COPING WITH MARKET VOLATILITY

Direct stock investors: Seek refuge in quality stocks

MF investors should limit exposure to volatile categories like smallcap and momentum

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Abhishek Singh, 43, a Ghaziabad-based businessman, began investing in equities two years ago, expecting annual returns of 18-20 per cent. However, the January 6, 2025, fall in the Sensex by 1,400 points and the frequent bouts of volatility over the past three months have shaken his confidence.

Novice investors like Singh must understand that volatility is an inherent part of equity markets and learn to navigate through such phases.

What is driving volatility?

Elevated valuations, indices reaching lifetime highs, disappointing earnings growth, and persistent geopolitical tensions have contributed to the recent volatility.

"The heightened volatility at the start of 2025, especially the sharp fall witnessed on Monday, was likely fuelled by concerns regarding the HMPV (human metapneumovirus) virus, though its severity and economic impact remain unclear, as well as subdued quarterly updates ahead of the third quarter earnings season," says Shreyas Devalkar, head of equity, Axis Mutual Fund.

US President-elect Donald Trump's "America First" policies could boost US economic growth but may also lead to higher inflation, interest rates, bond yields, and a stronger dollar. "Many emerging market currencies, including the rupee, are already under pressure," says Devalkar. All this could dampen flows into emerging markets, including India, in the near term.

Equity earnings have slowed due to reduced capital expenditure ahead of elections, weak consumption, and sluggish exports.

WORST HIT

Seven indices that have declined the most over past three months

	Returns (%)				
Index	3-month	1-year	3-year	5-year	10-year
Nifty Energy	-18.7	-1.7	12.5	16.2	14.7
Nifty 200 Momentum 30	-16.1	12.4	13.9	21.9	18.2
Nifty High Beta 50	-16.1	-4.9	14.9	18.5	6.1
Nifty Metal	-16.0	4.8	13.0	23.8	12.3
Nifty Commodities	-15.8	2.8	10.3	17.6	11.4
Nifty500 Momentum 50	-15.8	15.3	16.7	27.7	19.1
Nifty PSE	-15.7	13.9	30.9	23.2	9.9

Data as on December 10, 2025 Source: Navigation RA

India's broader markets have seen significant gains over the past four years. "This has attracted incremental flows into SMEs (small and medium enterprises), micro, and small-cap stocks. While earnings growth has been strong due to a low base and increased government spending, valuations have run ahead of earnings growth," says Jatin Khemani, managing partner and chief investment officer, Stalwart Investment Advisors LLP. He warns that stocks with no track record, especially in the SME space, are trading at astronomical valuations. "Investors are underestimating risks, particularly on the execution side," says Khemani.

Stay invested

Long-term equity data from 1980-2024 show more than 10 per cent declines in all but four years. "Investors need to treat a 10-20 per cent fall as the norm," says Arun Kumar, head of research, Fundsindia.com.

Equities generate returns aligned with nominal GDP growth over the long term. "India remains one of the fastest-growing economies globally, with robust domestic demand, a resilient economy, and a sound financial system," says Devalkar.

Equities offer inflation-beating returns and the opportunity to build wealth through compounding. "Time in the market is more important than timing the market," adds Devalkar.

Resilience through diversification

To navigate volatility, investors must diversify their portfolios. Most investors should allocate around 20-30 per cent to a mix of debt and gold. Debt provides stability. "If there is a steep fall, you can transfer funds from debt into equities," says Kumar. Gold, which tend to perform well during equity downturns, acts as a hedge.

Diversifying geographically and across market caps and investment styles can also enhance resilience. "Different geographies perform well at different times. And while momentum and alpha strategies have done well recently, investors could move towards quality if the economy slows further," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Investors should exercise caution vis-à-vis sector funds, which require precise entry and exit timing, and carry high concentration risk. "If at all you invest in these funds, do so when their past performance is lacklustre," says Kumar. Limit exposure to 10-15 per cent of the equity portfolio.

After the rally in small caps, rebalance portfolio. "Valuations are very high. Investors need to pare exposure to small-cap stocks," says Dhawan. A 10-15 per cent exposure would be sufficient. Do not stop systematic investment plans (SIPs) in funds amid volatility.

Sound businesses at fair valuations

Direct equity investors should focus on business quality and valuations. "What matters in the long term is whether the business is good and the valuation at which it was purchased was fair," says Manish Bhandari, chief executive officer and portfolio manager, Vallum Capital Advisors. He suggested staying committed to chosen stocks while reviewing the portfolio at key turning points.

Investors should consider reducing exposure to overvalued segments and moving towards those offering better risk-reward. "The BFSI (banking, financial services, and insurance) sector, which constitutes nearly a third of the index and profit pool, has been a laggard in the recent bull market. Large private banks and standalone health insurance companies appear well-positioned for the next three to five years," says Khemani. He recommends paring exposure to SMEs, micro and smallcaps.

The writer is a Mumbai-based independent financial journalist