Bond Index Funds:
Rewarding Debt, Not Discipline

Bond indices often assign weights to their underlying instruments by their indebtedness. This creates a **structural flaw** that many investors may overlook. Read more about its consequences on **Slide 6** of the May'26 Monthly Market Review.

MONTHLY MARKET REVIEW

June 2026

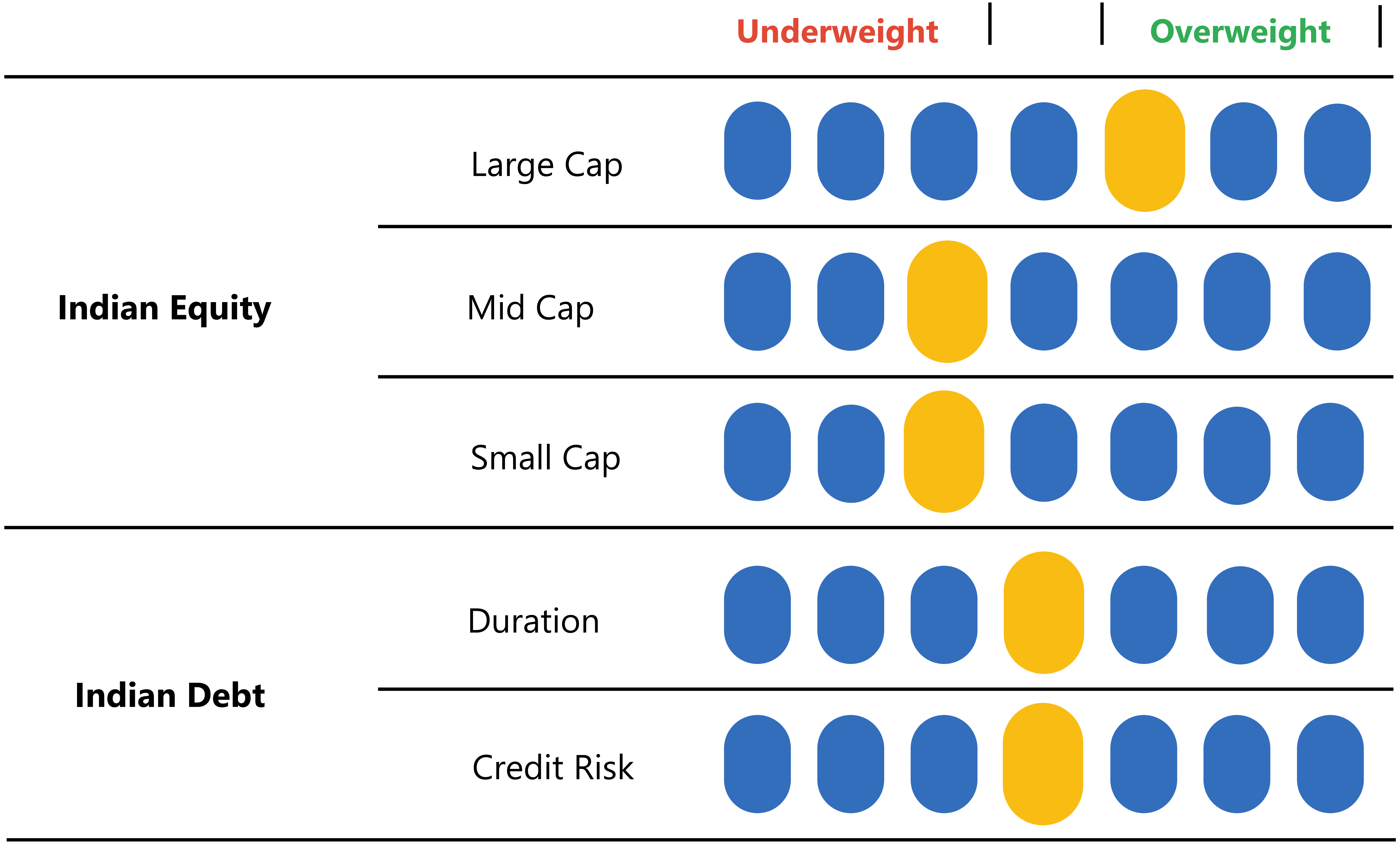
"Buy at the point of maximum pessimism; sell at the point of maximum optimism."
– Sir John Templeton

INDEX

Snapshot

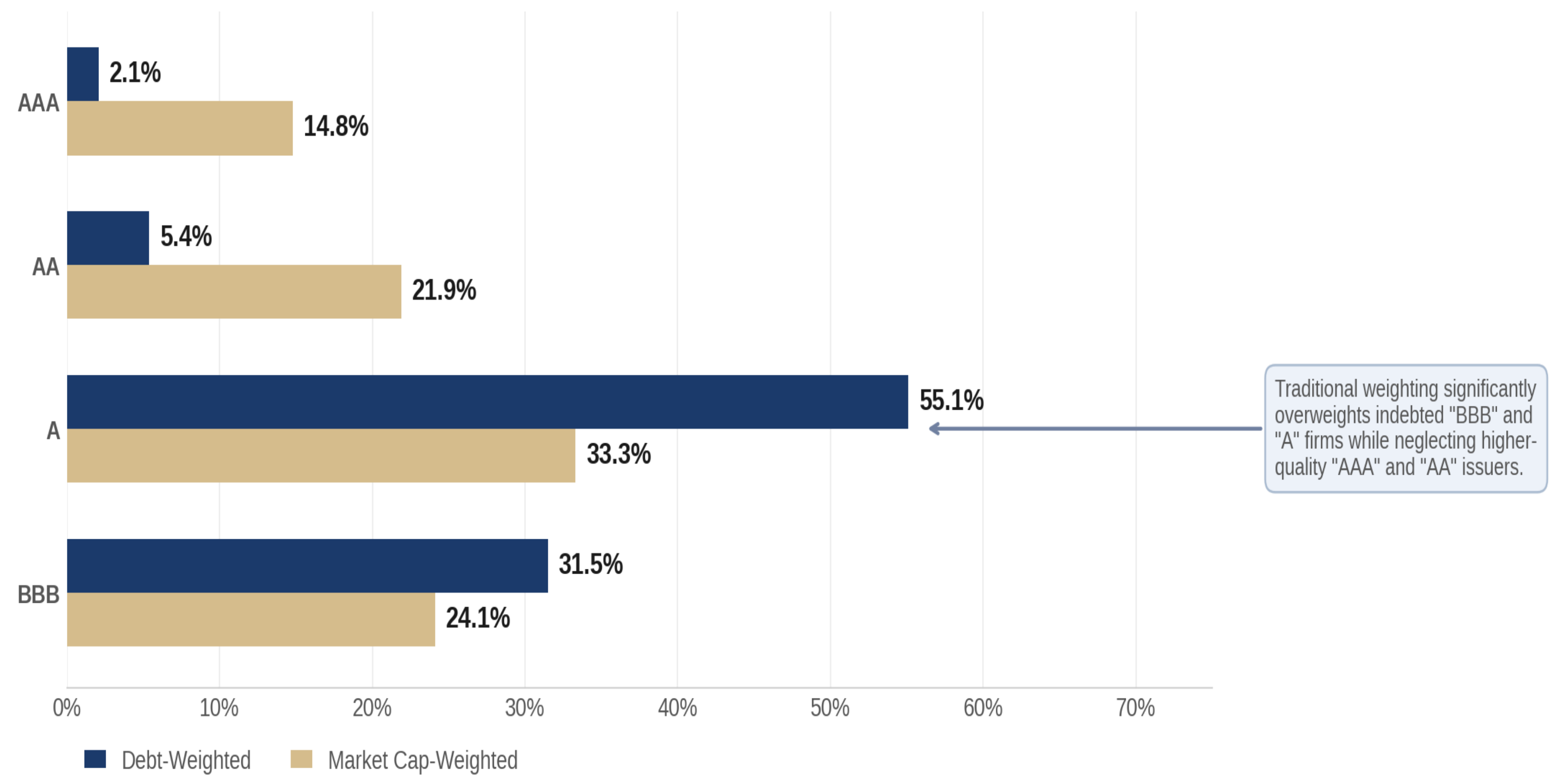
- **Snapshot –** Mid/small caps outperformed in May on domestic DII support; Nifty 50 closed the month down -1.7% under sustained FPI selling pressure.
- **Asset Class Views** – Overweight domestic equity (mid/small caps) and duration; global rate and commodity volatility warrants selective, quality-focused positioning.
- **The Hidden Risks of Bond Indices –** Debt-weighted bond indices systematically overweight leveraged sectors and lower-quality credit, amplify duration and procyclical risk, yet offer liquidity advantages; alternatives and hybrid approaches are emerging globally and in India.
- **India – Equity Market** – Microcaps (+3.0%) and midcaps (+2.6%) led the month while the Nifty 50 (-1.7%) lagged, confirming a structural FPI-DII divergence across capitalisations.
- **India – Equity Market (Sectoral)** – Metals and Pharma outperformed on global commodity tailwinds; IT and FMCG continued de-rating amid US macro headwinds and sluggish domestic demand.
- **India – Equity Market (Valuation)** – Large caps trade near fair value; Defence and Capital Markets sectors appear stretched while IT, FMCG, and Consumption offer contrarian value potential.
- **India – Debt Markets** – Bond yields have softened from recent highs but remain above six-month levels amid elevated borrowing and global rate pressures.
- **India – Macroeconomic Data** – GDP at 7.8%, PMI at 55, and strong auto sales confirm macro resilience; the rupee at 95.06 and softening POL demand reflect geopolitical oil-shock pass-through.
- **US – Equity Market** – Nasdaq returned 41.2% over 1 year on AI-led earnings strength; S&P 500 resilience near all-time highs despite 4.8% Treasury yields signals elevated risk appetite.
- **US – Key Macroeconomic Updates** – Inflation at 3.8%, a historic 8-4 FOMC dissent, and front-end yields above the Fed Funds rate collectively signal rising policy uncertainty and rate-hike tail risk.
- **US – Debt Market & Global Commodities** – Brent crude fell 31% as the Hormuz Strait reopens; gold, silver, and base metals rose amid currency and industrial demand tailwinds; BDI surged 21%.
- **Global Equity Markets** – Japan's Nikkei led globally (+74.7% 1Y) on structural governance reforms; India's extended underperformance vs peers increasingly looks like a contrarian opportunity.
- **Asset Class Returns Summary** – A diversified portfolio in domestic equities and duration bonds is well-positioned for FY27 with tailwinds from rate cuts, consumption recovery, and commodity disinflation.

Asset Class Views



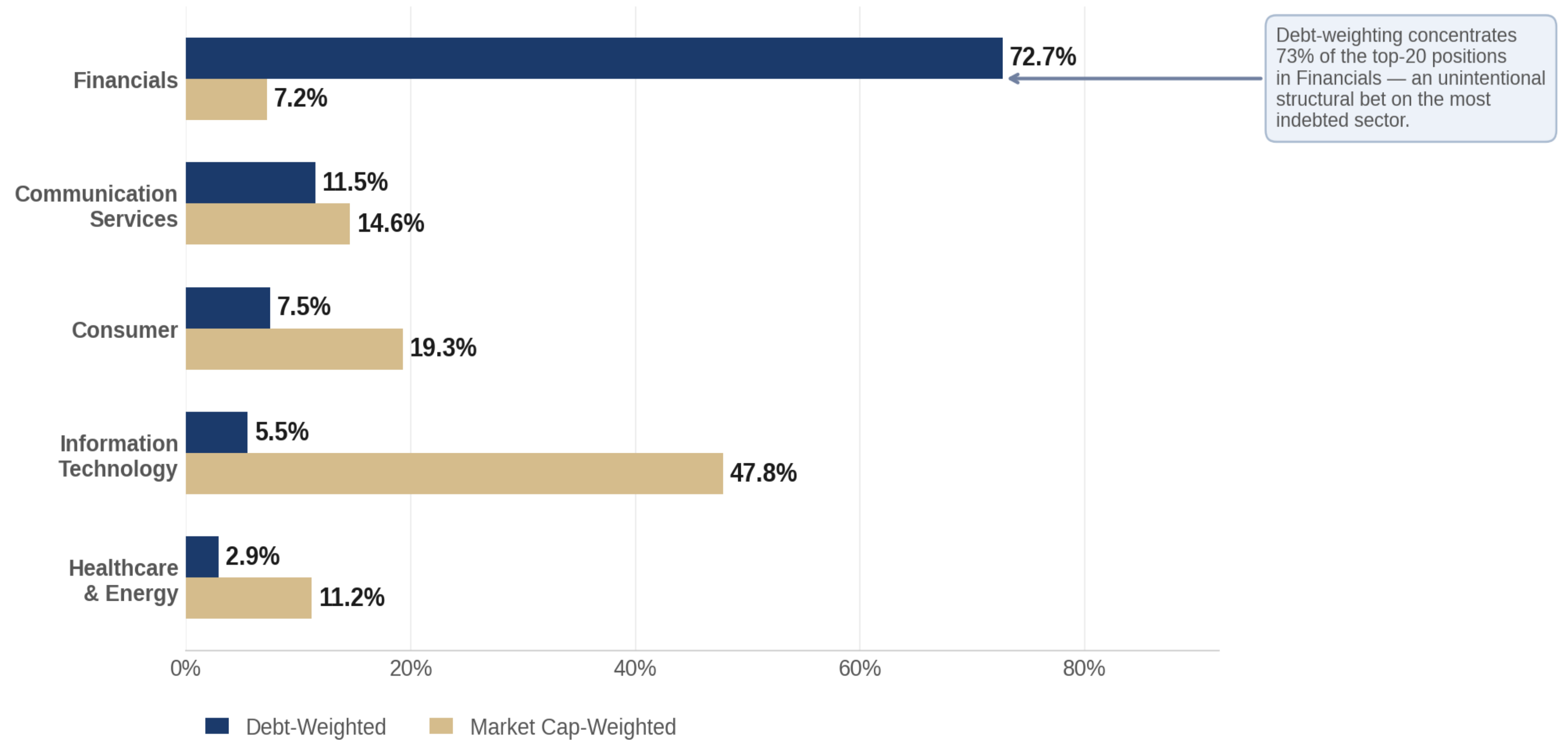
The Hidden Risks of Bond Indices

The Credit Quality Gap: Debt-Weighted vs. Market Cap. Weighted within (S&P500)



***Source: Appleton Partners, Bloomberg, S&P, and Moody's**, using the SSGA SPDR S&P 500 ETF Trust as the S&P 500 proxy, with ratings as of November 28, 2023.*

The Sector Exposure Gap: Debt-Weighted vs. Market Cap-Weighted

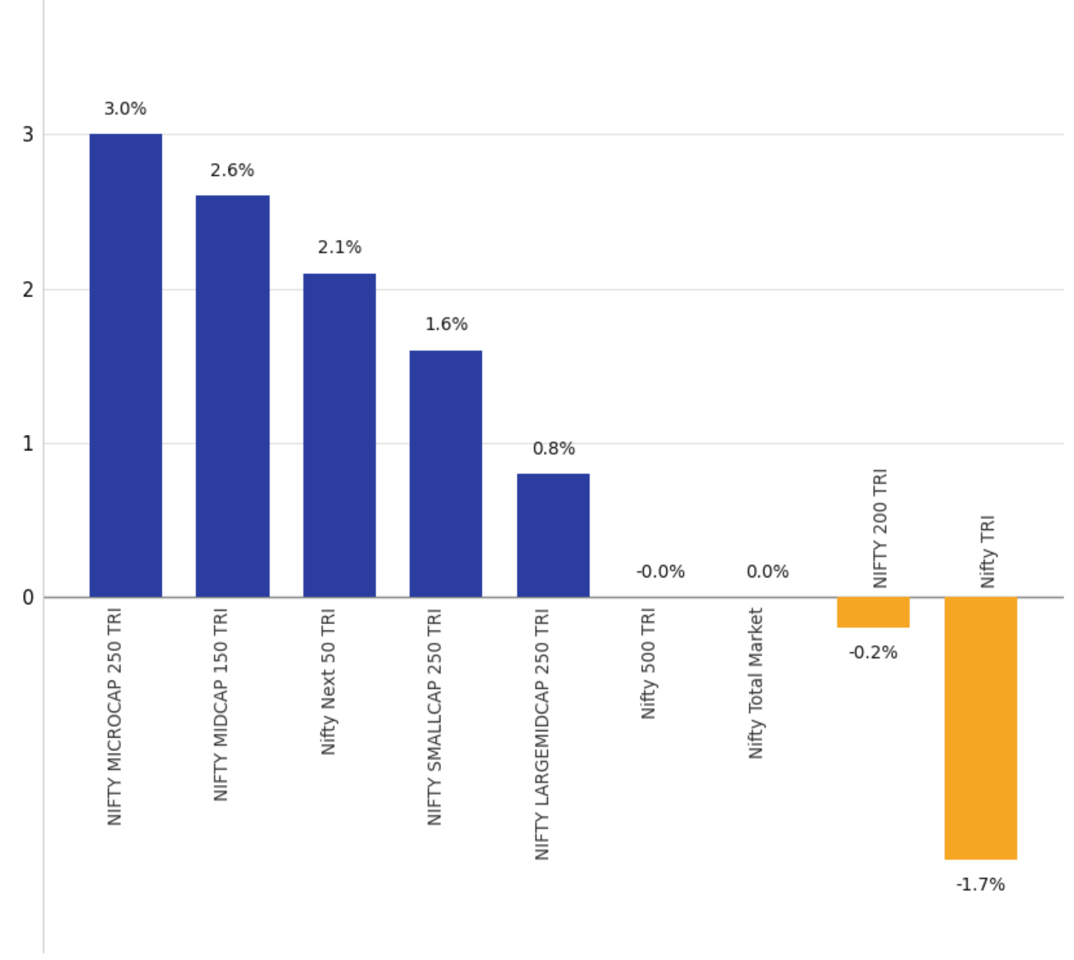


***Source: Appleton Partners, Bloomberg, S&P, and Moody's**, using the SSGA SPDR S&P 500 ETF Trust as the S&P 500 proxy, with ratings as of November 28, 2023.*

- Credit quality gap: Weighting by debt outstanding allocates 2.1% to AAA vs. 14.8% under market-cap weighting, and 5.4% to AA vs. 21.9%, a structural two-notch quality downgrade invisibly embedded in passive bond portfolios that prudent investors should be aware of.
- Sector distortion: Financials command 72.7% of debt-weighted sector exposure vs. 7.2% when market-cap weighted. Likewise, Technology drops from 47.8% to 5.5%. This is called the “Bums Problem”: when the most indebted instruments attract the greatest passive inflows regardless of repayment capacity or creditworthiness.
- Procyclical feedback loop: More debt issued → higher index weight → greater passive inflows. This deepens exposure as credit quality deteriorates. Some Eurozone sovereign bond indices gained index weight at peak leverage ahead of near-default, compelling passive investors to amplify losses at the worst point in the credit cycle.
- Some arguments in favor of debt-weighting indices say that debt-weighted indices offers unmatched market liquidity, scalability, and self-rebalancing efficiency. Additionally, institutional allocators face binding capacity constraints with fundamental alternatives.
- In India, debt-weighted by default: NIFTY Corporate Bond, Banking & PSU, and G-Sec indices weight by outstanding market value, concentrating duration in high-issuance PSU issuers (NHAI, REC, PFC) at decade-high real yields of ~4.0%+. On the opposite spectrum, Invesco India Nifty G-Sec Fund’s hybrid liquidity-plus-outstanding weighting marks early domestic adaptation, and more optionality for investors.

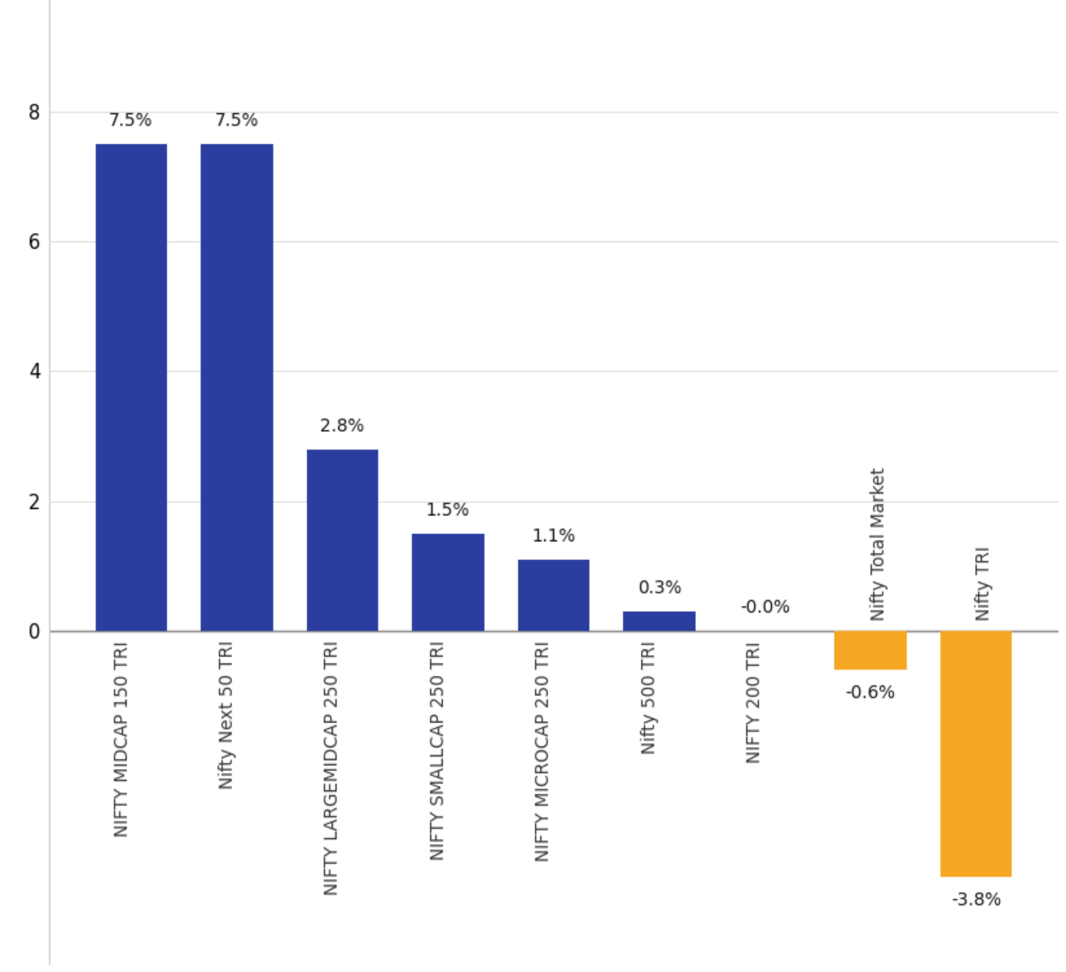
Indian - Equity Market

1 Month Returns



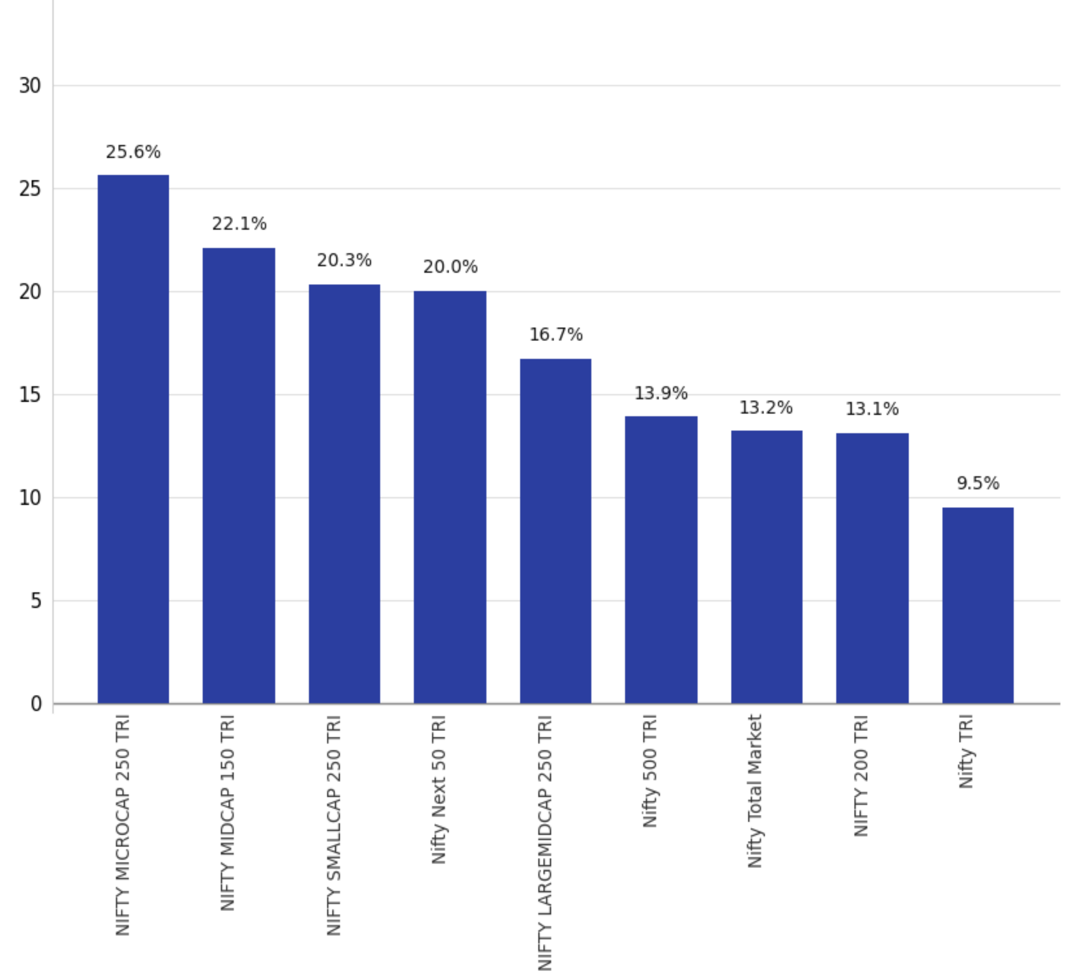
1-Month returns are absolute returns for the period 30-Apr-2026 to 29-May-2026.
Source: NGEN

1 Year Returns



1-Year (30-May-2025 to 29-May-2026) CAGR
Source: NGEN

3 Year Returns

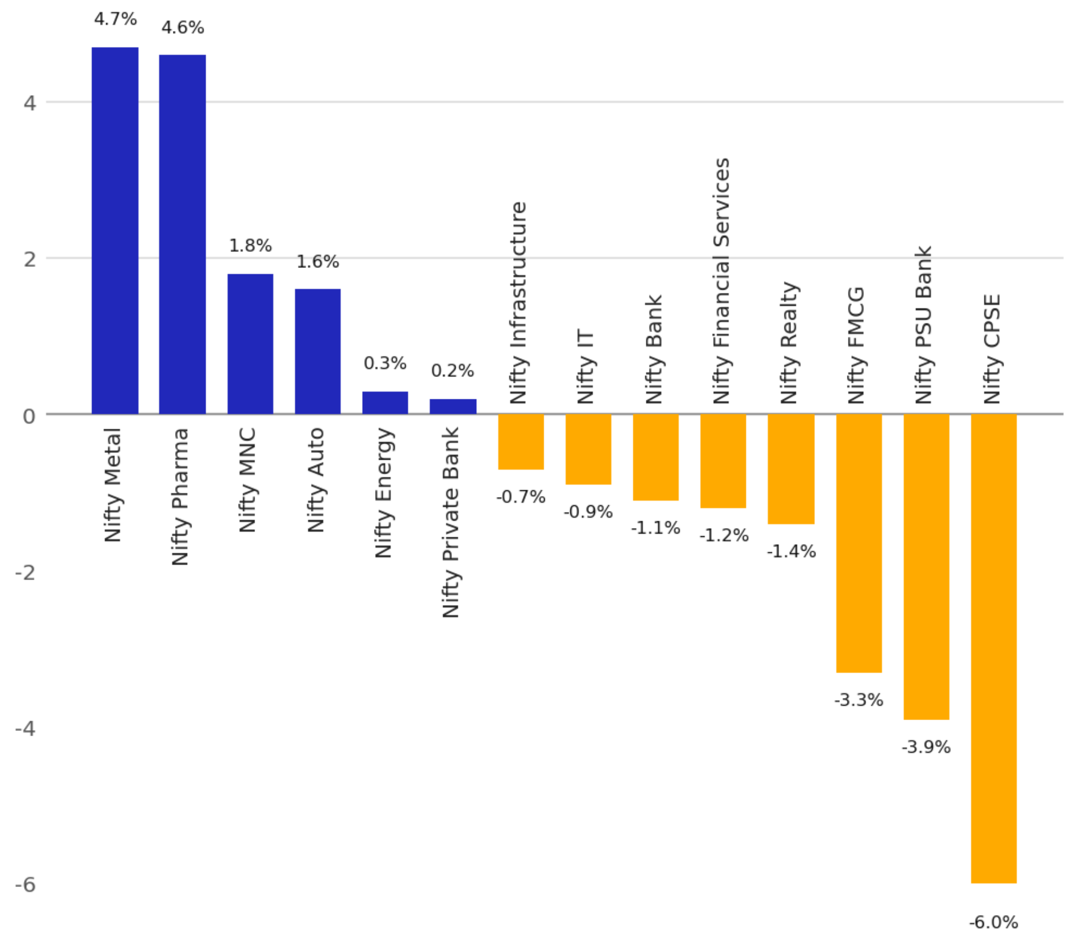


3 Years (31-May-2023 to 29-May-2026) CAGR
Source: NGEN

- Microcap (+3.0%) and midcap (+2.6%) indices outpaced the Nifty 50 (-1.7%) in May, driven by DII-led rotation into domestic-oriented broader market themes at the expense of FPI-dominated large-cap stocks.
- The Nifty's -3.8% 1-year CAGR reflects sustained FPI selling pressure, over $6B in April 2026 outflows alone, amplified by the Hormuz-driven oil spike, rupee depreciation, and elevated import costs.
- The 3-year return differential (Microcap +25.6% CAGR vs Nifty +9.5%) illustrates a structural bifurcation: domestically-driven themes (defence, capex, consumption) outpaced FII-centric blue chips by 16 percentage points.
- Q4 FY26 earnings show median profit growth of ~21.5% YoY across 3,181 stocks, providing support to broader market valuations even as large-cap EPS growth moderated.
- FPI positioning in India is at multi-year underweight levels, a contrarian signal; any geopolitical normalisation or currency stabilisation could catalyse a sharp re-rating rally in Nifty 50 large-cap stocks.

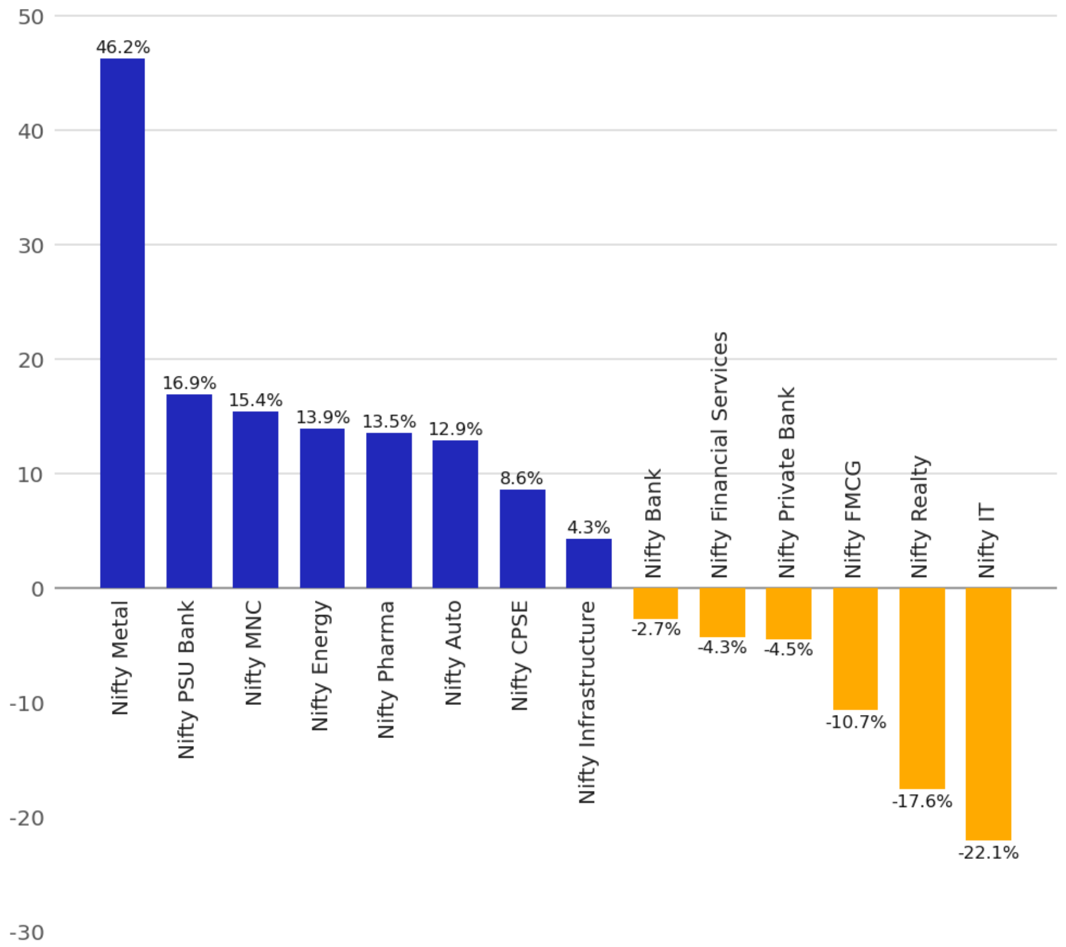
Indian - Equity Market (Sectoral)

1 Month Returns



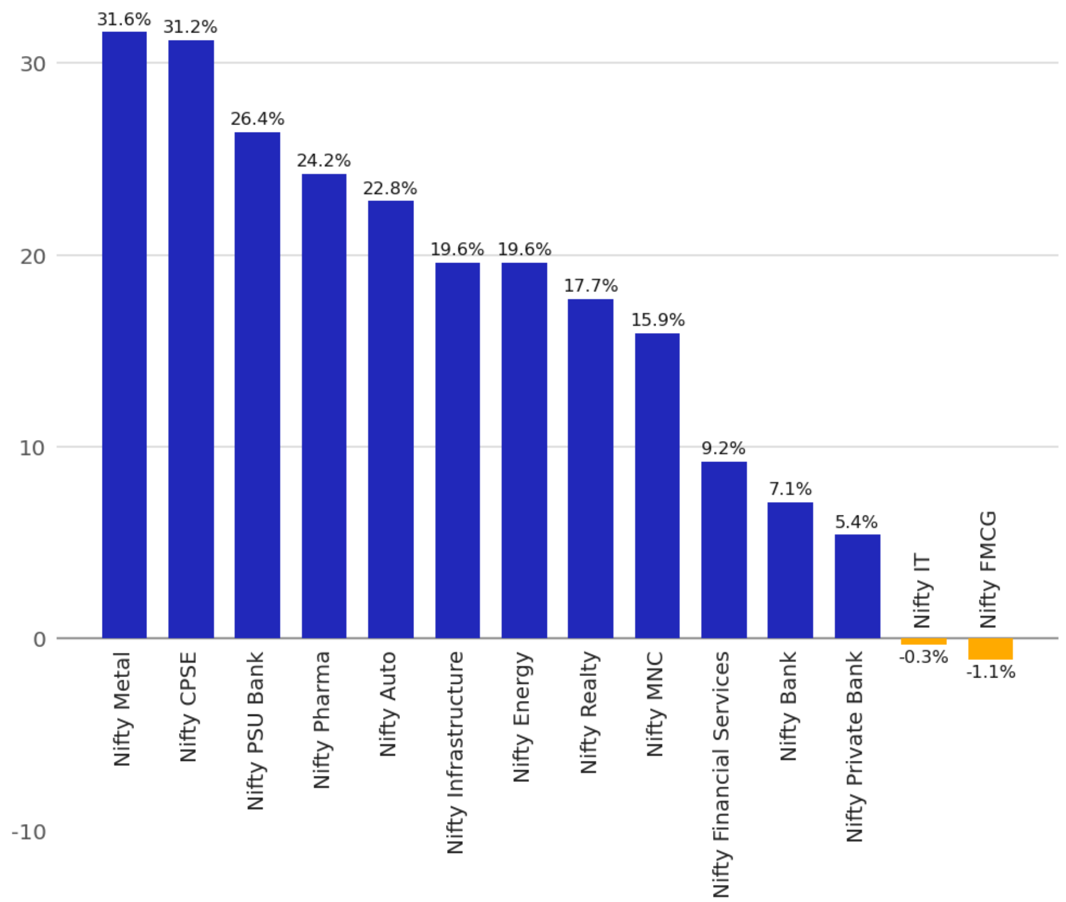
From 30-Apr-26 to 29-May-26 (Absolute Returns)
Source: NGEN

1 Year Returns



From 30-May-25 to 29-May-26 (CAGR Returns)
Source: NGEN

3 Year Returns



From 31-May-23 to 29-May-26 (CAGR Returns)
Source: NGEN

- Metals led all sectors (+4.7% in May, +46.2% 1-year CAGR), driven by China's infrastructure stimulus, India's domestic capex spending, and global supply constraints, a sustained supercycle, not merely a tactical bounce.
- Nifty IT's -17.6% 1-year return is the worst sectoral performance, reflecting AI-driven pricing compression, US enterprise IT budget tightening, and margin compression at key export realisation levels.
- Nifty FMCG's -22.1% 1-year CAGR marks a prolonged valuation reset, elevated input costs, sluggish rural demand during the oil inflation shock, and historically high PE multiples driving persistent de-rating.
- PSU-linked sectors (Metals, CPSE, PSU Banks) dominate the 3-year CAGR leaderboard (26-32%), reflecting structural re-rating on improved governance, generous dividend policies, and sustained government capex beneficiary status.
- Private banks' underperformance (-3.9% in May, +5.4% over 3 years) despite healthy NII growth suggests markets are pricing medium-term risks: NIM compression, credit cost normalization, and NBFC asset quality concerns.

Indian Equity Market (Valuation)

Valuation: Broader Market Indices

	Current PE (29th May)	5Y Avg PE	Current PB (29th May)	5Y Avg PB
Nifty 50	20.3	21.8	3.2	5.2
Nifty Next 50	19.3	22.9	3.8	4.9
Nifty 100	20.1	22.1	3.3	4.9
Nifty 200	21.5	22.9	3.5	4.2
Nifty 500	22.4	23.4	3.6	4.9
Nifty Total Market 750	22.6	23.3	3.6	7.0
Nifty LargeMidcap 250	23.9	25.4	3.9	4.8
Nifty Midcap 150	28.9	30.3	4.8	5.2
Nifty Smallcap 250	33.7	26.1	3.6	4.9
Nifty Microcap 250	27.1	30.1	3.4	4.4

(Source: Trendlyne on 1st and 2nd June)

Valuation: Sectoral Indices

	Current PE (29th May)	5Y Avg PE	Current PB (29th May)	5Y Avg PB
Nifty Bank	13.7	15.0	1.9	2.5
Nifty Pvt. Bank	17.3	16.5	2.1	2.5
Nifty PSU Bank	7.9	7.7	1.3	1.2
Nifty Financial Services	16.3	16.6	2.7	3.3
Nifty Capital Markets	48.2	35.8	13.8	12.7
Nifty Energy	15.5	12.5	2.5	2.3
Nifty Metal	20.1	17.0	3.5	2.4
Nifty Infra	21.0	19.0	3.1	3.0
Nifty Auto	30.4	31.9	4.5	5.0
Nifty Manufacturing	27.3	23.6	4.6	4.3
Nifty Defense	55.7	37.8	12.1	9.7
Nifty FMCG	34.0	38.9	8.6	10.7
Nifty Consumption	36.2	39.0	7.5	8.4
Nifty IT	19.8	26.3	5.4	8.0
Nifty Pharma	37.6	30.9	5.3	4.9
Nifty Healthcare	40.3	34.3	5.8	5.4

(Source: Trendlyne on 1st and 2nd June)

- Large-cap indices (Nifty 50 PE: 20.3x; Nifty 100 PE: 20.1x) trade slightly below 5-year average PEs of ~21-22x, indicating fair-to-slightly-attractive valuations, a measured entry opportunity for long-horizon investors.
- Nifty Smallcap 250's current PE of 33.7x significantly exceeds its 5-year average of 26.1x, a stretched valuation premium vulnerable to sentiment shifts or liquidity withdrawal, which could trigger sharp mean-reversion.
- Nifty IT at 19.8x PE vs a 5-year average of 26.3x appears deeply discounted historically, but the gap reflects structural earnings headwinds; re-rating requires a clear catalyst, BFSI tech spending recovery or AI monetisation.
- Defence (PE 55.7x vs 5Y avg 37.8x) and Capital Markets (PE 48.2x vs 5Y avg 35.8x) carry the most elevated valuations, sustainable only if order books remain intact; any execution shortfall risks sharp de-rating.
- FMCG (PE 34.0x vs avg 38.9x) and Consumption (PE 36.2x vs avg 39.0x) are trading below historical averages, a contrarian entry signal contingent on India's rural demand recovery and wage growth acceleration in H2 FY27.

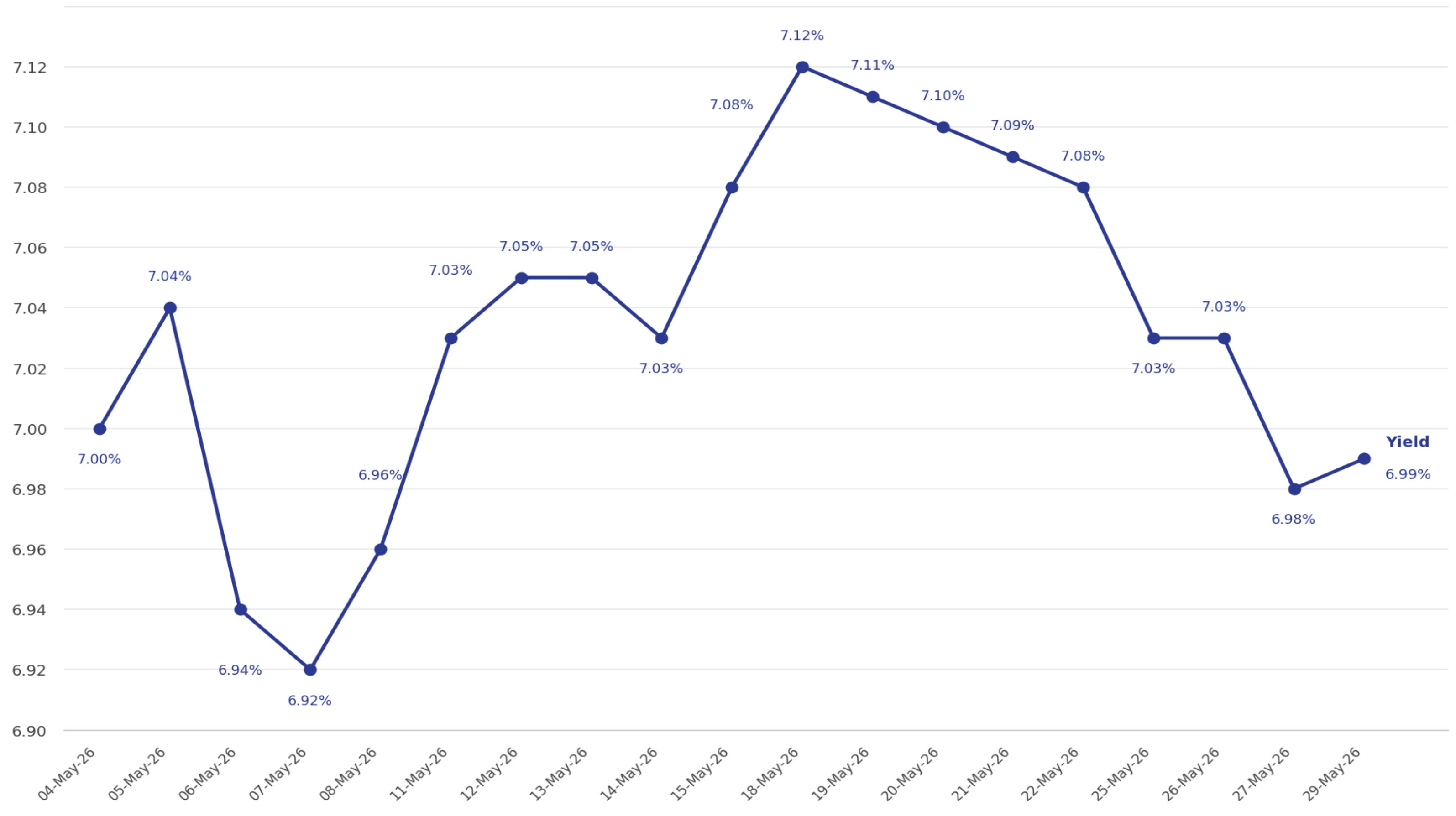
India - Debt Markets

Debt Market Indicators

Instrument	4-May-26	1 Week Ago	1 Month Ago	6 Months Ago
Call Rate	5.29%	5.12%	5.20%	5.42%
5 Year G-Sec	6.78%	6.68%	6.89%	6.18%
10 Year G-Sec	7.02%	6.94%	7.14%	6.53%
1 Year AAA Corporate Bond	7.58%	7.49%	7.58%	6.99%
3 Year AAA Corporate Bond	7.43%	7.36%	7.72%	6.80%
5 Year AAA Corporate Bond	7.50%	7.44%	7.73%	6.93%

Source: https://www.kotakmf.com/daily_newsletter • Created with Datawrapper

10 Year G-Sec Movement



Source: Ngen • Created with Datawrapper

- The 10Y G-Sec declined from a May peak of 7.12% to 6.99%, a 13bps easing driven by receding headline inflation, RBI's hold at 5.25%, and initial normalisation of Brent crude from its Hormuz-crisis highs.
- All maturities remain significantly elevated vs 6 months ago (10Y: 6.99% vs 6.53%), tracking global rate pressures, India's Rs.17.2T gross borrowing programme, and residual geopolitical risk premia in long-end bonds.
- AAA corporate bond spreads remain tight (~80-90bps over G-Secs), indicating strong credit demand and limited system-level stress; however, spread widening risk is elevated if a global risk-off episode intensifies.
- The call rate at 5.29% (above the 5.25% repo rate) signals persistent liquidity tightness; if RBI resumes easing in H2 FY27, both short and long-duration bond portfolios stand to benefit significantly from carry and capital gains.

India - Macroeconomic Data

Data Snapshot

Description	Data (unit)
Inflation Rate (%)	3.48
Indian Rupee	95.01
Interest Rate - Policy Rate (%)	5.25
Unemployment Rate (%)	5.2
GDP annual Growth Rate (%)	7.8
Government Debt to GDP (% of GDP)	81.29
Current Account to GDP (% of GDP)	-0.6
Current Account (USD Million)	-13172
Gold Reserves (tonnes)	880.52
Manufacturing PMI (points)	55

(Source : NGEN)

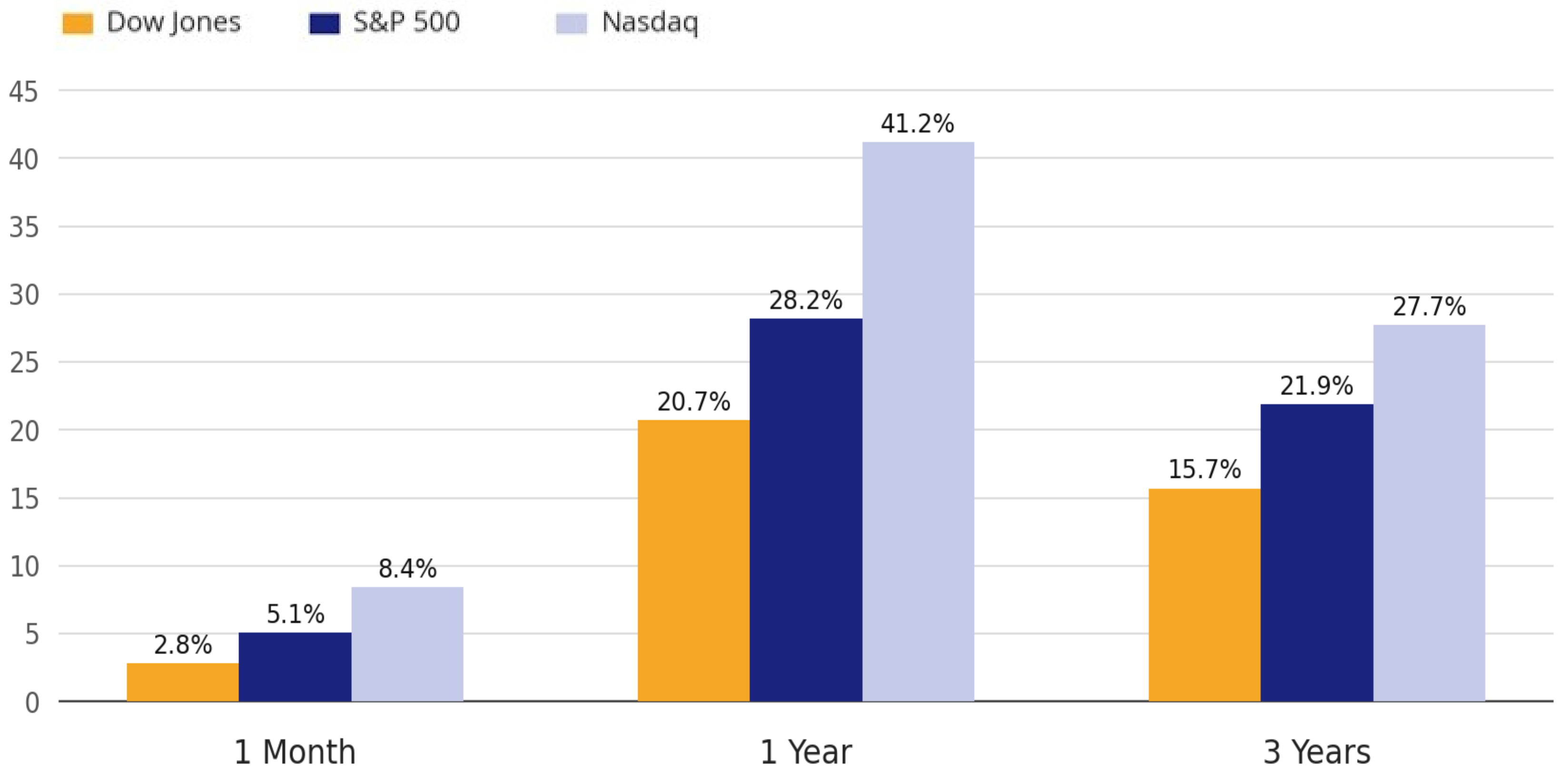
Consumption Indicators

		Change								12 Month Avg		12 Month Avg		Absolute							
Consumption/Demand (%, YoY*)	Units	Apr'25/ Mar'25	Apr-26	Mar-26	Feb-26	Jan-26	Dec-25	Nov-25	Oct-25	as of Apr'26	as of Apr'25	as of Apr'26	as of Apr'25	Apr-26	Mar-26	Feb-26	Jan-26	Dec-25	Nov-25	Oct-25	Units
Personal Loans	% chg, YoY	11.7		16.2	15.2	14.9	14.4	12.8	14.0	13.3	15.1	64.4	57.1		69.4	68.0	67.2	66.5	64.9	64.6	INR Tr
Retail Payments	% chg, YoY	13.9		15.8	18.7	14.1	15.7	15.7	5.8	13.7	16.2	87.9	77.7		108.6	88.5	91.9	92.2	83.6	89.3	INR Tr
Non-Oil Imports	% chg, YoY	17.6	19.3	6.5	29.9	25.7	11.6	1.8	34.1	13.3	8.1	51	45	53.3	47.4	50.7	57.8	50.1	48.9	61.9	USD Bn
Passenger cars sales (ex UVs)	% chg, YoY	-7.5	26.7	5.0	-2.9	-2.4	35.4	16.0	12.4	5.3	-10.4	118	113	131	124	118	134	130	123	131	000 no's
Passenger cars sales (incl UVs)	% chg, YoY	5.3	25.3	16.6	11.2	13.9	28.8	19.7	18.2	10.6	2.7	386	349	429	438	411	443	393	405	453	000 no's
POL Consumption	% chg, YoY	0.3	-4.6	3.2	4.5	0.3	4.5	0.6	-1.5	1.3	1.6	20.2	19.9	19.3	21.4	20.2	20.6	21.6	20.8	20.0	Mn Tonnes
Two wheelers	% chg, YoY	-16.7	28.4	19.3	35.2	26.2	39.4	21.2	2.1	16.1	5.1	1809	1610	1873	1976	1871	1926	1541	1944	2211	000' no's
Consumer Price Inflation*	% chg, YoY	3.3	3.5	3.4	3.2	2.7	1.2	0.5	0.0	2.1	4.5	2.1	4.5	3.4	3.1	2.4	1.5	0.6	0.6	1.2	3MMA
Core CPI (ex food and fuel)*	% chg, YoY	4.2	3.17	3.14	3.14	3.1	4.5	4.2	4.3	3.9	3.6	4.2	3.6	3.1	3.1	3.6	3.9	4.3	4.3	4.2	3MMA

- GDP at 7.8% reaffirms India's position as the fastest-growing major economy, underpinned by government capex, financial sector strength, and manufacturing revival, providing a constructive macro backdrop for domestic equities.
- Passenger car sales (+26.7% YoY ex-UVs) and two-wheeler sales (+28.4% YoY) in April 2026 reflect broad-based discretionary demand recovery; strong mass-market two-wheeler volumes signal rural and semi-urban income stabilisation.
- POL consumption's -4.6% YoY decline reflects demand destruction at the Hormuz-driven fuel price peak, a temporary anomaly; as Brent crude normalises, fuel demand should sharply revert, supporting petro-logistics activity.
- Personal loan growth (+16.2% YoY) and retail payment volumes (+15.8% YoY) signal a healthy credit cycle; however, rising household leverage warrants monitoring, especially as unsecured NBFC NPAs begin to inch higher.
- The rupee at 95.01 represents substantial depreciation, compressing real household purchasing power, raising manufacturing input costs, and contributing to imported inflation in processed goods and electronics segments.

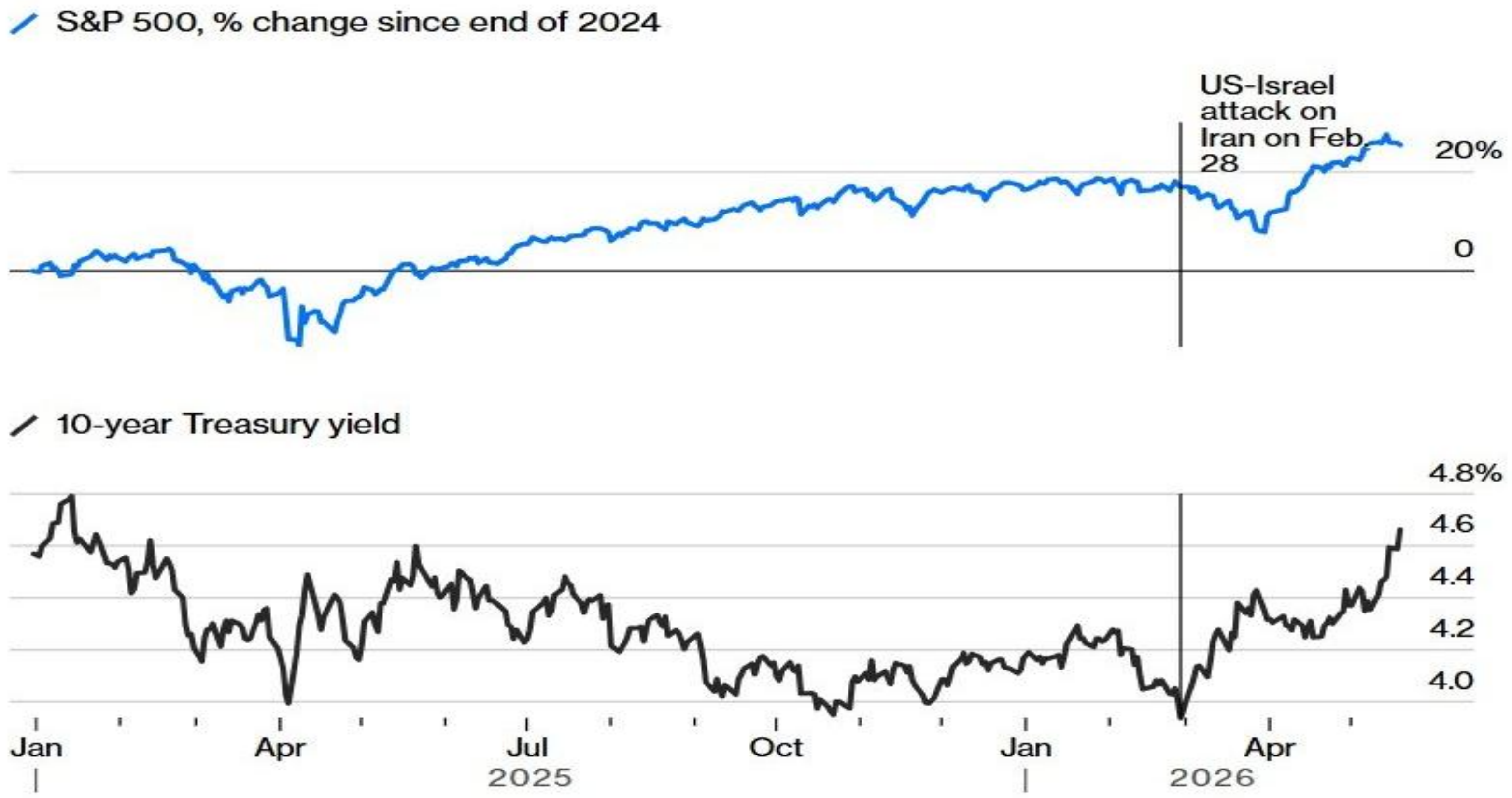
US - Equity Market

Trailing Returns



Source: NGEN, 1 Month (30-Apr-26 to 29-May-26), Absolute Return for 1 Month; CAGR for 1 Year and 3 Year
Created with Datawrapper

Strong earnings growth has more than compensated for high borrowing costs



Note: S&P 500 chart shows price change since end of 2024.
Source: Bloomberg

- Nasdaq's 41.2% 1-year CAGR validates sustained AI mega-cap dominance: Nvidia, Microsoft, Meta, and Alphabet continue to drive earnings upgrades that consistently outpace rising borrowing costs.
- The S&P 500 is up ~20% since end-2024 despite 10Y Treasury yields at 4.8% and a US-Israel strike on Iran (Feb 28), institutional conviction and earnings resilience have consistently dominated macro headwinds.
- Dow Jones (+20.7% 1Y) vs Nasdaq (+41.2% 1Y) divergence highlights concentrated market breadth, the AI-driven tech rally powers headline performance, with value and cyclical sectors meaningfully lagging the mega-caps.
- 10Y Treasury yields at 4.8% historically pressure equity multiples; the S&P 500 holding near highs implies either strong confidence in durable earnings growth or a compression of equity risk premium that may prove unsustainable.
- The Fed's historic 8-4 dissent at April FOMC signals growing policy divergence, with three officials rejecting an easing bias, a resumed hiking cycle is a meaningful tail risk if the May CPI (June 10) surprises upward.

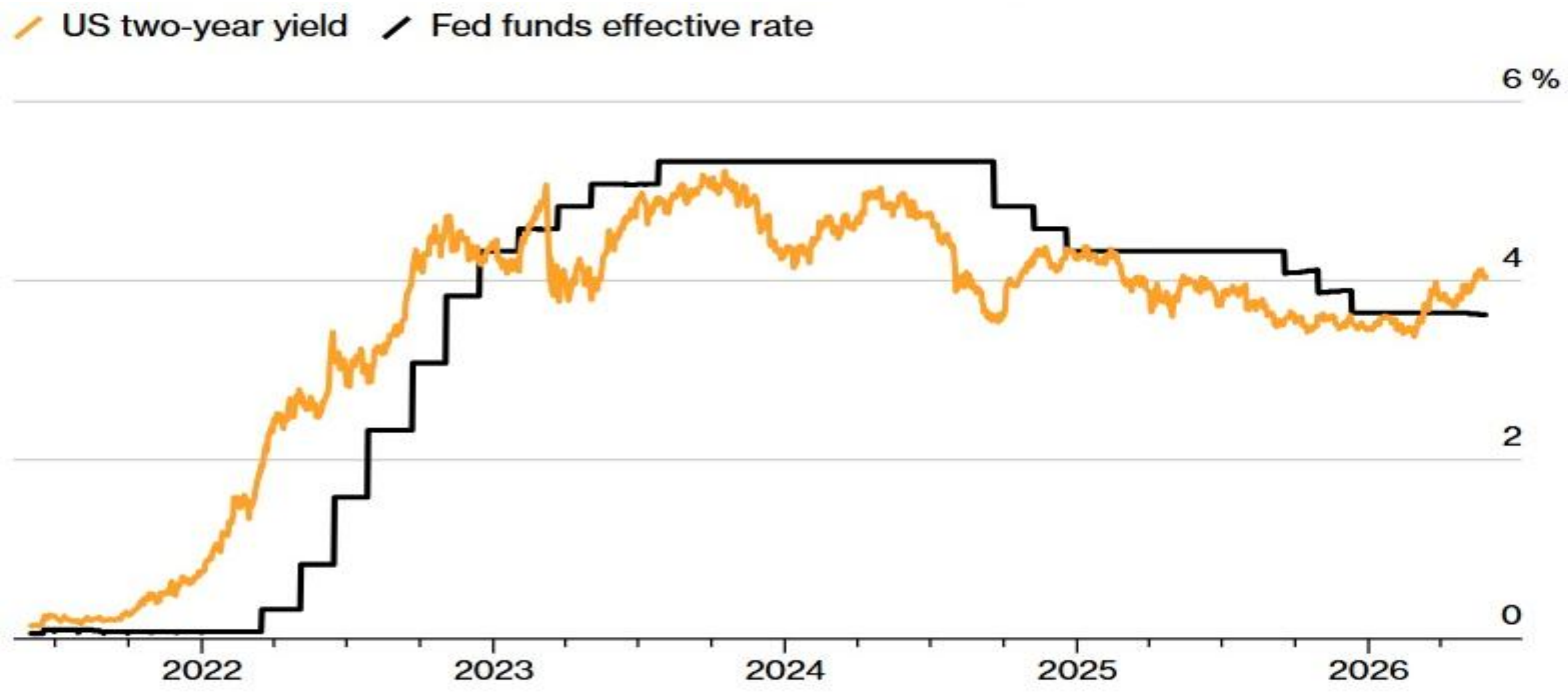
US - Key Macroeconomic Updates

Data Snapshot

Indicator	Value
Inflation rate (%)	3.8
Dollar	99.18
Interest Rate (%)	3.75
Unemployment Rate (%)	4.3
Consumer Price Index (CPI) (Points)	333.02
Imports (USD Billion)	381.17
Exports (USD Billion)	320.86
Core Consumer Prices (Points)	335.42
Producer Prices (Points)	156.5

(Source : NGEN)

Bond Traders Signal Looming Fed Hiking Cycle, As Front-end yields remain well above current policy rate



Source: Bloomberg

- US inflation at 3.8% remains above the 2% target, driven by energy spillovers from the Hormuz crisis; with Brent now down 31%, a disinflation tailwind of 50-70bps in CPI is anticipated over the next 2-3 months.
- The DXY at 99.18 below the key 100 level marks a notable dollar softening, a second-order tailwind for EM currencies (INR may find a floor), and potential re-pricing of USD-denominated commodities and global capital flows.
- The US trade deficit of ~$60B/month (imports $381B vs exports $321B) reflects structural consumption strength but signals rising fiscal vulnerability, context for sovereign credit concerns and sustained 10Y yields above 4.5%.
- Unemployment at 4.3% is trending gradually higher from its 2023 lows, a slowly cooling labour market that reduces urgency for pre-emptive Fed action; sub-100K payrolls would sharply shift the calculus toward rate cuts.
- Critical chart signal: US 2Y yields remaining elevated above the Fed Funds rate historically precedes either a Fed hiking cycle or risk-off repricing; bond traders are pricing policy risk, not imminent easing, at current levels.

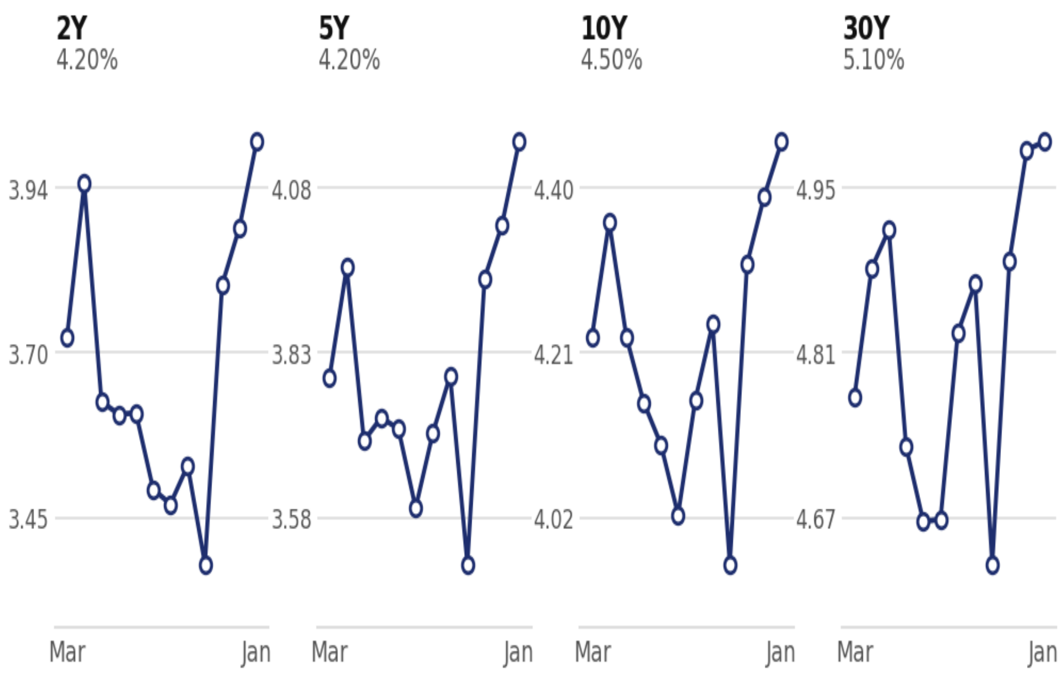
US - Debt Market & Global Commodities

Global Commodities

Commodity	Price (29-May-26)	Price (Prev Month)	1 Month Difference
Gold (INR/10 gm)	155,964	147,456	5.77%
Gold ($/oz)	4,536	4,542	-0.13%
Silver (INR/1 kg)	263,371	236,440	11.39%
Silver ($/oz)	75	71	5.28%
Brent Crude($/bbl)	97	142	-31.31%
Crude Oil (INR/1 bbl)	8,516	9,445	-9.84%
NYMEX Crude($/bbl)	91	110	-17.63%
Natural Gas (INR/1 mmbtu)	315	254	23.70%
Aluminium (INR/1 kg)	388	371	4.64%
Copper (INR/1 kg)	1,356	1,279	6.06%
Nickel (INR/1 kg)	1,832	1,840	-0.41%
Lead (INR/1 kg)	210	203	3.28%
Zinc (INR/1 kg)	372	348	7.03%
Mentha Oil (INR/1 kg)	1,054	1,115	-5.44%
Baltic Dry Index	3,224	2,670	20.75%

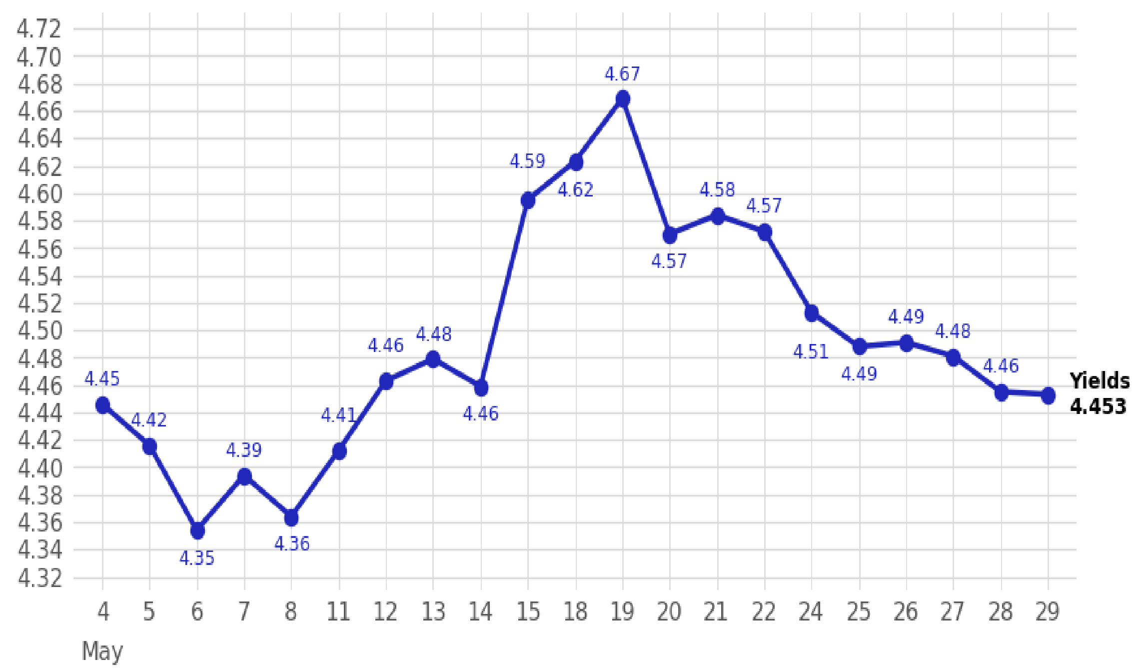
Source: Aditya Birla Mutual Fund Daily Update • Created with Datawrapper

US Rates



Source: Investing.com • Created with Datawrapper

US 10 Year Bond Yield - May

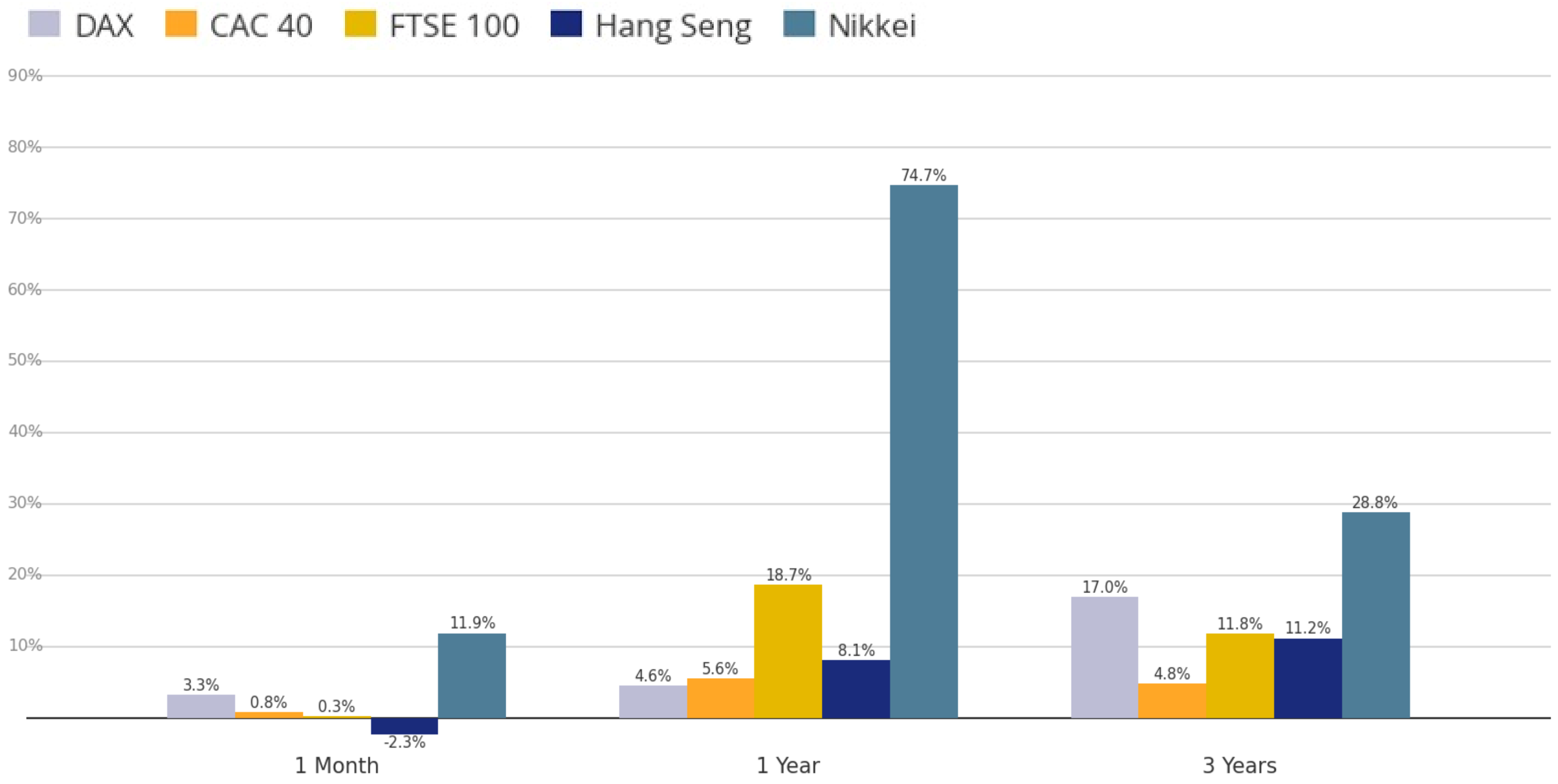


Source: Investing.com • Created with Datawrapper

- Brent crude's 31% monthly decline is the defining macro event, as the Iran <> US conflict enters a period of uneasy ceasefire, supply normalisation creates a direct disinflationary impact of ~0.3-0.5% on US CPI and improves India's trade deficit outlook.
- Gold's divergence, flat in USD (-0.13%) but up 5.77% in INR, precisely captures ~6% rupee depreciation; Indian gold fund investors benefited from a currency windfall, underscoring the value of FX overlay in cross-asset allocations.
- Silver's surge (+11.39% INR, +5.28% USD) reflects dual demand: accelerating solar and EV adoption driving industrial offtake, and safe-haven buying during geopolitical resolution, making silver a structurally compelling energy transition commodity.
- The Baltic Dry Index rising 20.75% is a high-conviction leading indicator of global trade recovery; sharp BDI moves historically precede 2-3 month improvements in global manufacturing PMIs and corporate earnings revisions.
- The US 10Y yield peaked at 4.67% in mid-May before declining to 4.45%, driven by falling energy prices and improving inflation expectations; if sustained, this trajectory provides a more supportive backdrop for equity multiples globally.

Global Equity Markets

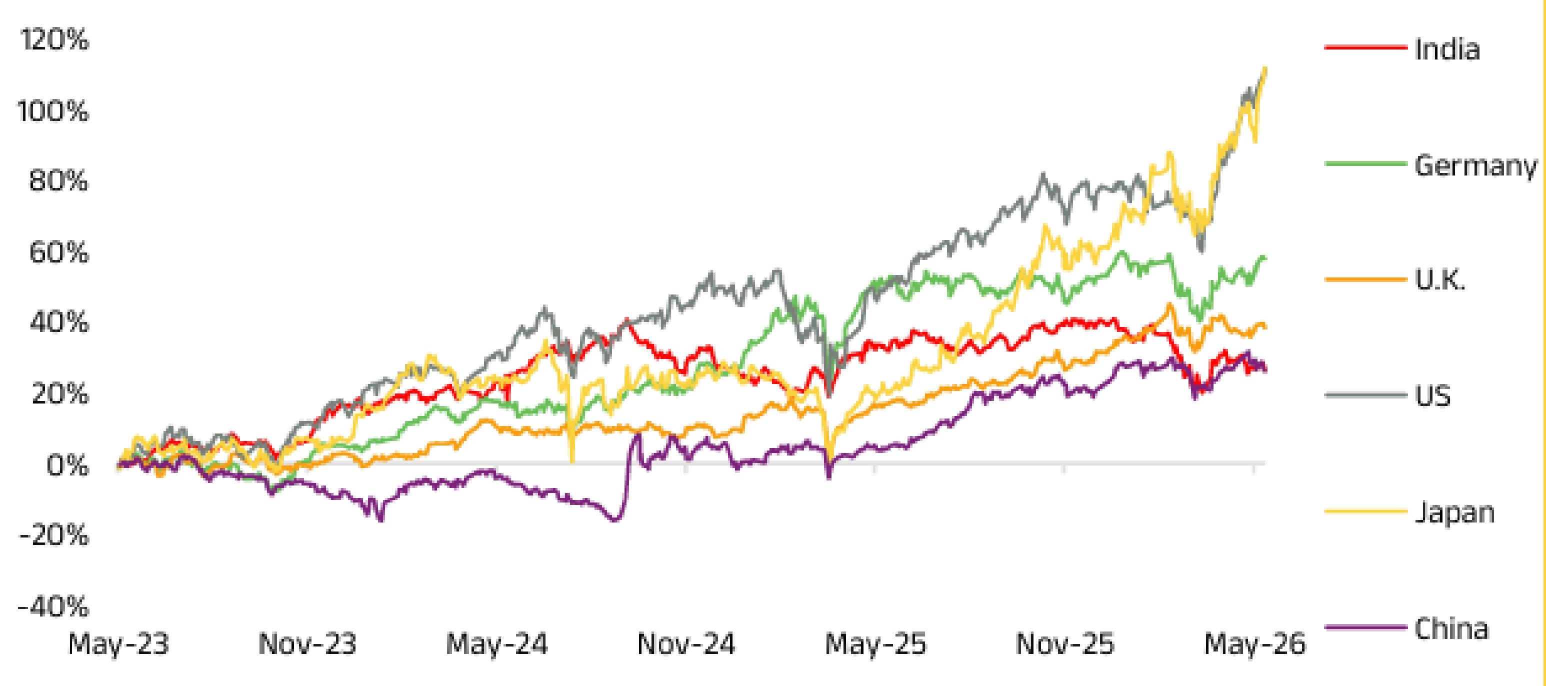
Global Indices



1 Month Return(30 Apr 2026 - 29 May 2026), 1 Year Return(30 May 2025 - 29 May 2026), 3 Year Return(31 May 2023 - 29 May 2026)

Source: NGEN · Created with Datawrapper

Comparative Performance of Major Global Equity Market



Source: Refinitiv

- Japan's Nikkei delivered +74.7% 1-year and +26.8% 3-year CAGR, the clear global leader, driven by structural corporate governance reforms, yen-driven export competitiveness, and broad foreign capital rotation into Japanese equities.
- The Hang Seng's -2.3% monthly return and muted multi-year performance reflect persistent China headwinds: prolonged property deleveraging, deflationary risk despite stimulus, and an ongoing geopolitical discount from US-China tech decoupling.
- Germany's DAX gained 3.3% in May as European markets recovered alongside easing Middle East risk and lower energy costs; however, deindustrialisation risk, weak PMI data, and China export dependency cap the medium-term upside.
- Over 3 years, Japan (~+120%) and the US (~+100%) have dramatically outpaced India (~+30%), driven by AI and governance re-ratings; India's relative underperformance combined with 7.8% GDP growth looks increasingly like a contrarian reversal opportunity.
- China's ~-20% 3-year return underlines the durability of its structural slowdown, property sector overhang, regulatory risk, and Western capital decoupling are entrenched headwinds; tactical bounces on stimulus are likely but the re-rating remains elusive.

Asset Class Returns Snapshot

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026*
8.66	19.57	41.29	7.91	31.49	44.4	31.6	13.9	26.91	25.02	167.27	10.73
7.39	14.97	37.65	6.03	23.79	27.97	28.71	9.74	26.29	22.93	74.73	5.58
0.22	12.94	21.83	-0.21	21.75	18.4	1.35	2.51	15.37	20.61	32.51	5.13
-3.92	11.35	5.11	-2.14	13.04	17.89	-4.21	0.46	7.29	9.57	7.76	-0.24
-6.65	5.12	-0.05	-4.38	10.72	12.29	-8.2	-12.55	7.26	8.95	6.82	-1.75
-9.68	4.3	-2.76	-10.54	9.53	-0.29	-11.83	-18.11	-10.46	7.96	6.37	-4.98

Gold (Domestic Prices)	Silver (Domestic Prices)	G-Sec (ABSL CRISIL 10Y GILT ETF)	China Equity (Hang Seng)	US Equity (S&P 500)	Indian Equity (Nifty 500 TRI)

Sources: NGEN, data as of 29th May 2026

Thank You!