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Small Cap Funds: Turning Market Corrections into Long-Term Wealth Creation Opportunities

The recent phase in the market has witnessed a *meaningful correction* in the small-cap segment, driven by a combination of global and domestic factors. Rising geopolitical tensions, persistent inflationary pressures, and uncertainty around interest rates have created bouts of volatility across asset classes. More importantly, small-cap stocks had remained at elevated valuations for nearly two to three years prior to this phase, and the recent decline reflects a natural process of valuation normalisation rather than any structural weakness in the segment.

It is important to understand that such corrections, while uncomfortable in the short term, often lay the foundation for **stronger long-term returns**. Small-cap companies represent businesses that are still in their growth phase. They tend to be more agile, operate in niche or emerging sectors, and benefit significantly from the broader economic expansion. As India continues to grow through increased consumption, manufacturing push, and infrastructure development, many of these smaller companies are well-positioned to scale up their operations and earnings over time. This earnings growth, when combined with improving market sentiment, has historically translated into superior long-term returns for investors.

The current environment, therefore, presents a relatively **favourable entry point**. With prices having corrected from their peaks, investors are now able to participate in these growth stories at more reasonable valuations. *This is particularly relevant for investors with a long-term investment horizon of six to seven years or more.* Over such a period, the impact of short-term volatility tends to diminish, while the benefits of compounding and earnings growth become more pronounced. Investors who enter during periods of correction and remain disciplined are often the ones who generate meaningful wealth over time.

The trend is also visible in recent developments within the mutual fund industry. The launch of new small-cap funds by fund houses such as Abakkus and Wealth Company indicates that institutional participants are beginning to see value emerging in this space. Typically, such product launches are aligned with phases where long-term opportunities are improving, even if short-term sentiment remains cautious. This further reinforces the view that the current correction may be more of an opportunity than a risk for patient investors.

The movement of the **Nifty Smallcap 250 index**, as depicted in the graph, clearly reflects this evolving market phase. The index experienced a sharp decline from late 2024 into early 2025, signalling the unwinding of excess valuations. This was followed by a partial recovery, suggesting selective buying interest in quality names. More recently, the index has entered a phase of consolidation, with fluctuations within a narrower range. Importantly, it continues to trade below its earlier highs, indicating that the earlier froth has largely been removed and the market is transitioning into a more stable accumulation zone.

Such phases of consolidation are typically characterised by reduced speculative activity and increased focus on fundamentals. For long-term investors, this is often the most constructive phase to build exposure, as it allows investments to be made gradually at relatively favourable levels without the pressure of chasing momentum. Over time, as earnings visibility improves and macroeconomic uncertainties stabilise, this accumulated base can act as a strong foundation for the next leg of growth.

In conclusion, while small-cap funds may continue to exhibit volatility in the near term, their long-term investment case remains intact. The combination of corrected valuations, strong underlying growth potential, and improving investment opportunities makes the current environment conducive for gradual allocation. Investors who are able to adopt a disciplined approach and remain invested over a period of six to seven years are likely to benefit from the compounding effect of earnings growth and market recovery, thereby achieving meaningful capital appreciation over time.

Some of the **worst-hit small-cap funds from around October 2024 onwards** include:

Fund Name	NAV as on 31st October, 2024 (in Rs.)	NAV as on 12th March, 2026 (in Rs.)	Change in NAV
Kotak Small Cap Fund	276.70	232.54	−15.96%
Bank of India Small Cap Fund	49.27	42.00	−14.75%
Quant Small Cap Fund	270.22	230.45	-14.72%
Mahindra Manulife Small Cap Fund	20.39	18.04	-11.53%
Aditya Birla Sun Life Small Cap Fund	89.38	80.09	-10.39%

MFD Details:
Nilanjan Dey
MFD
ARN - 84929

Regards,
Trina Dutta
Research Executive, Wishlist Capital

* Mutual funds are subject to market risks. Please read all scheme-related documents carefully before investing. Past performance does not indicate future results. Investments are subject to market fluctuations, and there is no assurance of returns.