

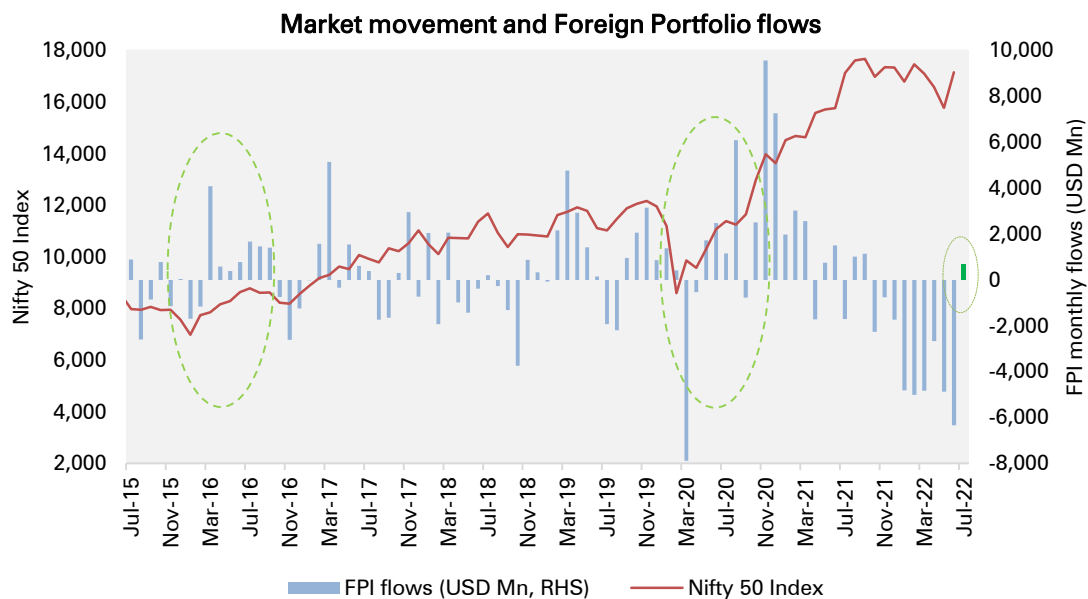
Is India getting too big to ignore?

August 12, 2022

In our previous communications, we have emphasized the strength of domestic investor participation in Indian equity markets. Domestic Institutional Investors (DII's) have bought equities worth ~USD 32bn in CY2022, which is the highest in last 15 years. This increased participation by domestic investors have kept the Indian markets resilient as compared to global markets. Foreign Portfolio Investors have sold ~USD 28bn this year which is record selling, owing to the following reasons:

1. Expected INR depreciation
2. Valuations are not cheap
3. Earnings cut are yet to happen
4. Crude is a big risk to the country

Historically, we have seen Indian markets rally whenever foreign selling moderates. July 2022 too saw foreign investors returning to India (+USD 836mn) after nine consecutive months of selling, and Nifty went up 8.7%.

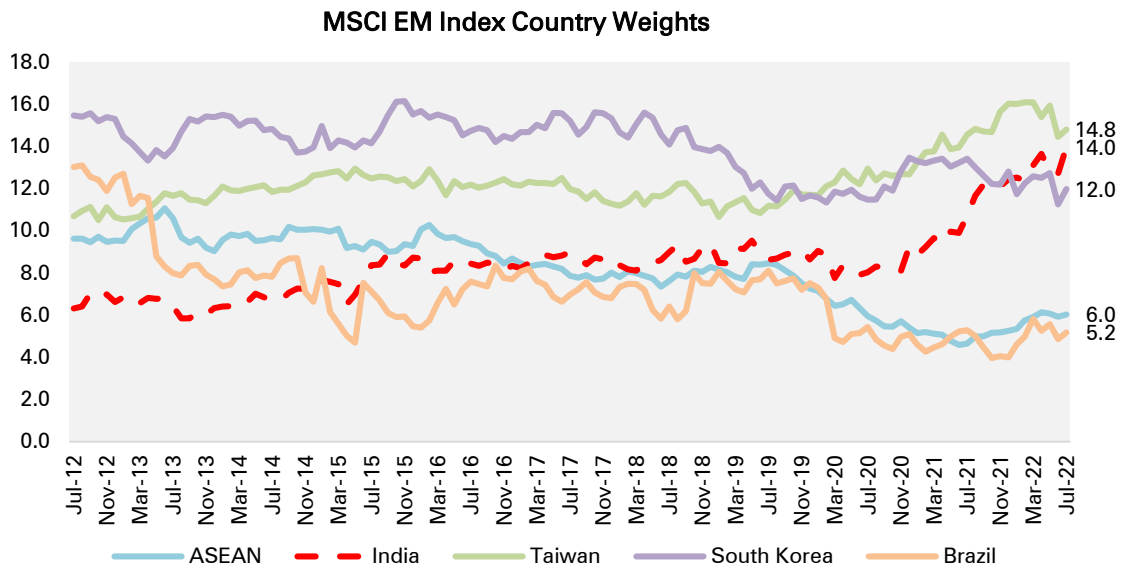


Source: Morgan Stanley Research, Morningstar Direct

In this note, we have highlighted India's increasing weightage to the MSCI EM index, even as most emerging market equity funds remain underweight on India.

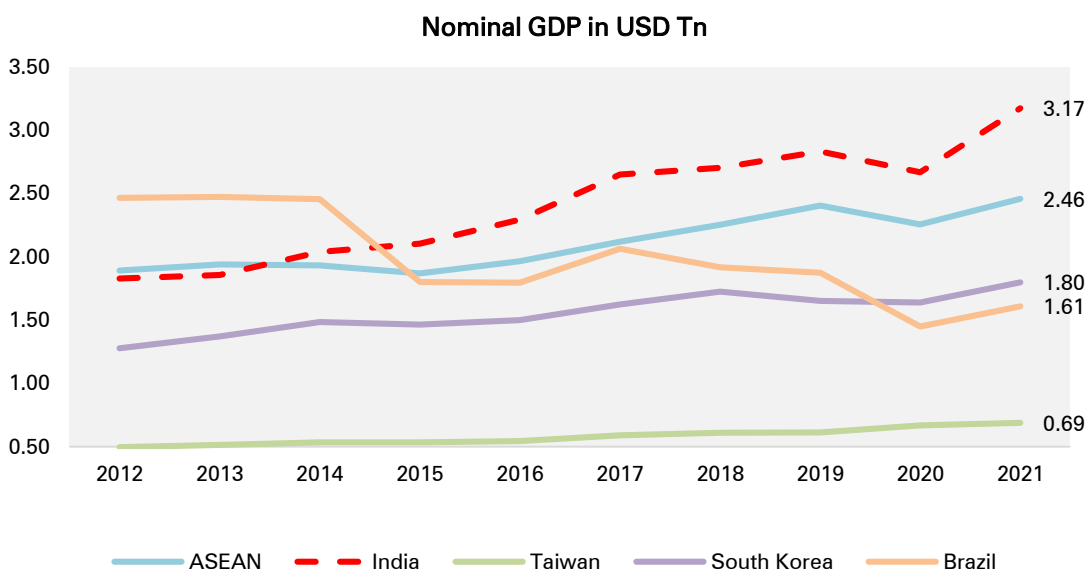
Did you know?

India used to be closer to weight of ASEAN countries combined or weight of Brazil in MSCI EM Index till mid-2019. Now India's weight in MSCI EM Index is higher than that of Korea and very close to Taiwan. Despite this change in the weight of India in the index, several investors may not be mentally placing India at par with Korea or Taiwan.



Source: Morningstar Direct; ASEAN countries are being represented by Thailand, Indonesia, Malaysia, Philippines and Singapore

India is projected to be the fastest growing major economy in the coming decades. The country is much larger in terms of nominal GDP compared to ASEAN, Korea and Taiwan, yet its weightage in MSCI EM has been relatively lower till recently.



Source: World Bank, Trading Economics for Taiwan data; ASEAN countries are being represented by Thailand, Indonesia, Malaysia, Philippines and Singapore

India has more depth than its peers: While average free float market cap of top 20 companies in India is comparable to Korea and Taiwan, a close look at the number of companies with free

float market cap >USD 2bn reveals that India is double that of Korea and significantly ahead of Taiwan. India hence offers a lot more to investors.

Indian Market - Large & Competitive	India	Korea	Taiwan
Avg. free float market cap of top 20 firms (USD Bn)	32	25	36
# of cos >USD 2bn free float market cap	121	60	84

Source: Macquarie Research; June 2022

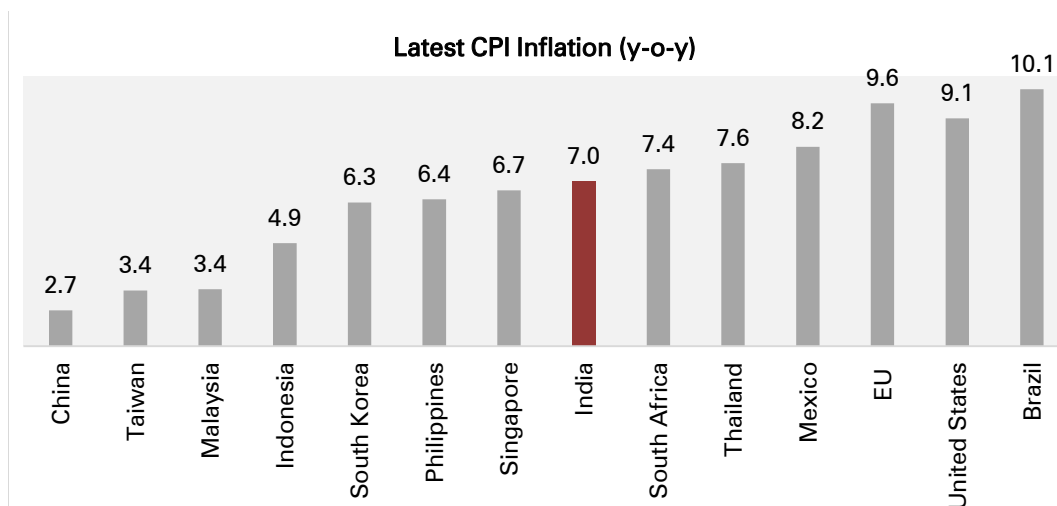
Sectorally too, India offers more diversification and investors have a large universe of companies to choose from across sectors. Hence Indian market is not about just 2-3 sectors.

MSCI Weights	India	Korea	Taiwan
Materials	9.23	7.55	5.58
Communications	2.72	8.32	2.64
Consumer Cyclical	8.62	8.42	2.54
Consumer Staples	9.33	3.11	1.75
Healthcare	4.97	5.72	-
Industrials	4.20	8.98	4.03
Real Estate	0.60	-	-
Technology	16.00	47.51	69.11
Energy	13.72	1.44	0.34
Financials	24.26	8.38	14.02
Utilities	6.37	0.57	-
Top 3 Sectors (%)	53.98	64.91	88.71

Source: Morningstar Direct; July 31, 2022

Inflation has been a worry for investors across the globe

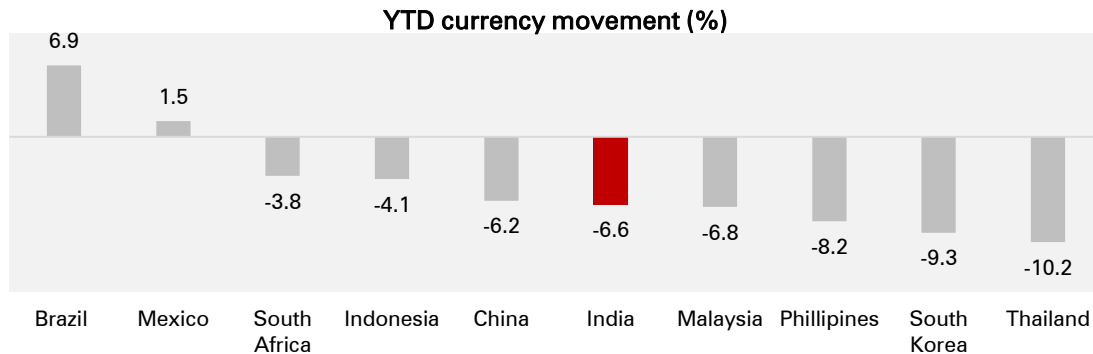
While inflation in India has been above RBI's comfort levels of 6%, it is actually not as bad when compared to other markets. India is self-sufficient in food (wheat, sugar, vegetables etc.) and its inflation is more driven by external supply-side shocks. The Government and the Central Bank's (RBI) concerted efforts have helped to soften inflation in recent months.



Source: Bloomberg; Data as of June 2022

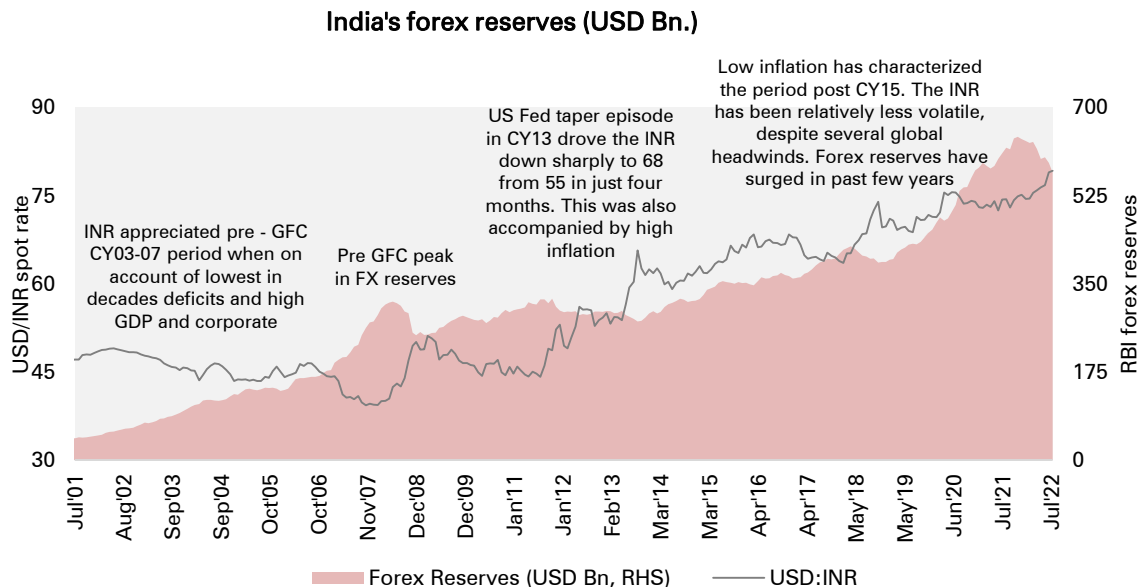
How has the currency behaved?

While INR has depreciated versus USD in the last two months, on a YTD basis, INR's depreciation has been lower compared to other EM currencies. The RBI is committed to ensure an orderly movement of the Indian Rupee and hence announced a slew of measures aimed at encouraging capital flows, which included easing regulations on foreign currency deposits and external commercial borrowing and relaxing norms for foreign investment flows into the debt market.



Source: Bloomberg; Data as of July 31, 2022

India's forex reserves of USD 574bn, thereby has provided a valuable support in the face of record FPI outflows and external supply shocks emanating from the war in Ukraine this year. India's forex reserves today are at ~12 months' imports cover level as compared to an avg. 7 months import cover levels during the US Fed 'taper tantrum' period of 2013-14, which along with RBI's intervention in FX markets have prevented any wild swings in the Indian Rupee.

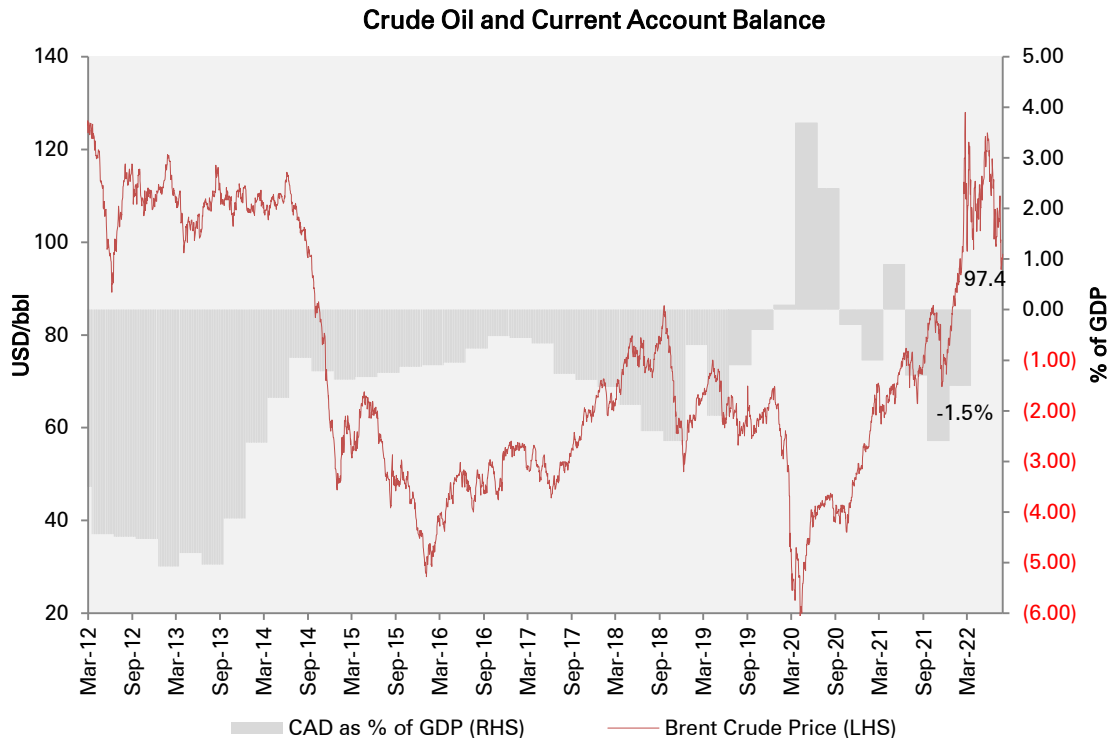


Source: Bloomberg; Data as of July 31, 2022

What are the key risks?

India imports ~80% of its energy requirements. The recent fall in crude oil prices below USD 100/- a barrel also contributed to the rally in Indian equity markets.

Sustained high crude prices have an impact on current account balance and hence the currency. Going forward how crude prices move is going to be an important factor for India.

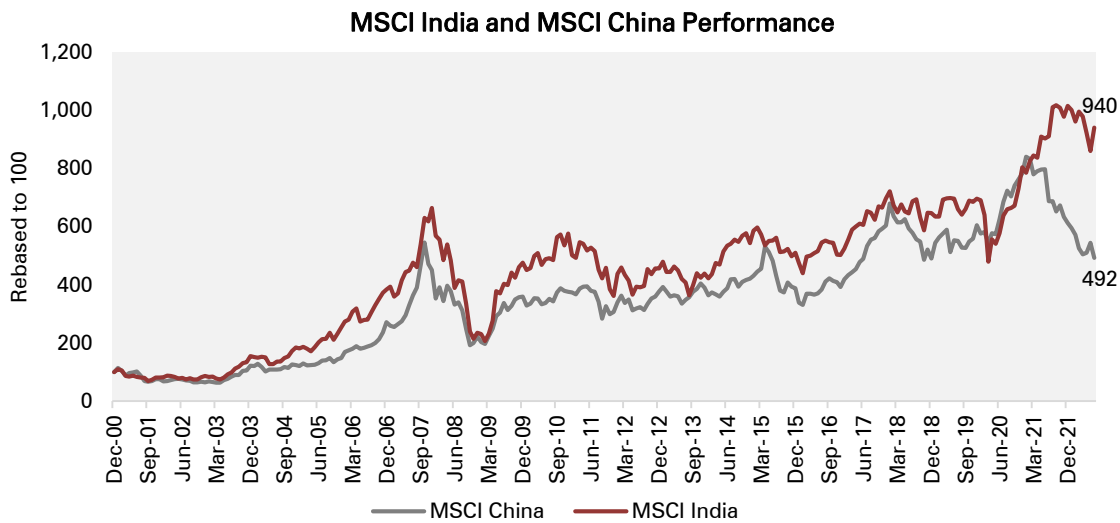


Source: Bloomberg; Data as of August 10, 2022

Source: CMIE, Morgan Stanley research; FY refers to 1-year period ending March

How has India fared compared to China?

Most global investors have dedicated allocations to China. Chinese equities trade at much cheaper valuations as compared to India. However, if one looks at USD returns, India has outperformed China in the long run and short run and that too significantly.



Source: Morningstar Direct; Currency: USD

Performance as on July 31, 2022:

% returns	1 Year	3 Year	5 Year	7 Year	10 Year	15 Year	20 Year
MSCI India	3.19	12.51	7.57	7.63	9.15	4.64	13.54
MSCI China	-28.35	-3.65	-1.57	1.91	4.29	2.04	10.15

Above returns are all annualized; Source: Morningstar Direct; Currency: USD

Is India is getting too big to ignore despite its elevated valuation levels?

India was ~8.5% of MSCI EM Index till mid-2019 and is now ~14% of the MSCI EM Index. India has several structural positives as compared to other EM's such as – favorable demographics, aspiring middle class, no political uncertainty, no risk of credit bubble and much more depth in markets.

Most investors take exposure to India through the emerging market route. Given the size of the country and the investing opportunities it offers; we believe India deserves sizable allocations in investor portfolios through actively management funds.

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