



INDIA - ECONOMIC GROWTH AGENDA NEEDS TO CONTINUE

- **PM Modi to regain power with his ruling Bharatiya Janata Party poised for a comfortable majority**
- **The government must now focus on an accelerated reform agenda for continued growth**
- **We favour investing in industries with domestic exposure**

We increased allocation to Indian equities in early May and have an overweight position within our Emerging Market equity allocation. 19th May 2019 marked the conclusion of India's 2019 general elections for 543 seats of the lower house of the Parliament (the Lok Sabha). 900 million people were eligible to cast their vote, with the turnout at c. 67%. Election results are out today and PM Modi's BJP-led National Democratic Alliance (NDA) has retained power. The market rallied at the beginning of the week post the exit polls which predicted a BJP majority. The news seems to be priced in and equity indices fluctuated through the day ending slightly down.

In its latest term, the BJP government implemented several reforms including a nationwide Goods and Services Tax (GST), an Indian Bankruptcy Code, lowered inflation and implemented a digital footprint that promoted financial inclusion. 345 million people were brought into the banking system in just four years, according to the World Bank. However physical and social infrastructure still needs fixing and the government must focus on an accelerated reform agenda that ushers in a sustainable economic transformation over the next five years, setting the stage for continued growth. It needs to focus on job creation, private sector investment and management of credit risk. It will be assessed for its execution on improving infrastructure, ease of doing business and its budget discipline. The expectation of rate cuts is strengthening and the RBI could step up on liquidity measures.

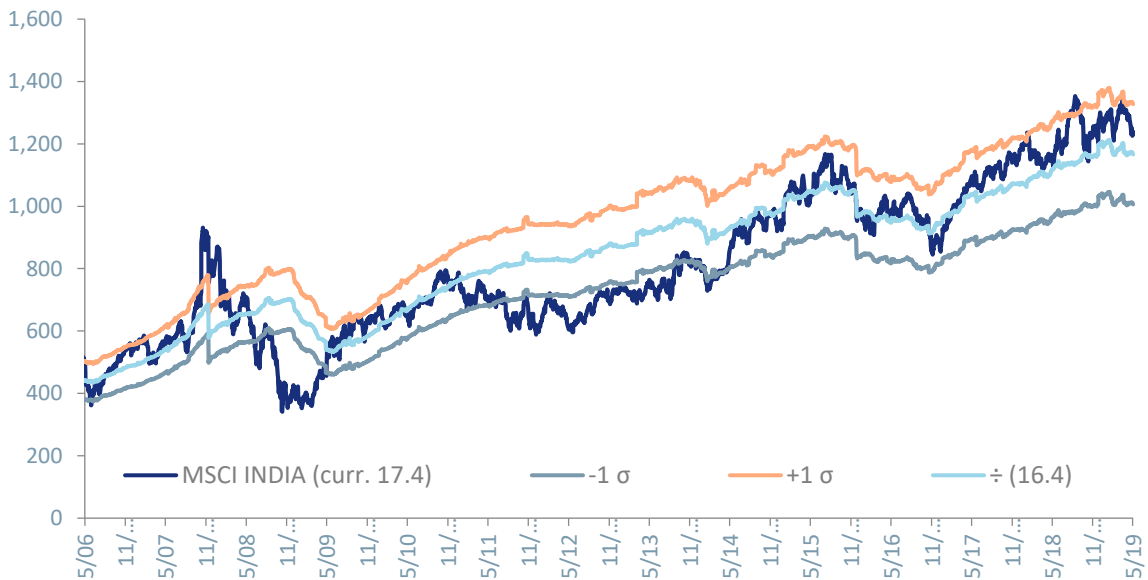
We favour domestically oriented businesses, especially in the Financials (private sector banks), Industrials (infra build) and Consumer sectors. Our fair value for the MSCI India Index indicates 5% upside from current levels with estimates of 16% earnings growth and at 19X 2019 Price to Earnings. We are at the onset of a multi-year earnings growth cycle, hence the high valuation multiple is justified. India benefits from strong internal drivers which makes its markets more immune to the trade war than other Emerging and Developed Markets. Headwinds include slowing global growth and rising oil prices.

Market commentary

After remaining relatively flat for the first two months of 1Q19, the MSCI India rose by 9.2% in March (net returns in USD). It was flat in April and fell early May in line with other emerging markets over global macro concerns related to escalation of US-China trade issues, a spike in oil prices and uncertainty around the election outcome. The positive market reaction this week was on the back of earnings recovery along with the possibility of a stable government coming into power. Foreign inflows picked up as market expectations of a potentially stable government rose.

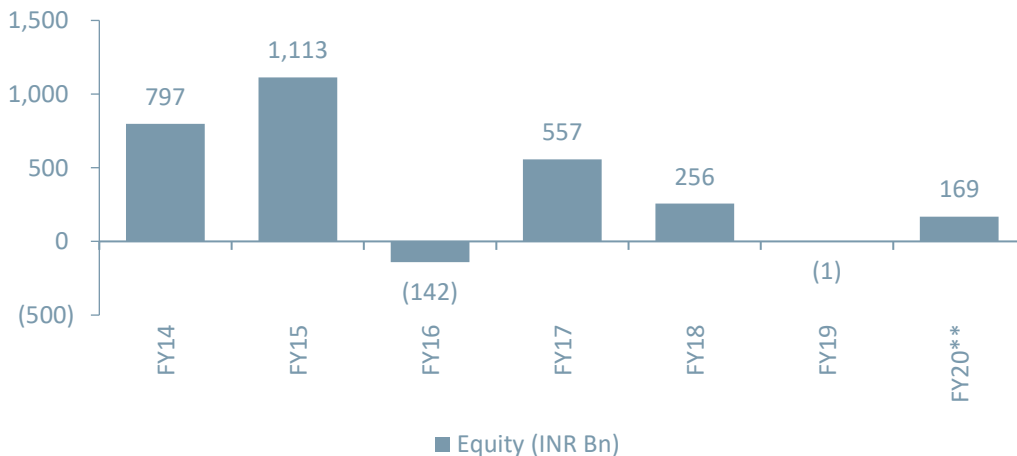
Looking at earnings, 2014-2017 was a lackluster period with banks plagued by bad loans. In spite of demonetization and GST we are now seeing signs of an earnings recovery. For the ongoing fiscal year ending March 2020, earnings growth could accelerate to mid to high teens (we estimate 16%) with a strong rebound in the financial sector, which had weighed on earnings numbers in the last year. Indian markets are not expensive as valuations are close to the median, as seen in the chart below.

Exhibit: MSCI India: PRICE/EARNING RATIO (12m fwd) vs +/- 1 std dev historical multiple



Source: Bloomberg, 22nd May 2019

Exhibit: FPI / FII - Net Equity flows



Source: National Securities Depository Ltd. ** upto 22-May-2019

Economic overview

Growth momentum in 1H19 may slow down, nevertheless we expect stability in 2H19 as political uncertainty fades, and as fiscal stimulus boosts both consumption and public/private spending. Economic growth is likely to reaccelerate with PMIs in expansion mode and strong credit growth. Corporate revenue growth is strong, supporting earnings.

We expect further upside from Indian equities as the consumption cycle is still early to mid-stage.

Exhibit: Real GDP Growth (%)

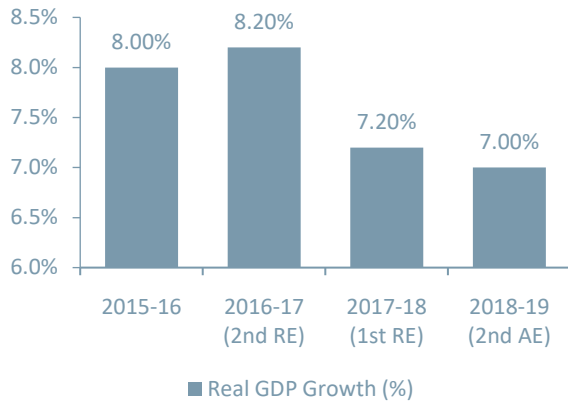
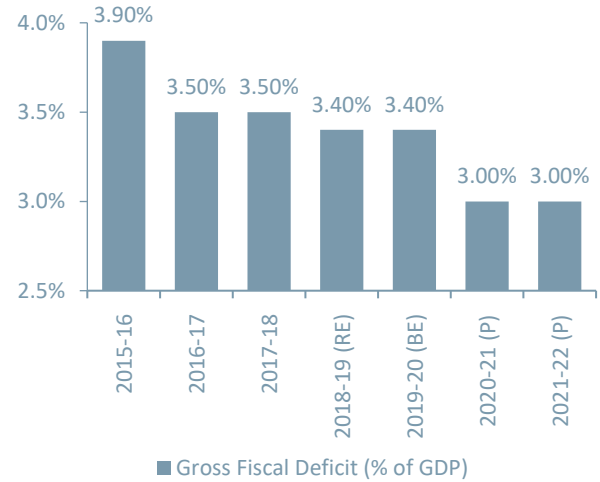


Exhibit: Gross Fiscal Deficit (% of GDP)



Source: Ministry of Finance, Dept of Economic Affairs (DEA); RE: Revised Estimates, BE: Budget Estimates, AE: Advance Estimates, P: Projections

Exhibit: Current Account Balance (%)

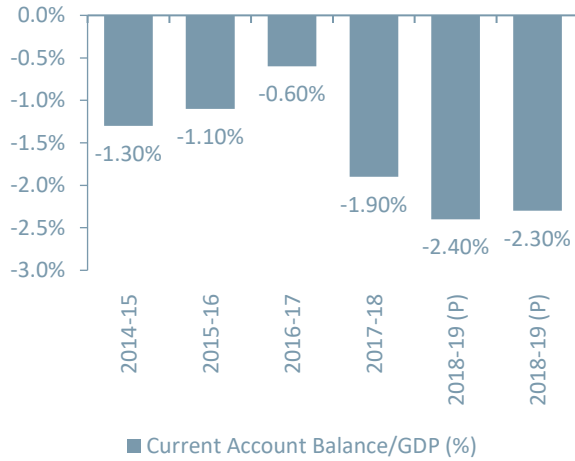
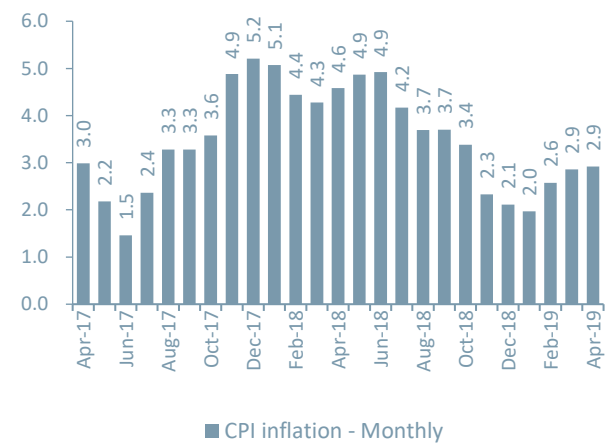


Exhibit: CPI inflation (%)

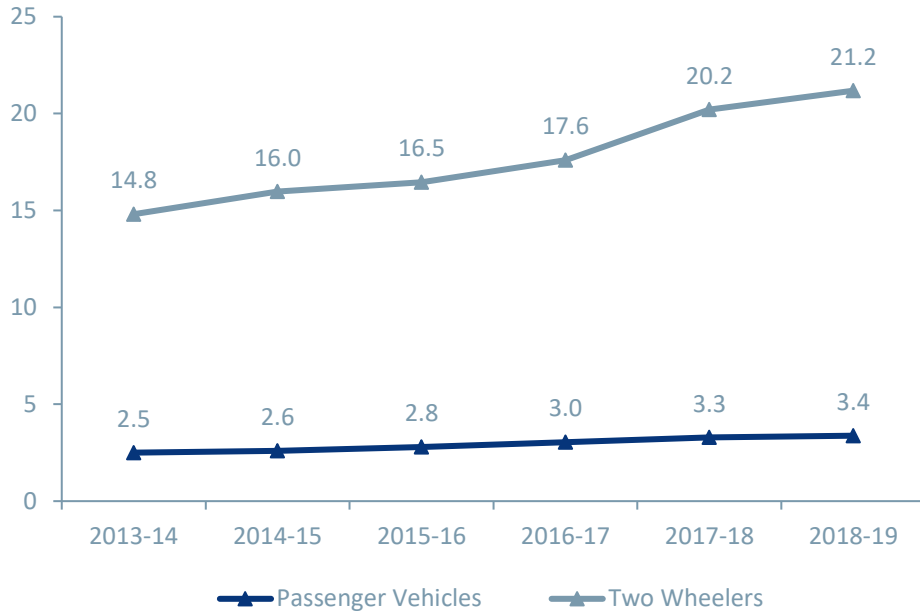


Source: Ministry of Finance, DEA, RBI; P: Projections

Source: M/O Statistics & Programme Implementation

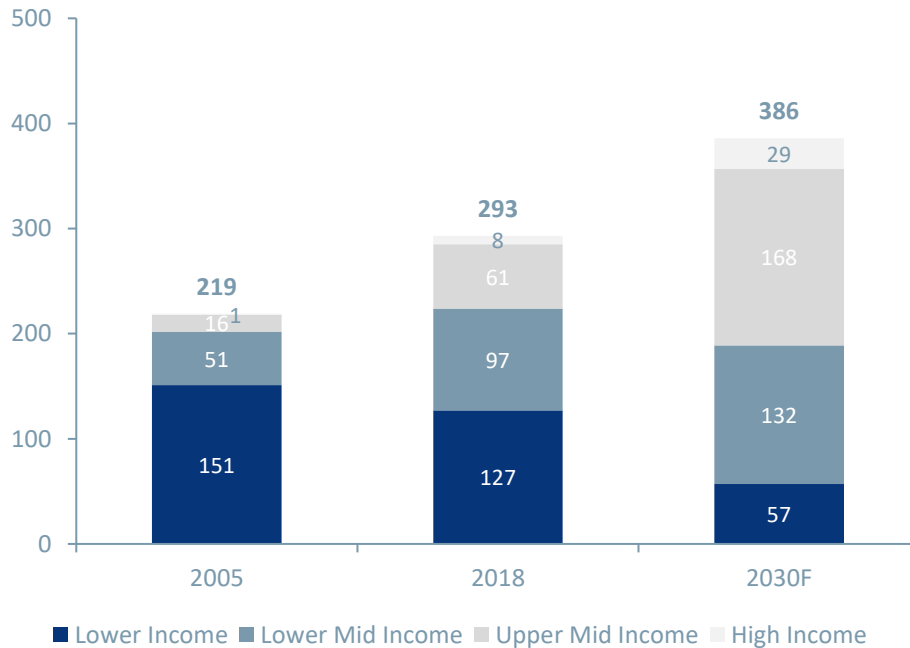
Consumption Trends

Exhibit: Automobile Domestic Sales Trends (in Mn) -Passenger Vehicles and Two Wheelers



Source: Society of Indian Automobile Manufacturers

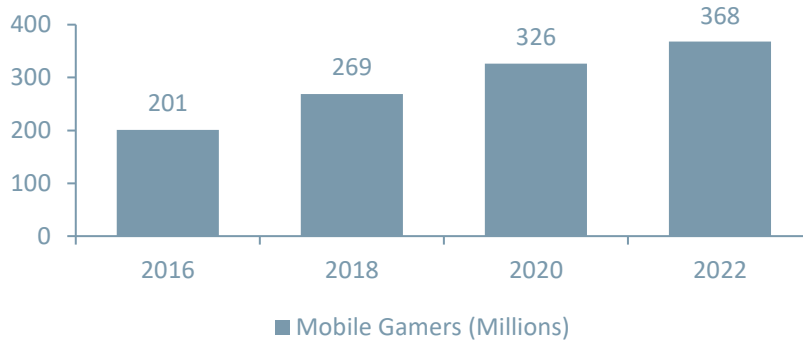
Exhibit: Evolution of the household-income profile in India: Million Households



Source: World Economic Forum - Future of Consumption in Fast-Growth Consumer Markets: India, Jan 2019
 Note: Low income: <\$4,000, Lower-mid: \$4,000-8,500, Upper-mid: \$8,500-40,000, High income: >\$40,000 basis income per household in real terms

Internet Penetration and Digitization

Exhibit: The changing face of the Indian mobile user



Source: Economic Times, InMobi Report- Feb 2019

Exhibit: Time Spent in video viewing (In minutes)

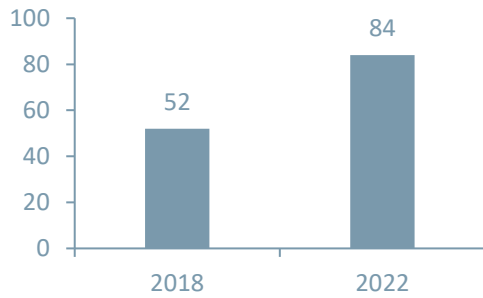
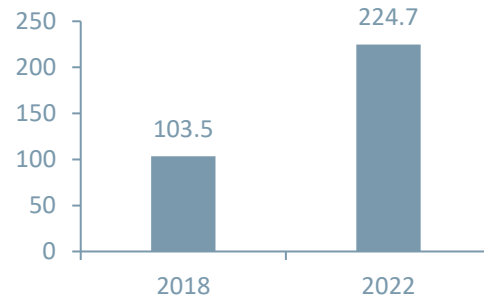


Exhibit: No of smartphone video viewers (in Mn)



Source: Economic Times, InMobi Report- Feb 2019

Source: Economic Times, InMobi Report- Feb 2019

India is on a path to using technology to provide structure to its economy. These moves will bring a large part of the population into the organized sectors and enable them to access cheaper financing. Synchronization of taxes through the Goods and Services Tax (GST) and opening of bank accounts have been the biggest changes.

Exhibit: Number of smartphone users (in Mn)

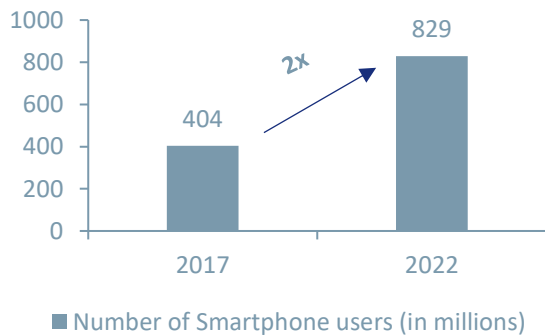
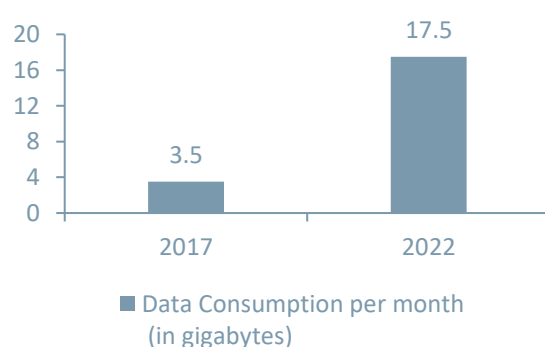


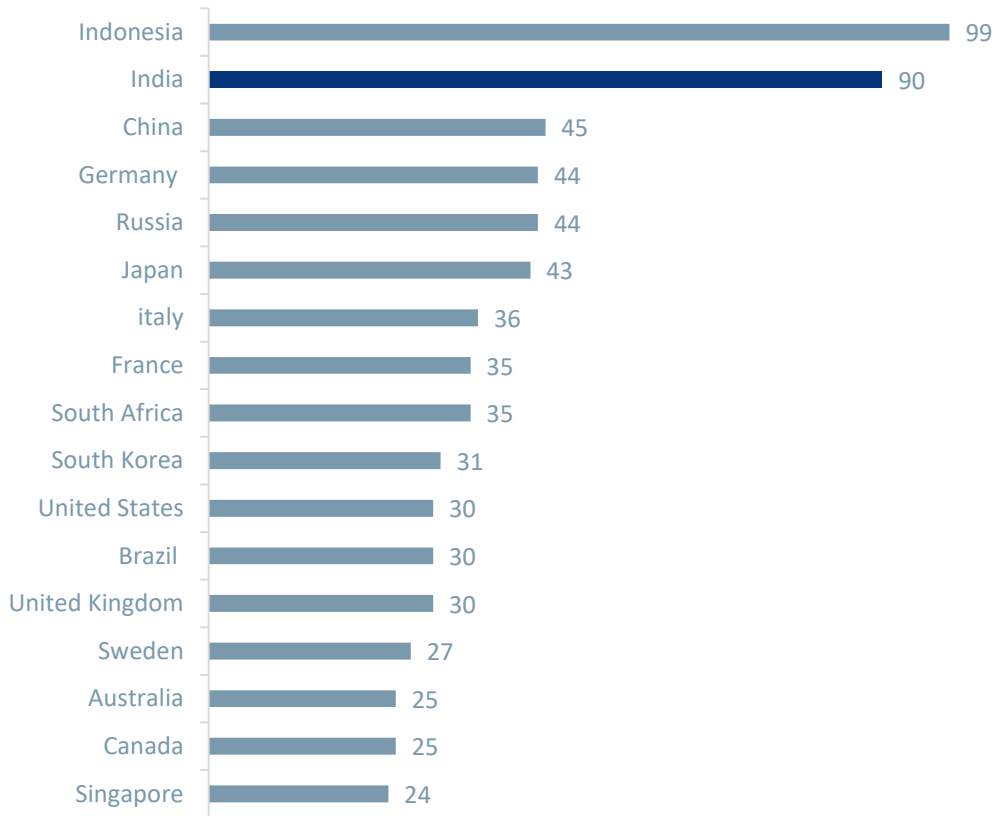
Exhibit: Smartphone Data Consumption / month (Gb)



Source: Cisco -India Device Growth Traffic Profiles, 2018

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Exhibit: Growth in Country Digital Adoption Index, % growth (2014-17)



Source: McKinsey Global Institute analysis, March 2019

Note: McKinsey Global Institute's Country Digital Adoption Index represents the level of adoption of digital applications by individuals, businesses, and governments across 17 major digital economies

Exhibit: Number of Digital Transactions (Bn) - Vision 2021

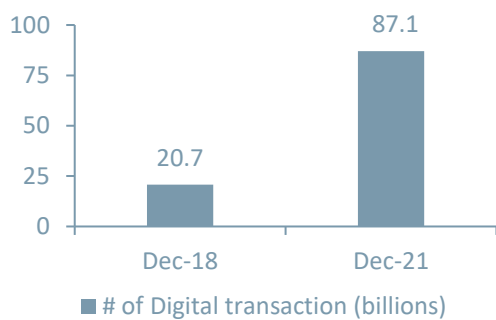
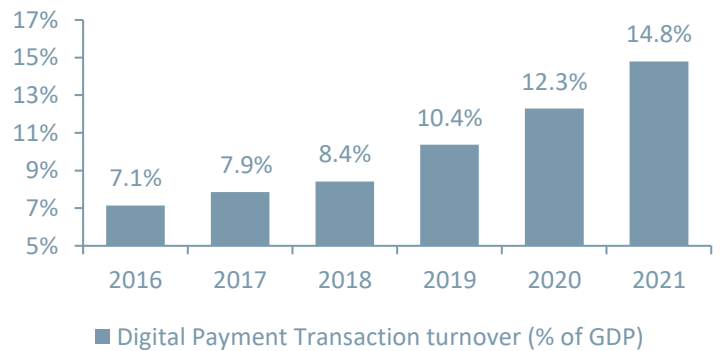


Exhibit: The RBI aims to push up digital transactions



Source: RBI, Payment and Settlement Systems In India: Vision – 2019-2021, May 2019

Our preferred sectors:

To benefit from India's growing consumption cycle and ecommerce adoption we like growth stocks in the consumer discretionary and industrial sectors and private sector banks. Shared mobility, electric vehicles and autonomous vehicles are important in lowering pollution levels and are in line with new regulations on emissions. Companies that are investing in these new technologies should see exponential growth.

Consumer discretionary: Strong consumer loan growth and rising real incomes support consumption. Domestic auto sales in the two wheeler and four wheeler category should continue to increase (though there has been a drop in demand in the last month) in contrast to the rest of the world supported by rising income levels, urbanization and credit penetration.

Financials: Sustained economic growth and borrowing from the growing middle class should support growing income for the private sector banks. The shift to digital payments is a game changer but not investable as many players are private (digital payments are led by Paytm or channels such as WhatsApp).

Industrials: Infrastructure build remains key to India's economic growth backed by strong public capex.

Diversified solutions – investing through funds: Active managers are best able to catch the shifting demographic trends and offer diversification across the large cap and mid cap space.

The funds on our focus list:

Fund	Investment Objective	Market Cap	Total Return Annualized 3 years
Goldman Sachs India Equity Portfolio	Seeks to provide capital growth over the longer term. Bottom-up, style agnostic approach. Aims to invest in sound businesses at a discount to intrinsic value	Multi Cap	9.13%
Kotak India Growth Fund	Aims to achieve capital appreciation. Strong bottom-up with a top-down thematic overlay. Endeavours to derive value from macro trends and to identify stock specific opportunities	Large Cap	9.80%
Kotak India Midcap Fund	The fund aims to achieve long term capital appreciation by primarily investing at least two thirds of its total assets in mid-cap companies.	Mid Cap	10.23%
Emirates India Equity Fund (for Sharia compliant investors)	The fund will aim to achieve medium- to long-term capital growth through investments made in a portfolio of Shari'a compliant Indian equities.	Large Cap	n/a

Source: Morningstar, data as of April 21st 2019

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