MARKETS

Retail Investors' Rs 10-Lakh Crore Smallcap Bet Backfires As Stocks Face Heat

After riding on the small-cap stocks boom in recent years, many investors—especially mom-and-pop ones—are now left wondering what's next.

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The start of 2025 has been a volatile and bumpy ride for India's $4.89 trillion stock market, giving a reality check to retail investors. These individual investors are bleeding heavily from their small-cap bets—the darlings that turned dangerous this year.

The local stock market faces multiple domestic challenges, including the risk of earnings downgrades, slowing economic growth, delayed rate cuts, and high valuations. On the global front, rising US bond yields and a strengthening dollar—fueled by President-elect Donald Trump's proposed tariff policies—add to the pressure.

Amid these challenges, Indian stocks remain cautious and volatile, slipping back into the 'correction' zone after a brief recovery. Typically, a decline of over 10% from the 52-week high is considered a 'correction', while a drop of more than 20% marks a shift into 'bear market' territory.

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The benchmark gauges — Nifty 50 and 30-stock Sensex — have fallen by 11.6% and 10.7% respectively, since hitting a life-high in late September last year.

What makes the situation worse? As of Monday, the Nifty 50 recorded its weakest start to a year since 2016, plunging 4.83% in the first nine sessions.

Meanwhile, the NSE Small Cap 250 has dropped over 6.40% in the first nine sessions of 2025, marking its steepest start to any year. Mid-cap indices also faced their sharpest opening decline since 2011, underscoring a rough beginning across the board.

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The recent turmoil has dealt a significant blow to retail investors, with small-cap stocks experiencing the sharpest declines. Over the years, retail investors have increasingly gravitated toward these companies, building substantial holdings.

As of September quarter, domestic institutions and global funds hold 24.53% and 21.76% of the free-float value in small-cap companies, respectively. Retail investors, however, hold nearly an all-time high of 27.06%, according to PRIME Database.

What's interesting is promoters of these firms currently hold 21.76%, with their stake declining each quarter. Back in March 2014, they held 30.9%. The shareholding data for the December quarter is yet to be released.

The value of retail investors' investment in small-cap companies as of the September quarter stood over Rs 10.28 lakh crore.

The data clearly shows the continuing overwhelming presence of retail investors in mid and small-cap companies, which institutions typically have much lower exposure to, because of the risks involved and also because their mandate doesn't permit them to, said Pranav Haldea, managing director of PRIME Database Group.

In contrast, retail investors invest in these stocks, often mistaking their low price for value or speculating on companies facing severe setbacks, in hopes of a turnaround in their stocks, Haldea said.

This trend does not apply to large-cap companies, where domestic and global institutions hold a significantly larger share than retail investors. These institutions account for over 35% of the stake, while retail investors hold only 12.35%.

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Retail investors flock to small caps in anticipation of higher gains, as they has delivered stellar returns in the last couple of years, according to Shweta Rajani, head of mutual funds, Anand Rathi Wealth Ltd. They tend to buy on past performance, Rajani said.

Profitability will be the key driver for the market and we are expecting the small caps to not face any major pressure going forward this financial year, said Rajani. "We do not expect small caps to face any exceptional pressure due to current macroeconomic conditions."
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What's shocking is that Kotak Securities still sees reward-risk balance for the Indian market as quite poor, despite the recent correction. The reaction of "euphoric retail investors, the bedrock of the market, will be interesting to see", Kotak said in a note.

Many 'narrative' stocks have a long way to fall, based on the true value of such companies, the brokerage added. Investors were willing to give any multiple for stocks, irrespective of the business models and fundamentals, Kotak said, given the irrational buying that sent the benchmarks to life high. Investors used "exotic valuation methodologies and multiples and believe any random narrative about sectors and stocks."

After riding on the small-cap stocks boom in recent years, many investors—especially mom-and-pop ones—are now left wondering what's next.

The expectations of high volatility in markets across the globe in the first half of 2025 have already triggered global funds to move funds away from risky assets.

So far in January, foreign institutions have been net sellers of $4.1 billion worth of Indian equities. While being net buyers in primary market, FIIs have already sold secondary stocks worth $4.2 billion.

There are unprecedented divergences in growth, inflation and rate dynamics across key economies that bring in significant uncertainty to Indian markets, Nomura said in a note. "The risk premium is thus likely to increase." The brokerage assigned a year-end target of 23,784 for the benchmark Nifty 50, implying a mere 2.6% upside from Tuesday's close.

Retail investors should ideally invest through mutual fund route given the lack of time and expertise, according to Haldea. "Even if you want to invest directly, stick with larger names as the downside is limited."

The strategy for investors to beat market volatility is to stay diversified across asset classes, market caps, sectors, and categories, Rajani said. "This approach allows investors to ride out market volatility comfortably, without the need to micromanage their portfolio."

Meanwhile, market experts also advise investors to **sit on cash**, until the volatility subsides and to hold a large **margin of safety**.
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