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'The risk-reward potential looks better in large-caps at this stage'

1 In a significant part of the large-cap sector, the valuations have become reasonable and growth could surprise on the upside in FY26. **Rahul Singh**, chief investment officer, Equities, Tata Mutual Fund, in an interview to **Saikat Neogi** underlines that the expectations on mid- and small-caps in terms of earnings growth are on the higher side and could see disappointment if there are execution challenges or persistent macro slowdown.

What kind of asset allocation strategy should a retail investor look at in the new year?

Asset allocation can be 40% in balanced/hybrid/multi asset funds, another 30-40% in core diversified categories like large-caps coupled or large and mid-caps and remaining in small cap/sectoral funds (banking/healthcare). However, it also depends on the investor's risk appetite and goals to be achieved.

Should investors now take a staggered approach to invest in select mid- and small-caps?

Mid- and small-caps are trading at premium to large caps. Some of that is justified by the nature of the economic growth that has been led by the investment cycle recovery which

benefits the sectors that are small-cap and mid-cap dominated. However, the risk-reward potential seems better in large-caps at this stage. In a significant part of the large-cap sectors, the valuations have become reasonable and growth could surprise on the upside in FY26. On the other hand, the expectations on mid- and small-caps in terms of earnings growth are on the higher side and could see disappointment if there are execution challenges or persistent macro slowdown. Even though the capex cycle recovery is supportive of small- and mid-caps, a staggered approach will reduce the risk inherent in valuations.

How can hybrid funds offer a balanced investment approach?

By allocating funds in equity and debt based on

LONGER DURATION FUNDS, GILT FUNDS & CORPORATE BOND FUNDS MAY BE PREFERRED FOR UPCOMING RATE CYCLE



equity market valuations, these funds not only help manage the volatility risk but also can take advantage of that. Also, the allocation changes are done based on a formula which removes the emotion from that decision.

What are the pockets of opportunities available now?

We are currently positive on the banking and pharma/healthcare sectors. The banking sector is particularly attractive from a valuation standpoint, given that they are trading at a 35% discount to the Nifty 50, which is three times their historical average. The recent regulatory actions and the Reserve Bank of India's hawkish stance notwithstanding, we anticipate growth drivers for banks in 2025. However, we prefer private banks over their public sector undertaking (PSU) peers due to their superior profitability and historically low valuation gap compared to the latter.

In the pharma/healthcare sector, we see a blend of cyclical recovery, outsourcing

opportunities, and structural growth in hospitals and diagnostics. While valuations, especially in hospitals and branded generics, have risen sharply, we expect earnings momentum to continue, supporting these valuations and delivering compounding returns. We remain selective, concentrating on large-cap companies with strong earnings potential.

As debt funds offer stability and predictable returns, what types of funds should retail investors look at now?

Given our view on rates, we believe investors should increase the duration and look to invest in longer duration funds. Gilt funds and corporate bond funds may be preferred for upcoming rate cycle.

Inflows into thematic funds have cooled in November. Should investors now take a cautious approach to invest in these funds?

Yes. All the themes like defence, manufacturing, capital goods, power and real estate are becoming more stock specific now, which can be better addressed through the core category diversified funds.