

India | Theme Update

Q3 2026

In a Nutshell

Self-help and de-rating build base for Q4 rotation

Summary

Indian equities consolidated in the third quarter (Q3) of 2026, giving back a portion of their strong Q2 rebound. Against a backdrop of surging global bond yields, oil returning above \$100 and a weak monsoon, the Xtrackers MSCI India Swap ETF fell -5.6% (all dollar terms), lagging a +1.7% rise in the FTSE All-World index.

Near-term performance was held back by foreign outflows and heavy domestic share issuance. Over the past two years, global investors have rotated out of India to fund allocations into AI-dominated Asian markets such as Taiwan and South Korea – halving India's weight in the MSCI Emerging Markets (EM) index and leaving two-thirds of EM funds underweight the country.

In contrast to foreign investor capitulation, India's fundamentals and policy self-help have rarely been stronger. Record non-resident deposit inflows have bolstered FX reserves and bank liquidity, corporate leverage sits at a 25-year low, profit growth is rebounding strongly, domestic fund inflows remain at record highs and equities have de-rated to a rare P/E discount to global markets.

Post-quarter-end trading has brought a marked shift in absolute and relative performance. While India's negligible correlation to the AI-led bull market has been a headwind this year, its diversification value has been evident in early Q4 (to 15 October): the Sensex is up +3.0%, diverging from the sea of red across Asian indices, led by South Korea's Kospi (-17.8%). As Sarda Capital highlights, the Nifty 500's correlation to the global AI complex has been just 0.11 in 2026 – during the ten worst days for AI stocks this year (averaging -3.9%), the Nifty 500 fell just 0.2% on average.

Macro & Industry Developments

Headwinds & Self-Help

Q3 delivered a stiff macro test for India. Alongside resurgent oil prices driven by the US–Iran conflict, the unfolding El Niño we flagged in Q2 resulted in India's worst monsoon in over a decade. To contain food and energy inflation risks, the Reserve Bank of India (RBI) reversed its 2025 easing cycle with a precautionary rate hike.

True to form, policymakers countered these external pressures with decisive self-help measures. Repeating its successful 2013 'Taper Tantrum' playbook on a much larger scale, the RBI mobilised \$132.9bn (3.1% of GDP) in non-resident foreign-currency deposits in August – bolstering reserves and domestic bank liquidity to fund decade-high credit growth. Simultaneously, New Delhi scrapped withholding and capital gains taxes for foreign investors in sovereign bonds, clearing the path for Bloomberg Global Aggregate Index inclusion and an estimated \$25bn in passive inflows.

Chart: Banking system credit growth trend (YoY%)

Source: Jefferies, Kotak, RBI

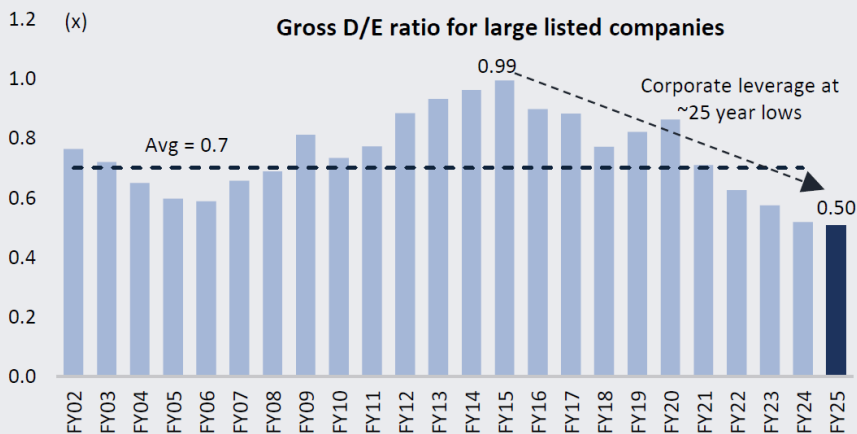
Aided by \$132.9bn in non-resident inflows, bank deposit growth surged to 17.3% YoY in September, funding an 18.1% YoY expansion in bank credit

Earnings & Balance Sheets

Despite higher oil prices, domestic economic activity accelerated through Q3. Real GDP grew by 7.8% YoY in Q2 – nearly triple the pace of global growth – underpinned by rising private investment and double-digit growth in power demand and auto sales following recent tax cuts.

This domestic momentum is feeding directly into the bottom line: after a spell of single-digit growth in 2024–25, corporate earnings rose +17.7% YoY in Q2 and are projected to exceed +20% in Q3. With corporate leverage sitting at a 25-year low, Indian companies are well insulated from higher interest rates and well placed to fund the next leg of capital expenditure.

Corporate leverage at multi-decade lows

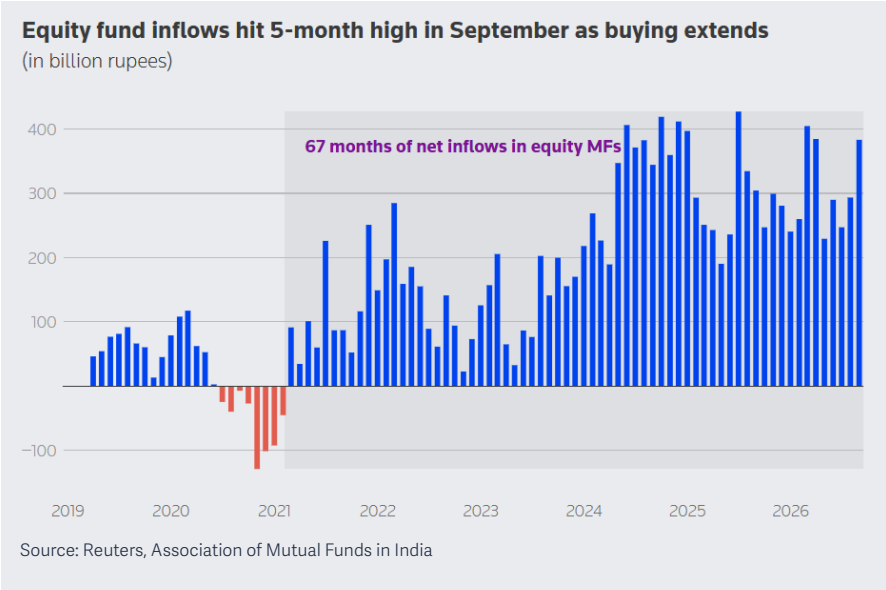


Source: CMIE, Jefferies, WhiteOak

Gross debt-to-equity for large listed Indian corporates has halved over the past decade to a 25-year low of 0.50x

Domestic Inflows

The structural migration of Indian household savings into equities continues to support the domestic market. While foreign investors sold Indian equities in Q3, domestic equity mutual funds recorded their 67th consecutive month of net inflows in September. Systematic investment plan (SIP) contributions reached a record ~\$3.4bn per month, lifting total domestic mutual fund net buying to +\$39.5bn YTD (following a record +\$58.1bn in 2025).

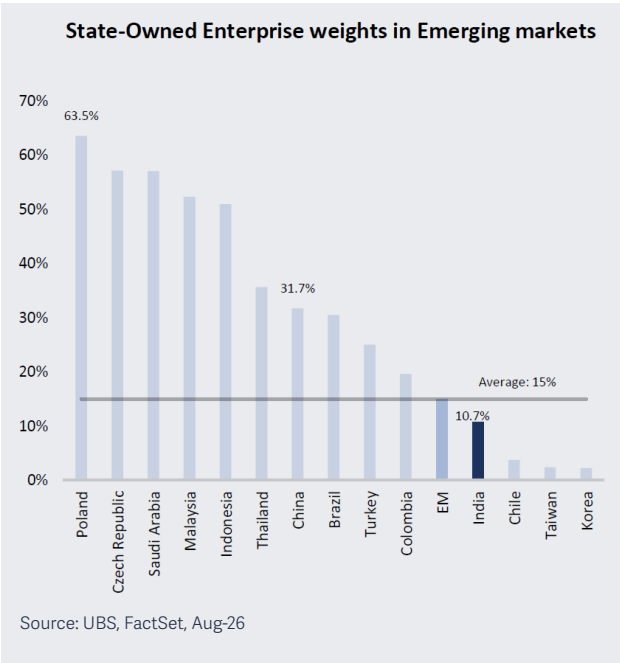


Domestic equity mutual funds have recorded 67 consecutive months of net inflows, underpinned by record monthly savings-plan contributions of ~\$3.4bn from Indian households

Oil, Ownership & Tariffs

To shield households from higher crude prices, New Delhi has held petrol and diesel prices steady since May – requiring state-owned retailers to absorb the margin squeeze. Equity investors are largely insulated from state intervention, with nearly 90% of the MSCI India index in private-sector hands. The pro-market trajectory was reinforced by the sale of a 60.7% stake in IDBI Bank to Fairfax Financial in October – India’s largest privatisation since Air India in 2022 – even as countries such as the UK move in the opposite direction via nationalisation.

Likewise, while US lawmakers have debated secondary tariffs linked to Russian oil imports, MSCI India companies generate 77% of their revenues domestically, and exemptions for IT Services and Pharma leave just 1.4% of index revenues exposed to US tariffs.

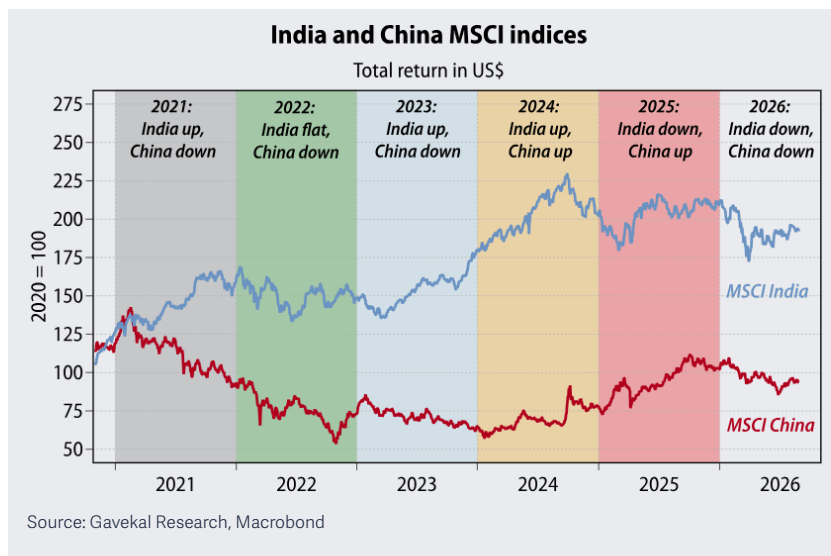


State-owned enterprises account for just 10.7% of MSCI India – below the 15.0% EM average and a third of China's 31.7% – insulating investors from state-directed policy

Performance

The Xtrackers MSCI India Swap ETF fell -5.6% (dollar terms) in Q3, trailing the +1.7% rise in the FTSE All-World index by 7.3%. Over the past two years, extreme concentration in AI hardware has reshaped the EM landscape: Taiwan and South Korea now account for over 50% of the MSCI EM index, while India's weight has almost halved from ~20% in September 2024 to 10.7%. With two-thirds of global EM funds now underweight India and foreign ownership of large caps at a 10-year low of 17.6%, foreign positioning is washed out. JPM estimates that a simple return to benchmark weight implies \$115bn of foreign inflows.

Within our broader portfolios, we hold Indian equities alongside onshore Chinese equities (via the Amundi MSCI China A Swap ETF), which have historically acted as each other's 'yin and yang' – moving in opposite directions in 2021, 2023 and 2025 to dampen volatility. While both markets have unusually consolidated in 2026, Chinese President Xi Jinping's September visit to India – his first in seven years – hints at a pragmatic thaw in bilateral trade and commodity ties that offers unpriced upside for both allocations.

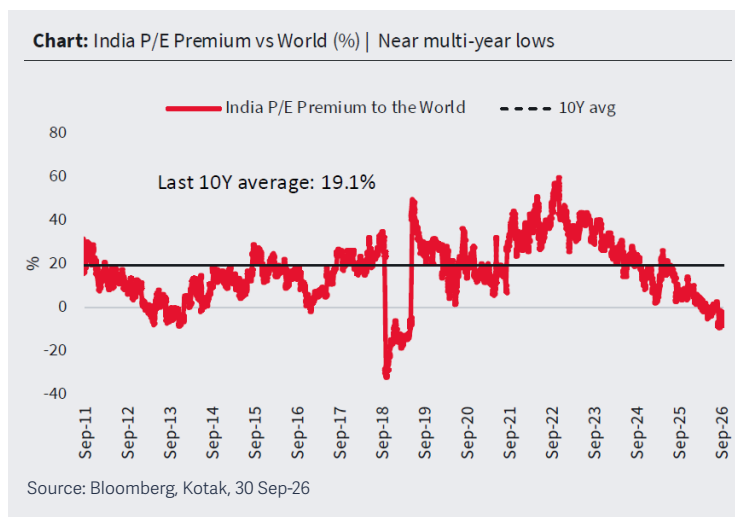


Historically, Indian and Chinese equities have moved inversely, acting as natural portfolio diversifiers. Following a rare simultaneous pullback in 2026, both markets are priced for diplomatic caution

Valuation

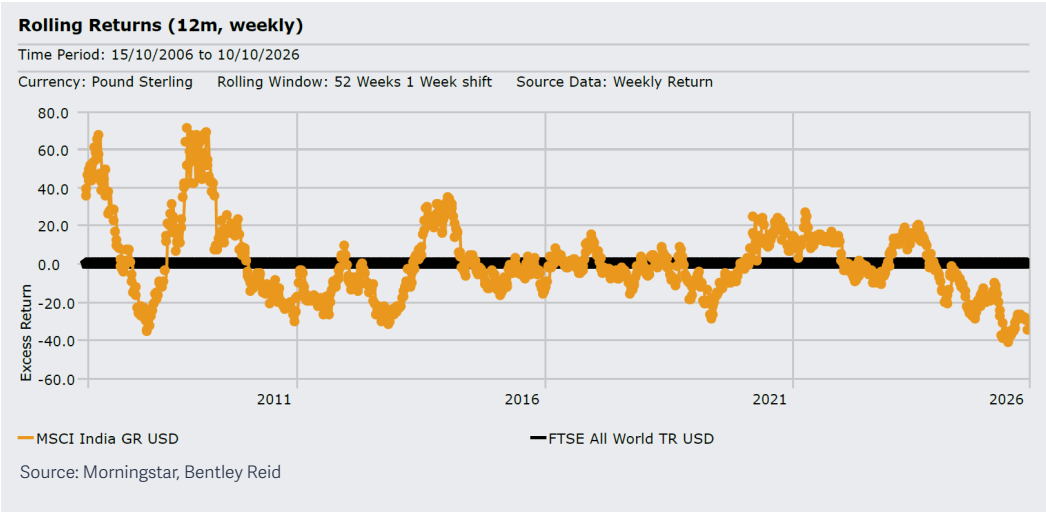
Two years of relative underperformance coupled with rising corporate earnings have transformed India's valuation profile from a perennial premium into a rare discount to global markets.

On an absolute basis, the Nifty 12-month forward P/E has compressed to 17.2x – more than one standard deviation below its 10-year average (20.9x) – placing the market on an attractive price-to-earnings-growth (PEG) ratio of just 1.1x against consensus expectations for 16-17% annual earnings growth over the next two years.



Having traded at an average 19.1% P/E premium to global equities over the past decade, India has de-rated into a rare valuation discount, while its forward P/B (2.5x) also sits well below its 10-year average (2.9x)

Similarly, India’s 12-month rolling return versus the FTSE All-World sits near the bottom of its 20-year range – a trough from which Indian equities have historically delivered strong performance.



Positioning

We access the India theme via the Xtrackers MSCI India Swap ETF, the cheapest available Indian equity ETF (0.19% annual fee).

The fund invests in 165 companies listed in India. Top holdings in this market-cap-weighted index include HDFC Bank, Reliance Industries and ICICI Bank (at 30 September 2026).

The fund’s swap structure avoids India’s onerous capital gains tax (CGT), which ranges from 12.5% to 20.0% on physical transactions and drags heavily on physically implemented competitor funds.

Top 10 index constituents

Issuer	ISIN	Weight
HDFC BANK	INE040A01034	6.94%
RELIANCE INDUSTRIES LTD	INE002A01018	6.15%
ICICI BANK	INE090A01021	5.63%
BHARTI AIRTEL LTD	INE397D01024	3.89%
AXIS BANK	INE238A01034	2.43%
INFOSYS	INE009A01021	2.42%
LARSEN AND TOUBRO LTD	INE018A01030	2.18%
MAHINDRA AND MAHINDRA LTD	INE101A01026	2.12%
BAJAJ FINANCE LTD	INE296A01032	1.87%
KOTAK MAHINDRA BANK LTD	INE237A01036	1.71%

Source: DWS

The fund invests in large- and mid-cap companies listed in India, covering 85% of the free-float Indian market capitalisation

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