Executive summary

India, with all its structural tailwinds like growing population, increasing per capita income, demographic dividends, an underpenetrated market etc., has always traded at a substantial premium to most developed markets historically, with intermittent patches of underperformance due to sometimes external factors (Global Financial Crisis / Commodity Crisis / War crisis etc. which triggered a flight to safety) and sometimes internal factors (political instability / fiscal imbalances). Surprisingly, in the last 2 years we have been in one of those patches of underperformance, but due to a new reason, i.e. the absence of the AI play which its peer-set like Korea / Taiwan / US etc. offered to investors.

Foreign investors have sold Indian equities on a scale the market has not seen before. **Net FII equity outflows reached about $30 billion as of 14 June 2026, already exceeding the entire $19 billion of net selling in CY25**, and FPI ownership of NSE-listed companies has fallen to 15.8%, a 17-year low. Two forces drove the exit. A **pull**, as the 2025-26 AI rally rerated Korea, Taiwan and China and left India the worst-performing large emerging market in more than three decades, and a **push**, as a premium market met faltering earnings. The selling has not been uniform. It hit the sectors which were over-owned by the foreigners, i.e. IT and financials.

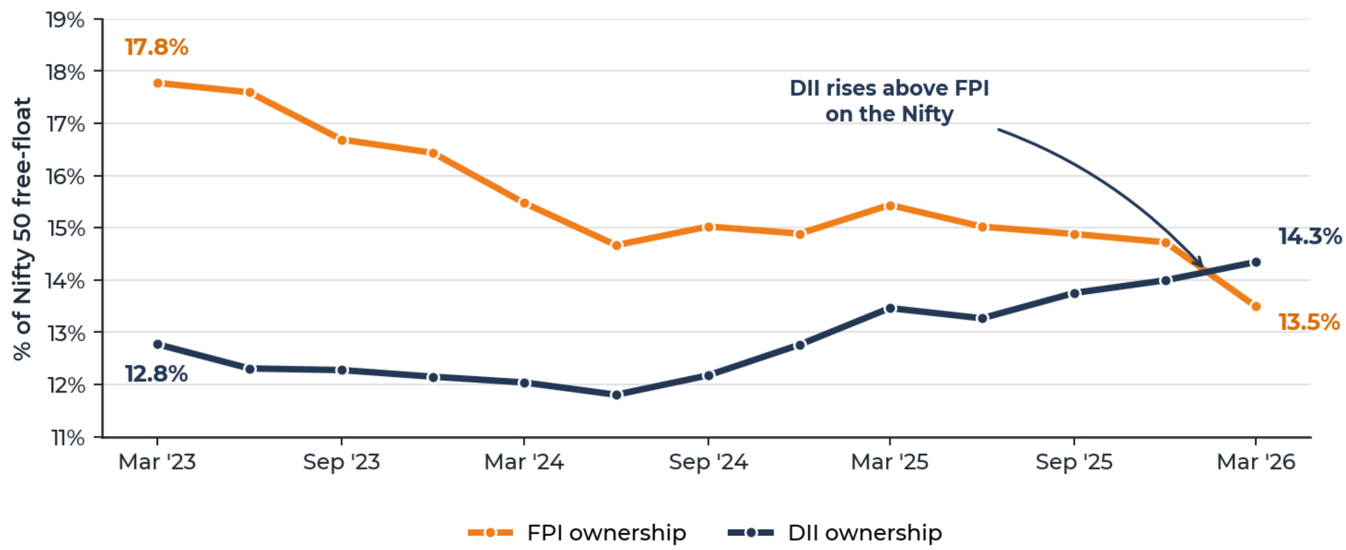
Why foreign money exited: Tale of pull and push....

On the pull side, **the 2025 AI capital cycle turned Korea's KOSPI up 76% and Taiwan's TAIEX up 26%** riding on the strength of demand for memory and foundry, while the Hang Seng rose 28% and MSCI China rerated on a domestic AI breakthrough. Against that, **MSCI India returned roughly 4% in dollars in 2025 and underperformed MSCI EM by the widest margin since 1993.** Capital is a relative game, and India offered neither the AI exposure nor the cheaper entry that the rest of EM did.

The push was domestic. India entered 2026 as still the most expensive large market in EM, even though that premium had come off its peak with the steady exit of foreign money. **MSCI India's forward P/E reached a premium of about 100% over EM in 2024, against a ten-year average near 60%, and even after narrowing as India lagged EM through 2025 it held in the low-20s against the low-teens for EM.** That premium had been underwritten by post-Covid earnings, with Nifty 50 profit compounding at about 26% a year over FY21-FY24. But growth then faltered, **decelerating to roughly 11% in FY25 and 9.6% in FY26** (some base effect as well). India became an exit market as it was expensive without underlying earnings growth, plus it became the funding trade for the AI rotation.

The result, as we can see in the chart below, is structural: foreign ownership of the Nifty has fallen from 17.8% to 13.5% in three years, while domestic institutions have quietly crossed above them for the first time.

Chart 1: Domestic money has overtaken the foreigners. FPI vs DII ownership of the Nifty 50



Source: Capitaline (FPI and DII ownership of the Nifty 50 free-float, quarterly March 2023 to March 2026). Relative-return and valuation references: MSCI, Korea Exchange, Taiwan Stock Exchange, year to 31 December 2025; MSCI India forward P/E vs MSCI EM, CY2025.

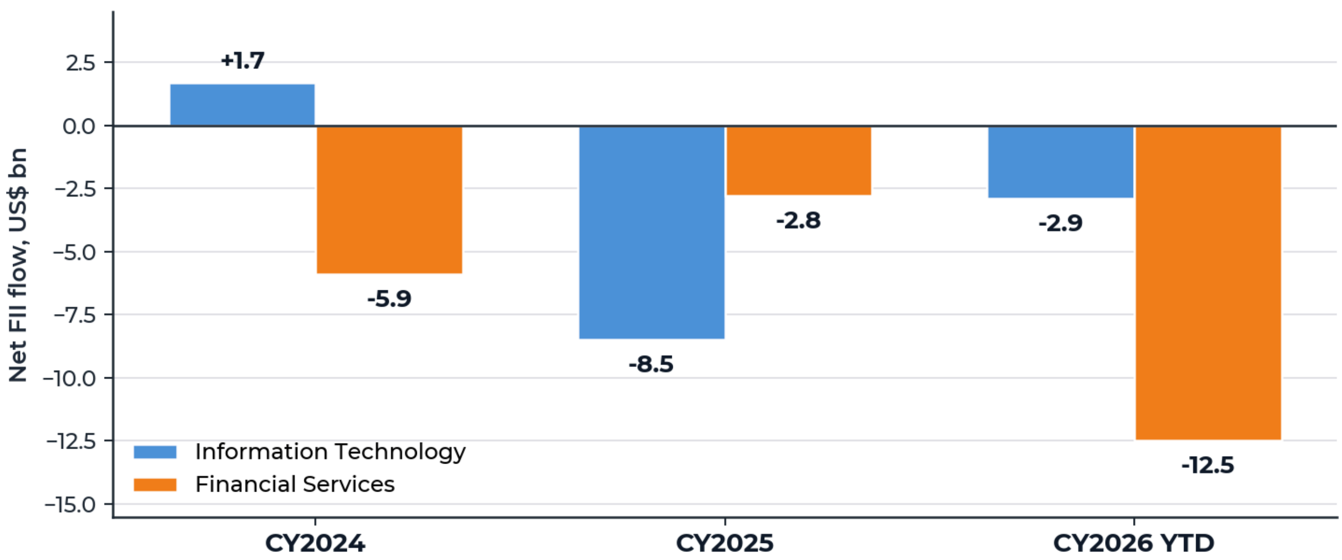
> **The exit has a floor.** FPI ownership of NSE-listed companies has fallen to 15.8%, a 17-year low, while domestic institutions have risen to a record 19.6%, **owning more of India Inc than foreigners by the widest margin in over a hundred quarters.** The arithmetic of "foreigners are leaving India" can only run so far before there is less left to leave, or maybe the premium comes off substantially as other markets gain valuation. That is the single most important fact behind everything that follows: the marginal seller is finite, and we can already see where it is running out of stock.

Foreigners sold what they could & they owned; IT, then Financials

Foreign selling is never spread evenly. It concentrates in what foreigners own, the large, liquid, index-heavy names, and in 2026 that meant the two sectors that have always anchored the foreign book, i.e. Information technology (Indian IT Services) and financial services (BFSI). The chart below tracks cumulative net FII flows into the two sectors over three calendar years.

Through 2025, **IT bore the brunt: foreigners pulled roughly 8.5 billion dollars out of Indian IT** as the generative-AI debate questioned the labour-arbitrage model, while financials saw only modest net selling. In 2026 that reversed. **IT outflows shrank to about 2.9 billion dollars, the bulk of it early in the year, while financial services became the single most-sold sector in the market, roughly 12.5 billion dollars and counting**, with the heaviest fortnights in March and April.

Chart 2: Where FII selling concentrated: IT in 2025, Financials in 2026. Cumulative net FII flows by sector



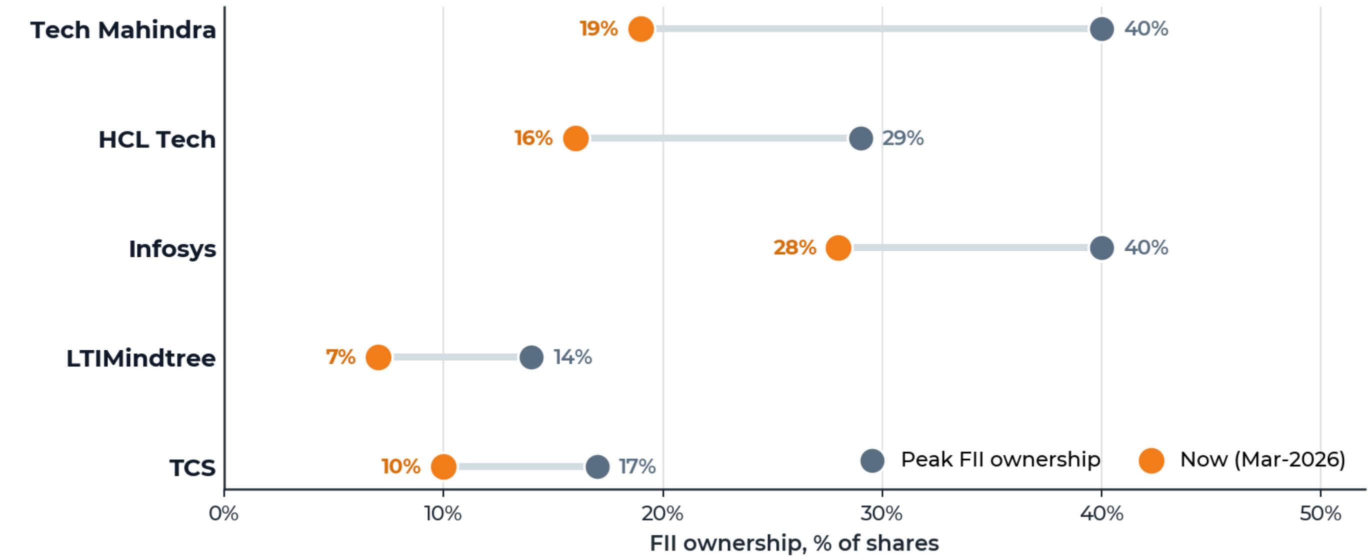
Source: NSDL fortnightly FII net investment by sector (new classification), aggregated to calendar year; CY2026 to 31 May 2026. US$ mn converted to US$ bn. A positive figure is net buying, a negative figure net selling.

IT: Sector with lower growth for longer- Selling as if no tomorrow....

When a sector has been sold for two years, the question is not whether it is cheap but whether the seller has anything left to sell. In IT (Indian IT services), the answer is sharp deceleration in incremental selling. **Foreign ownership of the large IT names has fallen to multi-year lows**: TCS from about 17% to under 10%, Infosys from a peak near 40% to about 28%, HCL Tech from 29% to 16%, Tech Mahindra from 40% to 19%, and LTIMindtree from 14% to under 7%. The index has paid for it. **The Nifty IT index fell roughly 39% from its December 2024 peak, one of the steepest sector drawdowns on record**, with the largecaps down most off their highs, TCS about 52% and Infosys about 43%.

That has reset valuations below their own history. **Nifty IT trades at about 16x forward earnings against a five-year average near 25x, a discount of roughly a third**, on a sector where the structural concern, AI disruption of the services model, is now well understood and largely in the price. The flow has turned with it. **Net FII selling in IT shrank to under 200 million dollars in May 2026, from the 600 million to 1.6 billion-dollar fortnights of 2025**, and the index has been among the market's best performers off its lows, the top sectoral gainer on several sessions in late May and early June. We do not need an earnings upcycle for this to work. We need only the marginal seller to be done, and that condition may be close.

Chart 3: Foreign ownership of IT has fallen to multi-year lows



Source: Screener.in / BSE shareholding (FII %, March 2026); multi-year peak from Capitaline. Index level and drawdown: NSE; Nifty IT peak 45,378 on 10 December 2024. Valuation: Bloomberg consensus forward P/E.

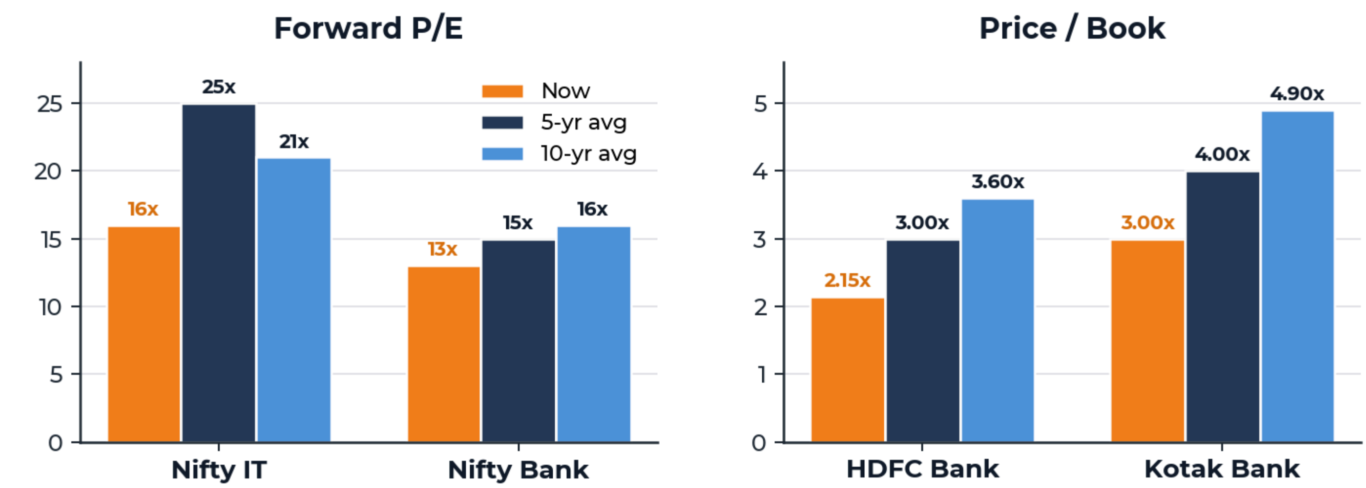
> **What "exhausted" looks like.** IT is the template for the rest of this note: ownership back to a decade low, valuations a third below their own average, the structural fear in the price, and the flow turning from heavy selling to roughly net flat. **The bounce that follows is not a new bull market. It is the absence of a seller.**

Banks: Now in the crosshairs, but the index hides the damage

Financial services is the largest single sector in the foreign investors' book, which makes it a natural sell and provides an easy exit to foreign money. And it has played out in a similar way: **roughly 12.5 billion dollars of net FII outflows in 2026, more than the prior two years of foreign selling combined, and the most-sold sector in the market in every month since March.** Yet the Nifty Bank index made a record high as recently as February 2026 and has outperformed the Nifty over the past year. The contradiction resolves at the stock level. **The selling was led by names foreigners own most, the large private banks, while domestic-favoured public-sector banks held the index up.**

The clearest public illustration is the index's largest constituent. **HDFC Bank, the most widely held Indian stock in foreign portfolios, is down about 19% over the past year and roughly 22% from its peak, the worst-performing stock in the Nifty Bank index**, even as State Bank of India rose about 30% over the same window. Foreign selling along with some fundamental changes led to the whole difference. The de-rating has pushed valuations below their own history: **HDFC Bank trades at about 2.15x book against a five-year average near 3.0x and a ten-year average near 3.6x**, Kotak at a similar discount, and Nifty Bank at roughly 13x forward earnings against a ten-year average near 16x.

Chart 4: Valuations have reset below their own history



Source: Bloomberg. Forward P/E and P/B as of June 2026 vs trailing five- and ten-year averages. HDFC Bank and Kotak Mahindra Bank shown as public index constituents; price performance per NSE, split-adjusted, to 17 June 2026.

The large private banks: foreign holdings have eased but stay high

BANK	FII OWNERSHIP (MAR-24 → MAR-26)	MF OWNERSHIP (MAR-24 → MAR-26)
HDFC Bank	48% → **44%**	20% → **26%**
ICICI Bank	45% → **44%**	24% → **28%**
Kotak Mahindra Bank	38% → **26%**	13% → **24%**
State Bank of India	11% → 11%	12% → **13%**

Source: Capitaline, exchange shareholding, March 2026 vs March 2024. Domestic mutual funds have risen to records as foreigners trimmed, but HDFC Bank and ICICI Bank are still about 44% foreign-owned. The handover is underway, not complete. HDFC Bank shown as a public index constituent.

How much more selling, and where it is not???

When a sector has been sold for a year, the instinct is to call it oversold but in case of BFSI still there is massive FII holding so it may not pause yet. Unlike IT, where foreign ownership has fallen to multi-year lows, the large private banks still carry high foreign ownership. **HDFC Bank and ICICI Bank are each about 44% foreign-owned, Kotak 26%, against a market average near 16%**, and foreigners remain modestly overweight financials at close to 30% of their equity book. In the heavyweights, there is still plenty to sell.

Lower down the ladder, foreign ownership has always been thin. It steps down within financials much as it does across the cap curve. **Public-sector banks sit near 6 to 14%, the larger NBFCs in the low-to-mid twenties but many others in single digits, and the smaller small-finance banks in single digits**, at or below the market average. Because foreigners were never heavily invested here, these segments carry the least foreign supply overhang, and on our reading the better risk-reward within BFSI sits there rather than in the crowded large private banks.

FII ownership across BFSI by segment: Mar-2024 vs now

SEGMENT	REPRESENTATIVE NAMES: FII OWNERSHIP (MAR-2024 → MAR-2026)
Large private banks	HDFC Bank (48% → **44%**), ICICI Bank (45% → **44%**), IndusInd (40% → **29%**), Kotak (38% → **26%**)
Public-sector banks	Canara (11% → 14%), SBI (11% → 11%), Bank of Baroda (12% → 10%), PNB (5% → 6%)
NBFCs	Shriram (54% → **45%**), Cholamandalam (26% → 25%), Bajaj Finance (21% → 21%), L&T Finance (11% → **8%**)
Small finance banks	AU (39% → **37%**), Ujjivan (20% → 17%), Suryoday (3% → 5%)

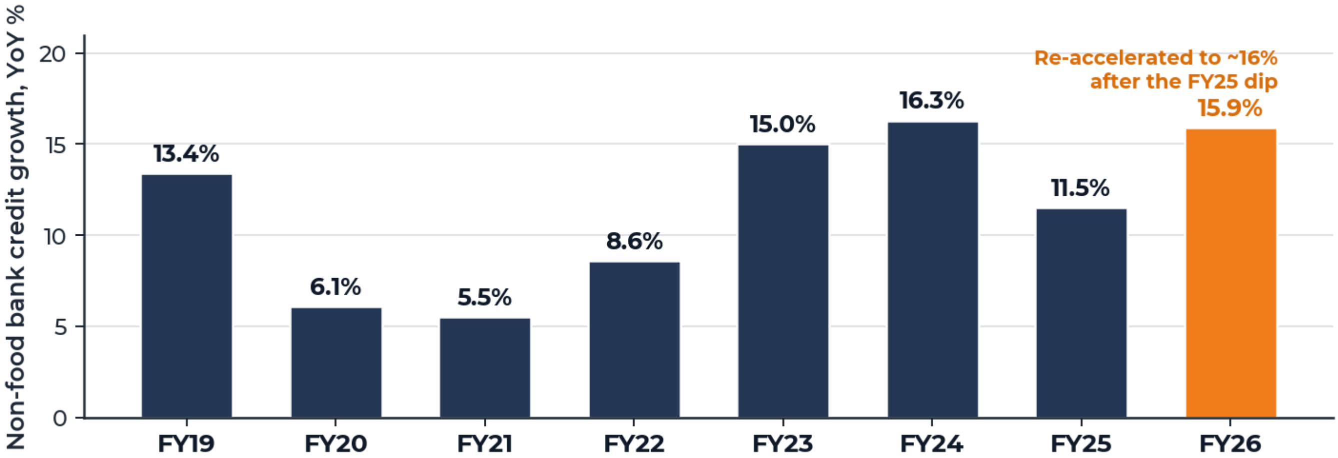
Source: Screener.in / BSE shareholding; FII = foreign institutional / portfolio investors, March 2024 vs March 2026 (multi-year peaks via Capitaline). Only the large private banks sit well above the ~16% market average; public-sector and smaller banks, most NBFCs and the small-finance banks are at or below it. Names are sector representatives, not recommendations; HDFC Bank shown as a public index constituent.

The valuation case for banks is not in dispute. **Goldman Sachs, even while cutting India to marketweight, kept an overweight on banks on what it called historically low valuations.** Our refinement is on the flow: within a cheap sector, the names foreigners already do not own are the ones without a selling overhang still to clear.

Where the asymmetry sits within BFSI. The IT template does not map onto the bank heavyweights. **The large private banks still carry roughly 44% foreign ownership, so the selling there can't be called out as conclusive.** The better risk-reward sits lower down the ladder: the public-sector and smaller banks, and the select NBFCs and small-finance banks where foreign ownership already sits below the market average, carry the least foreign supply to weigh on them, the BFSI analogue of the under-owned mid-cap market.

Beneath the selling, the credit cycle is strong. The sector foreigners are exiting is not deteriorating, it is lending more. **Outstanding bank credit reached a record ₹212.9 lakh crore in March 2026, and non-food credit growth re-accelerated to about 16% in FY26 (15.8% in the latest fortnight to end-April 2026; total bank credit up 17.1%) from roughly 11% in FY25**, among the fastest in over a decade, led by services (+18.6%) and industry (+15.1%). Deposit growth is catching up, easing the funding squeeze that slowed lending in FY25. The foreign exit is a flow event laid over an improving fundamental base.

Chart 7: Bank credit growth has re-accelerated. Non-food bank credit growth, YoY



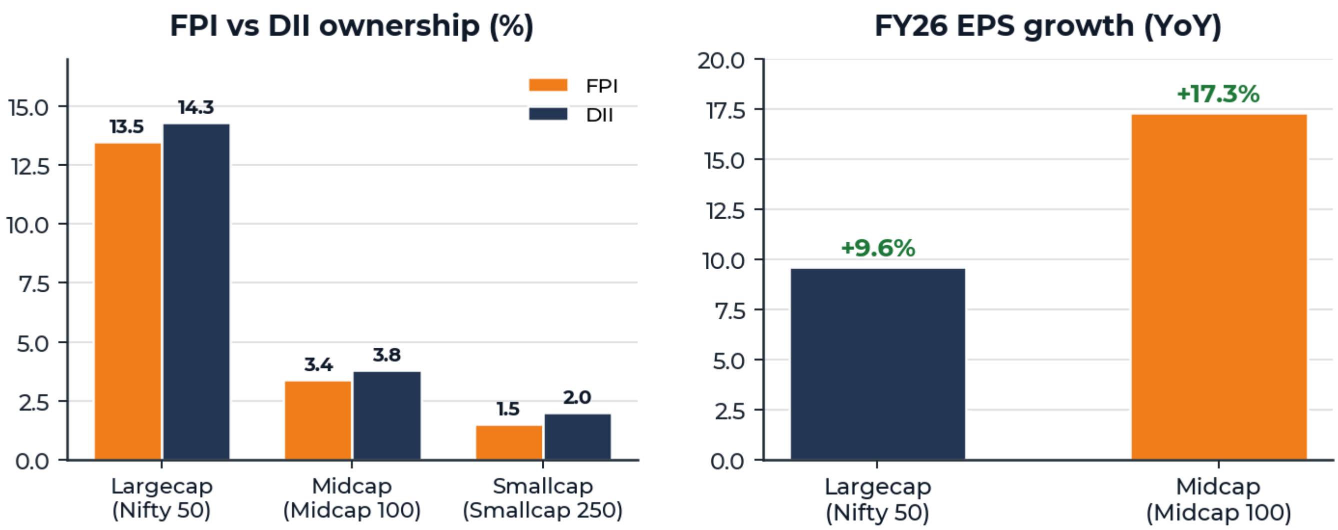
Source: RBI sectoral deployment of bank credit; FY = year ended March. FY24 shown ex the HDFC-HDFC Bank merger (about 16%); the headline including the merger was about 20%. Outstanding non-food bank credit at a record ₹212.9 lakh crore (March 2026).

Midcaps married to micro fundamentals- Unhurt by foreigner's exit...

The clearest evidence that this is a flow story, not a fundamental one, is where the market is making new highs. **The Nifty Midcap 100 made a fresh all-time high of 62,907 in June 2026, even as the Nifty 50 sits about 8% below its January peak.** The reason is ownership. Foreign investors are structurally absent from the broad market: **FPI ownership steps down the cap curve, from about 13.5% of the Nifty to roughly 3.4% of the midcap index and 1.5% of smallcaps.** As Kotak Institutional Equities puts it, mandates, liquidity and compliance keep foreigners anchored to large, liquid names, so when they sell, the Nifty-50 names bear the brunt and the rest is largely untouched.

Lower foreign ownership would not matter if the earnings were not there, but they are. **Nifty Midcap 100 earnings grew about 17% in FY26 against 9.6% for the Nifty 50**, and the revision trend runs the same way, midcaps saw FY26 estimate upgrades while largecaps were cut. Forward consensus extends it, with midcap and smallcap earnings expected to outgrow the Nifty over the next two years. A segment the foreigners cannot easily sell, compounding faster than the one they are selling, is the cleanest expression of the rotation now underway.

Chart 5: The market the foreigners do not own grows fastest



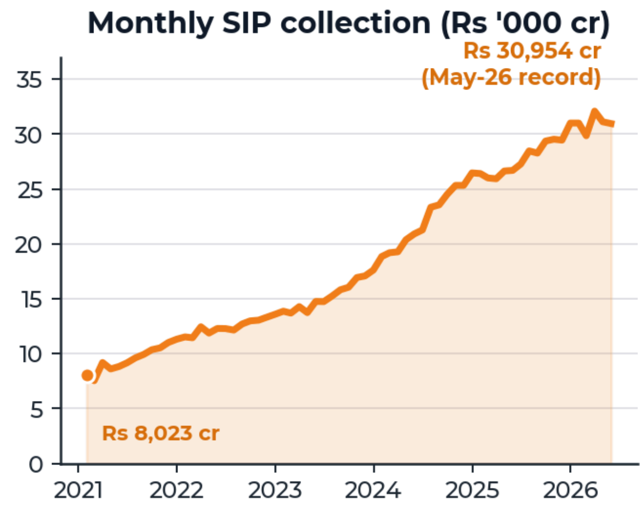
Source: Capitaline (FPI and DII ownership by index segment, March 2026, free-float basis) and Bloomberg (FY26 EPS growth, aggregate trailing-twelve-month EPS, Nifty 50 and Nifty Midcap 100). Nifty Midcap 100 all-time high 62,907.50 (June 2026); 62,379 close on 18 June 2026, per NSE.

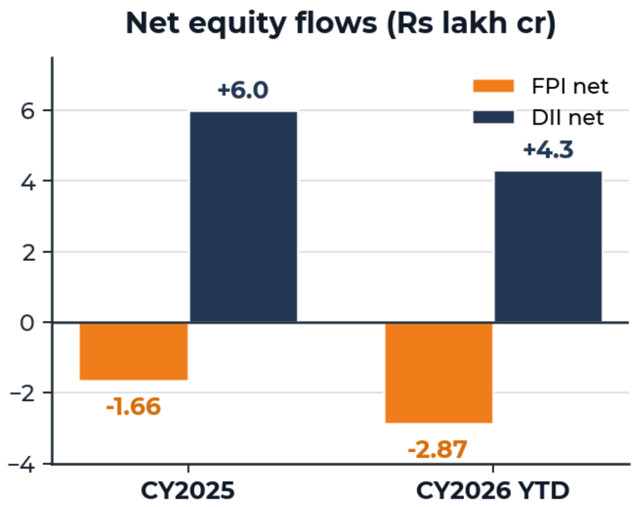
DII buys what FII sells ....

The reason a record foreign exit has produced about an 8% largecap drawdown rather than a crash is the domestic bid. **Monthly SIP contributions have climbed from about ₹8,000 crore in early 2021 to a record ₹30,954 crore in May 2026**, a price-insensitive flow that arrives every month regardless of the headlines. Domestic institutions **bought roughly ₹6 lakh crore of equities in 2025 and another ₹4.3 lakh crore in the first half of 2026, close to ₹4,000 crore a day, absorbing about 98% of the foreign selling in the worst month.**

The consequence is structural. Domestic institutions now own more of India Inc than foreigners, by the widest margin in over a hundred quarters. The marginal price-setter in Indian equities is no longer the foreign allocator deciding India's weight in a global book, it is the domestic saver moving money out of deposits and into equities by standing instruction. That does not make foreign flows irrelevant, they still set the tone for the largecaps and the heavyweight sectors, but it changes what their absence means. **A market with a permanent domestic bid does not need foreigners to buy; it needs only the selling to slow/stop**, which has somewhat happened in the IT services side.

Chart 6: The domestic backstop. Record SIP flows and DII buying dwarf the foreign exit





Source: AMFI (monthly SIP contributions) and NSDL/BSE (FII and DII net equity flows). CY2026 flows to mid-June 2026.

Sowilo positioning: Which couple we prefer?

We believe that both Macro and Micro matter for our performance: we use Macro to choose and switch between sectors, and Micro to choose and switch within them. Our approach follows a two-step process. **First**, within our preferred sectors we look for companies that pass our guiding principles (leadership / quality / process / scale / technology) and where FPIs hold low stakes with higher earnings growth. **Second**, we bottom-fish where the foreign seller has the least left to sell: IT, where ownership and valuations are at multi-year lows, and the under-owned segments of financials, public-sector and smaller banks and select NBFCs and small-finance banks, rather than the large private banks foreigners still hold near 44%. We treat the foreign exit as a flow event against a permanent domestic backstop, not a verdict on the quality of Indian businesses. When the selling slows, the names where it slows first carry the next move. **We are positioned for that sequence, not for a call on its timing. So we prefer good quality, well-run, compounding stories at our bargain price.**

> **What to watch.** A single fortnight of net foreign buying into financials would mark the same inflexion IT has already passed. A sustained narrowing of MSCI India's valuation premium to EM would signal the AI-rotation pull is fading. And continued mid-cap earnings delivery, the FY26 upgrade cycle holding into FY27, is what keeps the breadth trade intact while the largecaps wait for the foreigners to finish.

Regards,

Team Sowilo