

Braced for a Choppy Market

What Our De-Risking Model Is Telling Us

We allocated to cash in the portfolio. Here is why.

On 12 October we moved about 30% of the Wright Factor Fund and the Alpha Fund out of equities and into cash. Why? Because our de-risking discipline, built and tested on ten years of data, says this is the moment to step back: small caps breaking trend while foreign investors are selling.

This letter explains what triggered the move, how this discipline has served investors in the past, where we think the market sits, and the three ways we think the next quarter could unfold.

The short version. Small caps have outrun large caps by 21% since April and are now giving some of that back. The Nifty's recent bounce is almost entirely one sector, IT, rallying 14% on roughly 1% growth. Foreign investors have sold about ₹85,000 crore of Indian equities in the last 20 sessions. We read this as a choppy market rather than a crash, and choppy is bad for small caps: it is the one state where stepping back has historically paid.

Why we stepped back

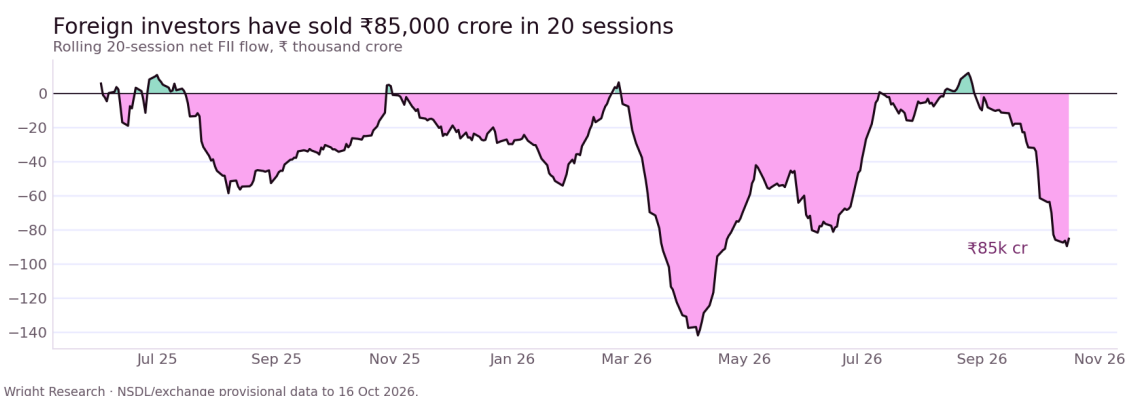
Our de-risking discipline watches two things: whether small caps have broken their trend, and whether foreign investors are selling. Both conditions have been true since 8 October.

What we check	What we look for	Reading on 16 Oct
Small-cap trend	Nifty Smallcap 250 closes below its 100-day average for three sessions	17,638 vs 17,872; below since 8 Oct
Foreign selling	Net FII flow over the last 20 sessions is negative	–₹85,141 crore
How much to cut	Scales with Nifty 50 volatility relative to its 3-year norm, capped at 50%	30% moved to cash
Where the cash goes	Nifty ETF if the Nifty holds its own trend, otherwise liquid funds	Nifty 50 at 23,146 vs 23,772 average; liquid



We watch small caps rather than the Nifty because that is where the big drawdowns have come from. In early 2025 the Factor Fund fell 26% while the Nifty fell 6%. A Nifty-based trigger would have missed it entirely.

The foreign-selling filter is what stops us from cutting in every quiet dip. A trend break only counts while foreigners are net sellers. That one condition removed most false alarms in the slow grinds of 2015 and 2016 and cost nothing in the years since.



When do we buy back equities? We buy back on the first close at least 4% above the lowest Smallcap 250 close since we stepped back. With the low at 17,638, that is about 18,343 unless the index makes a new low first.

Ten years of evidence

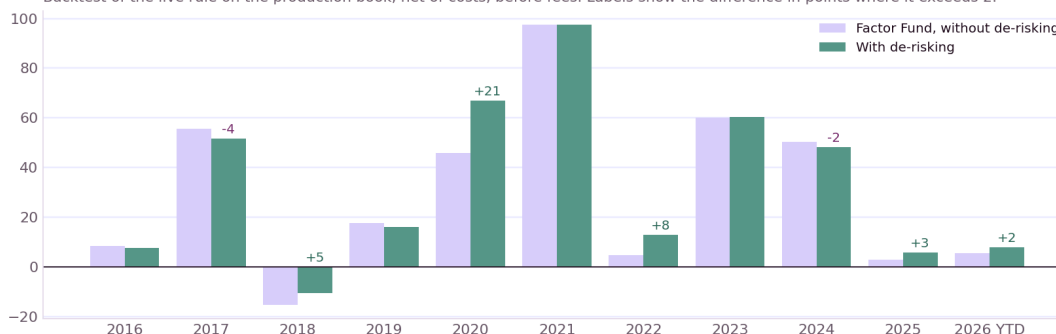
Over ten years the main gift of this discipline is a smaller worst case. On the Factor Fund it cut the maximum drawdown from 35% to 22% while adding about three points a year of return. On the Alpha Fund, from 34% to 21%.

Apr 2016 to Oct 2026	Return per year	Worst drawdown	Return per unit of drawdown
Factor Fund, without de-risking	30.0%	-34.8%	0.86

Apr 2016 to Oct 2026	Return per year	Worst drawdown	Return per unit of drawdown
Factor Fund, with de-risking	32.8%	-21.6%	1.52
Alpha Fund, without de-risking	36.5%	-33.6%	1.09
Alpha Fund, with de-risking	40.0%	-21.0%	1.90

Calendar-year returns, Factor Fund, %

Backtest of the live rule on the production book, net of costs, before fees. Labels show the difference in points where it exceeds 2.

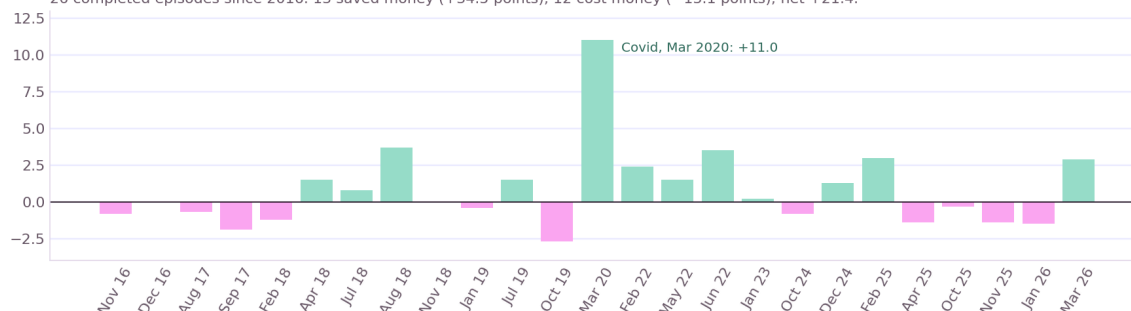


Wright Research · Apr 2016 to 16 Oct 2026. Past performance does not indicate future results.

We have been fully invested 86% of the time. When we stepped back, we took out 39% of the book on average and never more than half. We have done so 25 times. Thirteen of those saved money, worth 34.5 points in total; twelve were false alarms that cost 13.1 points. The net is 21.4 points in investors' favour.

Every time we stepped back: points saved or lost vs staying invested

26 completed episodes since 2016. 13 saved money (+34.5 points), 12 cost money (-13.1 points); net +21.4.



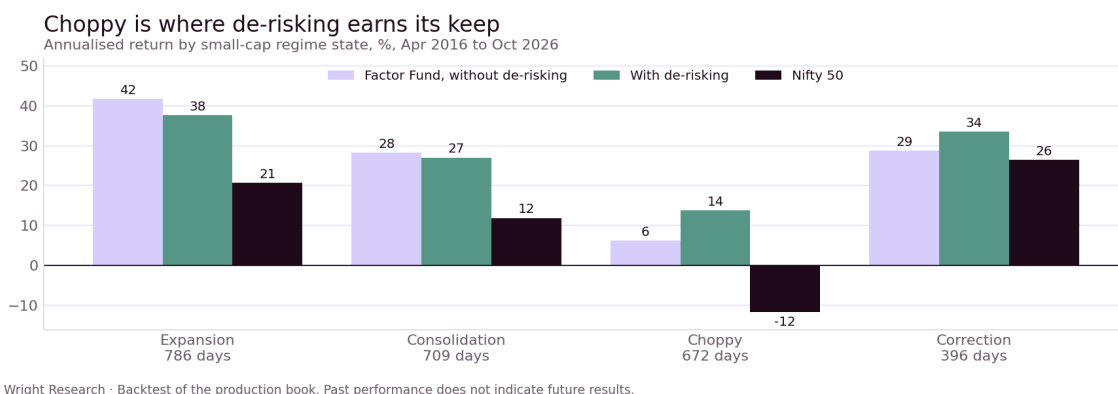
Wright Research · Overlay return minus book return over each episode. A false alarm typically costs 1 to 3 points.

Reading this honestly. What is robust is the drawdown: the worst case falls from 35% to 22%, and still from 24% to 17% if you set 2020 aside. The weak spot is a slow, low-volatility grind like 2015 to 2016, where small caps fell 28% without ever breaking cleanly. No trend-based approach catches that.

Where the market sits: choppy, and choppy is bad for small caps

We sort the market into a handful of states using price, volatility, flows and rates. Today our reading is **Choppy**: a nervous, sideways-to-down market with rising volatility, in place for small caps since 6 October and for the Nifty since 12 October. It is not a Correction, and that distinction matters more than it sounds.

Choppy, not Correction, is the dangerous state for small caps. In Choppy spells, small caps have tended to lose money over the following month, and the odds of a positive month are little better than a coin flip. Correction, counter-intuitively, is a buying state: the market only earns that label after a sharp fall, and what follows has usually been a strong month. Selling on a Correction label has historically meant selling the bottom.

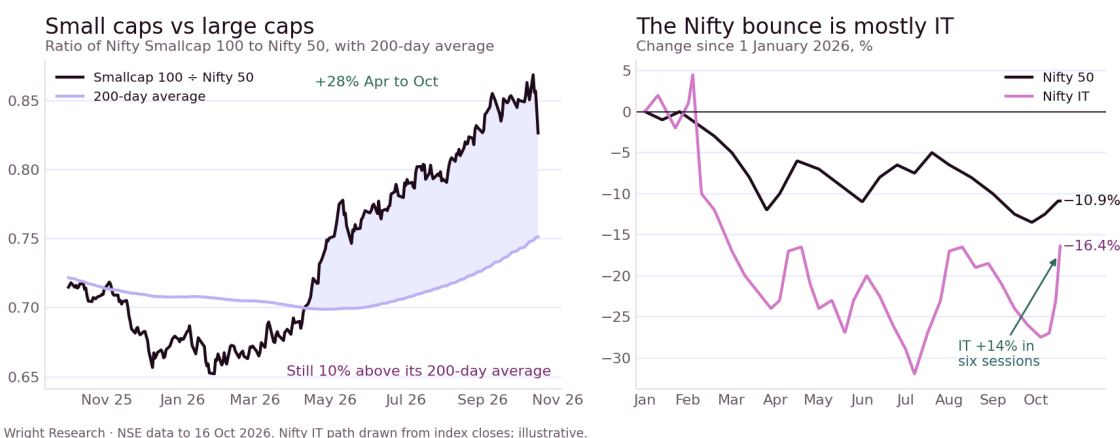


In Choppy, the Factor Fund has earned about 6% a year without de-risking and 14% with it, against -12% for the Nifty 50. In every other state de-risking costs a little or adds a little. Choppy is the one state where the de-risking earns its keep, and it is the state we are in now.

We use these states to understand the market, not to trade it. Our de-risking decisions rest directly on trend and flows, which have tested better than any market label, including our own.

Markets: a reversion is under way, but not the one it looks like

Two things moved sharply in October. Small caps started giving back their lead over large caps, and the Nifty bounced off its low for the year. We read the first as the start of a real mean reversion and the second as something narrower.



Small caps. From April to early October the Nifty Smallcap 100 outran the Nifty 50 by about 28%, while the Nifty itself was falling. Foreign investors were selling large caps and domestic money was buying the broader market. In the last week that ratio posted its sharpest drop of the rally, at exactly the point

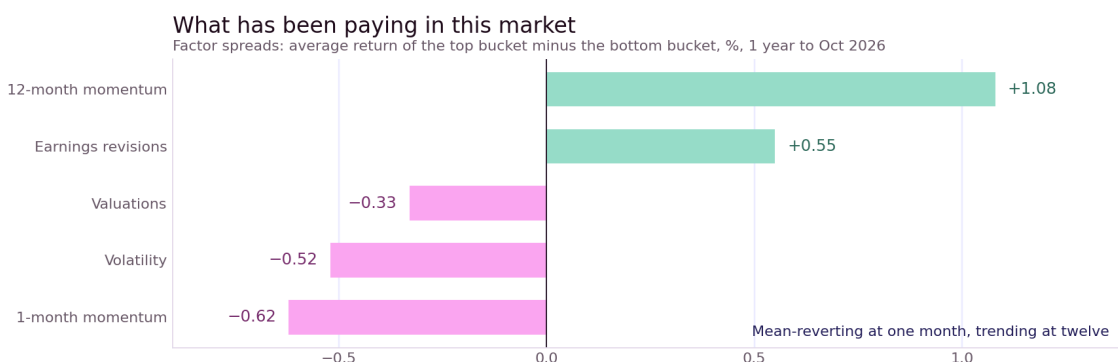
where the valuation gap between small and large caps was widest. The ratio is still about 10% above its 200-day average, so this reversion has room to run.

That does not mean small caps are finished. It means the rising-tide phase, where almost any small cap beat the large caps, is over. What replaces it is dispersion: the companies with earnings upgrades and real profit growth keep compounding, the ones that were simply expensive de-rate, and the index averages the two. Our job in this phase is to find the first group and avoid the second.

The Nifty. The index has recovered from -13.5% for the year to about -11%. Almost all of that is Nifty IT, up 14% in six sessions. IT is roughly 12% of the Nifty, so its move alone accounts for most of the bounce; strip it out and the rest of the market is still grinding sideways, about 7% below its 200-day average.

The IT rally itself rests on thin ground. The results were in line rather than strong: TCS grew half a percent in constant currency, HCLTech 2.6%, and Infosys guided to 1.5–3% growth for the year back in July. A 14% move on 1–3% growth is a positioning squeeze off very low expectations, not a re-rating. Infosys reports on 23 October and will decide whether it holds.

Our factor data backs the caution. Over the past year, chasing the previous month's winners lost money, with a spread of -0.6% between recent movers and laggards, while twelve-month leaders kept leading at +1.1%. This market has rewarded patience with long-term winners and punished chasing short-term moves. A two-week IT bounce against a twelve-month downtrend is exactly the kind of move it has punished.



Wright Research · Factor engine data to 16 Oct 2026. Not a recommendation.

Outlook: three scenarios for the next quarter

We have seen this kind of range-bound market 24 times since 2013. The median spell lasts about 57 trading days and we are roughly 18 in. When these spells ended, 13 broke higher and 11 broke lower. That is close to a coin flip, so rather than call a direction we lay out the three paths and what each would mean.

The global backdrop matters more than usual. The Nifty is down 11% this year while US semiconductor stocks are up over 60%. India has been the other side of the AI trade: foreign money left for chip-heavy markets, and Indian IT sits on the losing side of AI through pricing pressure rather than new revenue. How the AI trade unwinds, slowly or sharply, is the swing factor for Indian flows.

	Range continues	Breaks higher	Breaks lower
Rough odds, next month	~78%	~17%	~5%
Trigger	Foreign selling steady; volatility near average; Infosys guides in line	AI trade unwinds slowly; foreign flows turn positive; Nifty back above its 200-day near 24,300	Disorderly AI sell-off; volatility spikes; foreign selling deepens
Nifty 50	Sideways in a few-percent band; IT bounce fades	Broad participation; domestic cyclical and financials lead	New lows for the year; a correction state
Small caps	Ratio drifts back toward its 200-day; dispersion, not collapse	Beta works again; laggards catch up	Worst segment; ratio breaks its 100-day
What worked historically	Momentum, growth and selectivity; high beta lagged	Value and broad risk-on	Momentum faded; quality did not reliably protect
Our positioning	Stays at 30% cash until small caps bounce 4% off their low	We buy back on the bounce; a 15-session cooling period follows	Stays cut; we can deepen the cut up to its 50% cap
What we watch	Infosys on 23 Oct; 20-session FII flow; our volatility reading	Two weeks of positive FII flow; Nifty above 24,300	India VIX above 20; Smallcap 250 making new lows

The takeaway is the same across all three. In two of them small-cap beta does not pay and the IT bounce does not last. In all three, the stocks that have done well are the twelve-month leaders with upward earnings revisions, and the ones that have hurt are the high-volatility names whose prices ran ahead of their earnings.

What this means for your portfolio

If you hold the Factor Fund or the Alpha Fund, about 30% of your allocation is in cash today and 70% is in equities, with the equity portion tilted towards companies whose earnings are being revised up and away from the highest-volatility small and mid caps. That is the position this discipline has taken in every past Choppy spell, and it is the state where that position has helped most.

We are not predicting a crash. The most likely path is more of the same sideways market. The cash is there because the cost of being wrong in a quiet market is one to three points, and the cost of being wrong in a disorderly one has historically been ten or more. We re-enter mechanically on a 4% bounce in the small-cap index, which means we will be back in before any recovery is far along, and we will not be fully invested at the exact low. We have never aimed to be.

We will write again when we buy back in or when any of the three scenarios above becomes clearly the one we are in.