

# Mutual funds cut exposure to private banks for 2nd straight month in April. Is banking sector under pressure?

By Surbhi Khanna: poste on May 26, 2026



With mutual funds reducing their weight or allocation in private banks for a second consecutive month in April, market experts believe that this drop is tactical rotation and not a structural shift and also appears to be driven more by near term earnings and margin concerns rather than fears around asset quality deterioration.

Vishal Dhawan, Founder & CEO, Plan Ahead Wealth Advisors told ETMutualFunds that this drop reflects tactical rotation, and not a structural shift indicating a tactical sector rotation in our view, fund managers are taking profits out of heavily owned private banks to chase certain sectors with better return prospects and relatively better insulated from FPI outflows that have been significant this year.

Additionally, the trimming is a reflection of short-term earnings growth concerns i.e. margin pressures rather than asset quality. Balance sheets of Indian private banks remain clean, with non-performing assets (NPAs) hovering around multi-decadal lows.”

However, banks are dealing with an intense deposit crunch. To keep up with high loan demands, they are forced to offer higher interest rates on deposits, squeezing their Net Interest Margins (NIMs) and temporarily slowing down earnings growth, Dhawan further said.

Another expert, Sagar Shinde VP Research at W by Grow shared with ETMutualFunds that over the last few quarters, private banks have faced pressure from rising deposit costs, intense competition for liabilities, and slower retail credit growth, which has affected profitability expectations and this has led fund managers to moderate exposure after a long period of overweight positioning in the sector.

Shinde further said that, however, asset quality across large private banks remains relatively stable, with most banks continuing to maintain adequate provisioning buffers and healthy balance sheets and the shift therefore looks more like a tactical allocation change amid macro uncertainty and valuation resets rather than a sign of a major structural problem within the banking system.

According to a report by Motilal Oswal Financial Services, the weight in the private sector in April was recorded at 17.3% which is down 30 basis points on monthly basis and 150 basis points on a yearly basis.

The report further highlighted that weight in March 2026 was recorded at 17.6% and in April 2025 was recorded at 18.8%.

On a monthly basis, the weights of Technology, Private Banks, Healthcare, Oil & Gas, Automobiles, Telecom, Insurance, and Cement saw a MoM moderation in weights. Private Banks with a weightage of 17.3% became the top sector holding for mutual funds in April 2026, followed by Automobiles (8.4%), Capital Goods (7.8%), and Healthcare (7.5%).

The recent correction has made valuations of several private banks more attractive. While earnings growth may remain under pressure in the near term due to margin challenges, fundamentally strong private banks with healthy balance sheets and stable deposit franchises continue to remain solid long-term investment opportunities, Shinde further said.

To this, Dhawan said that retail investors need not necessarily reduce exposure, if your portfolio is drastically skewed toward banking sector funds, trimming back to a diversified equity fund is wise and if

you invest through multi-cap or flexi-cap funds, your fund managers are already adjusting these weights for you, and hence we do not see any need for reduction.

He further mentioned that Public Sector Undertaking (PSU) banks have enjoyed a massive valuation re-rating over the past two years, driven by lower valuations a couple of years ago and cleaner balance sheets. However, because of the recent correction in private banking, the valuation premium has narrowed significantly; private banks are starting to look historically reasonable and highly attractive on a risk-reward basis for long-term investors compared to other overheated sectors.

### **Historical performance**

An analysis by ETMutualFunds showed that in the last one month, the banking sector-based funds on an average lost 3.48% and in the last three months, these funds were down 6.33%. Further analysis showed that around 67 banking sector funds have completed three years of existence in the market which includes private sector and PSU sector-based funds.

Eight PSU bank ETFs lost over 16% in the last three months with Nippon India ETF Nifty PSU Bank BeES being the biggest loser as the scheme gave a negative return of 16.76% in the last three months. DSP Nifty Private Bank Index Fund gave a negative return of 9.06% in the last three months and ICICI Pru Nifty Financial Services Ex-Bank ETF was the last one in the list to deliver negative return as the fund lost 1.08%. Only Quant BFSI Fund gave positive returns of around 0.19%

### **Is this short-term correction a buying opportunity or a warning sign?**

Dhawan said banking is the cyclical engine of India's GDP. A 6% breather over a quarter provides an accumulation window if you have a long-term investment horizon, accumulating high-quality private banking assets during a cyclical downturn has historically yielded robust long-term returns.

He further said that the sector is facing margin pressure due to deposit crunch; however, due to the current geopolitical environment, the RBI can increase repo rate in the current financial year to curtail inflation, which is likely to increase due to oil prices increase and currency depreciation, this could provide a boost to margins as interest on loans gets adjusted faster than deposits and this could act as a positive for the sector. Ultimately, the risk-reward dynamics are in favour of the sector for the long-term investor.

Shinde said that at this point, the correction appears more like a cyclical reset rather than a warning sign of deeper stress in the sector; the decline has largely been triggered by concerns around net interest margins, elevated bond yields, and moderation in earnings expectations after a period of strong performance.

He further said that the banking system continues to see healthy credit growth and stable asset quality, while recent corrections have made valuations of several private banks more attractive for long-term investors. However, short-term volatility may persist due to macro and interest-rate uncertainties, making staggered investments a better approach during corrections.

The banking sector based funds gave negative average returns in the last six months, and current calendar year so far. These funds lost 4.47% in the last six months and 5.29% in the current calendar year so far. The long term performance of these funds was 12.86% average return in the last three years and 11.86% average return in the last five years.

### **How should existing investors respond to the correction?**

Shinde said that existing investors should avoid panic selling based on short-term underperformance. Banking remains a key pillar of the Indian economy, supported by long-term drivers like rising credit growth and financialisation. The current weakness is largely due to temporary margin pressure, and long-term

investors may consider continuing SIPs or gradually increasing exposure during corrections instead of exiting after short-term declines.

He further said that some near-term underperformance in banking stocks may continue due to pressure from deposit costs, interest-rate uncertainty and tight liquidity conditions. However, much of the concern is already reflected in valuations, and fundamentally strong private banks could see gradual recovery once earnings visibility and rate outlook improve.

Dhawan advised existing investors to continue SIPs in banking sector funds instead of reacting emotionally to short-term declines. "Market corrections help SIP investors accumulate more units at lower NAVs, which improves long-term averaging benefits," he said.

For fresh investments, he suggested using staggered investing approaches such as Systematic Transfer Plans (STPs) or phased investments over the next three to six months.

He also cautioned that short-term underperformance in the banking sector may continue due to slowing economic growth, sticky inflation and tight liquidity conditions.

Higher-for-longer interest rates may keep liquidity tight and continue to pressure bank margins for some time. However, from a long-term perspective, the current valuation and risk-reward dynamics remain supportive for investors," Dhawan added.

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