2POINT2 CAPITAL

2Point2 Capital Investor Update Q2 FY26

Dear Investors,

This is the thirty-seventh quarterly letter to our Investors. Our letters to you will provide an update on our investment performance and present our views on relevant topics.

PERFORMANCE

2Point2 Long Term Value Fund

The 2Point2 Long Term Value Fund (launched in July 2016) is our only strategy under the PMS license granted to us by SEBI. This strategy focuses on generating long term returns by holding a concentrated portfolio of investments (15-18 stocks).

Returns Summary

	2Point2	BSE 500 TRI#	Out-performance
FY17*	26.8%	12.2%	+14.6%
FY18	16.6%	13.2%	+3.4%
FY19	14.4%	9.7%	+4.7%
FY20	-24.6%	-26.5%	+1.9%
FY21	73.9%	78.6%	-4.7%
FY22	17.8%	22.3%	-4.5%
FY23	10.0%	-0.9%	+10.9%
FY24	45.2%	40.2%	+5.0%
FY25	11.0%	6.0%	+5.0%
YTD FY26	15.0%	7.2%	+7.8%
CAGR Return	**19.9%**	**14.7%**	**+5.2%**
Cumulative Return*	**433.4%**	**253.1%**	**+180.3%**

**FY17 returns are for an 8-month period. Cumulative returns are from 20th July 2016 to 30th September 2025. As mandated by SEBI, returns are calculated on a time-weighted basis (TWRR) on aggregate portfolio. Returns are net of expenses and fees. Performance related information provided here is not verified by SEBI.*
#TRI is Total Return Index – includes returns from dividends received

"Link to performance relative to other portfolio managers" - https://tinyurl.com/549h8kb6

Note: Returns of individual clients will differ from the above numbers based on the timing of their investments. The above returns are on the consolidated pool of capital.

Commentary

Our portfolio returned -8.5% in Q2 FY26. The BSE 500, Nifty 50 and Nifty Midcap 100 index generated returns of -3.2%, -3.2% and -5.2% in this period. As of 30th September 2025, we had a 77.1% equity exposure (ex of REITs) in the PMS on a consolidated basis (new portfolios would have lower exposure), with the rest lying in interest earning assets. Our portfolio companies reported a median YoY profit growth of 5% in Q1 FY26. The low profit growth was due to the weak performance of the Banks/NBFCs in the portfolio which were impacted by asset quality issues.

The Case for a Vibrant Short-Selling Market in India

India's recent regulatory supervision has been focused on limiting retail activity in only the F&O segment (220+ stocks), engendered by the explosive increase in volumes in this segment post COVID. There has been limited regulatory action to curb retail activity in 90%+ of the other actively traded 2500+ stocks on the exchange. Since COVID, most small and mid-cap stocks have seen a stratospheric rise. No one (investors, regulators or the government) is complaining as investors in aggregate have created wealth. The losses in specific pump and dump stocks are few and far between (especially in bull markets), and also not easily quantifiable. The bulk of the losses is deferred and will only show up as permanent erosion of wealth in the next bear market.

India's equity market is among the world's most vibrant, but its rules on short-selling remain among the most restrictive. Western regulators view shorting as a stabilizing, liquidity-enhancing activity. India still treats it primarily as a speculative risk. The absence of a robust short-selling mechanism has contributed to price manipulation, circular trading, and unchecked speculation, particularly in small-cap stocks where bearish views have no outlet.

Evolution of Shorting in India

Pre-2001: The Badla era

Short-selling in Indian markets prior to 2001 was widely practiced but largely unregulated and conducted through mechanisms such as badla (carry forward) trading and informal borrowings. The badla system allowed investors to sell shares they did not own, effectively enabling naked short-selling, with settlement deferred to the next period instead of immediate delivery. This allowed leveraged longs and shorts to roll indefinitely.

The Ketan Parekh scam (2001) exploited this lax environment. Using circular trading, with heavy reliance on carry-forward funding, certain operators drove up stock prices (e.g., Global Trust Bank, HFCL). When prices collapsed, markets faced massive defaults, and the system's reliance on naked shorting/badla was exposed. As a result, SEBI banned all forms of short-selling in March 2001 and simultaneously abolished the badla system, replacing it with rolling settlement (T+3, T+2 etc). This move ensured timely delivery and payment settlement, reducing settlement defaults and speculative lending risks. This effectively stopped naked shorting as positions could not be rolled over beyond a point.

Evolution of the Derivatives Market

Futures and options (F&O) based short-selling in India began around 2000, when derivatives trading was formally introduced to replace the badla system. The first index futures contracts were launched in June 2000, followed by stock options in June 2001 and stock futures in November 2001. The launch was on just 31 stocks. These instruments enabled market participants to express bearish views. Initial F&O participation was dominated by institutional investors and arbitrageurs; retail involvement expanded slowly as awareness and access grew.

Between 2010-2020: The F&O segment grew rapidly in this period. As more stocks met liquidity and volume requirements, the universe of eligible F&O stocks rose to ~200 by the mid-2010s.

2020- Onwards: F&O trading volumes surged dramatically after the COVID pandemic, driven largely by retail participation and new demat account openings. India became the world's largest equity derivatives market by volume, surpassing traditional global leaders. However, the list of eligible stocks expanded only gradually to 220+ stocks currently. This is still less than 10% of the number of liquid listed stocks on the exchange.

Securities Lending and Borrowing (SLB) Framework in 2007

To enable legal short-selling, SEBI introduced the Securities Lending and Borrowing Mechanism (SLBM) in 2007. The framework allows investors to borrow shares before shorting and lend idle holdings through exchange-cleared contracts, thereby ensuring transparent settlement and minimal counterparty risk. Only ~340 stocks that meet various regulatory criteria are currently part of the SLB.

The SLB market remains shallow and underutilised. Activity is concentrated in F&O eligible large caps; of the ~340 permitted stocks, barely 100-125 trade with meaningful liquidity. High borrowing costs, fixed monthly tenors, position caps, and mandatory closures before corporate actions have constrained participation. As a result, SLB has not evolved into a deep financing market comparable to those in developed economies. Market participants overwhelmingly prefer futures and options to take short exposure.

The Global Short-Selling Landscape

In the US, UK, and Europe, a significant share of securities lending happens over-the-counter (OTC), directly between institutions or via brokers. Banks and brokers can arrange customized deals for any share, including small and mid-caps and even bonds, leading to much deeper and more flexible shorting markets. OTC arrangements allow greater flexibility on terms, contract lengths, securities covered, and fees as compared to the SLB window in India. As a result, these markets have deep OTC securities lending pools. US has approx. USD 1.2 trillion worth of securities on loan at any point of time.

Enabling a Vibrant Shorting Market – Need of the Hour

India's capital markets have matured dramatically since COVID - record F&O participation, record IPOs, and a surge in domestic savings flowing into equities. In such an evolved ecosystem, there is no reason for regulators to have such restricted norms on short-selling. Regulatory bodies justify them as protection against downward "manipulation", but most research evidence suggests that long-term bans may do more harm than good for the following reasons.

Delayed Price Discovery

The lack of short positions prevents the market from correcting inflated prices, especially for low-capitalization stocks, leading them to trade above their intrinsic value. Short sellers incorporate negative information that long-only holders may ignore, pushing prices toward fair value sooner.

Nithin Kamath of Zerodha highlighted[1], this "structural long-only" bias not only limits real price discovery but also dampens the overall analytical rigor in India's equity markets, as shorting talent is underdeveloped and alternative mechanisms for expressing scepticism are either unavailable or uneconomic.

Deterring Impropriety by Promoters and Enabling Regulatory Action

Activist short sellers play an important, if unpopular, role in maintaining market discipline. By publishing detailed reports that expose accounting irregularities, inflated asset values, or governance lapses, they act as an external check on corporate malfeasance. Even if such reports cause sharp price corrections, their presence discourages aggressive accounting, opaque related-party structures, and unchecked promoter leverage -- all of which thrive in markets where shorting is restricted or stigmatised. In this sense, credible activist shorts serve as the market's "forensic wing," also complementing regulators by uncovering what traditional sell-side coverage often overlooks. We look at three such case studies below.

1. Luckin Coffee

   Luckin Coffee went public on Nasdaq in 2019 amid a rosy narrative of being the fastest growing coffee chain in China, outpacing Starbucks. The firm's stock plummeted when *Muddy Waters* published a detailed (but anonymous) report in January 2020, alleging fabricated sales; the markets responded immediately as the stock crashed by more than 90% in just two months. In April 2020, the company admitted to inflating revenues. Regulators (the SEC and Chinese authorities) appointed audit firms to corroborate the fraud. Ultimately, investigations confirmed that Luckin had inflated its 2019 revenues by ~ USD 310 million; the company was fined, delisted from NASDAQ, and restructured under new management. The depth and speed of the exposure underscores how short-sellers force transparency in jurisdictions where regulatory and media scrutiny is lax. In effect, they compress the timeline under which misconduct can grow unchecked.

2. Nikola Corporation

   In September 2020, Hindenburg Research published a report accusing Nikola Corporation, a US electric and hydrogen truck startup, of "an intricate fraud built on dozens of lies." The report alleged that Nikola had exaggerated its technological capabilities, most notably that its flagship truck had been filmed rolling down a hill to simulate self-propulsion, and misled investors about its in-house hydrogen and battery technologies. The publication came just days after Nikola announced a high-profile USD 2 billion partnership with General Motors, under which GM was to take an 11% equity stake and build Nikola's Badger pickup. Within weeks of the report, Nikola's share price collapsed and regulators including the SEC and DOJ launched investigations. By November 2020, the GM deal also fell through. Founder Trevor Milton resigned shortly after and was later convicted of securities and wire fraud. Nikola ultimately settled with the SEC for USD 125 million, and by 2025 had filed for bankruptcy protection. The case stands as a defining example of how activist short reports can expose overhyped narratives, precipitate regulatory action, and avert further investor losses. It is noteworthy that short-sellers were able to expose a fraud that even a company like GM missed.

[1] https://x.com/Nithin0dha/status/1944707834991845571

3. Adani Hindenburg

   In January 2023, Hindenburg Research published a 100-page report accusing the Adani Group of extensive stock manipulation and accounting irregularities, citing offshore shell entities, opaque promoter shareholding, and high leverage concealed through related-party transactions. The report led the group to focus on deleveraging the balance sheet across companies, and on improving disclosure practices. Stocks such as Adani Green Energy and Adani Total Gas, previously at extreme valuations, remain 50-80% below pre-report levels even two years later. The episode demonstrated that short-seller scrutiny, while disruptive in the near term, can serve as a catalyst for better governance, reduced leverage, and removal of excesses in valuation.

The economic incentives of short-selling create a self-funding mechanism for market oversight. Unlike regulators, who operate with limited resources and bureaucratic constraints, short sellers can justify multi-million-dollar investigative efforts because financial returns are directly tied to uncovering wrongdoing. This incentive alignment explains why firms like Muddy Waters, Hindenburg, and Citron deploy forensic accountants, lawyers, and field investigators - resources that even well-staffed regulators cannot continuously devote.

Increasing Liquidity and Stability

Short-selling enhances market liquidity by increasing both the number of participants and the volume of two-way trades. Every short sale creates a natural counterparty for buyers, adding depth to order books and narrowing bid–ask spreads. Studies[2] in the US and Europe show that when shorting bans were imposed (e.g., during the 2008 crisis or the 2020 pandemic), spreads widened and trading volumes fell sharply, illustrating how critical shorting is to continuous price discovery. By enabling investors to express both bullish and bearish views efficiently, shorting ensures that liquidity is not one-sided, prices can adjust smoothly to new information rather than react violently when sentiment turns. In essence, a liquid shorting ecosystem makes markets more stable, not less, by keeping buyers and sellers engaged even in falling markets.

Critics argue that short-selling invites manipulation by bad actors who spread sensational or fabricated claims. While such instances exist, the remedy lies in oversight and accountability, not prohibition. The harm from occasional false short theses is negligible compared to the unchecked excesses on the long side that often go unquestioned. Allowing credible short sellers to highlight risks in companies such as IL&FS, DHFL, or Yes Bank – may have shortened the timeline of discovery of these frauds, and hence the quantum of systemic damage too.

A deeper, more flexible shorting ecosystem would strengthen India's equity markets by enabling genuine two-way price discovery, discouraging speculative excesses, and fostering analytical discipline. With nearly every other segment of India's capital markets now operating at global scale, from derivatives to primary issuance, it is time the shorting framework caught up. For a market as large and sophisticated as India's, allowing balanced participation of both bulls and bears is not a regulatory risk; it is a prerequisite for maturity.

[2] Beber and Pagano (2013); Boehmer, Jones & Zhang (2009); ESMA (2024); H. Tian (2024)

If you have any queries (about your portfolio, 2Point2 Capital or investing in general), do reach out to us at the below coordinates. We would love to talk.

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Thanks and Regards,
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