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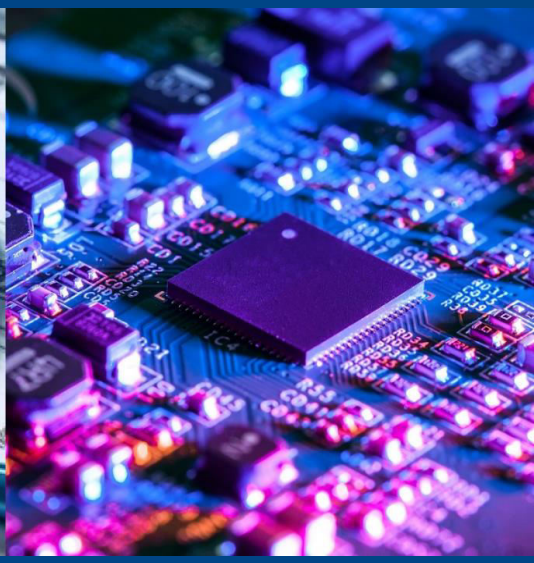

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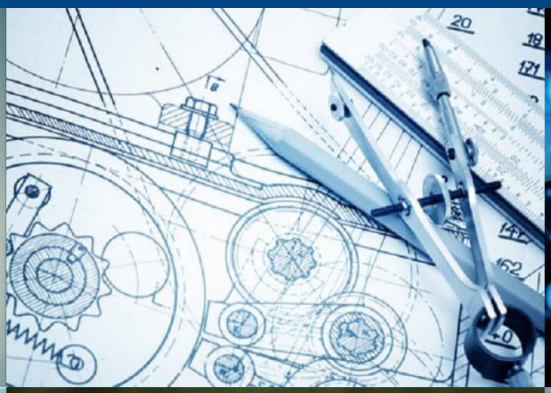

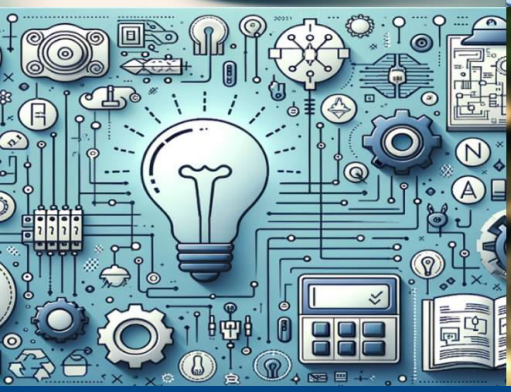

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Relative Valuation as a Stock Selection Framework: Evidence from Selected Indian Sectors

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ABSTRACT: This study examines whether relative valuation can function as a practical stock-selection framework in the Indian equity market. A structured sector-wise comparative model was applied to five sectors: Petroleum Products, Banking, Cement and Cement Products, Insurance, and Healthcare Services. Within each sector, firms were assessed using a multi-indicator framework that combined valuation multiples with supporting financial variables, including price-to-earnings ratio, enterprise value to EBITDA, return on equity, return on capital employed, debt-equity ratio, reserves, sales, profit after tax, and asset strength. Three firms were shortlisted from each sector, producing a final sample of fifteen companies. The valuation reference date was 28 March 2025, and subsequent stock performance was tested from 1 April 2025 to 30 June 2025. The shortlisted sample generated an overall average return of 10.79 percent, with ten of the fifteen firms producing positive returns. Banking and Healthcare Services emerged as the most effective sectors for valuation-based selection, while Cement and Cement Products showed the weakest outcome. A comparison of shortlisted-company returns with broader sector averages further indicates that relative valuation worked selectively rather than uniformly across industries. The study concludes that relative valuation remains useful as a first-stage screening tool, but its effectiveness depends on sector conditions, supporting company fundamentals, and market context. The findings add to the Indian valuation literature by shifting attention from static valuation description toward post-selection performance testing.

KEYWORDS: relative valuation, stock selection, Indian equity market, sector-wise analysis, valuation multiples, post-selection returns

I. INTRODUCTION

Valuation is central to investment analysis because market decisions ultimately depend on whether current prices appropriately reflect business fundamentals. Among the major approaches available to analysts, relative valuation remains one of the most widely used because it is market-linked, comparatively simple to apply, and less assumption-heavy than long-horizon intrinsic valuation models such as discounted cash flow analysis. In practical finance, analysts frequently begin by comparing firms within a sector through ratios such as price-to-earnings (P/E), price-to-book, and enterprise value to EBITDA, while also reviewing profitability, leverage, and capital efficiency indicators.

The practical appeal of relative valuation is especially strong in the Indian market, where firms operating in the same broad industry often display substantial differences in return ratios, reserves, balance-sheet structure, and growth expectations. Yet a key challenge remains. A company that appears attractive on one metric may look less attractive on another. A low P/E ratio can indicate undervaluation, but it may also reflect weak growth expectations, poor quality of earnings, or sector pessimism. Likewise, a premium multiple may appear expensive, while still being justified by stronger profitability, better cash-flow resilience, or superior strategic positioning. This means valuation cannot be reduced to a single number; it must be interpreted through a broader comparative framework.

This creates a more important practical question than valuation ranking alone: do companies selected through a structured relative valuation framework actually perform favourably after selection? If the answer is yes, relative

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valuation has practical investment relevance beyond descriptive comparison. If not, its usefulness is more limited and may require support from additional filters such as sector trend, earnings momentum, or business visibility. The present study addresses this issue through a sector-wise comparative framework applied to selected Indian companies and then tests the post-selection stock performance of the shortlisted firms. In this way, the study moves from valuation description toward valuation effectiveness.

II. LITERATURE REVIEW AND RESEARCH GAP

The literature on relative valuation establishes that multiples-based valuation is both theoretically relevant and practically important. Alford (1992) showed that valuation accuracy depends strongly on the selection of comparable firms. Cheng and McNamara (2000) found that valuation improves when analysts combine benchmarks rather than rely on a single ratio. Liu, Nissim, and Thomas (2002), as well as Lie and Lie (2002), demonstrated that no single multiple is universally superior across all settings, though earnings-based and enterprise-based measures often perform strongly. Bhojraj and Lee (2002) further emphasized that economically similar peers can outperform broad industry classifications in valuation work, reinforcing the importance of disciplined peer selection. These studies support the view that relative valuation is not merely a shortcut; it is a structured comparative method whose quality depends on both metric choice and peer design.

A second stream of literature links valuation-related variables with future stock returns. Basu (1983) showed that low-P/E stocks can generate superior subsequent returns. Ou and Penman (1989) demonstrated that financial statement analysis contains predictive information for equity returns. Fama and French (1992, 1993) highlighted the importance of valuation-related variables in explaining return behaviour, while Mohanram (2005) and Penman and Reggiani (2013) illustrated how additional accounting filters can improve stock differentiation. In the Indian context, Gupta (2018, 2019) showed that the predictive usefulness of valuation multiples depends on firm-level value drivers and systematic variable selection. The literature therefore suggests that valuation is most useful when interpreted through a multi-variable and sector-aware framework rather than a single-ratio screen.

Despite this rich literature, three gaps remain relevant. First, a large share of the research focuses on valuation accuracy at a point in time rather than on whether shortlisted firms actually outperform after selection. Second, sector-wise evidence from India remains limited, especially studies comparing multiple sectors under a common comparative framework. Third, practical stock screening often relies too heavily on one or two ratios, whereas real-world decision-making can benefit from combining valuation, profitability, leverage, and balance-sheet indicators. The present study addresses these gaps by using a structured, sector-wise, multi-indicator relative valuation framework and then testing the immediate post-selection performance of the final shortlisted firms.

III. OBJECTIVES AND HYPOTHESES

The study has four objectives: to conduct sector-wise relative valuation and identify final shortlisted companies within selected Indian sectors; to examine the subsequent stock performance of those shortlisted firms during the period from 1 April 2025 to 30 June 2025; to compare post-selection performance across sectors; and to evaluate whether relative valuation is effective as a practical stock-selection framework. In line with these objectives, four hypotheses guide the analysis. H1 proposes that meaningful valuation variation exists within the selected sectors. H2 proposes that the relative valuation framework can identify a distinct set of attractive firms within each sector. H3 proposes that the shortlisted companies generate favourable subsequent stock performance. H4 proposes that the effectiveness of the framework varies across sectors.

IV. DATA AND METHODOLOGY

The study uses a descriptive and comparative analytical design based entirely on secondary data. The sector universe was drawn from five selected sectors: Petroleum Products, Banking, Cement and Cement Products, Insurance, and Healthcare Services. A broader company universe was first reviewed within each sector and then reduced to a final shortlist of three firms per sector using the relative valuation workbook prepared for the thesis. This produced a final sample of fifteen firms for post-selection performance analysis.

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The valuation reference date was 28 March 2025, chosen because 31 March 2025 was a market holiday. The subsequent testing period ran from 1 April 2025 to 30 June 2025, and closing prices on 30 June 2025 were used for return computation. The benchmark used for contextual comparison was the Nifty 50, which generated a return of 8.49 percent over the same period. Because the selected firms came from multiple sectors, a common market benchmark was more appropriate than a sector-specific index.

The independent variables included both valuation and supporting financial indicators: current market price, market capitalization, equity capital, reserves, return on equity, debt-equity ratio, return on capital employed, sales, profit after tax, total assets, P/E ratio, return on assets, and EV/EBITDA. The workbook also used practical screening checks such as earning capacity, reserve strength, relative price attractiveness, and the relationship between sales share and profit share. The dependent variable was subsequent stock return, calculated as the percentage change in closing price from 28 March 2025 to 30 June 2025.

The analysis is not based on advanced inferential econometrics. Instead, the hypotheses are evaluated through structured sector-wise comparison, company-level return analysis, and a comparison between the average return of shortlisted firms and the average return of the broader sector from which they were selected. This approach fits the workbook-driven design of the study and preserves its practical investment orientation. It also reflects the real-world way investors often use relative valuation: first as a screening device and then as part of a broader judgment process.

Table1. Sector universe and final shortlisted companies

Sector	Companies considered	Final shortlisted firms
Petroleum Products	20	Castrol India; BPCL; Panama Petrochem
Banking	32	Union Bank of India; Bank of Maharashtra; Tamilnad Mercantile Bank
Cement and Cement Products	41	Ambuja Cements; ACC; Mangalam Cement
Insurance	12	LIC; GIC Re; New India Assurance
Healthcare Services	41	Aster DM Healthcare; Narayana Hrudayalaya; Global Health

V. RESULTS

The company-wise results show that ten out of fifteen shortlisted firms generated positive returns during the testing period. The sample as a whole produced an average return of 10.79 percent, which indicates that the framework had meaningful practical value, though the outcome was not uniform. The strongest individual performer was Narayana Hrudayalaya with a return of 28.27 percent, followed by New India Assurance at 24.57 percent, Aster DM Healthcare at 23.28 percent, Bank of Maharashtra at 23.24 percent, and Union Bank of India at 21.73 percent. The weakest performers were General Insurance Corporation of India at -8.54 percent, Panama Petrochem at -7.25 percent, Global Health at -5.13 percent, Mangalam Cement at -2.87 percent, and ACC at -1.31 percent.

A benchmark comparison further sharpens the picture. Several shortlisted firms materially outperformed the Nifty 50 return of 8.49 percent, particularly in Banking, Insurance, and Healthcare Services. However, some firms underperformed both the benchmark and their own sector averages, indicating that valuation attractiveness did not always convert into favourable market performance. This mixed evidence is central to the study's interpretation: relative valuation was useful, but it did not work as an automatic or universal predictor.

At the sector level, Banking recorded the highest average return among the selected groups at 17.82 percent, followed by Healthcare Services at 15.47 percent and Insurance at 12.57 percent. Petroleum Products delivered a moderate average return of 7.06 percent, while Cement and Cement Products produced the weakest outcome at 1.03 percent. Sector-level dispersion also differed. Banking displayed a lower standard deviation than Healthcare Services and Insurance, indicating a more consistent return pattern among its shortlisted firms. By contrast, Insurance and Healthcare

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Services showed high average returns but greater internal variation, reflecting uneven company-level outcomes within otherwise strong sector groups.

A more demanding test is whether the selected firms outperformed the broader sector averages from which they were chosen. On this criterion, the framework succeeded clearly in only two sectors: Banking and Healthcare Services. In Banking, the shortlisted set returned 17.82 percent against a full-sector average of 16.55 percent. In Healthcare Services, the shortlisted set returned 15.47 percent against a full-sector average of 7.24 percent. In Petroleum Products, Insurance, and Cement and Cement Products, however, the shortlisted sets underperformed their broader sector averages. These findings imply that relative valuation had selective effectiveness rather than sector-wide dominance.

Table.2. Sector-wise performance of shortlisted firms

Sector	Selected avg. return %	Std. dev. %	Full-sector avg. return %	Interpretation
Petroleum Products	7.06	10.91	14.58	Mixed result; underperformed sector average
Banking	17.82	6.63	16.55	Strongest sector; outperformed sector average
Cement and Cement Products	1.03	4.45	14.84	Weakest sector; underperformed sector average
Insurance	12.57	14.98	17.82	Positive but uneven; underperformed sector average
Healthcare Services	15.47	14.71	7.24	Strong sector; outperformed sector average

VI. DISCUSSION

The results suggest that relative valuation works best when three conditions are aligned. First, the selected company must appear attractive relative to sector peers on valuation and supporting financial indicators. Second, the broader sector environment must be supportive. Third, the market must have enough confidence in the company's near-term business quality for the valuation signal to be recognized during the testing period. Banking and Healthcare Services satisfied these conditions more clearly than the other sectors in the sample. The weak outcome in Cement and Cement Products is particularly important. It shows that valuation attractiveness by itself does not guarantee strong post-selection returns. A sector may remain out of favour, or company-specific developments may prevent the re-rating that relative valuation seems to imply. Petroleum Products and Insurance also illustrate this point. Both sectors contained strong individual performers, yet the shortlisted groups as a whole failed to exceed the broader sector average. This means the framework can identify winners without necessarily producing the best set in every sector. The findings therefore support a practical but disciplined interpretation of relative valuation. It is highly useful as a first-stage screening tool because it narrows a broad universe into a manageable shortlist. However, it should be complemented by sector trend analysis, business momentum, and qualitative judgment. This interpretation is also consistent with the literature. The results support relative valuation theory and fundamental analysis, provide only limited support for a strict form of market efficiency, and are broadly consistent with behavioural explanations of uneven pricing and delayed market adjustment across sectors.

VII. CONCLUSION AND IMPLICATIONS

This article examined whether a structured relative valuation framework can identify Indian stocks that generate favourable short-term returns after selection. Using five sectors and fifteen final shortlisted companies, the study found that the framework had meaningful but selective effectiveness. Ten of the fifteen selected firms produced positive

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returns, and the sample generated an average return of 10.79 percent over the testing window. Yet the framework did not perform equally across sectors.

The main conclusion is that relative valuation remains useful as a practical stock-screening approach, but it is not a universal decision rule. It worked best in Banking and Healthcare Services, where the shortlisted firms also outperformed their broader sector averages. In Petroleum Products, Insurance, and especially Cement and Cement Products, the model was less effective. The results therefore show that valuation signals must be interpreted together with sector context and company-specific strength.

For investors and analysts, the implication is clear: relative valuation should be used to build a disciplined shortlist, not to replace deeper analysis. For researchers, the study points toward future work using longer holding periods, larger samples, and econometric testing across Indian sectors. By moving from valuation description to post-selection performance, the study contributes a practical perspective to the literature on applied equity valuation.

VIII. LIMITATIONS

The study is limited to five sectors and fifteen shortlisted firms, uses a three-month testing window, and follows a descriptive comparative approach rather than a fully econometric design. It also does not incorporate qualitative factors such as management guidance, policy developments, or major firm-specific events that may influence short-term stock performance. These limitations do not reduce the usefulness of the findings, but they define the context within which the conclusions should be interpreted.

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