The India Market Opportunity
Why India and Why Now

Introduction

India is the second most populous nation on earth with some 1.39 billion people and is the world's most populous democracy. According to the World Bank, India's pre-pandemic 10-year average GDP growth rate was 6.6% with per capita income growth averaging 6.89%. India's economic engine is in part fueled by capital creation derived from a robust stock market with over 5,000 listed companies reflecting the scale and diversity that accompanies such a large nation on the march to economic prosperity (the US equities market has ~4,200 listed companies). India's status as a premier emerging market is reflected in its recently boosted ~11% allocation in the MSCI emerging market index. Goldman Sachs recently issued a report forecasting that "India's market cap could increase from US$3.5tn currently to over US$5tn by 2024, making it the 5th largest market by capitalization. India's share of the global market cap and index weighting should also rise." India's market is also one of the "oldest" in the Asia region with it's average listing age more than double that of China's public companies (20 years vs. 9 years). Given the increasingly restrictive regulatory environment in China, it is likely that India may play an even larger role in the global emerging market segment in the coming years. Aiding India's rise is an aggressive vaccination strategy that foresees all eligible citizens fully inoculated by the end of the year. India's secular growth story is a compelling one. For investors the idiosyncratic behavior that the Indian stock market tends to exhibit versus global developed market indices enhances its appeal and place in a diversified global portfolio. This holds true for quantitative India based market neutral strategies as well, as they tend to have low correlation to their global systematic peers.

Ingredients for an accelerated and prolonged economic recovery are in place

As cited earlier, the Indian economy is one of the fastest growing large economies in the world with a 10-year pre-pandemic average annual GDP growth rate of 6.6%. As witnessed in the developed world, the impact of vaccines and the re-opening of economies has led to a period of rapid economic expansion for these nations, often doubling or tripling their "normal" annual GDP growth rates. It is our view that similar growth rate multiples will be seen in emerging markets as they too rise from the depths of the pandemic's effects. India's Nifty Fifty stock index has already risen over ~100% from its March 2020 lows and gains in mid and small-cap stocks have outperformed on the BSE with a rise of ~130% and ~180% respectively over that same period.

The covid-19 vaccination rollout in India is picking up pace, with more than 600 million doses already administered. The government aims to vaccinate all Indians by the end of this year. India took 19 days to administer the last 100 million doses, compared to 85 days to give the first 100 million jabs. About 14.5% of eligible adults have been fully vaccinated and 49% have received at least one shot since the beginning of the drive in January 2021.[1]

As the lockdowns ease and vaccination rates rise economic activity resumes and the adverse impact created by the COVID 19 pandemic is waning. India's merchandise trade has shown strong resilience to the second wave. Exports rose in June 2021 by 48.3% to $ 32.5bn compared to June 2020. These are also the second highest monthly exports recorded by the country so far. Exports of petroleum, oil and lubricants in June 2021 more than doubled from their year-ago level. Developed economies are fast recovering from the shock of the covid-19 pandemic helping Indian manufacturers grow their exports.[2]

Some examples of India's recovering industrial growth rates include transportation activity improving with Indian railways reporting an increase in freight traffic to 114.9mn tons in May 2021 from 111.7mn tons in April 2021. Energy demand is also on the rise with consumption of petroleum products growing sequentially by 8% to 16.3mn tons in June 2021, after shrinking to a nine-month low of 15.1mn tons in May 2021.[2]

In addition to a post-pandemic organic recovery fueling India's economic rise, our view that India has the potential to return rapidly to pre-pandemic growth rates and sustain such levels for years to come is re-enforced by several factors including: the demographic dividend of the Indian population with an expanding middle class and a large number of people under the age of 35 fueling consumption, favorable economic policies being pursued by the Government of India with a focus on growth and development, and an increasing interest among the population for pursuing entrepreneurial ventures.

India's expanding digital economy adds fuel to its growth engine

Technology adoption is fast rising in India. Still, the country is one of the largest untapped markets in the world with regards to digital adoption. The push for a digital economy should create a substantial rise in demand for goods and services, which should in turn create a highly consumer-oriented economy. India, already one of the fastest growing large economies in the world, should see its GDP further benefit from an expanding digital economy increasing consumer access to goods and services, which is leading to increased productivity, lower prices and increased consumption. Significant technology driven consumption in the economy is leading to higher job creation, wherein such jobs are typically higher paying. The digital economy's rise has the potential over time to meaningfully accelerate India's per capita income growth rate.

Indian technology firms have seen large investment flow in from large US corporations, indicating the growing footprint of India as a technology hub. A case in point is the recent $16bn acquisition of Flipkart (a large India e-commerce firm) by Walmart.

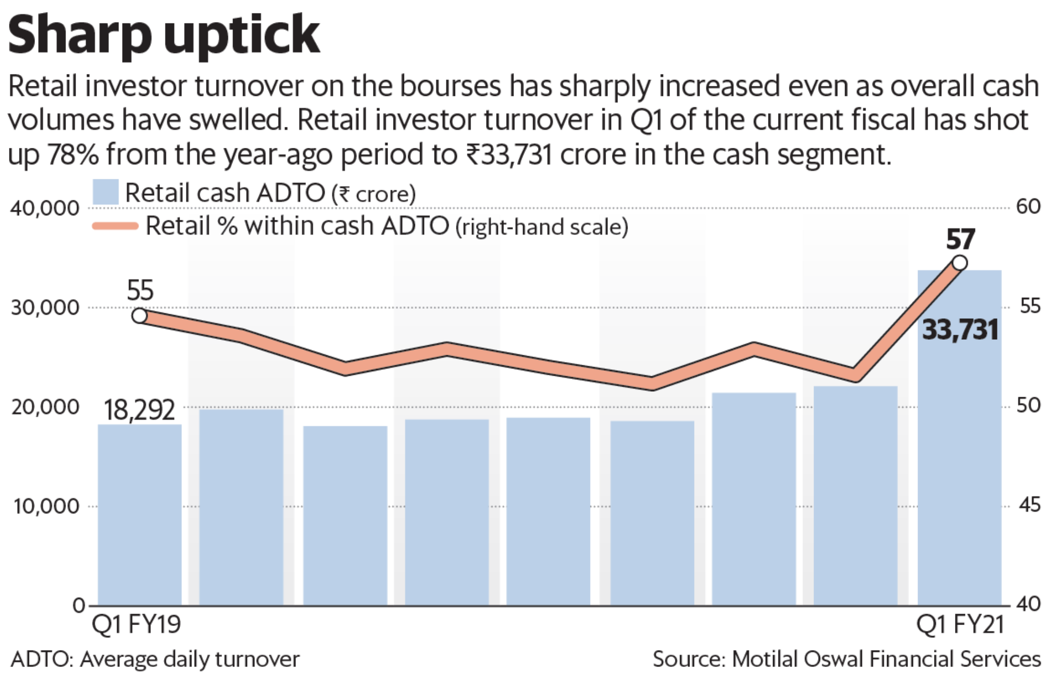
Increasing retail participation in the markets can drive prices higher

As the recovery accelerates and the population emerges from COVID 19's grip the rate of economic activity should result in higher spending power in the hands of more consumers, which in turn should drive revenue and earnings growth for Indian corporations.

Historically, retail participation in the Indian stock markets has been quite low compared to the developed world. With an expanding economy, increasing incomes, easy access to capital and credit, and a more tech-savvy society, increased participation by the retail investor in the Indian financial markets has the potential to rapidly expand in the near future.

This expansion is already underway as reported by SBI in a report that points out that 4.47 million retail investor accounts have been added during the first two months of this fiscal year and that the number of individual investors in the market increased by 14.2 million in FY21, with 12.25 million new accounts at CDSL and 1.97 million in NSDL, the report said. Also, the share of individual investors as a percent of total turnover on the stock exchange has risen to 45% from 39% in Mar'20, as shown by National Stock Exchange of India data (NSE).

Increased participation by the retail investors in the stock market and hence increased volumes and demand on the exchanges combined with corporate earnings growth, represents a pathway that is likely to lead to capital appreciation and higher returns for the investors in the long term



India’s rising weight in the MSCI emerging markets index

India is a major constituent of the MSCI emerging markets index, with MSCI India’s weighting in the MSCI emerging markets index currently around 11.66% (August’21). This weighting recently got a boost, with MSCI increasing the foreign inclusion factor (FIF) for several Indian stocks. This decision followed the Indian government’s decision to automatically treat the sectoral limit as the foreign portfolio investor (FPI) limit, hence freeing up investment limits for overseas investors. It is estimated that MSCI’s decision resulted in approximately $3bn of flows into the country. The MSCI EM index is estimated to be tracked by funds with assets under management of $1.8 trillion.[3] Global institutional allocators may want to reassess their India allocation within their emerging markets portfolio to see if it is in line with that of MSCI’s newly boosted weighting.

India Foreign Portfolio Investor (FPI) Flow growth

There has been a relentless inflow since February-May 2020. Inflows reached $36.8 billion in FY2021 — only second to the $42.2 billion in FY2015. For the quarter ended March 2021, foreign institutional investment (FII) holding in Nifty stocks stood at an all-time high of 28.9%, and the FII portfolio holding in BSE-500 was valued at about $600 billion, or about 46% of the total float.[4]

Staying Invested

Foreign Inflows into EM Equities

Country	Inflows ($ bn)	1-Year Index Return (%)
India	23.7	17.27
Vietnam	-0.9	29.63
Philippines	-2.5	-6.26
Indonesia	-3.2	-0.27
Turkey	-4.4	29.83
Malaysia	-6.1	2.62
Brazil	-6.6	8.29
South Africa	-7.4	10.50
Thailand	-8.2	-2.80
Taiwan	-12.9	28.60
South Korea	-21.2	42.87

SOURCE: Bloomberg

As depicted in the above graphic, India is the only country in the emerging market universe that got net inflows from foreign investors into the stock market for CY2020.[5]

Positive regulatory environment changes favoring foreign investment

Average yearly Foreign Direct Investment (FDI) inflows were at $63bn from 2014-2021, compared to average annual inflow of $30bn during 2004-2014. In absolute terms, FDI into India increased from $97 million in 1990-91 to more than $81.7 billion in 2020-21, according to data with the Reserve Bank of India.

While opening different sectors to foreign direct investment has been a gradual process spanning many governments, the FDI reforms initiated as a part of the 1991 reforms played a major role in cementing the government's intent in encouraging foreign investment. The government has further liberalized its investment policy in various sectors under its Self-Reliant India Movement, with an objective of boosting foreign investments in India.

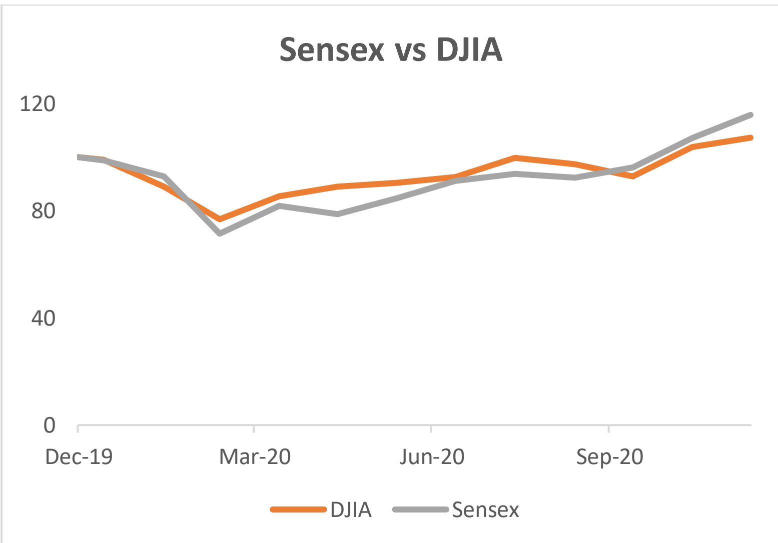
Technology transfers to Indian joint ventures (JVs) from the foreign parent firm have been made easier by removing many mandatory approval requirements. Reduction of controls on technology and royalty payments have also been announced to attract FDI.

India - top derivatives market in the world

India's burgeoning economy and robust stock market have helped create a large, diverse futures and derivatives market. Based on a recent FIA study, the Indian futures/derivatives market is in fact the most liquid in the world (https://www.fia.org/media/2407). In 2019, volumes on the National Stock Exchange of India (NSE) overtook those of the CME in the derivatives segment. The following numbers should provide some context around the scale and growth of India derivatives market; the number of derivatives contracts traded on the NSE for 2002-2003 was ~17million, which increased to 1billion in 2010-11, and is at 8.5billion for 2020-2021. The turnover was $58billion in 2002-03, $3.9 trillion in 2010-11, and increased to $86 trillion in 2020-21. NSE witnessed a 48% increase in number of F&O contracts traded in 2020, compared to 2019. For CME, the % change was – 0.20%. Source: NSE website.

Comparative performance with the US market

A simple comparison of the BSE Sensex and the Dow Jones index shows that since the onset of the covid-19 pandemic, the Indian equity market has outperformed the US equity market despite the excess liquidity provided to the US markets by the Federal stimulus program including unemployment check, federal market operations and increased money supply. While the DJIA returned 7.25% in 2020, Sensex returned 15.75% for the year. The correlation of the SENSEX index to the DJIA from 2010 through 2019 was 0.36 (source Bloomberg Capitaline). India's SENSEX constituents annualized corporate profit growth rates for the last 5 years were double that of the DJIA components (source: Bloomberg Capitaline)



Negative investment environment in China (the other significant investment alternative to India)

With Covid-19 infecting millions across the world, China is facing an unprecedented global backlash that could destabilize its reign as the world's factory of choice. China's weakening global position could prove a blessing in disguise for India to attract more investment. The northern state of Uttar Pradesh, which has a population the size of Brazil, is already forming an economic task force to attract firms keen to exit China. India is also readying a pool of land twice the size of Luxembourg to accommodate companies that want to move manufacturing out of China, and has reached out to 1,000 American multinationals, Bloomberg reported. The US-India Business Council (USIBC), a powerful lobby group that works to enhance investment flows between India and the US, also said that India has significantly stepped up its pitch.[6]

As governments in Europe, North America, and elsewhere try to support businesses reeling under financial pressure, they have also become more worried about China given their over-reliance on Chinese supply chains and growing geopolitical friction between China and the US. This adds to long standing concerns surrounding Beijing’s trade practices, intellectual property protections and now a rise in regulatory burdens further hampering access to Chinese markets. Japan, for example, recently announced a $2 billion subsidy program to get Japanese companies to relocate production from China to Japan.[7]

Historical impediments to India’s growth fade, opening the door for rapid expansion

Historically, two main factors have impeded economic growth in India: slow political decision making and lack of appropriate infrastructure. These factors are slowly becoming things of the past.

India seems to be on the way to moving past the era of coalition governments. The last two national elections resulted in a thumping majority for a single party. This will help speed up decision making processes.

On the infrastructure front, the government has made a big push in the recent budget to improve the nations infrastructure across all fronts. The governments infrastructure initiatives are designed to take advantage of the so-called multiplier effect where increased spending results in an economic impact that is a multiple of the money spent. This multiple would be seen in increased employment, an expansion of the workforce leading to a boost in consumption and revenues and profits for Indian companies as well as those who export into the Indian market.

The National Infrastructure pipeline (NIP) has been expanded from 6,835 projects in December 2019 to 7,400 in 2021, with projects worth approximately $15bn already completed. With an aim to be completed by 2025, the program requires a joint effort from the government and the financial sector. To aid this, the government has set up a Development Financial Institution (DFI) known as the National Bank for

Financing Infrastructure and Development. The DFI, with a capital base of $2.6bn and a lending target of $66bn in three years, will augment funding for real estate and infrastructure sectors.[8]
Recently, the Indian government undertook the single most important tax reform in the country's history, by implementing the Goods and Services Tax (GST). GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. It is an attempt to make India one unified common market, reduce the administrative complications, and simplify the indirect tax system. The introduction of GST is a significant step towards reforming the indirect taxation process in India.

The GST has multiple benefits for businesses, consumers, and the economy. For businesses, there will now be ease of doing business due to standardization. Multiple taxes being charged at multiple points, and all other allied factors have made it very difficult for businesses to operate in India. One of the core benefits of GST is that it is standard throughout the country and will simplify indirect taxes. GST is expected to come as a huge relief, making it easy to perform trade and conduct business irrespective of national geography.

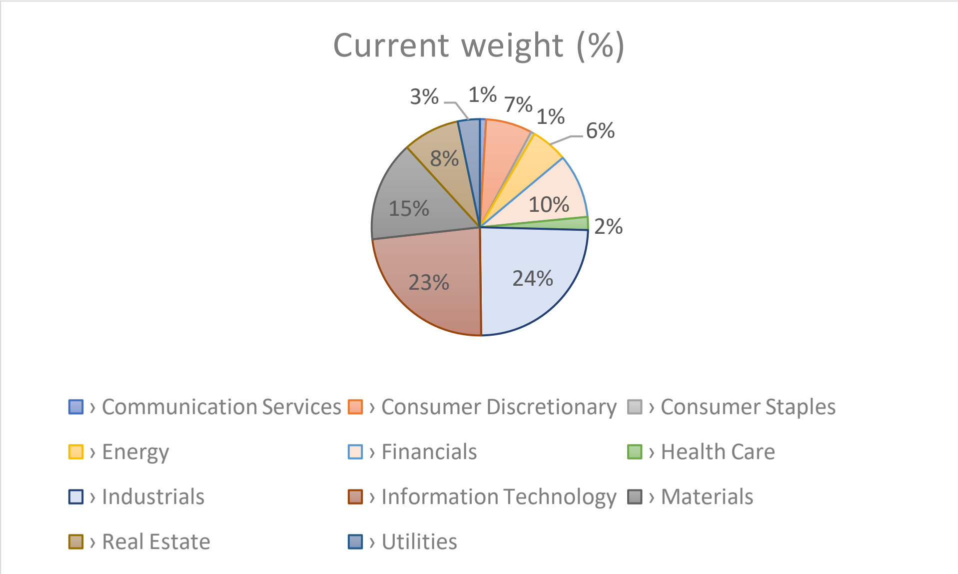
There will also be huge benefits for the economy as a whole. Introduction of GST will help reduce tax rates, remove multiple point taxation, and increase revenues. Basically, a uniform tax system will make India a common market, and will boost trade, commerce, and export. Together, these will help accelerate economic growth and boost the GDP of the country. Several experts are anticipating this growth to be somewhere around 1-2% and expecting GST to bring down inflation by roughly 2% as well.[9]

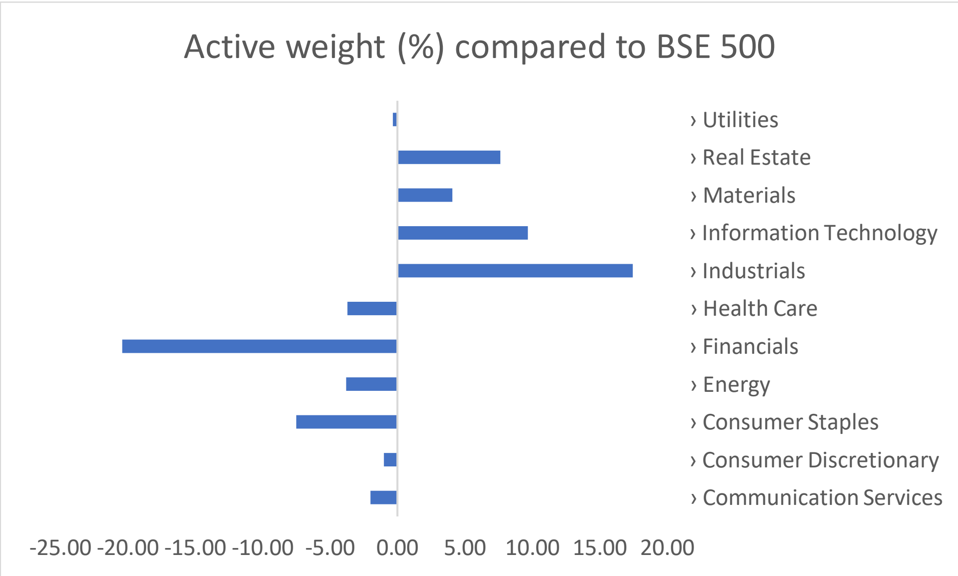
The Indian government has also worked towards introducing significant agricultural reforms. There is now increasing participation of the private sector in the farm sector, and that is expected to increase productivity and employment opportunities. The government is setting up 10,000 farmer producer organizations (FPO) and will spend ~ $1bn on them. The government has implemented the agriculture infrastructure scheme and till now, proposals worth $1.3bn from states have been received and about Rs $667bn worth of proposals have been by accepted and work is in progress on them.[10]

Which sectors to look at?

Over the past 12 months, our quant long only research program reflects healthcare, materials, consumer discretionary, information technology and industrials and utilities as the top overweight sectors, compared to the benchmark. The program continues to be bullish on industrials, IT, and materials. We have also increased our allocation to real estate, based on our multi factor model.

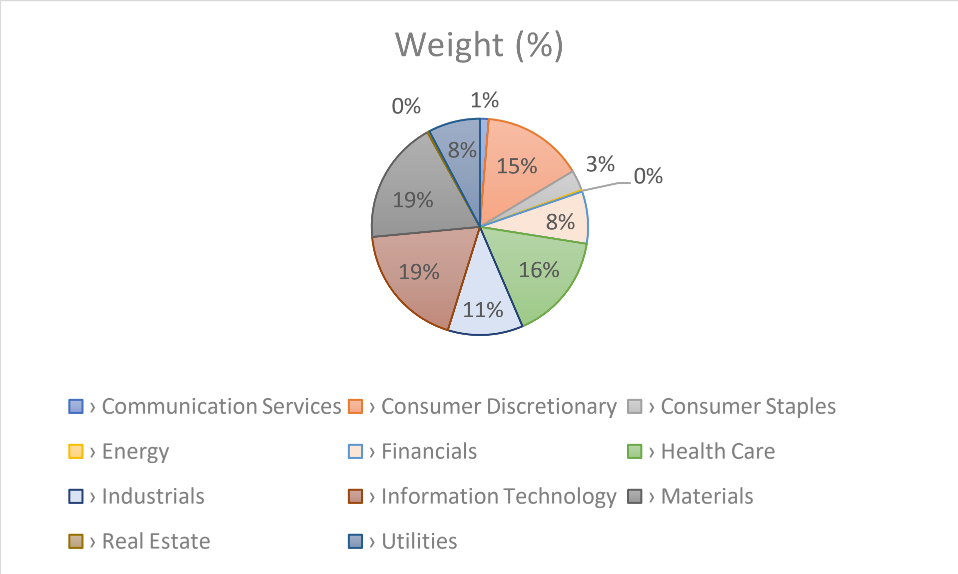
Current sectoral allocation

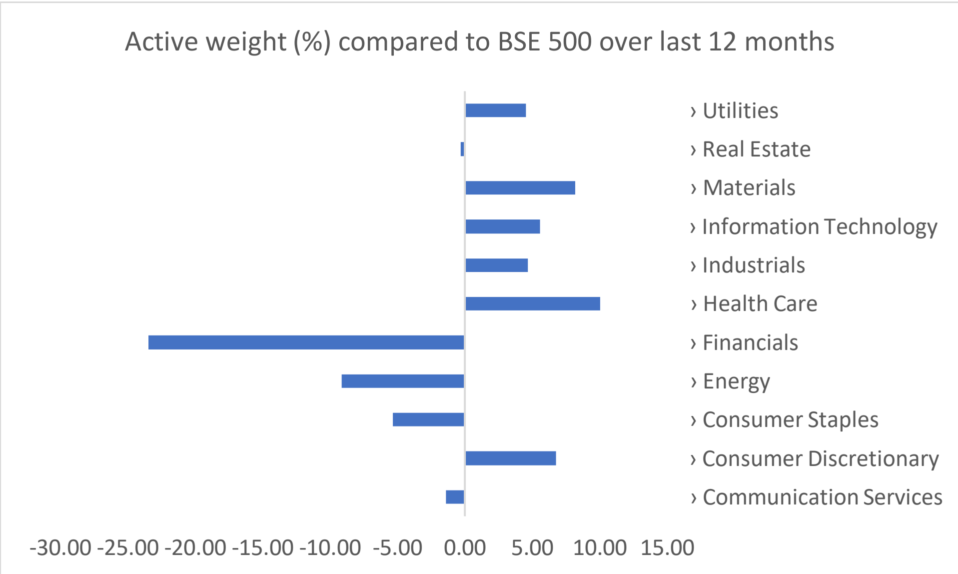




As can be visualized from above, our quant long only research program reflects industrials as our top overweight sector while financials is topmost underweighted sector in our portfolio, when compared to a universe of BSE 500.

Last 12 Month sectoral allocation



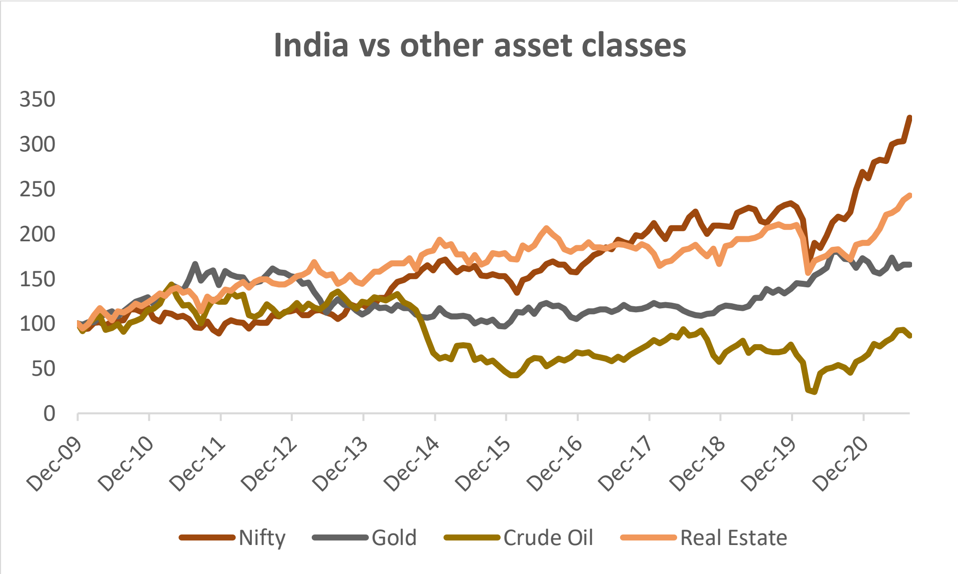


Our quant long only research program continues to be bullish on industrials, materials, and IT. Additionally, we have recently increased our allocation to real estate.

Note that the quant long only research program rebalances the portfolio regularly as the underlying technical and fundamental formulations vary dynamically.

Comparison with other investment options for investors

A comparison with other asset classes shows how the Indian stock market has shown outperformance over the last decade, with Nifty returns beating returns from traditional asset classes such as Gold and Real Estate.



Gold: Gold Spot US Dollar (XAU/USD)
Crude Oil: Crude Oil WTI Futures
Real Estate: Vanguard Real Estate Index Fund ETF (VNQ)

Conclusion

The opportunity in the Indian market is substantial. The ingredients are place for India to experience a rapid and prolonged recovery from the effects of the COVID 19 pandemic. India's role in the emerging market space is likely to expand as China's heavy regulatory hand takes hold of its economy and discourages foreign investment. India's stock market and derivatives markets are large and diverse and growing with foreign investments as percent of overall stock ownership still very low. India's markets exhibit low correlation to developed markets over time adding to its appeal. Systematic strategies executed in the India market also exhibit low correlation to developed markets as well as their global systematic peers. ESTEE possess local knowledge and expertise to help investors navigate and understand the opportunity set within the Indian markets, offering several investment vehicles that are designed to enable investors to gain exposure to this dynamic marketplace. We at ESTEE look forward to the opportunity to share our India market expertise with you.

Introduction to Estee

Founded in 2008, Estee Advisors Private Ltd is a quant-based investment management and execution and services provider. Estee is a pioneer in building algorithmic investment products and has a strong track record as an investment manager and trade execution services provider in Indian capital markets. Estee is present across three lines of business - Asset Management, Proprietary Trading, and Execution Services.

Estee is a SEBI-registered Portfolio Manager Service (PMS) provider and a registered broker-member with all the major Indian exchanges including NSE, BSE and MCX-SX. Estee Commodities Private Limited, a wholly owned subsidiary of Estee Advisors, is a registered broker-member with MCX. Estee's US affiliate, Estee Capital LLC, is a Commodity Pool Operator (CPO) with the National Futures Association (US) which is allowed to solicit funds to Qualified Eligible Participants (QEPs). Estee Capital LLC is also a Registered Trading Member with the Dubai Gold and Commodity Exchange (DGCX) and Singapore Exchange (SGX).

Estee offers several investment programs for clients seeking to gain exposure to the India market including; the Estee India long short market neutral strategy, which utilizes proprietary investment models to systematically build, trade and manage a portfolio of single stock futures on India's most liquid names, and the Estee India Long Alpha program which is a directional strategy that aims to consistently outperform the benchmark equity index while maintaining low volatility.

For additional information on ESTEE, its investment products and the India market opportunity in general, please reach out to:

Gaurav Sahni
Head, Asset Management, Estee Group
374 Millburn Avenue, suite 203E, Millburn, Nj 07041, USA
Email: gaurav.sahni@esteeadvisors.com
Telephone: (973) 912-9797

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