K3 Domestic AIF: Newsletter for Sept 2025

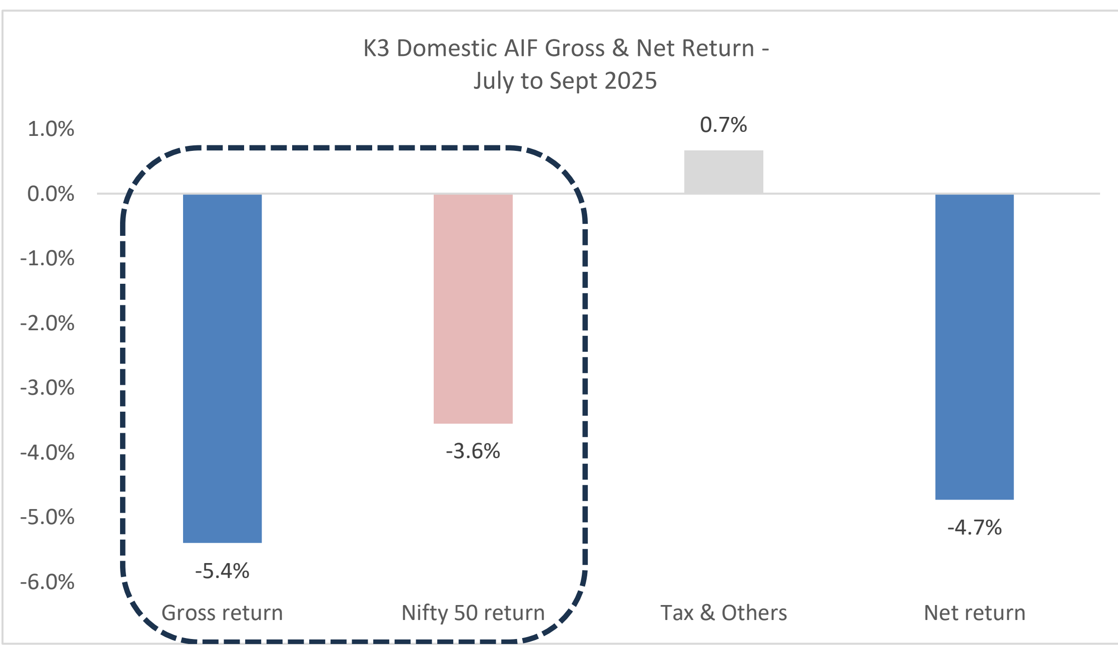
Over the past 15 months, Indian equity markets have been among the biggest underperformers globally. While elevated starting valuations have often been cited as a contributing factor, valuations alone rarely determine market performance. The core issue lies in India's growth narrative coming under scrutiny. Both GDP growth and corporate earnings have slowed, failing to keep pace with the earlier optimism reflected in market valuations.

In addition, the global investment landscape has evolved — with previously lagging markets regaining traction and drawing incremental capital flows. Another narrative weighing on sentiment has been the perception that India is "short on the AI theme," a topic we explore in more detail later.

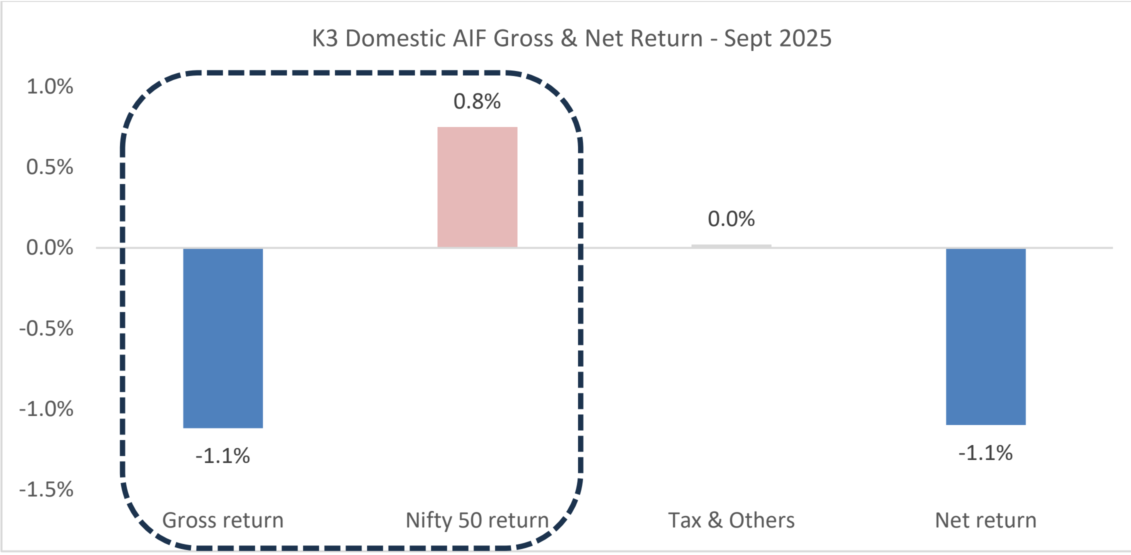
Adding to the challenges, the recent escalation in **U.S. trade tariffs** on Indian goods has negatively impacted export outlooks and the Indian rupee. The weaker FX environment has further discouraged foreign portfolio inflows, amplifying market pressure. Consequently, Indian indices experienced a notable decline during the September quarter.

After a relatively strong performance in the April–June quarter, **K3 Funds AIF** faced a pullback during the July–September period, marginally underperforming the benchmark Nifty index. The recent volatility underscores the difficulty of navigating an increasingly complex and rapidly shifting global environment.

Nonetheless, we remain steadfast in our investment philosophy — guided by fundamentals, disciplined in execution, and focused on achieving our long-term return objectives.



K3 Domestic AIF posted a loss of 1.1% in Sept (post tax and post fees basis).



Return Comparison

Month	K3 AIF Pre Tax Return	Nifty 50
April	0.5%	3.5%
May	2.9%	1.7%
June	5.1%	3.1%
July	-1.6%	-2.9%
Aug	-3.1%	-1.4%
Sept	-1.1%	0.8%

Performance Review - K3 Domestic Alternate Investment Fund

As of Sept end, we were at **120%** gross and **53%** net exposure for the fund. We continue to favor midcaps in the portfolio.

K3 Domestic AIF: Portfolio Breakup (based on market cap)

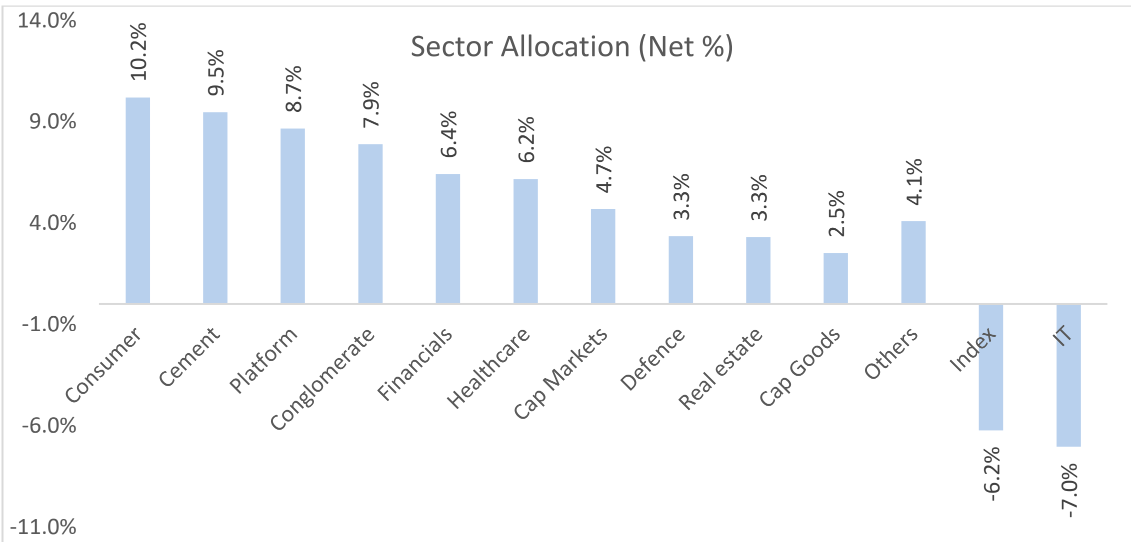
Category	Long	Short	Gross	Net
Large	34.6%	27.4%	62.0%	7.2%
Mid & Small	51.9%	5.6%	57.6%	46.3%
Total	**86.5%**	**33.1%**	**119.6%**	**53.4%**

K3 Domestic AIF: Longs vs Shorts

P/E and Growth, F2027e

Particulars	Wtd. Avg. EPS Growth %	Wtd. Avg. PE
Long portfolio	34.5%	24.4
Short portfolio	12.3%	23.4

K3 Domestic AIF: Sector Allocation (net positions in each sector based on actual positions as of Sept end)



In September, sectors where we had higher net exposure such as cement and platform stocks didn't work as per our expectations. We remain constructive on both these segments given higher expected revenue / earnings CAGR over next two years. We remain net short on Indian IT sector given weak revenue trajectory. We remain constructive on financial sector in general; currently the net exposure is managed lower given results/ guidance risk.

View on market

We have been bullish on India given plethora of positive macro factors and recent actions -

A) improving liquidity

B) positive upfront regulatory actions by RBI

C) government pro-growth policies like direct and Indirect taxes cut

D) time consolidation in the broader equity markets

However, none of these have reversed the foreign outflows which shows that there is a bigger issue in investor minds - which we try to address ahead.

"India is short on AI theme"

There are only two themes working in the world this year -

a) "Anti-currency" assets – Gold, silver, and digital currencies such as Bitcoin have benefited from heightened volatility and rising distrust in traditional monetary systems. The ongoing tariff disputes and geopolitical tensions have only amplified their appeal as substitutes for central bank–issued currencies.

b) The Artificial Intelligence (AI) theme – There appears to be near-universal consensus that AI's role in shaping economies and industries will continue to grow. While the ultimate end state remains uncertain, the direction is clear: AI adoption is accelerating across sectors, creating new market leaders and redefining competitive advantages.

Unfortunately, India has limited direct exposure to either of these global megatrends.

On the **"anti-currency" front**, higher gold prices do have a wealth effect on Indian households — household net worth could rise meaningfully if gold holdings were marked to market. However, India's cultural affinity for gold translates into consistent buying and limited selling; thus this wealth effect rarely translates into incremental liquidity or consumption.

On the **AI front**, India remains underrepresented in the global supply chain. In fact, the country may be structurally "short" the theme. The Indian IT services industry — a massive employer and export contributor — has long positioned itself as an executor rather than an innovator. As AI-driven automation advances, this model faces pressure. Recent workforce reductions, such as **TCS letting go of 3% of its employees**, highlight the early stages of this shift.

However, this environment may also present **selective opportunities**. We are particularly optimistic about Indian **digital platform companies**, which could emerge as indirect beneficiaries of AI adoption. As these businesses integrate AI into customer acquisition, engagement, and support functions, their operating efficiency and cost structures could improve meaningfully.

Meanwhile, **data center–linked and AI infrastructure plays** in India are attracting significant investor attention. While their long-term potential is substantial, these remain largely **story-driven at this stage**, with execution yet to be tested.

Can India become a self-help story?

Yes, we may not get massive foreign flows on account of no exposure to AI theme, but can we at least show some pickup in domestic demand which stops the outflows. Afterall the domestic flows into equities have been quite strong and can more or less keep markets buoyant if foreign outflows and primary issuances subside.

Many economist teams are calling for domestic demand revival starting Q4 given the fiscal, monetary and regulatory actions taken in last 6 months should start manifesting into the numbers. Consumption could see some revival as

A) income tax cuts lead to rise in disposable income

B) cut in GST tax rates - increases purchasing power

C) interest rates have come down - esp mortgage rates

D) inflation has been quite low generally - helps reduce pressure on middle class

The recent high frequency indicators have shown some uptick as well – ones we track are macro liquidity charts, GST collection growth, system credit growth, auto sales etc.

Where do we stand?

We are also positioned constructively in our portfolios. We have sub divided our gross/net into 3 categories -

1. **Growth / midcap basket** - where the play is mainly on higher growth companies. We have 30-40% net long exposure here. Ideally, we would like to take it higher as we get more confidence in growth pickup in corporate sector.

2. **Pair trades basket** - almost zero net exposure here. This should help us take our gross exposure higher, however given the swift moves in trades, we are as of now sitting on low gross in pairs. The market has been moving from quality stocks to beta stocks to quality stocks very rapidly and no one factor has been a winner this year on consistent basis.

3. **Tactical basket** - this hasn't worked again given the sharp reversals. For e.g. PSU sector has made a sharp comeback almost on no news flow after underperforming in July to mid-August.

In summary, September quarter's performance was not satisfactory for us. However, it wasn't the "investment process" issue, and we intend to get performance back on track in the next quarter.

Thank you for being a part of K3 Funds.

K3 team