Trade of the Decade Review

- INDIA -

The story so far as seen through our India blogs of recent years

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“India is Dennehy's tip for the next decade.”

This Is Money, 30 December 2009

Contents

Introduction by Brian Dennehy

To mark the visit of Narendra Modi, India's Prime Minister, in November 2015 we decided to collect some of our thoughts and research that we have produced over the years and publish them in this eBook.

India was our "Trade of the Decade" way back in 2009. As you read through this book you will see the evolution of the India story. Many of the themes that we write about have been in place for some time but more recent events, such as the election of Narendra Modi, have started to unlock much of the country's potential.

This is a story that is constantly evolving, and we will continue to monitor India's progress with great interest for many years to come. Happy reading!

P.S. If you would like to be kept up-to-date with our current research & ideas, do register on FundExpert.co.uk. Registration is free and you may opt-out at any time.

India – Jewel in the Asian crown

TopFunds Guide extract
July 2009 (pp. 19-20)

We highlighted the potential of India in some detail in our emerging market research first published in January 2007, and have continued to recommend it since. Over the last year, the Indian stock market is the only major market to be up in value, quite an achievement.

Here we explore why India should be a growing part of your portfolio, and how best to build that exposure.

The demographic dividend

While most commentary focussed on China early in 2007, we were drawn to the remarkable demographic mix of India. Half the population of 1.2 billion is aged under 25, which represents 25% of the whole world's under 25's. This is what has been called the "demographic dividend" – though it will only be a dividend if these young people can be put to work, which also requires key education reforms.

> "...the elections in India gave new impetus to the Indian stock market."

Coping with the Crash of 2008

While concerns grew from early in 2008 about the ability of emerging markets to sidestep growing problems in the developed world, India stood out as being much less dependent on exports than China, and with strong internal demand.

India was not totally immune – international capital flows into India dried up – but mainstream India was not ruffled by faraway problems founded in Anglo Saxon debt and poorly regulated banking systems. This came out in an invaluable discussion with Avinash Vazirani, manager of the Jupiter India fund, sadly on the day in late November 2008 of the Mumbai massacre. Avinash had just returned from India and, probably uniquely for a major economy, he was struck by the confidence that he encountered, despite concerns of some exporters and their banks becoming more cautious about lending.

Election lays foundation for reform

More recently, the elections in India gave new impetus to the Indian stock market. Prior to the election it was feared that another indecisive result would mean another coalition, delaying still further the urgent need for reforms. When the Congress party enjoyed a stunning victory, with a mandate for change and reform, the outlook for India, already positive, was transformed still further.

Be in no doubt that there are problems to be addressed in India. A multitude of reforms need to find their way through parliament, and huge expenditure is required on roads, housing and education, among other things.

But these problems, if solved, are the keys to unlocking the potential of India's youthful population, and the electorate have handed a mandate to the governing Congress party.

Stock market soaring

The positive implications of the election result were instantly understood, and the Sensex stock market index rose rapidly, by 17% in just one day. Having now risen 80% from the low in March 2009, it can be argued that the market requires a breather, and, rather than lump sum investments, we are inclined to make a long term commitment to monthly contributions.

Massive longer term potential

TopFunds Guide extract
January 2010 (p. 16)

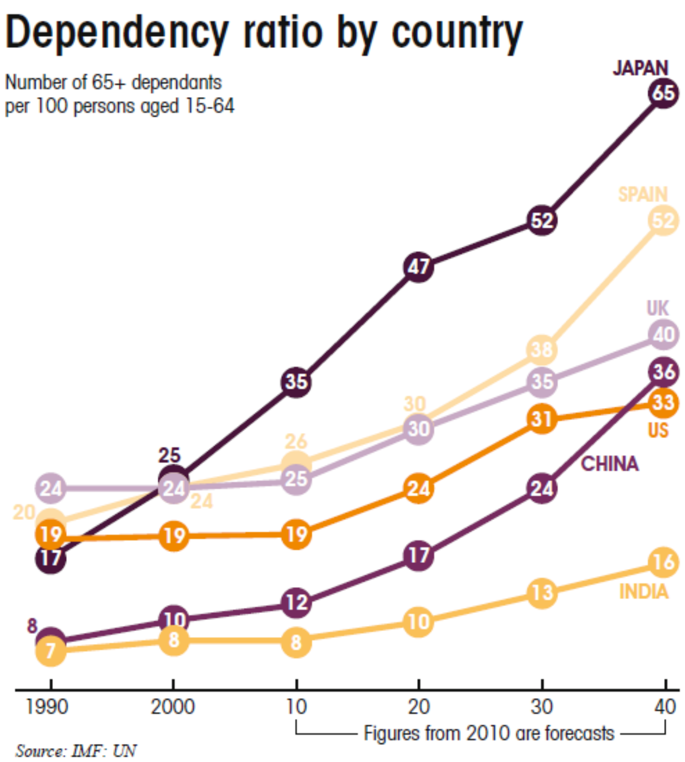
There is a risk as we focus on the short term that we miss the powerful long term, secular, changes driven by unfolding demographics.

The chart below shows the growing dependency ratio in a number of key countries – the ratio is the number of retirees per 100 people aged 15-65. This is not a parochial UK tendency, but a global one (India probably being the main exception, due to its remarkably young population).

Now think of this chart another way - it vividly illustrates the inexorable rising demand for income. The search for reliable income will be all the greater in countries like the UK, as final salary pension schemes close, and the Government reduces State benefits for the retired (by hook or by crook!).

In the years and decades to come high yielding shares, those with reliable dividend flows, will increasingly attract premium values, and the equity income funds that invest into them should be at the heart of portfolios (even for investors with a growth objective, to capture the powerful impetus provided by the reinvestment of dividends).

And while capital values might go up and down, remember dividend payouts are always positive.



Emerging Markets – global investors still underweight

TopFunds Guide extract
January 2010 (p. 20)

Never have we known such divergent views on nearly every asset class, and emerging markets are no exception. They are either good value and expected to explode upwards, or are already hugely over-valued and about to fall sharply, with China in the vanguard. So how should you respond?

Identify the most compelling long term trends and find the most painless way to gain an exposure.

Huge they might be, but China, India, and Brazil are still "emerging". This can be illustrated in a range of ways, focussing here on China:

> "It's not all about China."

- Electricity use per head in the US is 13,582Kwh. It is 6,185Kwh in the UK and 8,220Kwh in Japan. But in China it is just 2,041Kwh.
- By 2035 the Chinese economy might be 17 times as big as it was in 2004 (according to Goldman Sachs)

This economic transition will not be without turbulence, but there is a marked determination on the part of the Chinese Government, evidenced over years, and most recently with their huge and rapid response to the sharp slowdown in Autumn 2008.

Shorter term factors can also drive their stock markets somewhat higher. Many analysts expect global interest rates to stay lower for longer, as central bankers and politicians fear making the mistake of the 1930s, increasing rates too soon. That being the case there will remain a lot of cash washing around the globe looking for a home.

We believe a disproportionate amount of this money will find its way to emerging markets. With the developing world now responsible for just over half of global GDP, the vast majority of institutions and global funds will find themselves having far too little in emerging markets on a GDP-weighted basis.

It’s not all about China. Regular readers know that our favourite country is India, followed by Brazil. And emerging markets as a whole came of age in 2008 and 2009. As Barclays Capital put it:

“the ability of EM to weather the most severe financial crisis in seventy years dramatically changes the nature of the asset class”

Long term uptrends to drive profits?

TopFunds Guide extract
July 2011 (p. 6)

In the UK and other developed markets in the 1990s we enjoyed a marvellous uptrend, one which had begun around 1980 – happy days. It was driven by three factors: inflation and interest rates persistently falling from the highs of the 1970s; the post-War baby boomers going through their peak years of earnings and spending; and this positive trend was increasingly debt-fuelled! The latter two drivers are now in reverse, and the era of low interest rates is on borrowed time (with inflation already rearing its ugly head).

In contrast, during the 1990s emerging markets went mostly sideways, with lots of volatility, and only broke up out of that trend in 2004. While developed markets are now the laggards, the positive trend for emerging markets is far from over. Consider this:

- last year more cars were sold in China than the US
- in the US there are 700 cars per 1000 people
- in China there are 10 cars per 1000 people

Think about that. The potential is extraordinary.

But it isn’t just about China. For example, India is some years behind China in its development, and the potential is considerable - if we had to choose between the two, India is our preference.

“...when 800 million people live on no more than $2 per day, it is not difficult to improve on that.”

If you have travelled around India (rather than just seeing the high rise of Mumbai) you might well wonder, with such widespread poverty and squalor, how India is maintaining growth around 8% per annum. Part of the answer is that when 800 million people live on no more than $2 per day, it is not difficult to improve on that.

Opportunities for new employment will arise in many ways, and rebuilding its infrastructure will be key, as it has been in China. The Indian 5 year plan, beginning in 2013, is possibly the most ambitious infrastructure project in the world – it could mobilise their economy as in the US with railways in the 19th century, and roads in the 20th.

Costs can also be driven lower. For example, food prices are clearly a problem, but between 40-60% of fresh food goes rotten each year because of lack of cooling facilities and inefficient distribution. Allowing their market to open up to foreign competition (e.g. Tesco) would be a huge benefit.

Last but not least India contains 25% of the world's population aged under 25 – this can drive the growing prosperity of India for decades to come, providing better paid jobs can be created.

Asia: ready, steady…for growth and income

TopFunds Guide extract
Jan 2012 (p. 11)

Asia (excluding Japan) is a mix of very advanced economies, such as Singapore and South Korea, and emerging markets, such as the Indian and Chinese behemoths.

They don't have the debt problem of the other advanced economies, including Japan, and have an inherent dynamism. This is derived from a mix of long term positive trends - urbanisation, industrialisation, and, in many instances, favourable demographics.

Ironically, while Europe (including the UK), the US and Japan are desperate for growth, these Asian economies have deliberately been slowing themselves down, to extinguish inflation pressures. If only the problems of the eurozone were so straightforward!

"Asian economies are close to a new upswing."

Inflation pressures are now abating, with the "help" of an extra kicker from the downturn in Europe (which is the largest single trading block in the world, and very important for Asian economies for whom exports are vital).

Now action is being taken across Asia to reverse this downtrend, and, without the eurozone-style debt burden, this will work.

Asian economies are close to a new upswing. Usually their stock markets will anticipate this, and begin to rise ahead of events. However, in the short term the storms reaching out from the eurozone will likely delay a positive response by Asian stock markets. We will be closely observing the performance of Asian markets in coming months, for signs of that turnaround.

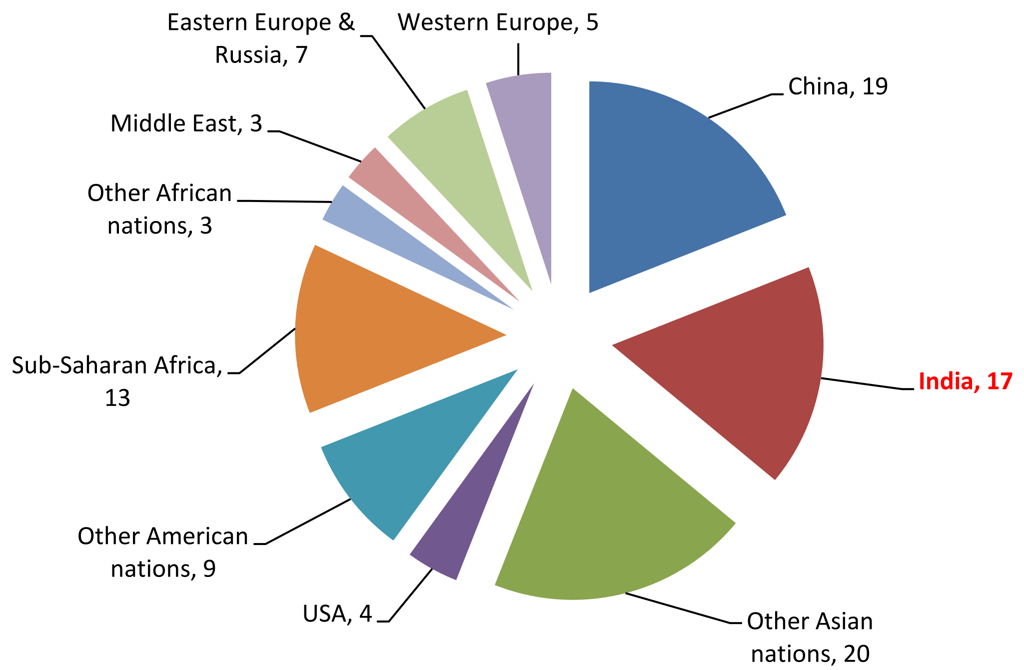
Our Changing World

TopFunds Guide extract
Jan 2012 (p. 14)

To truly appreciate what the world population will look like in 2020, the CIA projected this mix into just 100 people:

- Fifty-six of them would be from Asia, including 19 Chinese and 17 Indians
- Thirteen would be from the America's, including 4 from the United States
- Sixteen would be from Africa, including 13 from Sub-Saharan Africa
- Three would be from the Middle East
- Seven would be from Eastern Europe and Russia
- Only five would be from Western Europe!

Chart 1: CIA projections



Youth: a double-edged sword

TopFunds Guide extract
Jan 2012 (p. 15)

We have mentioned on many occasions how powerful the youth of India are as an economic motor for decades to come. India is home to 25% of the world's population aged under 25.

But economies can't grow by youth alone. There must be education, jobs, and a dynamic political and economic structure.

Sadly this can all go wrong. A key element in the "Arab spring" was dissatisfied youth. This was anticipated in a CIA report as long ago as 2001.

Although the populations in Europe are not as young, it creates a tinderbox environment when youth unemployment is so high e.g. 45% in Greece and 49% in Spain.

Populism and anti-immigrant sentiment is on the rise, and battalions of unemployed youths are easy fodder for demagogues.

"...younger populations of India, Indonesia, and Brazil have been significant drivers of their superior economic performance."

And it is unhelpful when democracy is already on hold as in Greece and Italy, now led by unelected technocrats.

Unsurprisingly, the Economist Democracy Index notes popular confidence declining in (democratic) political institutions in 2011.

Turning to the positives, in recent years the younger populations of India, Indonesia, and Brazil have been significant drivers of their superior economic performance.

Positives are vivid

In a short number of years those young people will enter the life stage when they are heavier spenders, bigger borrowers, and aspiring home owners - driving these economies to new levels.

Just to take India alone:

- India’s working population is as big as China’s
- Another 120 million people will enter the Indian workforce over the next 10 years
- This is more than the whole current working population of Brazil
- By 2020 India will hold approx. 21% of the total global workforce

Lesson? Be careful, but don’t be parochial in your investment choices.

Future Growth: the growing middle classes

TopFunds Guide extract
Jan 2012 (p. 16)

In the last section we highlighted the problems with ageing populations and the growing demand for reliable income. But there are also some positive demographic trends.

To meet the demand for reliable income, fund managers need to identify sectors or geographical areas which can generate reliable future profits from which dividend income can be paid.

A heavy concentration of young people can provide this edge.

Growing middle classes are another vital source of future growth.

> “Kentucky Fried Chicken makes more money in China than in the U.S.!”

The map on the next page highlights where tomorrow’s middle classes reside. The orange circle indicates the current size, and the purple circle vividly highlights how this will change over the next 20 years.

As you can see, the huge growth in middle classes is focussed on Asia, which also has the benefit of two very large nations with very young populations, India and Indonesia.

To give a sense of the potential, imagine the following:

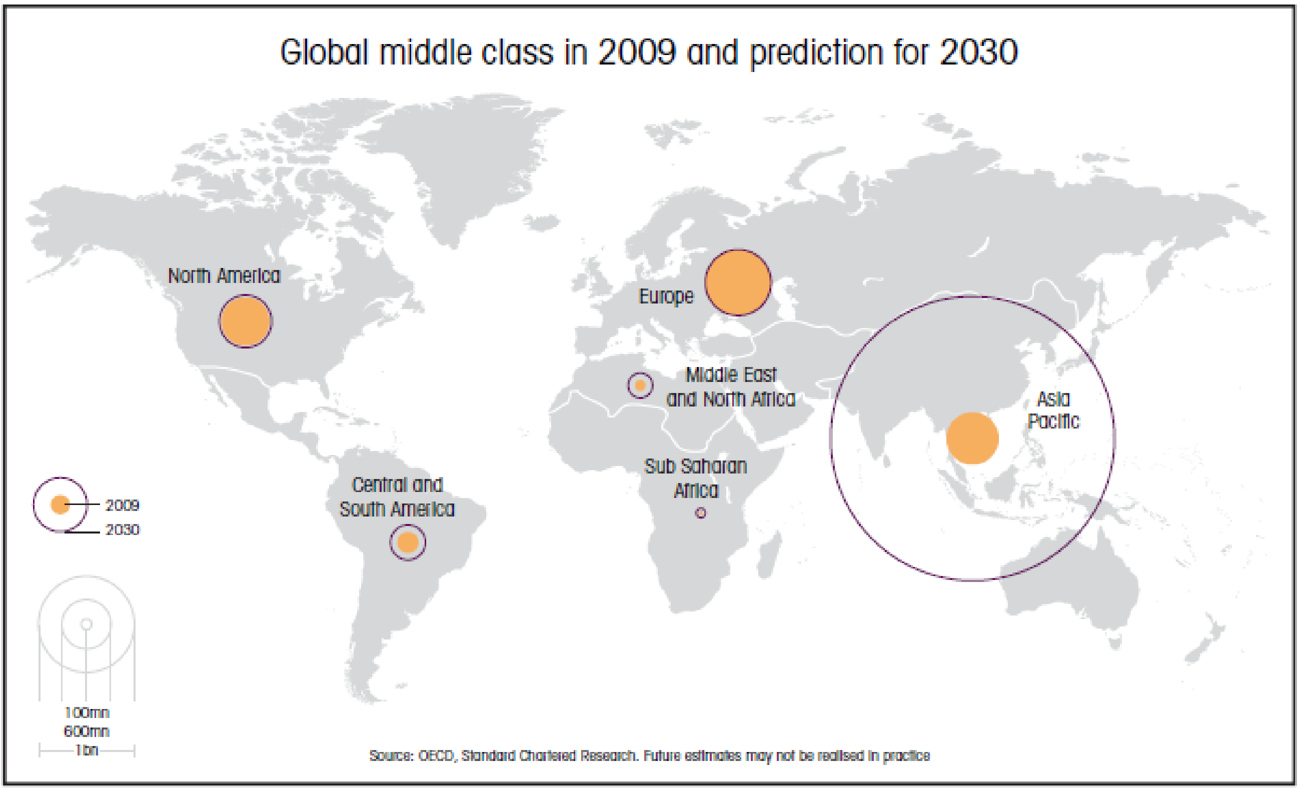
- everyone has a fridge in the UK
- 60% of Chinese enjoy fridges
- but only 18% have fridges in India

Billions of people across the emerging markets in Asia, South America, and Africa are becoming consumers for the first time - they want clothes, food and personal care products that we in the West take for granted. Yes, and fridges!

Kentucky Fried Chicken makes more money in China than in the U.S.!

Colgate-Palmolive is exploiting this potential, from shower gel to pet food. It shares its success with shareholders, having increased its dividend payout every year for the last 48 years.

Colgate-Palmolive will fit within the global equity income funds identified earlier. And don't overlook the fund we have frequently featured, M&G Global Basics, which invests in successful first world companies growing their profits in third world countries.



Global middle class in 2009 and prediction for 2030

Source: OECD, Standard Chartered Research. Future estimates may not be realised in practice

The Investor Conundrum

TopFunds Guide extract
Jan 2012 (p. 18)

We were clear that caution was, and is, warranted. But the right balance is art, not science.

We identified a process to guide you:

1. to buy assets/funds which are obviously cheap...
2. ...or where they benefit from clear long term up-trends
3. to take profits (reduce holdings) where assets/funds are no longer obviously cheap...
4. ...and similarly when risks are obviously rising

In the first category we noticed that China was good value, but still vulnerable, and so it transpired. In contrast the US market looked expensive, but there were pockets of value among very large businesses - these did then outperform.

We highlighted long term up-trends and the potential in China and India. We warned that food prices and lack of infrastructure remain problems in India - market falls in the last 6 months make investing now a more compelling proposition.

Opportunities in Emerging Markets

Tue 25 Sep 2012
Posted by: Brian Dennehy

BRIC funds invest exclusively into Brazil, Russia, India and China. But more flexible emerging market funds are typically better performers. In addition we suggest cherry picking two of those BRICs for investors of a contrarian nature, and who are comfortable taking on a bit more risk

Flexibility is key

Emerging markets are not homogeneous and there will always be disparities between them. It wasn't long ago that Thailand was a basket case and China was booming, yet a turn in fortunes now sees Thailand outperforming the MSCI index while China slows to a crawl. These fluctuations mean that the emphasis for most investors must be on flexible global funds, and on fund managers that use this flexibility wisely.

Having said that, investors who wish to take more risk could buy a focused fund, in particular the giants of China and India are currently much overlooked and this creates opportunities. Here are two…

> "...taking a longer view we believe the very young population will drive reform..."

China – the contrarian choice

China is attractive for contrarians. The Chinese market has not been cheaper since effective record began in 1990, and history tells us that the negative consensus surrounding it could highlight a market near a bottom.

India – for the long term

For those comfortable with higher risk and a 10 year+ timescale we still like India. It will be bumpy (there are a lot of reforms where action is needed), but there will ultimately be growth via the ballot box.

The potential upside is captured by **GDP per head** number comparing India with other emerging markets.

- Mexico $14,800
- Turkey $14,700
- Brazil $11,900
- China $8,500
- India $3,700

Exciting investor news: reforms in India announced

Tue 02 Oct 2012
Posted by: Brian Dennehy

The latest reforms announced by the Indian Prime Minister have turned the spotlight back on India. There is a very real possibility that the two year downturn is over, and a new bull market in Indian shares is anticipating a renewed long term boom for the Indian economy. Surprisingly it has attracted little interest from investors.

Huge potential

It is "surprising" that there is little interest because the potential upside is massive:

- India is the 2nd most populous country in the world, and will be number one by 2030
- More than 50% of its population is aged under 25
- The average age of an Indian in 2020 will be 29 years, compared to 37 for China and 48 for Japan. There is no demographic timebomb.
- Growth will also be driven by the rural population moving to the cities over the next 20-30 years. The precedents here are clearly positive, whether 18th century Britain or China.

Consider how low is the GDP per head in India compared to other countries:

- Mexico $14,800
- Turkey $14,700
- Brazil $11,900
- China $8,500
- **India $3,700**

This compares to $49,000 for the US and $36,600 for the UK.

More needs to be done

The latest proposals aren't an end in themselves – Walmart alone cannot transform and modernise India – but this is a profound, if small, first step which can transform confidence in the future, and, for example, persuade Indian companies to dust off mothballed investment plans. Early progress with the likes of Walmart and Ikea, creating jobs and helping subsistence farmers from whom they will buy direct, will encourage more progress, with the growing support of a youthful electorate.

There are problems. For example, poor infrastructure, widespread corruption and a weak judicial system, to name but three. There are clear risks, but the potential is huge, illustrated by these stats on how far it has yet to progress, as well as the internal contradictions:

- About half the population still practice "open defecation" (600m people)
- And it has more mobile phones than toilets
- It has more poor people than Africa
- Yet has more billionaires than Britain
- 42% of the children are officially underweight
- But is has nuclear weapons and a space programme

> "Investing in India is for those comfortable with higher risk and a 10 year+ timescale."

Such contradictions might distract investors from the potential, but we believe India is not just the trade of the decade, but of many decades to come.

Jupiter: "India's giveaway budget postpones the pain"

Thu 07 Mar 2013
Posted by: Brian Dennehy

The Indian stock market is a huge long term favourite of ours, with a very young population, and being probably a decade behind China in its development. But there is much to be done by the government to ensure this potential is fulfilled, and the recent budget was a little disappointing. Here we consider feedback from an expert, Avinash Vazirani, manager of the Jupiter India.

"With an eye firmly on national elections in 2014, the Indian government has delivered a populist budget aimed at securing the support of its core rural voters, while putting off more radical structural reform until later" says Avinash.

"The budget was a missed opportunity. We saw large increases in funding for rural development projects and a rise in the farm budget but measures aimed at boosting domestic and international investment in the country were few and far between."

Avinash notes that India's Finance Minister P. Chidambaram could have used the budget to introduce incentives to make investing in domestic shares more attractive for Indian investors who traditionally choose bonds over shares.

"It's difficult for stocks to compete when state-owned Indian companies are offering bonds with interest rates of 8% or thereabouts, free of tax."

There were some positive announcements in the budget including a cut in the transaction tax on Exchange-Traded Funds to encourage more investment by Indian pension funds and the introduction of a 15% investment allowance to boost capital expenditure by manufacturing firms.

A boost for Indian consumerism

The budget aside, the most encouraging development for the Indian economy remains the launch of the *Direct Benefit Transfer (DBT) Scheme*. This scheme allows government subsidies on a list of 39 items to be paid directly into a recipient's bank account that is linked to a unique biometric identification number given by the authorities.

"I have...seen queues of people waiting patiently to get their biometric identification. DBT has cut out the 'middle man' who would often skim off a percentage of the subsidy before handing it over to the designated recipient. It means more is getting into the hands of those with the greatest propensity and need to spend it," says Avinash.

Consumer goods companies should be one of the main beneficiaries of this new scheme as recipients spend the extra cash they receive on a range of products. Over the last five years, exposure to consumer goods companies in the Jupiter India Fund has increased significantly.

Avinash: positive on the outlook for the Indian economy

He says the current government did a good job of cutting the country's fiscal deficit to 5.2% of GDP for the year and is confident it can meet its new target, outlined in last week's budget, of a 4.8% shortfall in the twelve months starting April 15 – despite the projected 16% rise in expenditure announced in last week's budget.

Avinash concludes: "Even with a government that remains focused on cutting the deficit, we still believe the country's economy can grow by a healthy 6% this year, an improvement over the last 12 months and significantly better than growth in other parts of the world."

Templeton: "India's task is huge, but there is reason for optimism"

Thu 21 Mar 2013
Posted by: Brian Dennehy

The Indian stock market is a huge long term favourite of ours, with a very young population, and being probably a decade behind China in its development. But there is much to be done by the government to ensure this potential is fulfilled, and the recent budget was a little disappointing. Chetan Sehgal, Managing Director of Franklin Templeton India recently shared his outlook on the country's prospects and challenges.

He believes India is moving in the right direction and the entrepreneurial nature of its young demographic will help drive growth:

"The country is taking a lot of bold initiatives to further growth potential at a time when the overall global macro environment is quite challenging.

> "India remains a country of paradoxes and a land of opportunities."

India has had a vibrant stock market with a vast number of listed companies, and a culture of entrepreneurship and investment.

Corporate governance has come a long way. The financial industry at large has generally recognized India as a model of good corporate governance in the emerging markets realm, and there has been a marked increase in transparency by many listed companies.

The key to unlocking India's potential prosperity lies in increasing employment, productivity and innovation. The task is huge, but there's reason for optimism. The government has now started taking steps to revive growth through more effective policy action.

It seems that the country ultimately has to find solutions from within. However, we have seen many Indian entrepreneurs succeed against all odds, and if compounded, that spirit could help drive business in India."

Still much to be done

Mr Sehgal points out that India’s development may have been hampered by the challenging macro environment:

“India has certainly faced its share of recent economic challenges, plagued by the unsavory combination of slowing growth and rising inflation in 2012 that effectively tied the hands of the central bank here.

One urgent need is greater clarification on India title rights and taxation system. There is too much litigation, which has undermined investor confidence.”

India clearly has some daunting tasks ahead, given that energy prices are at historically elevated levels and the global economy is generally unsupportive.

Overall Mr Sehgal holds that India will continue to offer a long term opportunity for investors seeking growth:

“India remains a country of paradoxes and a land of opportunities. In our view, the healthy discussion and debate now taking place within this young, democratic, nation should ultimately result in higher potential for growth.”

Guest Blog: Diary from India

Tue 20 Aug 2013
Posted by: Neptune Investment Team

Kunal Desai (Fund Manager of the Neptune India Fund)

21-27 April, 2013

WEEKEND

I arrived in Mumbai in the early hours of Sunday morning and was greeted by the usual jostling scrum to get out of the airport. Although it is probably a cliché to think that an airport sums up the country itself, it is hard not to once you see the organised chaos on show in Mumbai’s Terminal 1.

The taxi journey across the city has been cut by more than 90 minutes thanks to the seaborne ‘Sealink’ bridge. It is an awesome piece of engineering – evidence that infrastructure can work in India, even if it was delayed by five years. After a quick nap, I meet up with two cousins at their favourite crab restaurant. They were educated at Cambridge and have now moved back to join the family construction company. Business is tough, but they are looking through this cyclical downturn and using it as an opportunity to become leaner and more efficient. They are adamant a brighter domestic future lies ahead. I get back to the hotel just in time to catch the featured FA Cup game. It seems strange that India enjoys more televised football than the UK. The other sports channels remain choc-a-bloc with jingoistic reruns of famous Indian cricketing victories.

“...they are looking through this cyclical downturn and using it as an opportunity to become leaner and more efficient.”

MONDAY

I touch down in Bangalore before breakfast with a small group of investors. They have come from the US, Europe and the Far East to try and get to grips with a country that can leave you dazed and confused. I find it interesting that many of them are ‘value’ investors, to them India looks cheap when compared with the rest of Asia. They believe that an economic turnaround is coming and they want to be part of this re-rating story. We visit Infosys’s flagship campus, equipped with a golf course and dance studio. The CFO was impressive – upbeat, positive yet realistic. Could this much maligned stock be the one that surprises this year? We then navigate the rush hour traffic to United Breweries HQ (makers of Kingfisher Beer) for dinner. The CEO complains about the myriad of regulation on a state-by-state basis, but on reflection does this benefit them given their strong relationships with state governments? The barriers to entry are high as companies can build 'moats'. Indeed from a stock picking angle, perhaps the strong get stronger.

TUESDAY

Our pre-dawn flight takes us on to Chennai, the capital of Tamil Nadu. The streets are bustling and full of colour. Our first meeting is with a rural branch of the HDFC Bank (India's second largest bank and a core holding of the Neptune India Fund). Microfinance has had bad press recently, but I am impressed with both HDFC Bank's efforts (rural areas represent 70% of new branch addition) and the non-urban entrepreneurialism of the female borrowers. HDFC Bank charges only 15% interest versus 25-40% from microfinance firms – they are doing their bit for the country. Our afternoon meetings are held at the hotel and we struggle to come to terms with how poorly the state power sector is run. The state has finally hiked power tariffs by 37% after five long years. The lights ironically cut out half way through the presentation. We dine with the interesting Murugappa Group who have exposure in the fertiliser space. I sit next to the Managing Director who tells me his son, studying at Warwick University, has no interest in joining the family business but instead wishes to create his own Indian internet start-up. Is this the next leg of the Indian IT sector? Police stalk the corridor outside my room – it is only when I see Sachin Tendulkar and Michael Clarke that I realise why: the India-Australia test series begins in Chennai the next day.

> "...we struggle to come to terms with how poorly the state power sector is run...the lights ironically cut out half way through the presentation."

WEDNESDAY

My alarm jolts me awake at 5am. We catch a flight to Ahmedabad, the largest city in Gujarat. The region has been a darling for investors as the state's leader, Narendra Modi, has run it properly and efficiently. Growth has beaten the country's average consistently over the last decade. I have been a number of times, but some other investors remark 'how Chinese' the roads and infrastructure appear. Our daytime meetings with government officials and think-tanks cover the topic of whether the impressive growth template can be replicated across India if Modi wins the General Election next year. His biggest impediment seems to be sponsorship from within his party though (he is autocratic and refers to himself in the third person). We then meet entrepreneurs from the illustrious IIM University who are energetic and full of ideas. Each one without hesitation confirms Modi would be their choice for Prime Minister. As the election looms, I would expect the market to get excited if this appears more likely.

THURSDAY

We are afforded a lie-in and leave for Chandigarh, in the Punjab, at 7am. It is the nation's 'breadbasket' with land prices being driven higher and higher as remittances from Punjabis abroad flood in. We visit a farm an hour away from the city where the farmer complains about the unreliable free power he receives. Instead he wants to pay for it as long its reliability is ensured. Our afternoon meetings involve discussions with journalists, consultants and local businessmen. The theme of unskilled labour becomes the focus. Fifteen million workers enter the workforce each year and not all of them can work for Infosys. China employed its unskilled through gluing 'Buzz Lightyears' together but what will India's response be? The development of exports will be critical for the country and I expect this to be an interesting theme of investing in the decade to come. We finish the day with a dinner with DLF, India's largest real estate company.

"The development of exports will be critical for the country and I expect this to be an interesting theme of investing in the decade to come."

FRIDAY

A post breakfast flight moves us on to Delhi. We check into the colonial Imperial Hotel for a full day of meetings with The Economist, Rating Agencies, the Planning Commission and the Government. Perhaps the highlight was the discussion with the Government over the introduction of biometric ID cards, known as the catchy 'UIDAI'. Every citizen will hold one and it will significantly reduce subsidy leakage by cutting out the middleman. The operation can enrol more than one million per day. The scheme seems to be past its financing problems and has the full support of all political parties. Following an entertaining lunch with The

Economist, we go on to visit India’s first F1 race track, built by Jaiprakash. It is mightily impressive but our pleas to have a go on the course are politely turned down.

SATURDAY

We wake up early in Agra and wander down to glimpse the Taj Mahal. Despite being much photographed, it really does take your breath away seeing it with your own eyes. My guidebook describes visiting it as ‘one of the most romantic experiences the world over’, but the author clearly did not go along with a group of eight male investors. I struggled to experience such emotions. Following a quick lunch, I speed along the Agra-Delhi expressway to catch my flight back to London. Exhausted, I close my eyes as we taxi onto the runway and only open them as we touch down at Heathrow.

Trigger's Tip: September 2013

Fri 30 Aug 2013
Posted by: Trigger (this is tongue-in-cheek)

India has been in the news lately, as its currency collapsed in the wake of talk that QE will be withdrawn (so called tapering). What's gone wrong?

- Hot money had flowed into India in pursuit of higher returns than in US bonds, and now those flows are reversing
- A government not renowned for its speed is now effectively paralysed ahead of 2014 elections.
- Normally their central bank would deal robustly with currency weakness, but they are in the midst of a handover to the new governor

Even confidence within India appears to have collapsed in a way in which it didn't in 2008 (as the rest of the world went into meltdown).

Companies aren't hiring, consumers aren't spending, inflation is high. Corruption remains rife, and doing business (for example if an overseas business) is simply too fraught with difficulty. Reform is desperately needed, infrastructure initiatives are long overdue.

"Reform is desperately needed, infrastructure initiatives are long overdue."

One minister was recently caught accepting a bribe, and sacrificed a goat to ward of such bad luck (being caught!) for the future.

Is there hope for such a country?

TV and the internet are key to changing expectations amongst the poor and young.
"This seemingly innocuous development has drastically changed Indians' expectations… even watching Jerry Springer brings hope!" observed one otherwise sceptical observer
Growth is driven by young populations, and India is uniquely attractive in this regard

Combining these factors creates the impetus for political deadlock and inertia to be broken.

It won’t happen fast, assume years. But the totally negative sentiment surrounding India in the short term creates another outstanding opportunity for regular saving over those years. The stock market may drift and go lower, and you will buy at ever attractive prices. But eventually it will explode upwards.

You just need patience.

India Stock Market Hits High: Time to Invest?

Fri 06 Dec 2013
Posted by: Brian Dennehy

India's stock market has just hit an all-time high. So is now a good time to be investing in India? We say yes and India will remain an exciting investment opportunity for the foreseeable future... But only for investors who are investing for the longer term, rather than quick gains.

What has changed?

India equities tumbled badly when tapering was threatened from 22nd May 2013. The negative sentiment which enveloped India was also characterized by a collapsing currency and a paralysed government ahead of elections in 2014. So what has changed for the better since the summer?

Firstly, the new boss of their central bank has pleasantly surprised (even shocked some) with an outline of much needed reforms. His example gives a very important lead to the new government from 2014.

> "..the biggest factor that will drive economic growth over the long term is India's huge youthful population."

Secondly, there is now a sense from opinion polls that a pro-business government might take power in 2014, a unique positive for India.

Thirdly, there has been a wave of investor optimism following a defeat for the ruling Congress party in Indian state elections this weekend. This gives hope that the pro-business opposition Hindu nationalist Bharatiya Janata party could gain victory in next year's general election.

These three factors alone could drive the Indian stock market sharply higher in the short term.

The bigger picture

Looking beyond 2014, the biggest factor that will drive economic growth over the long term is India's huge youthful population.

The economic growth of a country is driven by a growing population or improving productivity, ideally both. If you have a relatively young population, and low income levels, this creates headroom for both.

Young people get a bad press

It's not just today in Egypt or Turkey or Brazil. Remember those long haired hippies in the '60s who needed a good wash and National Service (so said their Dads!). Well those layabout junkies played key roles in the spirit of technology and discovery in the 1970s, and triggered advances in computer and medical technology in the 1980s which still have a place, an even bigger place, in our lives today. The teenage "baby boomers" of the 1960s also became increasingly avaricious consumers from the 1970s, with a huge boost from the increasing availability and use of consumer credit.

A bizarre potential

Of course India is a country of bizarre contrasts. They're flying to Mars (on a budget of course), but half the population have no toilets, and 40% of young children are undernourished. Yet the latter indicates how huge is the upside potential if they can drive ahead with reforms across a broad front (though don't expect fast progress).

Trigger's Tip: Keep Buying Indian Equities

Fri 02 May 2014
Posted by: Trigger (this is tongue-in-cheek)

Did you think I was barking when I said "Buy India"? I bet you thought India was an investment "dog". Silly you. What has happened since is a huge turnaround in their stock market. Where do we go from here?

Back in August 2013 India, along with other emerging markets was hit by the threat of the US tapering its money-printing exercise – the hot money flows into India began to reverse.

India was loathed by everyone – well, almost everyone!

Of course there were problems and this is what I said:
"*Even confidence within India appears to have collapsed in a way in which it didn't in 2008 (as the rest of the world went into meltdown). Companies aren't hiring, consumers aren't spending, inflation is high. Corruption remains rife, and doing business (for example if an overseas business) is simply too fraught with difficulty. Reform is desperately needed, infrastructure initiatives are long overdue. One minister was recently caught accepting a bribe, and sacrificed a goat to ward off such bad luck (being caught!) for the future*."

"India was loathed by everyone – well, almost everyone!"

Is there hope for such a country? I thought so, and still think so:

- TV and the internet are key to changing expectations amongst the poor and young.
- ..."This seemingly innocuous development has drastically changed Indians' expectations… even watching Jerry Springer brings hope!" observed one otherwise sceptical observer
- Growth is driven by young populations, and India is uniquely attractive in this regard

- Combining these factors creates the impetus for political deadlock and inertia to be broken

Of course change won't happen overnight in India. But the totally negative sentiment surrounding India in August created an outstanding opportunity.

Since August the Jupiter India fund is up a whopping Irish wolfhound size 25%! In contrast the UK and US stock markets are up a poodle-size 8% and 6% respectively.

And the future? Well, the future is bright, and it belongs to Asia. Booming Asian middle classes over the next 20 years will put the ageing, greying Western consumers in the shade (though they do love dogs).

India is mid a vast general election right now. No longer will they be dominated by caste and history – reform will define Indian elections in the future, not sectarianism. That is hugely positive. Just don't expect overnight change, this is a long play.

This remains an ideal environment for monthly investors. Take the dips in your stride, be patient, and there is a lot of money to be made.

Buy into the New India

Thu 22 May 2014
Posted by: Brian Dennehy

The Indian election result is not just a "Thatcher Moment" for India. It could also have a huge global impact, and certainly brings into focus the exciting potential which we have highlighted persistently in recent years. Here we consider opportunities in India in more detail, and ways in which you can invest.

India has often disappointed. Extraordinary potential, never quite realised. Expectations have changed significantly for the better following the election of recent weeks. Instead of voting along religious or caste lines, the huge Indian electorate, the biggest in the world, voted for reform.

That is extraordinary in itself. But it gets better. The winning BJP, led by Narendra Modi, is the first party in India's history to govern without the need for coalition support (the need for which would undoubtedly have held back the desperately needed reforms).

"Instead of voting along religious or caste lines, the huge Indian electorate, the biggest in the world, voted for reform."

The Potential For YOU

Before putting more meat on the bones of this blog we should highlight why you need to pay attention – this is not merely of academic interest.

First a little historic perspective. In 1820, before the greatest impact of the Industrial Revolution led by Britain, India and China were by far the two largest economies in the world. The two combined were also larger economies than the entire Roman Empire at the birth of Christendom. In 18 out of the last 20 centuries Asia accounted for more than half of world economic output.

You get the picture? Yet most UK-based investors behave as if it was 1820, and are extraordinarily parochial, investing largely in the UK, or into barely different developed markets nearby.

Then there are the demographics; the age of the population. Have a look at table 1 below. The median age of the Indian population is a mere 26 years. Compare that to Italy (44 years) or even Britain (40 years). A relatively youthful population is absolutely essential for a country wishing to sustain high levels of growth. A 25 year old working Indian with young children has much greater economic potential than a 70 year old Italian pensioner – it is that simple.

By 2025 the Indian population will be larger than China (which has driven world growth for much of the last two decades). Already half the population is aged under 26 years.

The current wealth of those young people is also important i.e. are they already wealthy? Is there obvious upside potential? Again looking at table 1, we express that in terms of the size of the economy (GDP) per head of population. For India this is $3,900 per person, and $30,100 in Italy.

You tell me – do you want to invest primarily into the greying, high income, populations of the West, or the youthful, but relatively poor, potential of the East (led by India in coming decades)?

Just these factors hopefully make the potential clear.

Need for Aggressive Reform

For all the clarity around the potential, it will come to nought if the population is not put to work. One of the great legacies of The Raj is a zeal for bureaucracy and regulation, and India cannot fulfil its potential without aggressive reform across a wide range. For example, India requires:

- Broadly-based privatization
- Reducing regulation of the inflexible labour market
- Enabling approval and execution of vital infrastructure projects
- Improving corporate and public governance (reducing corruption)
- Encouraging savings and improving access to credit
- Reducing spending on subsidies and simplifying the tax system
- Reducing red tape for foreign investors

Modi does not just have a mandate from the electorate to deal with the above, but also has a track record of delivering in his home State of Gujarat.

Such fundamental reforms cannot, and will not, occur overnight. Getting individual States to implement reforms passed by the central government will also not be easy – there is much vested interest at a local level, and the BJP are not as strong at that layer of government. Margaret Thatcher ripped into local government (coincidentally with notable Labour majorities), and centralized more government – this might not be as easy in India.

None of this will be easy, nor will it happen overnight. But the new government has been given an extraordinary mandate for reform, and it is right to feel confident as a long term investor.

You Missed The Boat With China; Redeem Yourself?

The time of greatest growth for China was the 1990s – but next to no UK investors were on board at that time. They waited until 2007 (after the peak in that year the market fell by more than 50%), and then got sucked in again by the compelling marketing of Anthony Bolton's Fidelity China Special Situations in May 2010 (and 2 years later it was still hurting from a 30% loss).

As with China so with India. The next decade should see the greatest, and easiest, gains by India, partly because it is starting from such a low ebb (*exemplified by the GDP per head number referred to above and in the table below*). These gains will flow through to their stock market. But most UK investors will only consider buying once the idea of buying Indian investments becomes accepted wisdom – perhaps by the end of this decade, but not sooner.

It's Better To Travel Than To Arrive

… It is vital you take a ***long*** view, at least five years. The Indian stock market has momentum right now, one of the best performers in the world so far in 2014, and this might continue for the rest of 2014. But it might not. Frankly no one knows.

For investors with ***shorter*** time horizons it is invariably better to travel than arrive. It was better to buy India for short term profits when everyone else was very negative. And it was better to buy India as the market moved up anticipating a positive election outcome. Plus, valuations are not cheap. The key to successful investment is buying at the right price.

Although Indian equities might seem decent value right now compared to their own history, compared to other Asian and emerging markets they look expensive. And some large investors, particularly in the US, have been almost euphoric about India – such enthusiasm tends to occur towards the end of a shorter term trend

If you are taking at least a five year view, buy now by all means – trying to market time is all too difficult. But expect short term volatility, and don't be scared off by it; and buy more on significant dips. If in doubt, set up a monthly savings plan and simply forget about it for 5 years.

Back in 2010 we named India as our ***"Trade For The Decade"*** (along with Japanese smaller companies).

There is a risk of over-optimism in the short term. But we recommend consistently building up your exposure to India in the years ahead, whether through small lump sums now, or regular monthly savings (which are also ideal if saving for children and grandchildren).

Investment into an Indian fund could certainly represent up to 5% of your portfolio, if you are comfortable with higher risk for this portion of your portfolio.

Table 1

Youth and Future Growth Potential			
	% population under age 24	**Median age**	**GDP per head of population**
Brazil	41	30.3	12,000
India	47	26.7	3,900
Indonesia	44	28.9	5,000
Turkey	43	29.2	15,000
Italy	23	44.2	30,100
UK	30	40.3	36,700

Brazil vs India

Fri 04 Jul 2014
Posted by: Brian Dennehy

As we write, the World Cup is gathering pace, yet views of Brazil as an investment destination are unremittingly gloomy. Last year when everyone was equally gloomy about India we said "buy India".

What Is The Difference?

There are many contrasts between India and Brazil, and we don't need to get bogged down with those in detail.

The fundamental difference, the one which will dictate success or failure for many years to come, is the appetite for reform.

By 2025 the Indian population will be larger than China (which has driven world growth for much of the last two decades). Already half the population is aged under 26 years.

Yet for all the clarity around the potential, it will come to nought if the population is not put to work. One of the great legacies of The Raj is a zeal for bureaucracy and regulation, and India cannot fulfill its potential without aggressive reform across a wide range.

For example, India requires:

- Broadly-based privatization
- Reducing regulation of the inflexible labour market
- Enabling approval and execution of vital infrastructure projects
- Improving corporate and public governance (reducing corruption)
- Encouraging savings and improving access to credit
- Reducing spending on subsidies and simplifying the tax system
- Reducing red tape for foreign investors

Then in the recent Presidential election something revolutionary happened in India. Instead of voting along religious or caste lines, the huge Indian electorate, the biggest in the world, voted for reform.

The new President, Narendra Modi, does not just have a mandate from the electorate to deal with the above, but also has a track record of delivering in his home State of Gujarat.

Brazil also requires widespread reform. The politicians lost sight of this as they enjoyed the profits from a boom in demand for their vast resources, particularly from China. But since this demand subsided, the true state of their economy was laid bare, and Brazilians took to the streets.

Brazil has a range of problems similar to India (poor infrastructure, too high inflation, need for a raft of structural reforms).

Yet, despite widespread protests, there appears to be no credible, organised, opposition with an agenda for much-needed reform.

India Ready For Change - Brazil Not

Some might see the upcoming Presidential election in October as an opportunity for Brazil to enjoy a Thatcher Moment, as did India with the recent election of Narendra Modi. But it is politics which is the most stark weakness.

India was ready for change, it is that simple. The emergence of strong political opposition, and then their overwhelming election, created a mandate for reform and a break from the past.

Yet in Brazil, despite the street protests and strikes often featured by our media, political opposition is weak, and it seems likely that the current ineffectual government of President Dilma Roussef will be re-elected.

One fund manager said:

"*Dilma's re-election would be a negative for the Brazilian economy over the next decade*"

That is good news for very patient monthly investors, prepared to back this young country with massive natural resources.

But everyone else should ignore any World Cup inspired party mood, and await a better time to invest in Brazil, at least until their stock market is so cheap that the negative outlook is priced-in.

In contrast you should consider buying India for the extreme long term potential. You need to be comfortable with high risk funds.

The election result in India was vital as a catalyst for unlocking its long term potential. That in Brazil does not hold out the same potential.

China vs India: which should you buy? Best funds?

Mon 14 Jul 2014
Posted by: Brian Dennehy

China and India have been in the headlines a lot in recent months, and the recent visit by David Cameron has served to further put India on a pedestal. Which should you emphasise in your portfolio? And what funds to buy?

Mr Cameron's visit to India last week again highlighted the growing attractions of India. In particular a very young population (50% are under age 24), and a huge mandate in the recent elections for new Prime Minister Narendra Modi to introduce wide ranging reforms and unlock the potential.

In contrast, the China analysis which comes across our desks ranges from cautious (at best) to apocalyptic. On the one hand everyone knows that it will take years to transition from an economy driven by (often wasteful) investment spending to one based on vibrant domestic demand; growth will inevitably slow down, but no one knows how serious that might be. On the other hand, there is a vast amount of debt within their complex banking system, and history suggests that this cannot be brought under control without serious trauma.

Not surprisingly, with these respective views being widely held, the Indian stock market has been doing rather well (and has been a frequent recommendation of ours), whereas investing in China has been a lot less fruitful.

For example, the MSCI China index is down 11% over the last year, vs up 13% for India.

Hidden Attractions?

Nonetheless, if you dig a little deeper, investing in China has attractions.

Firstly, it has not been ALL bad news for investors in China. If you invested at the beginning of 2013 in the Fidelity China Special Situations fund it has since risen 24% vs the broader Chinese stock market which is down 14%. This is because smaller companies have been performing better than the wider market might suggest, and these are often indicators of better times ahead (though not always).

Secondly, sometimes all, or a large part, of the bad news is already reflected in valuations. For example, the Chinese stock market is at a 40% discount to other world stock markets.

Clearly the Indian stock market has momentum right now. We believe the long term story is intact, and encourage investors to have an exposure. But don't overlook the certainty of sharp price moves over shorter periods.

China as an investment destination appears to be widely loathed. Yet valuations are attractive. These two factors usually highlight an early buying opportunity. It's still on a knife edge in the short term, so invest via monthly savings for now.

Toilets and Indian Potential

Mon 24 Nov 2014
Posted by: Brian Dennehy

Last week (19 November) was World Toilet Day. You may have missed it but there are millions in India for whom sanitation is a big problem. More broadly, toilets are an interesting lens through which to consider India as an investment.

The numbers are quite telling: **636 million Indians lack a toilet**, according to census data. Modi has pledged £1bn over 5 years to deal with the problem but giving the population access to sanitation is only one item in a long list of infrastructure developments that the country urgently needs. Toilets are one measure. Access to electricity is another. In China, about 99.8% of the population have access to electricity. In India, the number is only 75.3% (The World Bank).

"...800 million voters gave the pro-business BJP party an absolute majority."

All this shows the staggering growth potential in the country.

As we said before, one of the major "brakes" holding India back has been the government. Previous governments were inefficient and corrupt, focussing on redistributing wealth rather than concentrating on sustainable job growth and productivity reforms. This is why Modi's election holds such promise. **800 million voters gave the pro-business BJP party an absolute majority and a mandate to change.**

Yes, Modi's election was a watershed moment for the country but that's only the start. Corruption doesn't disappear overnight and the infrastructure the country desperately needs will take more than one election cycle to put in place. Nevertheless, Modi's pro-growth, pro-business election platform should signal the beginning of a more open, transparent business environment in the country, which will be attractive for foreign investment.

The limited access to toilets and sanitation is one example of the challenges the country faces. It has a government willing to tackle them, so there remains immense potential for investors.

India: the star of 2014. What about 2015?

Wed 17 Dec 2014
Posted by: Brian Dennehy

Around this time last year we pondered whether India's stock market (at that time hitting highs) was running out of steam. The answer was then, and is still, no.

What has changed in 2014?

We highlighted two factors likely to benefit India in our article last year: central bank reform and the potential offered by a pro-business government, both of which have borne fruit this year.

The Jupiter India fund is up 48.47% over the year, massively outperforming the mishmash that is the Specialist sector (within which it sits). More relevant, it is also almost 20% above the MSCI India stock market index (no closet trackers here).

Election dividend

India has benefitted from the (landslide) election of a pro-business and reform minded leader in Narenda Modi (see the spike in May in Chart 1); one of the largest exercises of democracy ever witnessed. That election, coupled with a prized simple majority for Modi's BJP party, means that India now has the chance to implement much needed reforms to continue its growth.

However, given India's performance over 2014, the question we have been often asked is: can it continue?

In one respect, India is entering 2015 with the wind at its back: **oil**. The falling oil price is a great opportunity for Modi to push through reforms in 2015. Historically, India was the third biggest importer of crude in 2013, so reducing this cost will allow more government funds to be redirected to other areas of the economy that desperately need it.

Modi's reforms have been well publicised but it is worth restating that, given the windfall offered by a falling oil price, he really does have a great window to push through those promised reforms in areas of:

1. manufacturing,
2. labour market reform
3. infrastructure, and
4. devolution of fiscal power to States.

Manufacturing and labour reform are closely tied together and illustrate one area where reform will make a huge difference: **achieving scale**.

As an example, in India, over 80% of companies employ only between 1-49 employees. Whereas in China about 54% of companies employ +200 and only 23% employ 1 to 49. If labour reform is successfully implemented Indian companies will be able to achieve the scale of their Chinese counterparts. This will massively increase their competitiveness globally as well as their attractiveness to external investment. A bright prospect, then, but not one that will come over night.

There are good precedents. In Gujarat (the province that Modi used to govern), labour reforms were very advanced relative to the rest of India. Gujarat produced 22% of Indian exports with 5% of population and 6% of India's geographic area. If Modi can generate the same efficiencies throughout India then he will be able to make full use of the growing young population eager to work.

Fundamentally, India is fortunate in that it has a working age population that is growing in size (94% are aged 65 or under, and 66% are aged 15-64 with this number predicted to rise to 68% in 2026; *World Bank*). However, supply of jobs has not risen to meet this growing demand. This fact, coupled with the windfall of cheaper oil presents a great opportunity just waiting to be grasped.

Japanese largesse

It's also important to draw out the connection with Japan. These substantial Indian reforms will require a lot of external investment, and one country with massive amounts of cash is Japan. Since his time as governor of Gujarat, there has existed a good relationship between

Narenda Modi and Shinzo Abe. Indeed, Abe, reinvigorated following his recent snap election victory, is keen to foster business ties with India; he is purported to follow only three people on Twitter: a journalist, his wife and Modi.

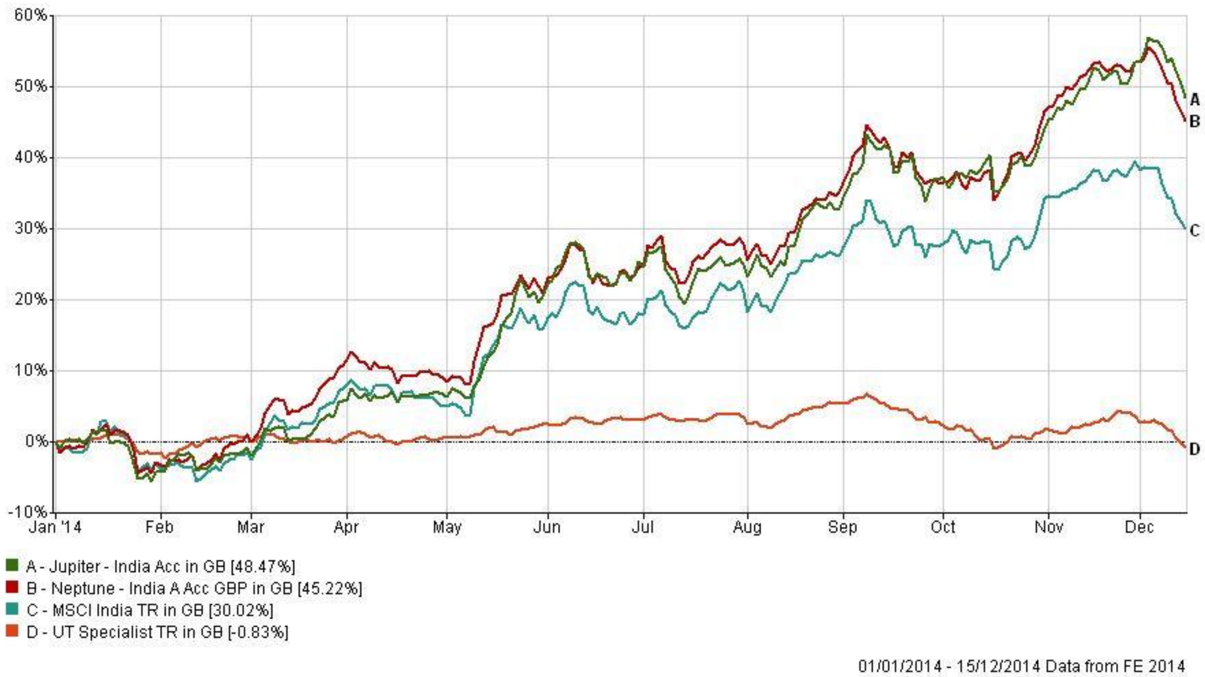
India needs foreign investment and Japan is heavily engaged in a QE initiative to try and stop deflation and kick-start their own economy; there will be a lot of yen looking for a home and some will more than likely end up in India. Modi also had a good record building ties with Japanese businesses during his time as governor of Gujarat and the Japanese corporate sector is excited about the prospects of a more open Indian economy.

Beyond the horizon

Polishing the crystal ball, if we really look into the future then it's possible that India would be 3rd largest economy by 2030 behind China (1) and US (2) (source: Neptune). The foundations for this leap could be laid in 2015.

One of the drivers behind the emerging market trade is the reform story: investors buy emerging markets on the basis that they will become more developed as economies. In that sense, India is one of the brightest lights in the sky.

Chart 1: Indian performance year to date



India: is a bounce coming?

Fri 15 May 2015
Posted by: Brian Dennehy

The Indian stock market has slipped in 2015. Is this something to worry you? Should you be getting out? Or is this the moment to invest (if you missed last year's stellar performance)? Let's take a look...

It's worth remembering that India had a fantastic 2014 - the best major stock market in the world - up around 50%. To understand why it has hit a rough patch it's worth looking at what factors drove the market higher in 2014.

The Demographic Dividend

The median age of the Indian population is a mere 26 years. Compare that to Italy (44 years) or even Britain (40 years). A relatively youthful population is absolutely essential for a country wishing to sustain high levels of growth.

Simply put, a 25 year old working Indian with young children has much greater economic potential than a 70 year old Italian pensioner.

"Simply put, a 25 year old working Indian with young children has much greater economic potential than a 70 year old Italian pensioner."

And there are a lot of them! India will overtake China as the most populous nation on earth by 2050.

Huge Headroom For Growth

Population tells part of the story but there is obvious upside potential for growth. If you take a simple measure (size of the economy (GDP) per head of population) then this becomes obvious:

- For Italy this is $30,100 per person...
- for India it is $3,900 per person.

Do you want to invest into the greying, high income, populations of the West, or the youthful potential of India?

Mandate For Reform

India had huge potential but the missing ingredient was reform. The election of a pro-business government - with a huge mandate - changed that. Now reforms are planned for:
1. manufacturing,
2. labour market
3. infrastructure, and
4. devolution of fiscal power to States.

Manufacturing and labour reform are closely tied together and illustrate one area where reform will make a huge difference: achieving scale.

As an example, in India, over 80% of companies employ only between 1-49 employees. Whereas in China about 54% of companies employ +200 and only 23% employ 1 to 49. None of these reforms will happen overnight, that is for sure. But the opportunity is huge. The projected GDP growth rate for India in 2023 is 7.9% vs China's predicted growth rate of 4.6% (*Harvard Center for International Development*).

The Oil Price Kicker

The falling oil price was a considerable benefit, as India was the fourth biggest importer of crude in 2013 behind the US, China and Japan (*U.S. Energy Information Administration*). This tailwind has lessened as the oil price has crept higher.

A Little Historic Perspective

In 1820, before the greatest impact of the Industrial Revolution led by Britain, India and China were by far the two largest economies in the world. The two combined were also larger economies than the entire Roman Empire at the birth of Christendom. In 18 out of the last 20 centuries Asia accounted for more than half of world economic output.

So you get the picture. Yet most UK-based investors behave as if it was 1820, and are extraordinarily parochial, investing largely in the UK, or into barely different developed markets nearby.

What happened in 2015?

After a rip roaring 2014, the market was a little expensive and due a breather. A healthy bull market (yes, we did used to have those) is punctuated by regular corrections and profit taking. And since late January the Indian stock market has slipped 10%, which we should cheer on two grounds:

1. It is healthy.
2. It creates another great long term buying opportunity.

We can say that the correction was triggered by a number of factors:

- bouncing oil price,
- some corporate results that weren't as exciting as the optimists hoped
- the China A-share market (proving that there's more than one game in town)...
- ...and even predictions of a below normal monsoon season.

Crucially, the slip isn't a result of missteps by the government but more a realisation that reforms will take time. Global volatility remains so we might not be at a bottom but long term investors will be buying.

China vs. India: not for the faint of heart

Thu 09 Jul 2015
Posted by: Brian Dennehy

The volatility in China's domestic share market (A-shares) has been enough to snatch some headlines from Greece over the last few weeks. India has cooled after a strong 2014. What does this mean for investors? And which funds should you consider?

The political fallout from a Grexit is enough to worry the markets but Greece is really a sideshow compared to the goings-on in China.

- In one day in June **$700 billion** was wiped of the value of Chinese stocks...
- ...that's around **3x Greece's gross domestic product** ($238 billion as of December 2014, according to *Trading Economics*).

Put it all on red

Culturally, the Chinese like their gambling. It is such a problem that President Xi declared "war" on global gaming centres in neighbouring countries seeking to attract Chinese to their casinos. In addition, as part of his anti-corruption drive he has also tightened the screws on Macau's casinos (declared the world's largest gaming centre in 2006).

The Chinese haven't needed to travel abroad to gamble! 80-90% of the trading in the A-shares market has been made up of retail investors, many with little financial education, lots of leverage and a belief that the state has their back. There are now many more retail trading accounts in the Chinese A-shares market than there are people in Brazil.

The headlines that you read - showing spectacular falls - concern the **Shanghai Composite Index**, which is made up of A-shares, which are not available to foreign investors due to Chinese government restrictions, and B-shares, which are.

Following the recent turbulence in the A-share market, over 70% of the stocks listed were suspended and the government extended its buying program to include small/medium companies and not just large blue chips. More intervention will likely follow.

But intervention in a market can have unintended consequences. The suspension of trading in some areas of the market exacerbated the sell-off in those still available to trade.

- The **A-shares** market is dominated by mainland investors and has been the most volatile (falling 32% between June and July).
- In the market used by most foreign investors (the Hong Kong **H-share** market) the volatility has been much less: down 21%.
- For comparison, **Threadneedle's China Opportunities** fund is down only 18% (see chart 1 below).

As we have said in the past, China's adjustment from an export-led to consumption-driven economy will not be without challenges, so we would expect to see weakness coming through. It's a fine balancing act but one that the Chinese certainly should be capable of managing...

Indian summer?

Following the election of Narendra Modi the India stock market blossomed in 2014 (the index went up over 30%, see chart 2 below). The reform program is still continuing but it is encountering some headwinds in the rise in the oil price and slower than expected rise in corporate earnings. We have seen the market plateau in recent months.

India is not cheap and there are challenges for Modi. Reforms required to ignite infrastructure development and simplify the tax system have met with opposition but that was always going to be the case.

Many headlines have lumped India in with the rest when they talk of an "emerging market crash" but this doesn't tell the whole story. India has held up well while the global emerging market sector has lost steam (see chart 2 below). This is what we'd expect given the strong reform agenda and the demographic potential waiting to be exploited.

The Indian stock market has held up while other emerging markets around it are losing their steam. Modi's strong mandate and the impact of reforms keep the long-term story intact.

Chart 1: The difference between the China A-share and H-share markets

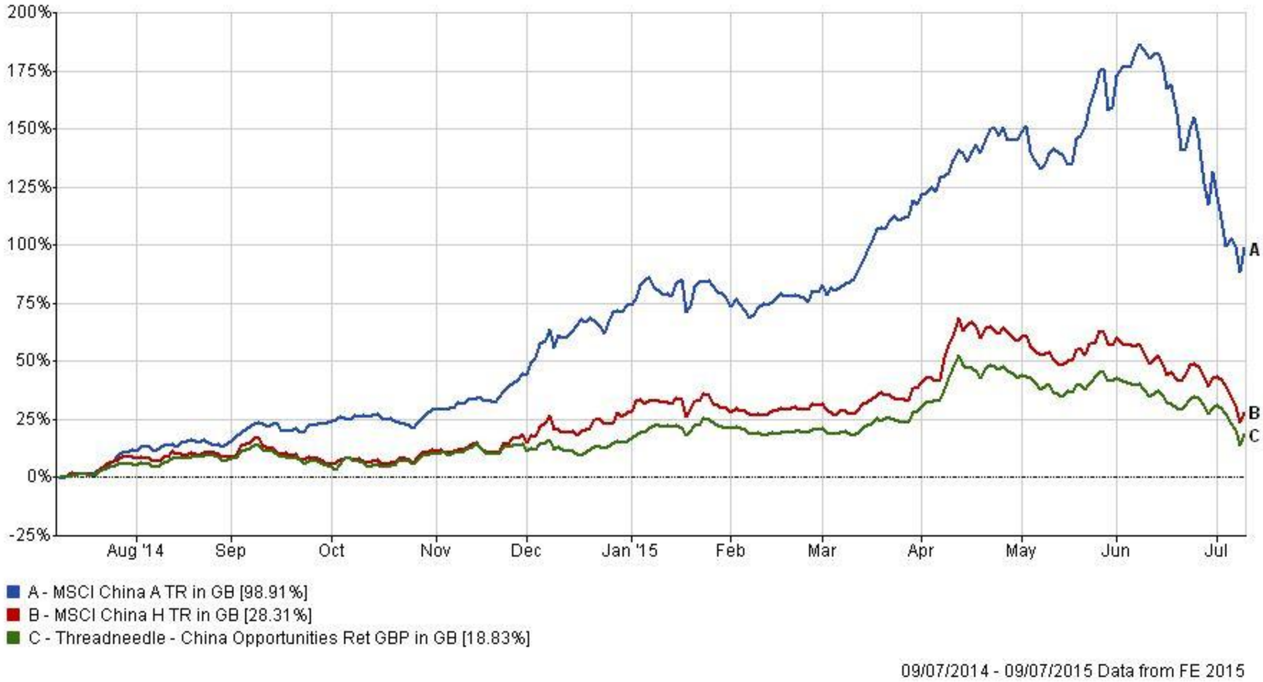
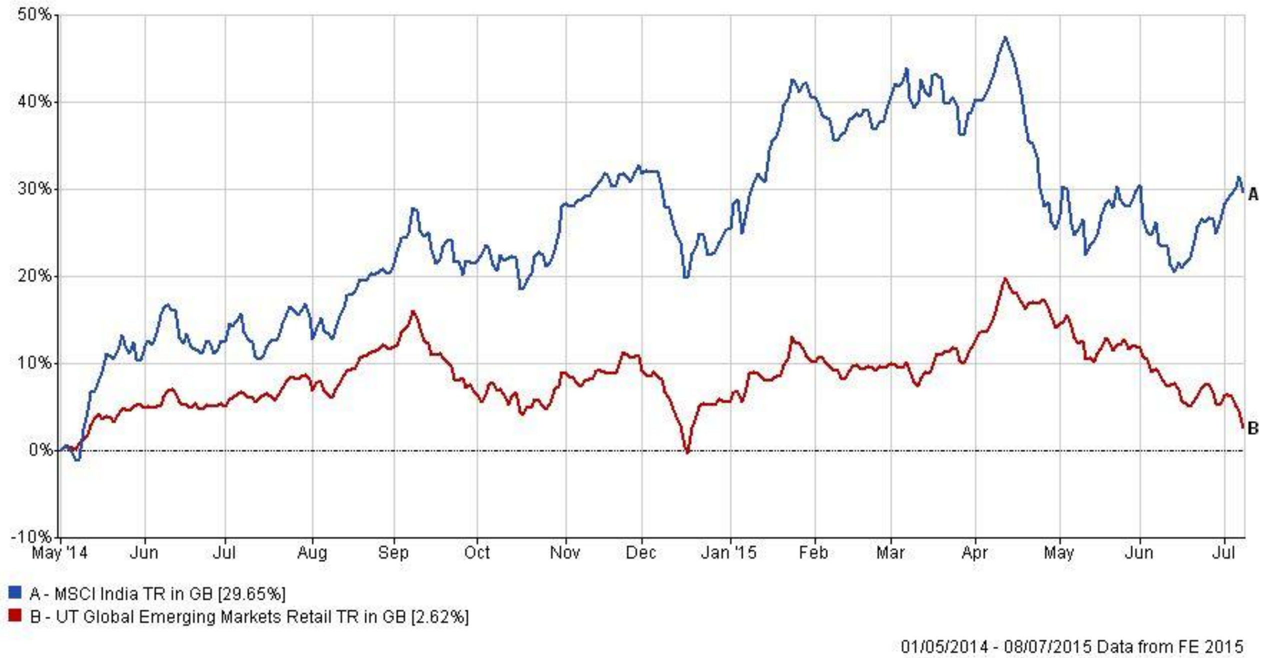


Chart 2: Indian stock market vs the Global Emerging Market Sector since 2014



India: Huge potential

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Posted by: Brian Dennehy

Narendra Modi visits the UK in November, so now is a good time to take another look at the trajectory of the Indian growth story. Why does it matter and what (if anything) should you be doing to take advantage?

Two factors drive economies - young and growing populations and rising productivity. India has both in spades. Let's take a closer look...

Demographics

India is set to be the most populous country on the planet by 2050, overtaking its neighbour China. The vital factor is the youthfulness of this population, essential for a country wishing to sustain high levels of growth.

For example, the median age of the population is a mere 26 years. This contrasts with 44 years in Italy, or 40 in the UK. Simply put, a 25 year old working Indian with young children has much greater economic potential than a 70 year old Italian pensioner.

The potential upside is also illustrated by the size of the economy (GDP) per head of population

- for Italy this is $30,100 per person
- for India it is $3,900 per person

Would you rather invest to into the greying, high income, populations of the West, or the youthful potential of India?

India is set to be the 3rd largest economy in the world by 2030, behind China and the US. The ongoing potential is highlighted by how far they are behind China in productivity terms.

Productivity

For example, in India 80% of companies employ only between 1-49 employees. Whereas in China about 54% of companies employ 200+, and only 23% employ 49 or less. The scope for India to increase its productivity is huge.

Reform is the key to unlocking this potential and Modi was elected with a strong reform mandate. There has been decent progress already, enabling productivity improvements throughout the economy but expectations of Big Bang reforms by now were far too optimistic.

The central government relies heavily on cooperation with State legislators, who are far from Modi-centric. So progress will be slow over many years, but nonetheless there should be progress driven by an electorate for whom there are already visible benefits, and demand for more change will continue.

One focus for reform is archaic labour laws. Manufacturing firms employing more than 100 people have to seek approval from the government to dismiss just one worker. And the extraordinarily complex minimum wage system has resulted in 1,171 different minimum wage rates.

But don't forget the longer term historical perspective…

In 1820, before the peak of Britain's industrial revolution, India and China were by far the two largest economies in the world. They were also larger economies than the entire Roman Empire at the birth of Christendom. In 18 out of the 20 last centuries Asia accounted for more than half of world economic output.

But most UK based investors are behaving as if it is 1820, being extraordinarily parochial, investing largely into the UK or nearby developed markets.

India is already the fastest growing major nation, despite terrible infrastructure and stifling bureaucracy.

The upside is substantial and will last for decades.

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