussions about investing become discussions about economic and financial collapse.

In this Outlook 2026 report, we have analyzed the global debt situation and assess the health of the global financial and economic situation. What we see is that government debt across developed countries has increased in two quanta; viz., a quantum jump post the Global Financial Crisis and another quantum jump post the Covid crisis.

While the governments and central banks should have worked to reduce the debt to the pre-crisis levels, they have not and that is a cause for concern over the longer term. However, on the other hand, the revenues of the governments are adequate to cover the interest payouts and are not a concern in the near-to-midterm.

Compared to the global developed economies, the Indian government debt is quite controlled and is further supported by the high growth rates. Similarly, the corporate and household debt levels in India are quite conservative compared to developed economies.

For 2026, the US nominal GDP is expected at around 4.7%. The Fed rate is expected to be 3.4%. India's nominal GDP is expected to be around 10%-11%. The RBI might cut rates to below 5% which would be supportive of growth. Expectations of low inflation and interest rates for the long-term is also supportive of higher valuation multiples.

Indian Markets in Context

While mainstream narratives often claim the Indian market is universally overvalued, a deeper analysis reveals significant opportunities for active management. Coming to the Indian stock market, the valuation multiple at 25 is slightly elevated for an expected earnings growth rate of 11%. However, if the earnings growth rates exceed 15% as projected by several research houses, the valuation multiples might prove to be fair.

Based on our valuation model, nearly 2/3rd of the market appears overvalued, while the rest is fair or undervalued. Undervalued opportunities are slightly higher in large and small caps compared to midcaps which have a higher overvaluation ratio. Within the Top 500 stocks by market cap, around 170 companies are potentially undervalued, and for the full market more than 400 companies provide a large universe for an active portfolio creation.

Sector wise, Financials, Utilities (Power), and Industrials are undervalued or fairly valued while, we would be cautious on Healthcare, Technology, and Consumer Staples given their elevated valuation multiples compared to their mild growth expectations.

Given this, for 2026, passive or index investors should have expectations of high single digits to mid-teens if earnings growth rates exceed 15%. Based on the analysis of the undervalued pool, investors in actively managed portfolios might have the potential for 18%-22% returns if the portfolios are selected based on mispriced growth opportunities, with growth and multiple re-rating both contributing to the total returns for the investors.

Of course, always be aware of equity risks and don't chase returns. Remember, Chasing Safety could lead to the Hunt for True Alpha. Happy Investing 2026!

Dr Vikas V Gupta

CEO and Chief Investment Strategist

OmniScience Capital

Sovereign Debt and Credit Outlook

General government debt represents the consolidated liabilities of central, state and local governments and provides a consistent basis for cross-country comparison. Over the past two decades, global public debt has risen markedly since the Global Financial Crisis and again following the pandemic, with the increase concentrated largely in advanced economies, while emerging and developing economies display lower average debt ratios, punctuated by sharp step-ups during periods of macro stress- most notably the Global Financial Crisis (2008–09) and the COVID-19 pandemic (2020).

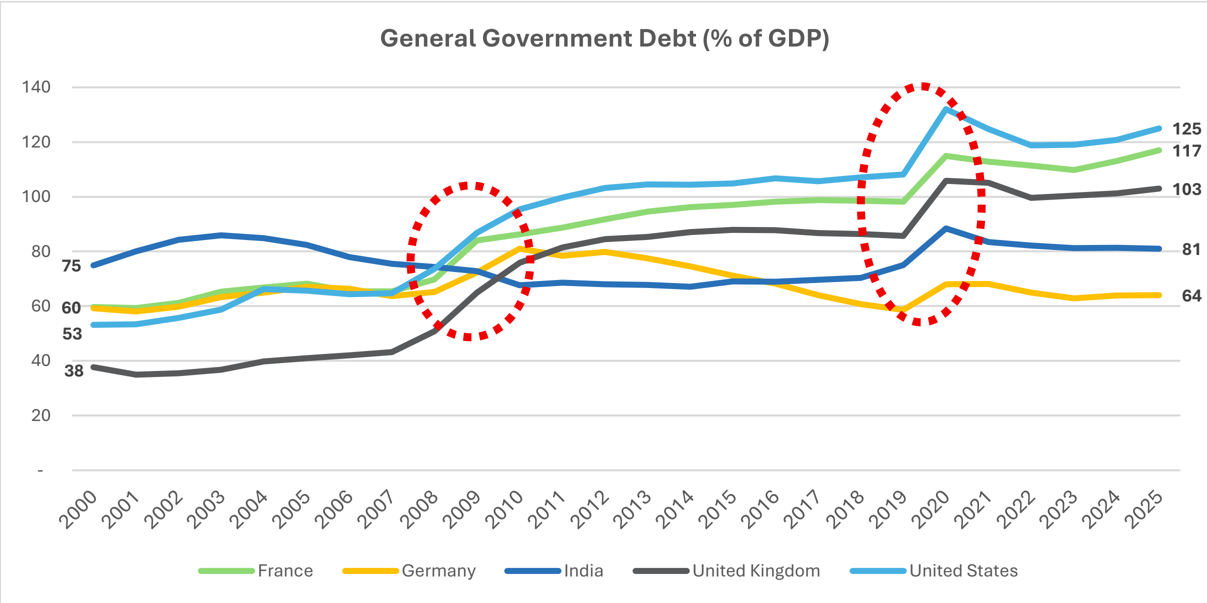

Exhibit 1 : Total stock of debt liabilities issued by the general government as a share of GDP
Source : IMF Global Debt Database (2025)

The rise in debt is best understood through a standard decomposition into primary fiscal balances, interest–growth differentials and stock-flow adjustments (like bank recapitalisations and guarantees, exchange rate management, assumption of contingent liabilities, accounting or statistical reclassifications and crisis-related interventions).[1] Increases in public debt often reflect not only primary fiscal deficits but also sizeable stock-flow adjustments and the crystallisation of contingent liabilities, which can cumulatively amplify debt levels over time, particularly during periods of economic and financial stress.

The level of public debt by itself is not a sufficient indicator of fiscal risk, and there is no universally valid threshold beyond which debt becomes unsustainable. What ultimately matters for debt sustainability is the government's capacity to service its obligations over time, which

[1] International Monetary Fund. Strategy, Policy, & Review Department "Review of The Debt Sustainability Framework For Market Access Countries", *Policy Papers* 2021, 003 (2021), accessed 12/17/2025, https://doi.org/10.5089/9781513568324.007

depends on factors such as the composition and maturity of debt, currency denomination, investor base, institutional credibility, and medium-term growth prospects.

Advanced economies are often able to sustain higher debt ratios because they combine deep domestic financial markets, stable investor demand, and strong revenue mobilisation with relatively low borrowing costs. Emerging and developing economies, by contrast, typically face lower debt tolerance owing to higher interest rates, greater exposure to exchange rate movements, narrower tax bases, and more volatile capital flows.

A key element cutting across these dimensions is the relationship between interest costs and the government's revenue base, illustrated by a simple revenue-based interest coverage ratio. Although this is not a comprehensive measure of sustainability, it provides a useful snapshot of the fiscal space available to service debt. The results show clear cross-country differences.

Country	Govt Debt (%GDP) (A)	10-Yr Bond Yield (B) [2]	Govt Revenue (% GDP) (C)	Rev ICR (C/(A*B))
France	117%	3.4%	51.4%	**12.8**
Germany	64%	2.6%	46.8%	**27.9**
India	81%	6.6%	20.5%	**3.8**
Japan	230%	1.7%	37.6%	**9.8**
UK	103%	4.6%	38.3%	**8.1**
US	125%	4.1%	29.9%	**5.9**

Exhibit 2 : Revenue based Interest Cover of Countries, 2025
Source : OmniScience Insights Labs

The same headline debt ratio can imply very different fiscal risks depending on interest costs and revenue capacity. Advanced economies' ability to sustain higher debt is closely tied to their institutional strength and financing conditions, whereas emerging economies' lower debt tolerance reflects structural constraints rather than fiscal indiscipline per se.

At the same time, it is important to acknowledge that assessments based on current interest costs and revenue capacity do not capture all sources of fiscal risk. Contingent liabilities arising from financial sector support, ageing-related expenditures, and other implicit obligations such as climate-related disasters, public health shocks and heightened geopolitical or defence-related expenditures. When combined with already high levels of public debt, these factors can materially affect debt sustainability.

[2] Interest costs are approximated using current 10-year sovereign yields; actual interest payments may be higher or lower depending on the coupon rates and maturity structure of outstanding debt.

Sovereign Credit Ratings Overview

Sovereign credit ratings provide a comparative assessment of fiscal positions and debt sustainability across countries.

Country	S&P	Moody's	DBRS
Germany	AAA	Aaa	AAA
United States	AA+	Aa1	AAA
United Kingdom	AA	Aa3	AA
China	A+	A1	A
France	A+	Aa3	AA
Japan	A+	A1	A (high)
India	BBB	Baa3	BBB

Exhibit 3 : Credit Ratings of Sovereign Debt, 2025

Source : Ratings' Agencies Publications, compiled by OmniScience Insights Labs

- **United States :** In May 2025, Moody's downgraded the United States sovereign rating from its top-tier Aaa status to Aa1 citing the federal government's inability to arrest structurally high fiscal deficits, where the debt-to-GDP is projected to only go up
- **France :** Similarly, France was downgraded by S&P Global Ratings to A+ from AA- in October 2025, highlighting that political fragmentation within the National Assembly has severely constrained the government's fiscal consolidation process
- **United Kingdom :** The country saw its AA rating affirmed with a stable outlook by S&P Global Ratings in October 2025, despite a challenging macroeconomic environment
- **Germany :** Germany stands apart as one of the few remaining top-rated sovereigns with AAA rating and a stable outlook from S&P Global Ratings as of June 2025
- **China :** China retained its A1 rating from Moody's, with a negative outlook throughout 2025. It reflects the risk that the central government will be forced to absorb significant debts from financially stressed Local Government Financing Vehicles (LGFVs) and the property sector. The inevitable transfer of leverage from the shadow banking system to the sovereign balance sheet deteriorates China's fiscal strength, eroding the buffers that previously supported a stable outlook
- **Japan :** Japan had its A+ rating affirmed with a stable outlook by S&P Global Ratings in March 2025, due to the unique structure of Japanese debt holding. Although the country's debt-to-GDP ratio is at 230%, the sovereign faces minimal refinancing risk because most of this debt is held by domestic institutions and funded in the local currency.
- **India :** India received a rating upgrade from S&P Global Ratings in August 2025, moving from BBB- to BBB with a stable outlook. High nominal GDP growth and improved quality of public expenditure has successfully crowded in private investment without widening the current account deficit. This is sufficient buffer to stabilize the debt-to-GDP ratio and interest payments, distinguishing its credit profile from other emerging market peers.

Omni Take

In conclusion, current general government debt levels do not represent imminent crisis, with medium-term dynamics remaining quantitatively manageable despite historical highs. However, the reluctance of major economies to actively correct their fiscal paths warrants criticism. Ultimately, while the situation is not alarming, this stability is not unconditional. It hinges on a delicate equilibrium between the ability to service debt and the cost of carrying it.

Non-Financial Corporate Debt: Levels and Trends

Non-financial corporate debt is a key indicator of leverage and financial vulnerability in the corporate sector. Below graph[3] charts its evolution as a share of GDP across selected economies, highlighting differences in levels, trends, and responses to major economic shocks.

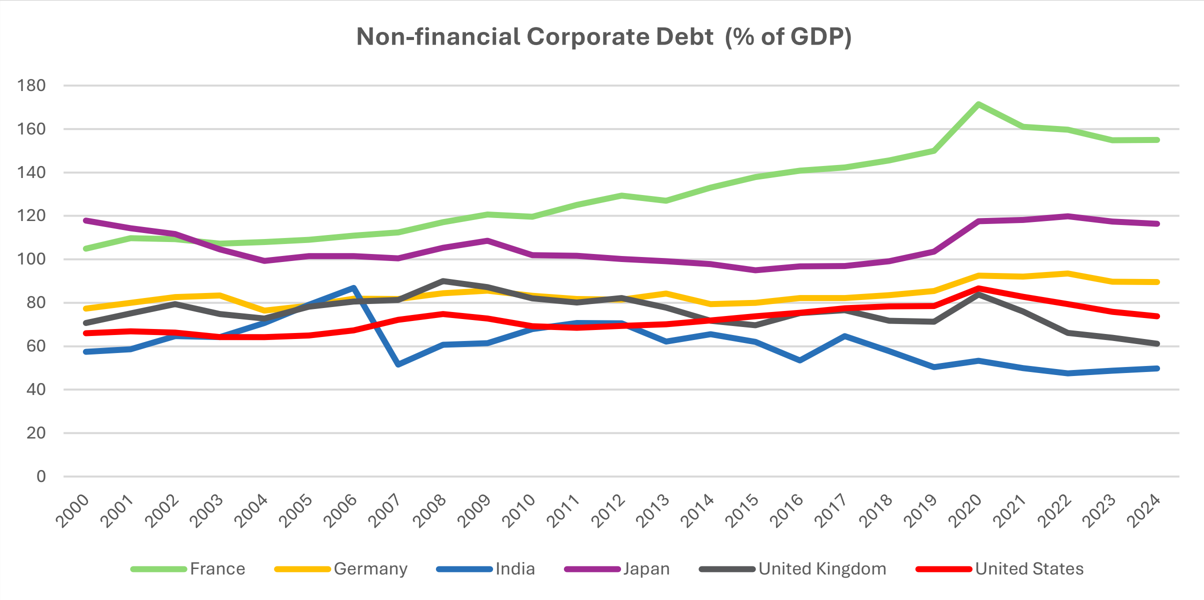

Exhibit 4 : Total stock of debt liabilities issued by the nonfinancial public sector as a share of GDP
Source : IMF Global Debt Database (2025)

France and Japan record persistently high corporate debt ratios. In France, corporate debt rises steadily from the early 2000s, with sharper increases following the global financial crisis and during the COVID-19 period. Japan's high corporate debt indicates structural reliance on debt financing under prolonged low interest rates. Germany shows a gradual upward trend, particularly after the mid-2010s and during the pandemic. The UK exhibits more cyclical behaviour, and the US

[3] International Monetary Fund (IMF), *Global Debt Database (GDD)*, "Total stock of loans and debt securities issued by nonfinancial corporations as a share of GDP," IMF DataMapper, accessed December 18, 2025, https://www.imf.org/external/datamapper/NFC_LS@GDD/CHN/FRA/DEU/IND/JPN/GBR/USA

displays moderate but sustained growth in corporate debt from the mid-2000s, consistent with the long-term expansion of market-based corporate financing.

India Takeaway

India stands strong with lower non-financial corporate debt ratios, generally ranging around 50-70% of GDP. The decline observed after 2016-17 coincides with the "twin balance sheet" crisis, during which both corporate and bank balance sheets were impaired. This is not just a cyclical response to weaker investment conditions; it represents a structural shift. For India, a deleveraged corporate sector entering a capex upcycle provides headroom for private investment, reinforcing a growth-led narrative as the economy moves toward 2026.

Global Household Debt Dynamics

Household leverage plays a dual role in the global macroeconomy, acting simultaneously as a driver of near-term growth and a potential source of medium-term vulnerability. In principle, access to credit allows households to effectively pull future demand forward to boost current economic activity.

Across OECD countries, mortgages typically represent the majority (60-80%) of household liabilities. The risk is not just the debt itself, but the fact that housing backing the debt is illiquid. If prices drop, households are trapped, freezing labor mobility and consumption. [4]

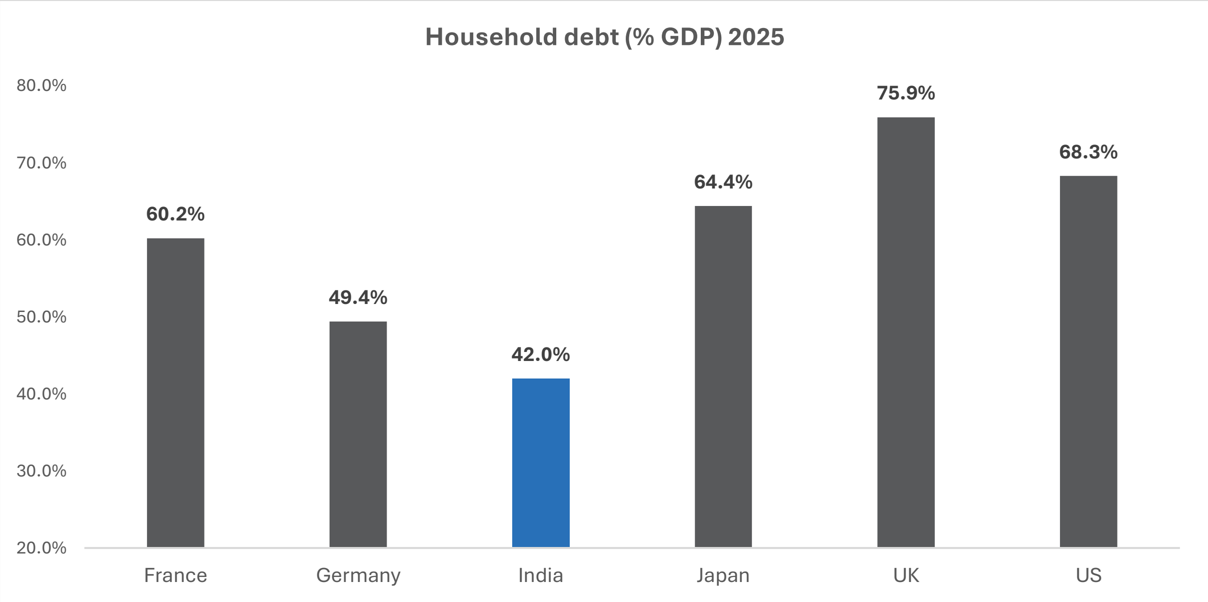

Exhibit 5 : Total stock of debt liabilities issued by households, including all debt instruments, as a share of GDP
Source : IMF Global Debt Database (2025)

[4] "Household Debt: Recent Developments and Challenges," *BIS Quarterly Review* (December 2017), accessed December 18, 2025, https://www.bis.org/publ/qtrpdf/r_qt1712f.pdf

UK and US are the most leveraged nations in this cohort. With leverage ratios hovering above 60%, Japan and France occupy a middle ground where the tension between institutional strength and financial risk is acute. Germany stands as an outlier among the advanced economies, with household debt significantly lower than its peers.

India Takeaway

At 42.0%, India's lower debt level signals strong health and a phase of financial deepening, where the future credit expansion will be driven by new access rather than over-leveraging, implying that the Indian economy retains significant headroom for further sustainable growth.

Central Bank Balance Sheet Dynamics

Since the mid-2000s, central bank assets as a % of GDP have expanded materially across major economies, marking a decisive shift in the global monetary regime. Balance sheets rose modestly pre-GFC but expanded sharply during the Global Financial Crisis and again- more forcefully- during COVID, reflecting aggressive liquidity provision, and market stabilisation efforts.

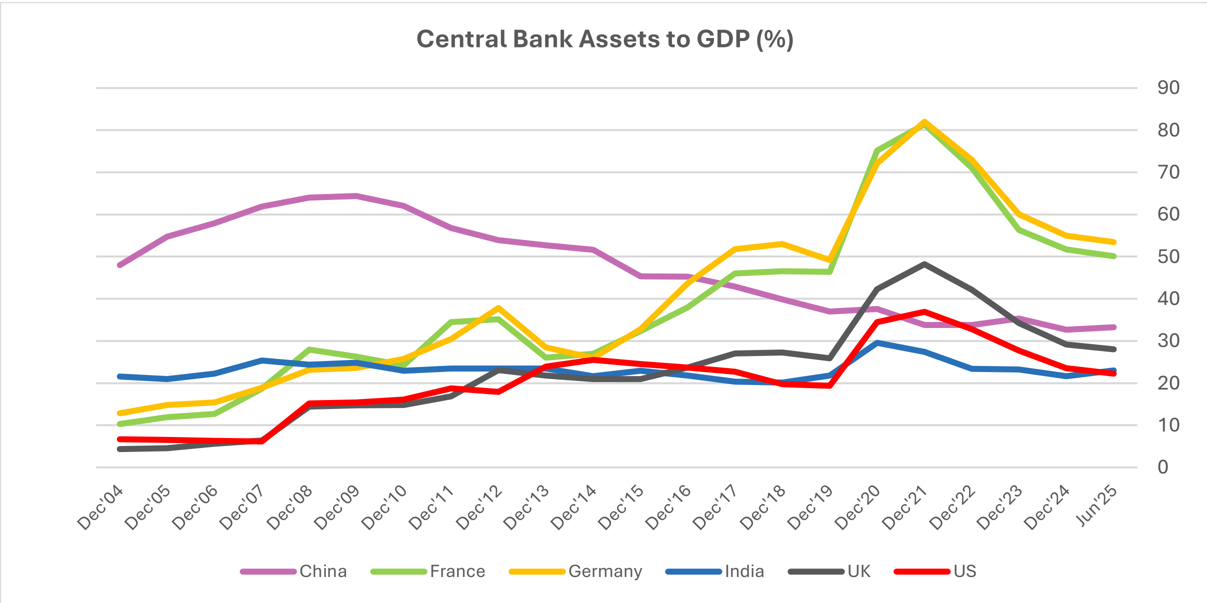

Exhibit 6 : Central Bank Total Assets to GDP
Source : Bank of International Settlements and OmniScience Insights Labs

The chart shows a clear and sustained increase in central bank assets relative to GDP in the United States, the United Kingdom and the major European economies following the global financial crisis and again after the pandemic. This behaviour is best understood in the context of the effective lower bound on nominal policy rates.

In advanced economies, the financial crisis of 2008–09 rapidly pushed policy rates to zero or close to zero. Further reductions in policy rates were either infeasible to restore market functioning and support aggregate demand. This constraint forced central banks to rely increasingly on balance-sheet based instruments i.e. large-scale asset purchases and credit easing. The expansion of balance sheets in advanced economies was not incidental; it was the main channel through which monetary accommodation was delivered once the policy rate instrument was exhausted.[5]

China's central bank balance sheet exhibits a trajectory distinct from advanced economies and India, characterized by a structural surge even before the GFC followed by a passive decline. This pattern was primarily driven by the mechanics of China's managed exchange rate and its surplus in both current and capital account during the 2000s. To maintain the currency peg in the face of massive inflows, the PBoC acted as a buyer of last resort, absorbing foreign currency and accumulating vast foreign assets. When the PBoC printed Yuan to buy Dollars (to suppress the exchange rate), inflation risk lingered. To sterilize this liquidity, they forced banks to buy PBoC bills or increased the reserve requirements. This pushed the assets-to-GDP ratio to outlier's levels, distinct from the domestic bond-buying programs seen in the West.

There are three primary reasons for subsequent decline in this ratio. First, unlike advanced economies, China did not rely heavily on quantitative easing in response to either the global financial crisis or the pandemic. While Western central banks had to resort to QE to encourage lending, China didn't need to do this. Because China's major banks are state-owned, the government didn't need to use financial incentives; it simply ordered them to lend.

Second, China's rapid nominal GDP growth mathematically outpaced the accumulation of reserves, naturally compressing the ratio over time. Third, during the 2015–2016 market volatility, sentiment turned against the Yuan. The PBoC had to sell dollars to defend the currency value, burning through nearly $1 trillion in foreign exchange reserves in roughly 18 months. This was a massive contraction of the asset side of the balance sheet.

India Takeaway

India's trajectory is markedly different. India did not face a binding lower bound constraint. Policy rates remained well above zero, allowing the RBI to inject liquidity through conventional policy tools like repo rates, LAF operations, and changes in reserve requirements. These instruments were sufficient to ease domestic liquidity conditions without resorting to large-scale asset purchases. The expansion of the RBI's balance sheet prior to the crisis was largely driven by foreign exchange reserve accumulation, not by credit or quantitative easing.

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[5] Duvvuri Subbarao, "Implications of the Expansion of Central Bank Balance Sheets" (comments at the Special Governors' Meeting, Kyoto, January 31, 2011), Bank for International Settlements, https://www.bis.org/review/r110131e.pdf.

Omni Take

In this sense, India's relatively moderate ratio of central bank assets to GDP represents an institutional advantage, providing policy space to respond to future shocks without the constraints faced by economies where balance sheets have already expanded substantially.

What's ahead in 2026?

Having mapped the structural contours of global leverage that define the economy's sensitivity to shocks, we now turn to the active drivers of asset pricing. There is a persistent narrative that markets are currently overvalued, fuelled by headlines about IPO frenzies and "all-time highs." Rather than relying on this general sentiment, we examine the trajectory of growth, inflation, and rates that will determine investment outcomes.

Global Macro Conditions and Policy Backdrop

In the US, the median outlook of FOMC anticipates Real GDP growth accelerating to 2.3%, exceeding the longer-run trend of 1.8%, while PCE inflation is projected to moderate further to 2.4%. Regarding interest rates, following the three rate cuts (75 basis points) delivered over 2025, the projections imply a significant slowing in the pace of easing. The median federal funds rate for 2026 is projected at 3.4%, a decline of only 20 basis points from the 2025 level. Mathematically, this spread translates to an implied probability of approximately 80% for a single quarter-point cut in 2026. While the consensus direction is downward, the data suggests the Fed is more likely to pause or cut just once rather than embark on an aggressive easing cycle.

Percent

Variable	Median[1]					Central Tendency[2]					Range[3]				
	2025	2026	2027	2028	Longer run	2025	2026	2027	2028	Longer run	2025	2026	2027	2028	Longer run
Change in real GDP	1.7	2.3	2.0	1.9	1.8	1.6–1.8	2.1–2.5	1.9–2.3	1.8–2.1	1.8–2.0	1.5–2.0	2.0–2.6	1.8–2.6	1.7–2.6	1.7–2.5
September projection	1.6	1.8	1.9	1.8	1.8	1.4–1.7	1.7–2.1	1.8–2.0	1.7–2.0	1.7–2.0	1.3–2.0	1.5–2.6	1.7–2.7	1.6–2.6	1.7–2.5
Unemployment rate	4.5	4.4	4.2	4.2	4.2	4.5–4.6	4.3–4.4	4.2–4.3	4.0–4.3	4.0–4.3	4.4–4.6	4.2–4.6	4.0–4.5	4.0–4.5	3.8–4.5
September projection	4.5	4.4	4.3	4.2	4.2	4.4–4.5	4.4–4.5	4.2–4.4	4.0–4.3	4.0–4.3	4.2–4.6	4.0–4.6	4.0–4.5	4.0–4.5	3.8–4.5
PCE inflation	2.9	2.4	2.1	2.0	2.0	2.8–2.9	2.3–2.5	2.0–2.2	2.0	2.0	2.7–2.9	2.2–2.7	2.0–2.3	2.0	2.0
September projection	3.0	2.6	2.1	2.0	2.0	2.9–3.0	2.4–2.7	2.0–2.2	2.0	2.0	2.5–3.2	2.2–2.8	2.0–2.4	2.0	2.0
Core PCE inflation[4]	3.0	2.5	2.1	2.0		2.9–3.0	2.4–2.6	2.0–2.2	2.0		2.7–3.1	2.2–2.7	2.0–2.5	2.0	
September projection	3.1	2.6	2.1	2.0		3.0–3.2	2.5–2.7	2.0–2.2	2.0		2.7–3.4	2.2–2.9	2.0–2.4	2.0–2.2	
Memo: Projected appropriate policy path															
Federal funds rate	3.6	3.4	3.1	3.1	3.0	3.6–3.9	2.9–3.6	2.9–3.6	2.8–3.6	2.8–3.5	3.4–3.9	2.1–3.9	2.4–3.9	2.6–3.9	2.6–3.9
September projection	3.6	3.4	3.1	3.1	3.0	3.6–4.1	2.9–3.6	2.9–3.6	2.8–3.6	2.8–3.5	2.9–4.4	2.6–3.9	2.4–3.9	2.6–3.9	2.6–3.9

Exhibit 7 : Economic Projections of FOMC (Dec 2025)

Source : US Federal Reserve

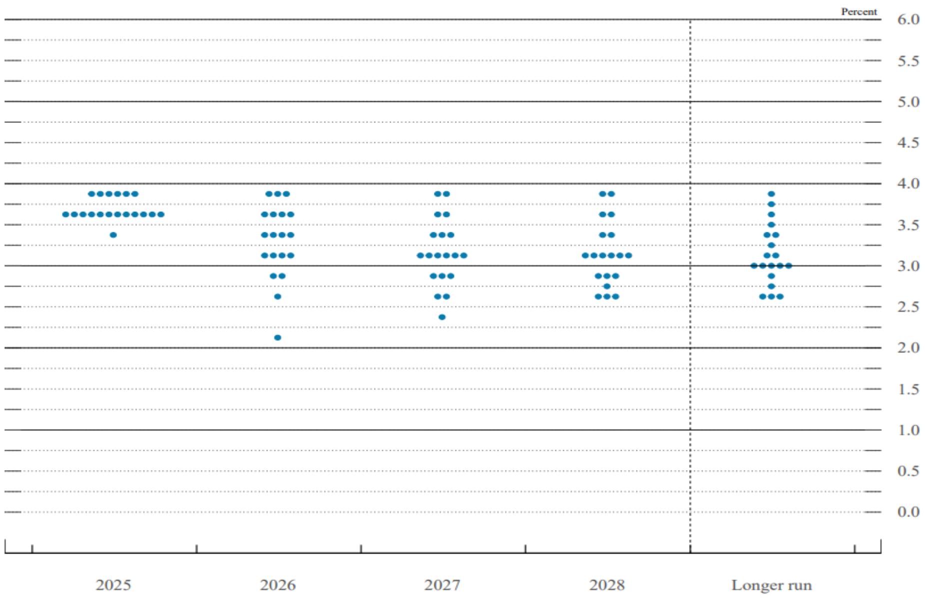


Exhibit 8 : FOMC Dot Plot of Projected Federal Funds Rate (Dec 2025)
Source : US Federal Reserve

India Macro Conditions and Policy Backdrop

In 2025, the Reserve Bank of India delivered four rate cuts, reducing the repo rate by a cumulative 125 basis points. A 25-basis point reduction in both February and April was followed by a deeper 50 basis point cut in June. A final 25 basis point cut came in December, bringing the policy rate down from 6.5% at the start of the year to 5.25% currently. Based on RBI's Dec 2025 downward revision of the inflation forecast to 3.9% and forecasted core pricing (excluding food and precious metals) pressure around 3-3.5%, India could have robust real growth. While Real GDP growth is likely to remain strong at 6.5-7% driven by domestic consumption and the policy support, the significant disinflation will, likely cap Nominal GDP growth at 10-11%. Expectations of further rate cuts should be guided by the evolution of growth and inflation dynamics.

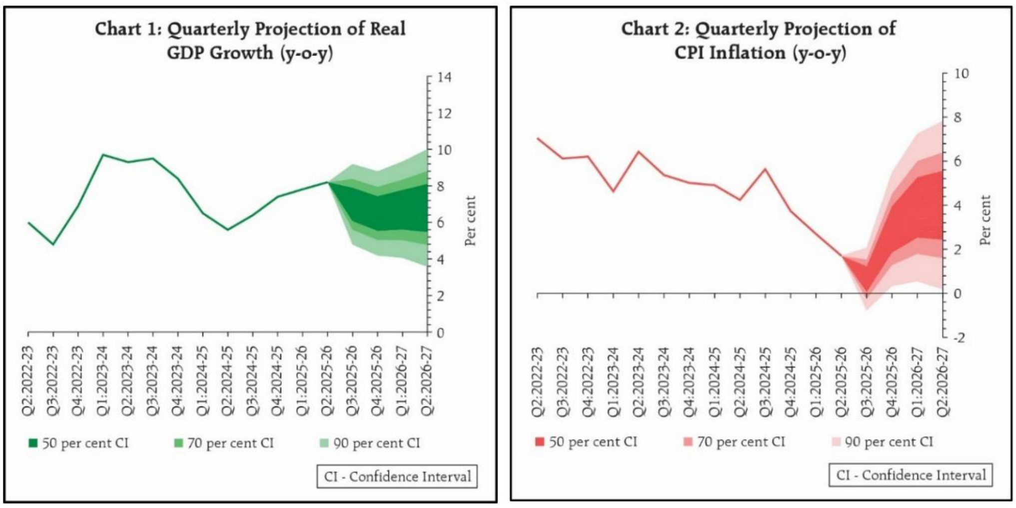
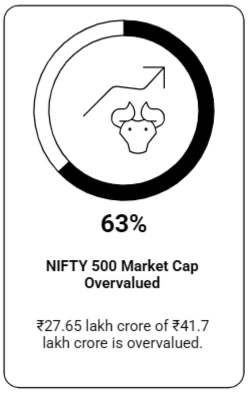
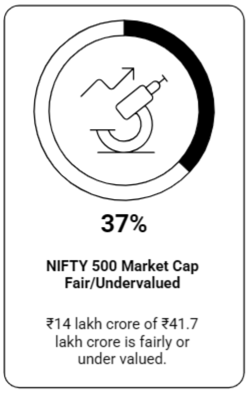


Exhibit 9 : Monetary Policy Statement 2025-26 (Dec 2025)
Source : Reserve Bank of India

Assessing Valuations in Indian Markets

Against this macroeconomic and policy backdrop in the US and India, it is useful to assess market valuations to see how these conditions are currently reflected in asset prices. The NIFTY 500, which broadly represents the Indian equity market, is currently valued at ~24.45x PE, with a growth estimate of ~11%. Relative to expected earnings growth, current valuation multiple appears on the higher side, indicating a market preference for near-term earnings certainty.





Under our valuation framework [6], approximately 65% of constituents appear overvalued, while the remaining 35% trade at fair value or below. At the aggregate level, ~63% of the NIFTY 500 market capitalisation (~₹27.65 lakh crore) appears overvalued, while the remaining 37% (~₹14 lakh crore) trades at fair or undervalued levels.

Distribution of Valuations Across Market-Cap Segments

Disaggregating the market by capitalisation provides insight into where valuation pressures are most pronounced. Accordingly, we analyse large-, mid- and small-cap segments through the lens of the P/E–growth relationship. Within the NIFTY 500 :

- Large-cap stocks (Top 100) are expected to deliver around 9.9% two-year forward earnings growth and are currently trading at a price-to-earnings multiple of about 22.8x. At this level of growth, valuations for large caps appear broadly fair
- Mid-cap stocks (ranked 101–250) are expected to grow earnings by around 13.7% and are trading at a P/E multiple of roughly 28.1x. Given the higher growth outlook, valuations in the mid-cap segment also appear largely fair, though with less room for disappointment
- Small-cap stocks (ranked 251–500) are expected to post earnings growth of about 11.7%, but are trading at a higher multiple of nearly 29.5x. At this combination of growth and valuation, small-cap stocks appear overvalued relative to their fundamentals.

[6] Methodologically, we estimate an implied P/E multiple for different earnings growth rates using a dividend discount framework, assuming an average cost of equity of 12% and full payout of earnings to shareholders. Actual market valuations are then compared against these implied multiples to assess relative valuation.

Segment	Key Metrics		No. of companies (% share)	
	Growth	PE	Overvalued	Undervalued
Top 100	9.9%	22.77	64 (64%)	36 (36%)
101-250	13.7%	28.14	104 (69%)	46 (31%)
251-500	11.7%	29.49	161 (64%)	89 (36%)
Top 250	10.6%	23.88	168 (67%)	82 (33%)
Top 500	10.7%	24.37	329 (66%)	171 (34%)

Exhibit 10 : Valuation Distribution Across Segments (1/2)
Source : OmniScience Insights Labs

Looking at the distribution of valuations across market-cap segments within the NIFTY 500 reinforces the pattern of valuation dispersion.

- Among large-cap stocks (Top 100), around 64.0% of companies appear overvalued, accounting for ~₹178 lakh crore of market capitalisation, while the remaining 36.0%, representing about ₹103 lakh crore, trade at fair or undervalued levels.
- In the mid-cap segment (stocks ranked 101–250), the share of overvalued stocks increases to 69.1%, corresponding to roughly ₹57 lakh crore of market capitalisation, compared with 30.9% or about ₹34 lakh crore assessed as fair or undervalued.
- For small-cap stocks (251–500), about 63.7% of companies, representing ~₹28 lakh crore of market capitalisation, are classified as overvalued, while the remaining 36.3%, or around ₹16 lakh crore, are assessed as fair or undervalued.

Segment	Market Cap (in Rs Cr)		
	Overvalued	Undervalued	Total
Top 100	1,78,27,792	1,03,04,971	2,81,32,763
101-250	56,61,708	34,12,126	90,73,834
251-500	27,62,639	15,76,687	43,39,326
Top 250	2,34,89,500	1,37,17,097	3,72,06,597
Top 500	2,62,52,139	1,52,93,784	4,15,45,923

Exhibit 11 : Valuation-Market Cap Distribution Across Segments (2/2)
Source : OmniScience Insights Labs

Taken together, these results suggest that while aggregate market valuations appear elevated and have attracted considerable commentary, valuation dispersion within the NIFTY 500 remains meaningful. With over 170 companies assessed as trading at fair or undervalued levels, the opportunity set for selective stock picking remains intact.

Where Valuations Diverge: A Sectoral View

While market-cap segmentation highlights broad patterns in valuation, sector-level analysis [7] allows for a more granular assessment of valuations by accounting for differences in growth drivers, and business cycles. We therefore turn to sector-level valuations to identify specific pockets of mispricing within the market.

Below chart plots sector-level (P/E) multiples against expected earnings growth, with each bubble representing a sector and the bubble size reflecting market capitalisation. The black dotted line represents the implied fair-value P/E for a given growth rate, based on the valuation framework discussed earlier. Sectors plotted above the line are trading at valuation levels that appear overvalued relative to their growth outlook, while sectors on or below the line are assessed as fairly valued or undervalued.

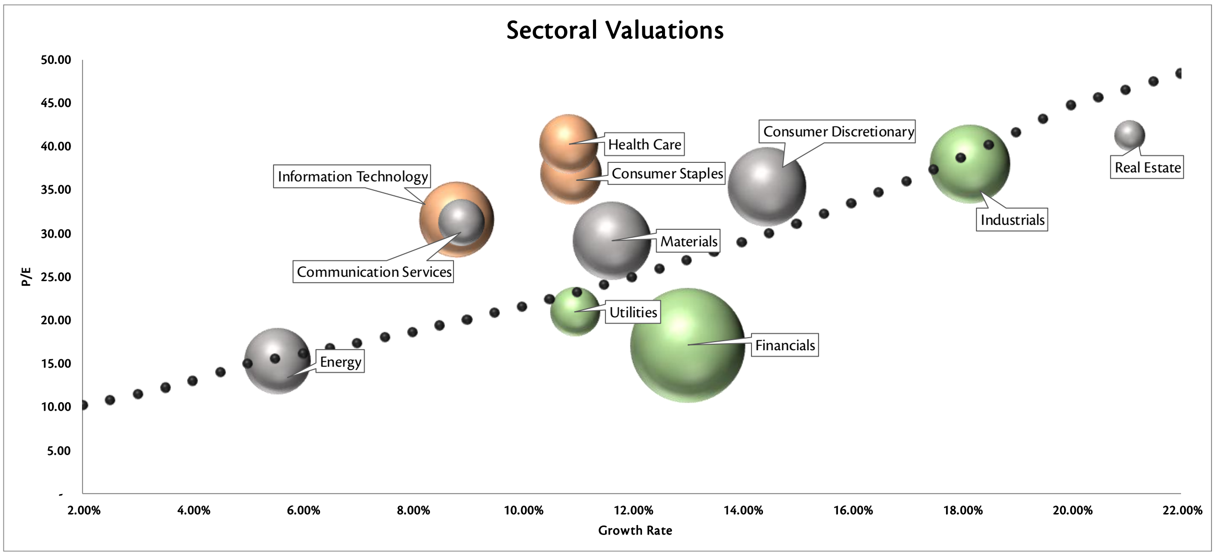


Exhibit 12 : Sector-Level Mispricing in a P/E–Growth Framework
Source : OmniScience Insights Labs

Sector	Key Metrics		No. of Companies	
	Growth	PE	Undervalued/ Fairly valued	Overvalued
Financials	13.03%	17.14	70	30
Industrials	18.17%	38.02	83	71
Utilities	10.97%	20.97	18	8
Consumer Staples	10.90%	36.93	14	35
Health Care	10.86%	40.33	23	48

[7] This sectoral assessment is based on all companies within each sector that have a market capitalisation exceeding ₹1,000 crore and for which sufficient valuation and growth data was available. Companies outside this universe were excluded from the analysis. Valuation classifications are derived using the P/E versus growth framework outlined earlier.

Information Technology	8.81%	31.62	25	38
Communication Services	8.90%	31.27	9	6
Consumer Discretionary	14.46%	36.73	57	103
Energy	5.54%	15.32	17	5
Materials	11.64%	29.19	86	80
Real Estate	21.07%	41.30	14	7
Grand Total			**416**	**431**

Exhibit 13 : Valuation Distribution Across Sectors (1/2)

Source : OmniScience Insights Labs

Sector	% of Companies		Market Cap (in Cr)		
	Undervalued/ Fairly Valued	Overvalued	Undervalued/ Fairly Valued	Overvalued	Total
Financials	70.0%	30.0%	77,71,173	32,35,379	1,10,06,552
Industrials	53.9%	46.1%	30,69,211	21,74,160	52,43,372
Utilities	69.2%	30.8%	14,58,139	5,45,304	20,03,443
Consumer Staples	28.6%	71.4%	9,09,620	21,60,149	30,69,769
Health Care	32.4%	67.6%	4,78,529	23,86,584	28,65,113
Information Technology	39.7%	60.3%	6,77,770	39,22,079	45,99,849
Communication Services	60.0%	40.0%	3,31,772	14,32,331	17,64,103
Consumer Discretionary	35.6%	64.4%	10,34,183	40,57,256	50,91,439
Energy	77.3%	22.7%	14,62,312	21,75,149	36,37,461
Materials	51.8%	48.2%	17,36,425	32,46,904	49,83,329
Real Estate	66.7%	33.3%	3,95,650	3,51,067	7,46,717
Grand Total			**1,93,24,785**	**2,56,86,361**	**4,50,11,146**

Exhibit 14 : Valuation Distribution Across Sectors (2/2)

Source : OmniScience Insights Labs

Sectors with Favourable Prospects

- *Financials* stand out as the most attractively positioned sector. With expected earnings growth of 13.0%, the sector is trading at a relatively modest P/E of 17.1x. Around 70% of companies in the sector are assessed as fairly valued or undervalued, with a market capitalisation of approximately ₹78 lakh crore. Given its size and valuation support, Financials remain a key area where mispricing appears favourable.
- *Utilities* also appear reasonably valued. The sector is expected to deliver 11.0% earnings growth and is trading at a P/E of about 21.0x. Nearly 69% of companies fall in the fair or undervalued category, covering a market capitalisation of roughly ₹15 lakh crore. Valuations in this sector appear aligned with growth expectations.
- *Industrials* has a relatively strong growth outlook of 18.2%, to justify a higher P/E of 38.0x. Still, about 54% of companies are assessed as fair or undervalued, representing a sizeable market capitalisation of around ₹31 lakh crore.

Energy appears inexpensive on valuation metrics; however, earnings growth expectations for the sector remain limited, which tempers its attractiveness despite low multiples. Real estate, on the other hand, screens as relatively inexpensive given its high expected growth, but the durability and sustainability of this growth remain uncertain, warranting a more cautious assessment.

Sectors to Be Cautious of

- *Consumer Staples* appear stretched at current levels. With earnings growth of around 10.9%, the sector is trading at a high P/E of 36.9x. About 71% of companies in the sector are assessed as overvalued, suggesting limited valuation comfort.
- *Health Care* also shows signs of overvaluation. Despite expected earnings growth of 10.9%, the sector is trading at a P/E of over 40x. Approximately 68% of companies are classified as overvalued, indicating that valuations are demanding relative to growth.
- *Information Technology* continues to face valuation pressure. With comparatively lower expected earnings growth of 8.8%, the sector is trading at a P/E of about 31.6x. Around 60% of companies are assessed as overvalued, suggesting that expectations remain elevated despite a moderation in growth.

Based on the sectoral analysis, there are roughly 70 fairly valued or undervalued companies in Financials, 83 in Industrials and 18 in Utilities. Even in sectors where valuations appear stretched, such as Consumer Staples, Health Care, and Information Technology, there are over 60 companies that continue to trade at fair or undervalued levels. This breadth of opportunities underscores that headline valuations mask substantial dispersion beneath the surface.

Importantly, across the broader market, there are more than 400 companies that are potentially undervalued, of which around 170 belong to the NIFTY 500, with the remainder drawn from the wider universe beyond the top 500 companies. Whether viewed by market capitalisation or by sector, it is clear that the market continues to offer ample opportunities for active investors to generate alpha.

Omni Take

In this environment, an active investment approach should be able to identify mispriced opportunities and deliver value through careful security selection. This underscores the role of a disciplined, Scientific Investing Framework, in systematically identifying mispricing and delivering alpha, especially when markets are noisy and narratives dominate.

Setting Capital Market Expectations

Against the current market backdrop, it is important to frame realistic return expectations for Indian investors. We compare prospective outcomes from passive investing with those from active strategies and highlight the factors that are likely to drive returns.

From a fundamental perspective, equity returns are driven by three primary components: earnings growth, changes in valuation multiples (re-rating or de-rating), and dividend yield. In the Indian equity market, dividend yield plays a relatively limited role in overall returns, with earnings growth and changes in valuation multiples accounting for the bulk of long-term performance. Below we attempt to frame expected outcomes in this context.

For a passive index investor, if the NIFTY 500 continues to deliver earnings growth of around 10%, returns are likely to be in the single-digit range, as any de-rating from current slightly elevated valuations would offset part of the growth. If earnings growth improves to the low-teens, return expectations could move to around 12–13%, largely driven by growth, with limited contribution from re-rating as valuations normalise toward fair value. In a scenario where earnings growth accelerates to 14–15%, investors could expect an additional 2–3% of return from valuation re-rating. A more pronounced decline in interest rates (if rates fall below 5%), would further support valuation expansion and enhance the contribution from re-rating.

We now chart the return potential available to an active investor who can systematically identify and allocate to the undervalued pool, where both earnings growth and valuation normalisation can contribute meaningfully to outcomes. The undervalued pool is characterised by a median P/E of about 22.5x and expected earnings growth of roughly 15.7%. At this combination of growth and valuation, the pool appears positioned for potential re-rating over time. If earnings growth sustains close to current expectations and valuations adjust toward fair value (PE of ~31x), re-rating could add an incremental 6% over 5 years and 11% over 3 years to returns over and above earnings growth. Under such a scenario, total returns could be ~26% on a three-year basis and ~22% on a five-year basis, driven by a combination of growth and valuation normalisation.

That said, sustaining 15–16% growth over a full five-year period may prove challenging. In a more conservative scenario where earnings growth moderates to around 13–14%, and valuations re-rate to a fair multiple closer to 29x PE, re-rating could still contribute 5–8% to returns. This would imply total return potential of roughly 21-22% over three years and 18–19% over five years.

Overall, while outcomes will remain sensitive to growth delivery and valuation discipline, the current positioning of the undervalued pool suggests that attractive medium-term return potential exists, particularly if earnings growth holds up and valuations gradually normalise.

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