September 2024

Power Play Performance from India

In cricket, a power play refers to the restriction of the number of fielders outside the 30-yard circle of the pitch. Within the first ten overs of a 50-over cricket match, only two fielders are allowed outside the 30-yard area. This allows the batters to be more aggressive and hit more fours and sixes with less chance of being caught out.

Similarly, the Indian stock market has recently entered a power play of its own, returning an impressive 39.7% over the past year. This surge can be likened to the early overs of a match, where optimism and aggression dominate the playing field. Investors are eager to capitalise on the momentum, much like batters seeking to exploit the gaps in the field.

However, just as in cricket, where the initial excitement can lead to reckless shots and subsequent wickets, the current bullish sentiment in the Indian market calls for caution. While the recent performance has been remarkable, it is essential to consider the potential pitfalls.

The MSCI India Index[1] (India Index) has outperformed the MSCI All Country World Index[2] (World Index) and MSCI Emerging Markets Index[3] (Emerging Market Index) over most periods over the last 20 years as shown in the table below.

Total Return Comparison (USD)

Total Return (annualised p.a.)	1 year	3 year	5 year	10 year	20 year
MSCI India	39.7%	11.1%	16.7%	9.6%	12.3%
MSCI ACWI	22.6%	5.2%	12.1%	8.8%	8.3%
MSCI Emerging Markets	15.1%	-3.1%	4.8%	2.6%	7.2%

Source: MSCI Factsheets, 30 August 2024

These returns have been driven by India making good policy choices, highlighted below, which have improved the business environment and resulted in strong GDP and earnings growth.

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Key Ingredients for Investor Confidence

- **Strong democratic systems**
  - India's elections have been considered "free and fair"
- **Reducing barriers to doing business**
  - Ease of business ranking has improved from 142 in 2014 to 63 in 2024[4]
- **Clear rules and regulations**
  - Simplification of business and tax regulations
- **Good growth prospects**[5]
  - India has strong economic growth prospects and is forecast to be the 2nd largest economy by 2075
  - India has a growing population and is now the country with the most people at 1.45 billion, with an increase in people entering the workforce
  - Income per person is expected to grow by 8% per year until 2028
  - The poverty rate has improved from 55.3% in 2005 to 11.3% in 2023
- **Encouraging investment**[6]
  - Restrictions on foreign ownership of Indian stocks were lifted in 2021
  - 17% of Indian households have stock market investments which should increase as the middle class grows

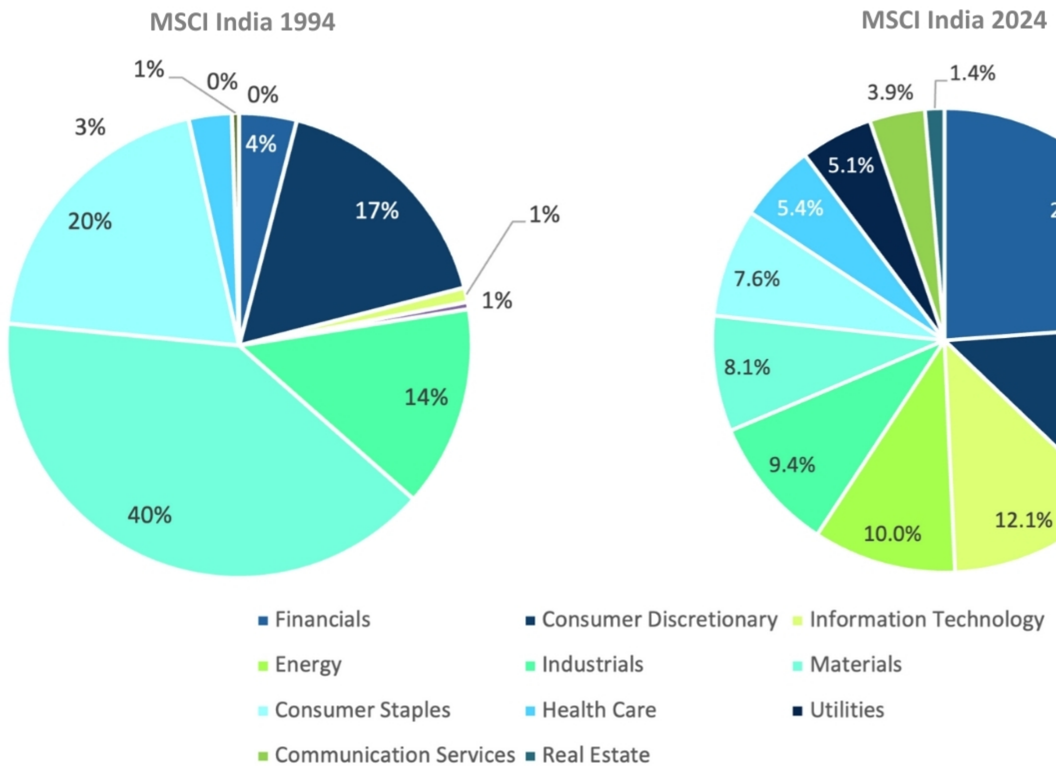
The MSCI India Index has attracted attention as a potential investment. Let's examine its characteristics and assess its suitability.

Overview of India's Stock Market

Index Characteristics Comparison	India	ACWI	EM
Number of companies	146	2,757	1,328
Market capitalisation (billion $'s)	1,522	76,671	7,648
Largest company market capitalisation	110	3,359	727
Top 10 index weight	34.8%	21.0%	25.7%
P/E[7]	27.8	21.4	15.7
P/E forward[8]	24.2	17.7	11.8
Dividend yield[9]	1.0%	1.9%	2.7%

Although India has delivered great performance, the table above shows that the market is narrow, with only 146 companies. The problem was even more acute several years ago, as the number of companies in the index was only 51 in 2004 and 64 in 2014. This paired with high index concentration with a Top 10 weight of 34.8% means that you are not accessing the traditional diversification benefit that is normally associated with passive index investing.

MSCI India Sector Weight 1994 vs 2024



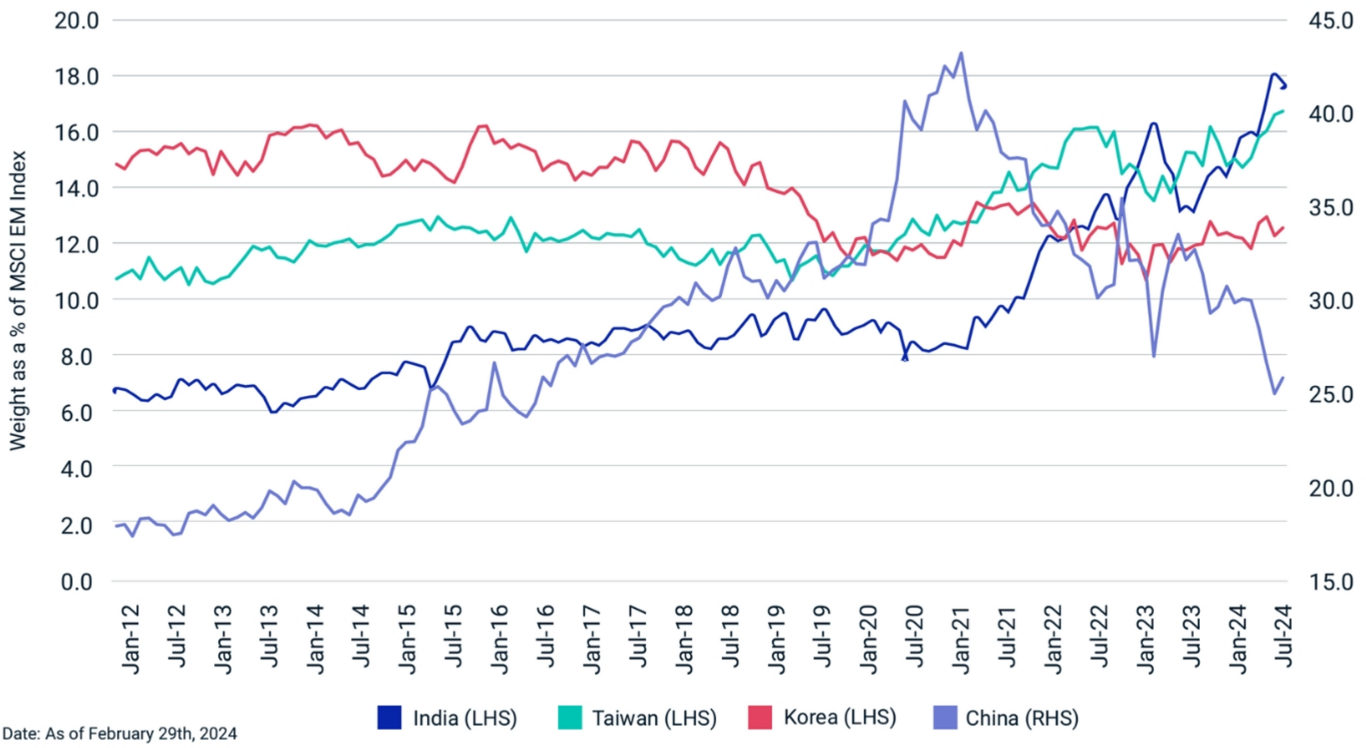
Source: MSCI ESG Research - India: An emerging world market story, as of 29 February 2024

India's sector composition has changed to reflect the changes in the underlying economy. While in the 1990s it was heavily tilted towards manufacturing and industrial activity, we've seen an increase in services-linked sectors, such as Financials and IT. Thus, for a long time, index exposure was not viable and passive index investing would have resulted in risky sector concentration.

The India Index has low exposure to IT shares at 12.1% compared to 24% for the World Index and Emerging Market Index, while it has higher exposure to Energy at 10% and Materials at 8%, compared to the 4% exposure that the World Index has to these sectors. Energy and Materials are highly cyclical industries that supply commodity products and do not control the price of the products they supply. The greater exposure to these sectors indicates that the India Index is of lower quality than the World and Emerging Market Index.

The chart below shows how the good stock market performance from India has led to India's weight in the Emerging Market Index growing from 7% to 18% since 2012. Thus, India has only recently become a bigger driver of Emerging Market returns, while its weight in the World Index has grown from 0.6% in 1993 to 2% in 2024. Although of increasing importance, India is still a minor contributor to World Index returns. As an illustration of this point, at a 2% weight, the return of 39.7% for India only contributed 0.8% to the World Index return of 22.6%.

MSCI Emerging Market Index – Top Markets by Market Capitalisation (%)



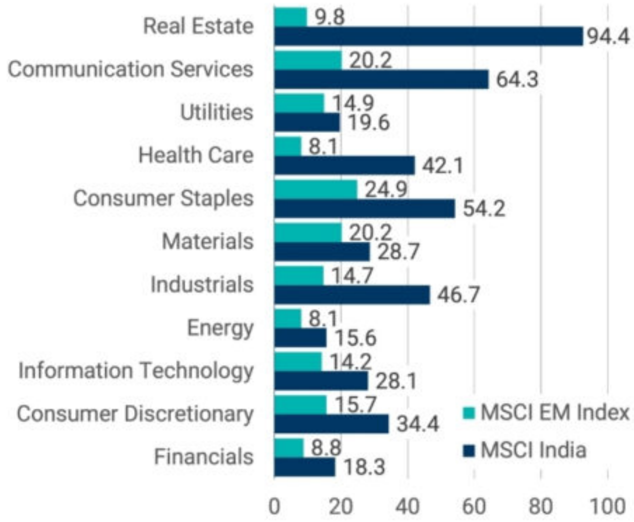
Source: MSCI ESG Research - India: An emerging world market story

Valuation of India and Implications for Future Returns

Although the India Index has delivered good returns, the valuation is elevated with a P/E ratio of 27.8 which is much higher than the World Index at 21.4 and the Emerging Market Index at 15.7. This translates into a lower dividend yield (DY) of 1%, compared to 1.9% for the World Index and 2.7% for the Emerging Market Index. The implied earnings growth from the P/E forward is 12.9% for India, compared to 17.3% for the World Index and 24.8% for the Emerging Market Index. This indicates that India is offering less growth and dividends for a higher price, which is not a good investment proposition.

When we look at the India Index valuations by sector compared to the Emerging Market Index, we find that the valuation exuberance is across the whole Indian market with all sectors trading at high PE multiples which all exceed the PE multiples of the comparable Emerging Market sector.

Sector PE Valuation of India vs Emerging Market



Source: FactSet, MSCI as of June 2024 (Lazard Asset Management presentation, September 2024)

We have seen this high-valuation movie before when Chinese investments were all the rage and trading at high valuations in 2015 and again in 2021, as shown in the chart below. The subsequent results have been poor, with Chinese investments well below their peak, indicating that caution is warranted when an investment has done very well and is in high demand.

Chinese Stock Market Performance and PE Valuation

Source: Refinitiv

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The index concentration, lower quality and high valuation indicate that a passive index investment in India is not necessarily the best investment option. We prefer to allocate capital to fund managers who conduct bottom-up analysis to find the best opportunities globally. Their efforts have resulted in the following exposure to Indian investments on a look-through basis.

Client Exposure to Indian Investments

Our Global Equity model portfolio has approximately 1.5% invested in India with the following shares being some of the bigger positions:

- **HDFC Bank** is a leading Indian mortgage finance business. Mortgage penetration is less than 10% of GDP, which is low relative to developed countries and other emerging markets. Rising urbanisation, growing incomes and favourable demographics should drive growth in this industry.
- **Axis Bank** is the 3rd largest privately owned bank and has the leading market share in payment devices and digital banking.
- **Titan** is India's largest speciality jewellery retailer. The company sells jewellery, watches, and eyewear at branded stores catering to high-end and mass markets. This massive market has historically been dominated by informal retailers, who still hold a 90% market share. Titan is expected to gain market share from these weaker players as customers increasingly appreciate the premium service and quality offered by Titan.

These investments have been identified by our highly-rated active fund managers and represent some of the best businesses in India, trading at prices that do not fully reflect their underlying value, thus creating an attractive investment opportunity. The lower exposure to India in the model portfolio is sensible, given that the overall market is expensive. However, within this expensive market, there is still potential for bottom-up stock picking.

Active Fund Managers Can Add Value in Narrow Markets

We are often asked why we don't make regional allocations in emerging markets. When China was outperforming, there was little focus on India. Passive regional investment options have their limitations and expose clients to unseen risks. We believe it is best to use well-rated funds from leading managers who can select the best investment opportunities from around the globe.

In conclusion, the cricket analogy still holds. As batters assess the field and adjust their strategy during a power play, investors must be strategic and discerning. Active managers who focus on quality investments at appropriate valuations allow them to navigate risks while seizing opportunities. This balanced approach will help investors thrive in the evolving landscape of Indian stocks, like a skilled cricketer steering their team through the innings.

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[1] The MSCI India Index is designed to measure the performance of the large and mid-cap segments of the Indian market
[2] The MSCI ACWI captures large and mid-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets countries
[3] The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries.
[4] https://tradingeconomics.com/india/ease-of-doing-business
[5] https://www.goldmansachs.com/insights/articles/how-india-could-rise-to-the-worlds-second-biggest-economy
[6] https://www.msci.com/documents/1296102/38312924/Country+Spotlights+-+India.pdf
[7] P/E ratio: This is a valuation measure which reflects the current share price divided by the earnings and indicates how many years of current earnings one is paying for a business
[8] P/E forward: This is similar to the P/E ratio but uses the 1-year forward projected earnings as a valuation measurement
[9] Dividend yield: This is a reflection of how much dividend income an investor could receive when investing in a share reflected in % terms to facilitate comparison with other investments which provide income

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MARKET REPORT

30 09 2024

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
SA Equity	ZAR	9.4%	15.3%	23.0%	14.0%	12.8%	8.5%	16.8%	14.3%
SA Listed Property	ZAR	18.4%	29.4%	50.3%	15.3%	4.9%	3.8%	27.3%	21.5%
SA Bonds	ZAR	10.4%	16.2%	25.5%	10.6%	9.2%	8.4%	8.9%	8.3%
SA Cash	ZAR	2.1%	6.4%	8.6%	6.9%	6.1%	6.6%	0.5%	0.4%
Balanced Benchmark	ZAR	7.6%	13.5%	21.8%	12.4%	11.4%	9.1%	11.7%	9.8%
SA Inflation (1 month lag)	ZAR	0.6%	2.9%	4.4%	5.6%	5.0%	4.9%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity	USD	6.4%	18.6%	32.5%	9.2%	13.2%	10.2%	17.7%	15.0%
Emerging Markets Equity	USD	8.9%	16.6%	26.9%	0.2%	5.3%	3.8%	18.6%	17.3%
Global Property	USD	16.0%	10.7%	28.8%	0.3%	1.4%	4.0%	21.1%	16.9%
Global Bonds	USD	6.9%	3.5%	11.9%	-3.1%	-0.9%	0.5%	7.7%	6.3%
US Cash	USD	1.3%	4.1%	5.5%	3.6%	2.4%	1.7%	0.7%	0.5%
MAJOR INDICES BASED TO RANDS									
SA Equity	ZAR	9.4%	15.3%	23.0%	14.0%	12.8%	8.5%	16.8%	14.3%
Global Equity	ZAR	0.4%	10.7%	21.2%	14.3%	16.1%	15.0%	15.9%	15.8%
Emerging Markets Equity	ZAR	2.0%	9.1%	13.9%	4.6%	7.9%	8.2%	14.0%	13.7%
Global Property	ZAR	9.5%	3.3%	17.8%	5.0%	4.0%	8.5%	18.6%	17.3%
SA Bonds	ZAR	10.4%	16.2%	25.5%	10.6%	9.2%	8.4%	8.9%	8.3%
Global Bonds	ZAR	0.9%	-2.5%	2.4%	1.4%	1.7%	4.8%	12.8%	13.8%
COMMODITIES									
Gold (US Dollars)	USD	12.8%	27.4%	40.4%	14.6%	11.9%	7.8%	14.2%	13.6%
Gold (Rands)	ZAR	6.4%	20.1%	28.5%	19.9%	14.8%	12.5%	16.9%	16.9%
CURRENCIES									
Rand / Dollar	ZAR	5.4%	5.9%	9.0%	-4.4%	-2.6%	-4.3%	14.0%	14.7%
Rand / GBP Pound	ZAR	-0.2%	0.9%	0.0%	-4.3%	-4.4%	-2.3%	12.0%	14.2%
Rand / Euro	ZAR	1.5%	4.9%	4.1%	-3.2%	-3.0%	-3.0%	11.6%	13.1%

KEY

Asset Class	Represented By:
SA Bonds	Satrix Bond Index Tracker
SA Cash	STeFi
SA Equity	Satrix ALSI Index Tracker
SA Listed Property	Satrix Property Index Tracker
Emerging Markets Equity	iShares Emerging Markets Equity Index Tracker
US Cash	Fidelity Institutional Liquidity The United States Dollar
Global Bonds	iShares Core Global Aggregate Bond ETF
Global Equity	iShares Developed World Index Tracker
Global Property	iShares Developed Real Estate Index Tracker

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Spot Rates		30-Sep-24	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	17.2	18.3	18.8	15.2	11.3	6.5
Rand/GBP	Rand	23.1	23.1	23.0	18.7	18.3	11.7
Rand/EUR	Rand	19.2	19.6	19.9	16.5	14.3	8.0
RATES							
SOFR 6m $	US$	4.7	5.7	5.9	2.1	0.3	2.2
Repo Rate	Rand	8.00	8.25	8.25	6.50	5.75	7.50
Prime	Rand	11.50	11.75	11.75	10.00	9.25	11.50
All Bond Index Yield	Rand	9.5	10.3	11.6	9.5	8.5	9.7
COMMODITIES							
Gold ($/oz)	US$	2,634.0	2,326.3	1,856.8	1,473.9	1,212.8	418.0
Platinum	US$	985.0	1,012.0	923.0	900.0	1,300.0	854.0
Oil (Brent Crude) $	US$	72.0	86.4	95.4	60.9	95.5	47.5
INFLATION							
SA Inflation	%	4.4	5.2	5.4	4.1	6.1	9.4

data provided by FE Analytics