



October 7, 2025

Morning Briefing

China & India Diverging

Check out the accompanying [chart collection](#).

Executive Summary: Chinese stocks are rallying on AI exuberance and a leap of faith that governmental reforms will bear fruit, with little fundamental support for their ascent from earnings or economic data. William likens it to a similar runup a decade ago, which preceded a sudden plummet. The government's team of investors can swoop into the stock market with buying support at critical times, but that does nothing for China's underlying structural problems. ... Also: Record outflows from India's stock market reflect concerns about the economy's ability to shoulder 50% US tariffs, which will imperil labor-intensive sectors that don't generate enough low-end jobs as it is. The economy needs a fiscal stimulus jolt.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay [here](#).

Chinese Markets I: Stocks May Be Outrunning the Economy. It's been a decade since Shanghai's [Wile E. Coyote moment](#): All through the summer of 2015, investors chased stock valuations higher and higher—until they realized the road below had disappeared. The market fell by [one-third](#) in just three weeks.

The China bulls are charging again, adding more than [\\$3 trillion](#) in market capitalization across mainland and Hong Kong equities so far this year. A valuation surge equivalent to annual GDP of France—and back to [2015 highs](#)—has investors squinting to see the road below ([Fig. 1](#)). It's hard to argue that underlying company fundamentals—or where the government's vital reforms will take them—are strong enough to support the bulls' stampede. Then again, leading the stock market have been AI stocks, which seem to be disconnected from China's economic performance.

On the economic front, there's scant evidence besides export data that a sustained economic recovery is afoot. Industrial production growth of [5.2% y/y](#) in August is the slowest in 12 months, while the [3.4% y/y pace](#) of retail sales is the lowest in 11 months ([Fig. 2](#)). Fixed-asset investment growth of just [0.5% y/y in August](#) is the worst since the pandemic days of 2020.

Deflation, meanwhile, isn't going anywhere despite President Xi Jinping's determination to stop excessive price competition. In August, China's consumer price index fell at the fastest rate ([-0.4% y/y](#)) in six months, a period before US President Donald Trump's tariffs hit ([Fig. 3](#)).

Let's consider why the economy could take a bite out of China's stock market rally:

(1) *Festering property crisis*. A major force behind weak consumer prices is a festering property crisis. As an industry that traditionally contributed [30% of GDP](#) shrinks, household confidence is waning. Nor are there encouraging signs that Team Xi is acting on pledges to clean up developers' balance sheets. So far this year through August, property investment [dropped 12.9% y/y](#), the lowest level since the Covid-19 pandemic ravaged property investing in 2020.

Not surprisingly, some investment banks worry that China's powerful stock rally is outrunning economic reality. Last month, Ting Lu of Nomura Holdings spoke for many when he warned that "the stock boom has the potential to lead to [irrational exuberance](#), an increase in leverage and the formation of a bubble."

(2) *Fundamental disconnect*. Raymond Cheng at Standard Chartered argues that "China's ongoing [equity rally](#) appears disconnected with the economic fundamentals," noting that "retail investors have played a key role as they have been shifting some of their bank deposits into equity markets."

China's [1.4 billion people](#) are sitting on [160 trillion yuan](#) (\$23.5 trillion) of household savings at a moment when deposit rates are falling. Therefore, relatively modest moves into the stock market can drive substantial returns.

(3) *Anticipatory rally*. Optimists argue, though, that the surge in Chinese shares is a bet that, this time, Xi will succeed in recalibrating growth engines, strengthening consumer spending, and guiding Asia's biggest economy upmarket. In essence, the rally is more of an anticipatory, rather than grounded, one.

Also, just as in the West, China stock enthusiasts are teeing off investment mega-themes like semiconductors, industrial automation, and artificial intelligence (AI). The AI boom is partly driven by the moment in the spotlight that startup DeepSeek experienced earlier this year and the advances made by Cambricon Technologies, which has been referred to as "[China's Nvidia](#)." Jack Ma's Alibaba Group is investing big in AI, too.

The trouble is that the China bulls' leap of faith might not be supported by events in Beijing and the performance of the overall economy.

Chinese Markets II: Reform Talk Requires Action. When Xi's reign began in 2013, the Communist Party pledged to let market forces play a "[*decisive*](#)" role in economic decision-making. The stock reckoning in 2015 was driven by investors' sudden realization that there was more talk than action.

In the years since, Xi's government has set up a "national team" of state-backed investors to jump into the stock market and save the day. This team stabilized the market amid the Covid-19 crisis. It sprang to action in April as Trump's "[*Liberation Day*](#)" tariffs hit markets anew.

Here's more:

(1) *National team.* With the [*national team*](#) big-footing the market, the broader rally began around [*September 2024*](#). It coincided with central bank rate cuts, reduced reserve-requirement ratios, and regulators' allowing companies to buy back shares and institutional investors to leverage balance sheets more easily.

Yet the momentum these steps unleashed is only part of the story. Team Xi also cajoled households to move their savings into stock—framing China's often casino-like market as a safe alternative to owning property—and steadily opened new channels for foreign funds to flow into Shanghai.

(2) *Extreme opacity.* Even as China expands investors' access and layers on options and [*exchange-traded funds*](#), though, speed bumps abound. One is a currency that isn't yet fully convertible. Another: extreme opacity.

China, for example, lacks a world-class credit rating company. On Xi's watch, China's media has become less free, and cyberspace is less free-wheeling. Beijing is working to silence economists who might not stick to the party line and to make it harder to know who owns which company. Rather than learn from the first-worst ethos that morphed tiny Hong Kong into a top financial center, Xi is [*Chinafying*](#) the place.

(3) *The wrong target.* The chronic weakness of household spending is exacerbated by high youth unemployment. Yale University's Stephen Roach, former chairman of Morgan Stanley

Asia, says all roads lead to mainlanders' saving too much and spending too little. Rather than a 5% annual GDP target, Roach says Xi [should target](#) making 50% of GDP by 2035 ([Fig. 4](#)).

"My answer: 7% consumption growth between now and 2035 versus 3.3% for the remainder of the Chinese economy," Roach explains. "The longer China waits, the tougher it will be to pull off this critical rebalancing strategy."

Until Xi makes this most vital of transitions, China can scarcely avoid more 2015-like episodes. That's *The Economist's* thesis in a [September 29 article](#) headlined "China's stock market rally may hurt the economy." One concern is how this [FOMO-driven](#) surge is causing investors to overlook the weak profits of [China's banks](#). The bigger one, though, is that Team Xi didn't set out only to revive the stock market but also to revive the broader economy via a surging stock market.

Things don't work that way, of course. Putting the cart before the proverbial horse seems prelude to another Roadrunner moment.

Indian Markets I: Why Foreigners Are Hitting 'Sell' Button. As 50% US tariffs slam India, Prime Minister Narendra Modi's economic team is pulling out all stops to convince global investors that all is well. On Friday, for example, Finance Minister Nirmala Sitharaman insisted that "our capacity to [absorb shocks](#) is strong" amid President Donald Trump's trade war.

International funds don't appear to be getting the message. This year could be on course for record outflows from Indian stocks. In the first nine months of 2025, foreign investors [dumped \\$17.6 billion](#)—\$2.7 billion in September alone. Such outflows are comparable to those in 2022, when Russia invaded Ukraine and global interest rates were rising.

Let's consider why overseas funds harbor concerns about India:

(1) *Modi's most challenging year.* Between shouldering the US's largest tariff—shared only by Brazil—dealing with disrupted trade flows worldwide, and navigating shifting political dynamics at home, this is proving to be the most turbulent year of the Modi era, which [began in 2014](#).

Modi's team is grappling with non-tariff fallout from Trump World as well: tightening [H-1B visa rules](#). The change affects thousands of skilled Indian workers who command outsized

salaries. Many send large portions of their pay back home to support families. India is among the world's most remittance-dependent economies, receiving approximately [\\$118.7 billion](#) in 2024.

According to the Reserve Bank of India, workers' shipping cash back home finances roughly half of India's merchandise trade deficit. That serves as a vital shock absorber against external shocks.

(2) *Trade war risks.* Trump may not be done punishing Modi's economy for being the [No. 2 buyer of Russian oil](#), support that helps Russia's President Vladimir Putin despite US sanctions. Trump is threatening to impose additional duties on [Indian pharmaceuticals](#).

All these challenges are reminding foreign investors that India has some of the globe's priciest valuations despite weak earnings.

Indian profits among MSCI-included companies are estimated to rise at a [5% pace this year](#), well below the 8% growth in 2024. That has the Nifty 50 Index underperforming regional peers. For five months, until September, the benchmark lagged behind the MSCI Asia Pacific Index. That's the longest divergence since 2013.

(3) *A pricey place.* The Nifty is [trading at 20 times](#) 12-month forward earnings, making India's stock market one of the [priciest](#) in Asia. India's MSCI-included companies trade at nearly 25x, a historical high ([Fig. 5](#)).

This isn't how investors thought this year would play out. In April, when Trump's trade war was shaking major markets everywhere, India was among the first to [rebound](#). For a time, it even won something of a [safe-haven bid](#). Few global funds expected a reversal in Indian flows to occur so quickly.

Now the fallout from Trump's tariffs is refocusing attention on India's domestic troubles. The levies are imperiling workers in labor-intensive sectors like jewelry, leather, and textiles. This, at a time when India's [7% growth](#) in recent years hasn't been creating enough jobs at the medium and lower ends of the income strata ([Fig. 6](#)).

Indian Markets II: Supply-Side Big Bang Still Needed. Modi has talked a good game of transforming India into a manufacturing power. Yet his "Make in India" campaign has been stymied by high tariffs, stringent regulations, a fragmented industrial base, low R&D investment, weak productivity, and chronic land access problems. So manufacturing's GDP

contribution has been [around 15%](#) since before the Modi era.

As the tariffs hit, India's response has been to treat the symptoms of its troubles, not the underlying causes. Here's why India's response may be insufficient:

(1) *More fiscal loosening needed.* In June, the Reserve Bank of India (RBI) announced a 50 bps rate cut to 5.5%. Last month, Modi's team [cut the goods and services](#) tax on a variety of consumer goods, automobiles, and farm products. Most goods taxed at 12% will now be taxed at 5%, while those taxed at 28% will now be taxed at 18%.

Along with boosting domestic demand to offset US tariffs, notes Carlos Casanova at Union Bancaire Privée, "the reform is expected to ease [inflationary pressures](#), creating room for the RBI to consider further rate cuts during its October policy review."

What's missing, though, is fiscal loosening sufficient to ensure that India continues growing faster than China. One of the hallmarks of Modi's premiership has been fiscal sobriety. Until now, he's shown an uncanny ability to augment lower rates with oratory skills that give whatever spending New Delhi an added multiplier effect.

The [\\$255 million](#) spending package unveiled by Sitharaman to date is not sufficient. It aims to increase access to credit. Only a significantly bigger stimulus jolt can alter the trajectory of India's [\\$3.56 trillion economy](#).

(2) *Trailing China in AI.* Even more important is rebooting the supply-side Big Bang that voters hired Modi to deliver 12 years ago. The slow pace of levelling playing fields and increasing competitiveness is catching up with India, particularly as both China's rise and the AI artificial intelligence boom upend global business.

Already, India faces a [talent drought](#) at the worst possible moment. Although India boasts a rapidly expanding digital economy and a young population, it has only one qualified engineer for every 10 job openings in generative AI roles. In February, OpenAI CEO Sam Altman [questioned](#) why India is playing a lead role in the AI revolution. India already has the second-highest number of OpenAI users worldwide.

There's little time to waste as China's DeepSeek and peers turn heads everywhere. The good news is that domestic institutions continue to [snap up](#) Indian stocks, cushioning the damage. Still, increasing foreign outflows are a wake-up call that Modi should take seriously.

Calendars

US: Tues: Atlanta Fed GDPNow 3.8%; Consumer Inflation Expectations; EIA Short-Term Energy Outlook; Bostic; Bowman; Kashkari. **Wed:** MBA Mortgage Applications; FOMC Meeting Minutes; Barr. (Source: FX Street)

Global: Tues: Germany Factory Orders 1.2%; UK Halifax House Price Index 0.4%; Lagarde; Nagel. **Wed:** Germany Industrial Production -1.0%; Germany Buba Monthly Report; BoE FPC Meeting Minutes; Lagarde; Elderson; Buch; Pill. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): During the October 3 week, forward earnings rose simultaneously for all three of these indexes for the 16th time in 20 weeks. LargeCap's forward earnings rose for a 20th straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's has dropped in just three of the 20 weeks since it bottomed during the May 16 week. SmallCap's has risen for 19 straight weeks since it bottomed during the May 23 week, its longest winning streak since it did so just over four years ago for 25 weeks through the August 27, 2021 week. LargeCap's forward earnings rose 0.2% w/w to its 18th straight weekly record high. MidCap's rose 0.4% w/w to 0.5% below its record high during the September 19 week. SmallCap's rose 0.1% w/w to a 23-month high and is 8.9% below its June 2022 record. LargeCap's forward earnings has soared 30.8% from its 54-week low during the week of February 1, 2023; MidCap's is 10.2% above its 55-week low during the week of March 10, 2023; but SmallCap's has lagged considerably and is up just 6.7% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tariff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 9.9%, 14.0%), MidCap (0.4, 1.0, 17.9), and SmallCap (-10.2, 4.2, 17.1).

S&P 500/400/600 Valuation ([link](#)): Valuations rose for all three of these indexes during the October 3 week. LargeCap's forward P/E rose 0.1pt w/w to 22.7, which was its highest level since the January 8, 2021 week when forward earnings was still recovering from the Covid-

19 shutdown. It's now 5.7pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.1pt w/w to a four-week high of 16.3, down from a 32-week high of 16.4 during the September 5 week. It's now 0.8pts below its 40-month high of 17.1 during the November 29 week and 4.1pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020 when forward earnings was depressed and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E rose 0.2pt w/w to a 33-week high of 15.7. It's 2.8pts above its 17-month low of 12.9 during the April 4 week and 5.1pts above its 14-year low of 10.6 in September 2022 but remains 1.4pts below its 41-month high of 17.1 during the November 29 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed, and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is at a 28% discount to LargeCap's P/E, up from a 26-year low 29% discount during the April 10 week, which matched its similar 29% discount during the July 5, 2024 week. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E is at a 31% discount the LargeCap's P/E, not much above its 13-month-low 33% discount during the August 7 week. That compares to a 23% discount during the November 29 week, which was its best reading since the March 2, 2023 week. It's now just 1ppt above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is at a 4% discount to MidCap's, up from a 13-month low 6% discount at the end of July and a 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

Global Economic Indicators

Eurozone Retail Sales ([link](#)): Eurozone retail sales have been fluctuating in a relative flat trend since April. Headline sales edged up 0.1% in August, following a 0.4% loss in July, a 0.5% gain in June, and a 0.3% decrease in May. Sales had been in recovery mode from mid-2023 through the first quarter of this year. Spending on automotive fuel rose 0.4% in August, while spending on food, drinks, and tobacco climbed 0.3%; non-food products ex fuel dipped 0.1% during the month. Versus a year ago, total retail sales rose 1.0%, led by gains in non-food products ex fuel (1.9% y/y) and automotive fuel (0.8), with spending on food, drinks, and tobacco (0.1) basically flat. On a month-over-month basis, sales among the four largest economies were mixed in August, increasing in both France (0.5) and Spain (0.4) and falling in Italy (-0.3) and Germany (-0.2). On a year-over-year basis, Spain (4.6%

y/y) led the pack, with Germany (1.8) also in the plus column; sales in France (-1.4) and Italy (-0.6) were below year-ago levels.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102

