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Liquidity stress in smallcap funds eases to 2.5-yr low

Liquidity stress in smallcap funds eased to its lowest level since February 2024, aided by a sharp recovery in smallcap stocks in recent months. The Nifty Smallcap 250 index is up 26 per cent since April 2026. ABHISHEK KUMAR writes

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Liquidity stress in smallcap funds lowest since February 2024

Experts attribute this to market recovery boosting trading volumes

ABHISHEK KUMAR
Mumbai, 20 July

Aided by a sharp recovery in smallcap stocks in recent months, liquidity stress in smallcap funds in June eased to its lowest level since the industry first began disclosing stress-test data in February 2024.

An analysis of the monthly stress-test disclosures of the 10 largest smallcap funds show the average number of days required to liquidate 50 per cent of their portfolios fell to 27 days in June. It was down from a peak of 44.2 days in January 2026.

The decline in liquidity stress from the January 2026 peak has been particularly sharp for select schemes, like those managed by Quant Mutual Fund (102 to 45 days), Tata Mutual Fund (69 to 36 days and HDFC Mutual Fund (75 to 46 days), shows data published by the Association of Mutual Funds in India (Amfi).

Chandraprakash Padiyar, senior fund manager at Tata Asset Management, said the surge in liquidity can largely be attributed to the change in market condition.

"It is mostly a case of market behavior. Over the last three-four months, trading volumes went up significantly in smallcaps as markets recovered. As a result, the expected number of days to liquidate smallcap portfolios has come down materially," he said.

He added that overall liquidity of a portfolio also depends on stock specific factors, such as corporate earnings outlook.

The Nifty Smallcap 250 index, which is the benchmark of most of the smallcap funds, is up 26 per cent since April 2026. The rally is expected to have boosted the trading volumes.

"The overall turnover in the cash segment of the market has seen a significant increase over the past year or so. In FY26, the average daily turnover in National Stock Exchange's (NSE's) cash segment was ₹1.06 trillion. It has surged to ₹1.38 trillion in FY27, so far. Also, Amfi data shows the number of smallcap stocks having average market capitalisation of more than ₹10,000 crore increased from 257 to 310 in the last one year," said Nilesh D Naik, head of PhonePe Mutual Funds.

The monthly stress test reporting was made mandatory by the Securities and Exchange Board of India (Sebi) in light of the growing valuation and liquidity concern in the mid-cap and smallcap space.

This was amid record flows into mutual fund (MF) schemes that predominantly invest in these segments.

However, net inflows into these schemes, which saw a decline as the equity market corrected post September 2024, surged back to elevated levels.

"Investor participation in these categories has remained resilient over the past two years, supported by disciplined investing through systematic investment plans (SIPs) and confidence in India's long-term growth story. Investors are increasingly choosing to stay invested through regular SIPs, allowing the benefits of rupee cost averaging to mitigate the impact of short-term market volatility and valuation concerns," ICRA Analytics said in a note.



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