APRIL 2024

Ten Reasons to Invest in Indian Equities

Investors' perspectives on India have begun to change, and the country's equity markets are becoming more popular. While some may consider this a short-term fad, we believe we have reached a tipping point where India is now too big to ignore. Indeed, we see many long-term aspects at play that render Indian equity markets particularly attractive. Below we list ten reasons why an allocation to Indian equities should be a part of investors' portfolios.

1. India's equity market is large and deep

India boasts a long-established equity culture. The Bombay Stock Exchange (BSE) in Mumbai, the largest Indian exchange, was founded in 1875 and is the oldest in Asia. Combined with the National Stock Exchange of India (NSE) and other local exchanges, the total market capitalisation of the Indian equity market exceeds 4.3 trillion USD (as of 31. December 2023), making it the fifth-largest world-wide and the second-largest among emerging markets (after China).

Indeed, the market capitalisation of Indian equities is equivalent to 70% of the Japanese market capitalisation and 63% of the market capitalisation of the exchanges combined within the Euronext. In the context of emerging markets, the weight of MSCI India accounts for approximately 16.3% of the total market cap of MSCI Emerging Markets[1] – a proportion that has steadily grown over the past decade. (See Figure 1).

2. Structural factors (demographic trends, digitalization and infrastructure) underpin economic growth

India's economic growth over the past decade has been remarkable. The country contributed an estimated 17.6% to global GDP growth in 2023, compared to less than 8% in 2001.

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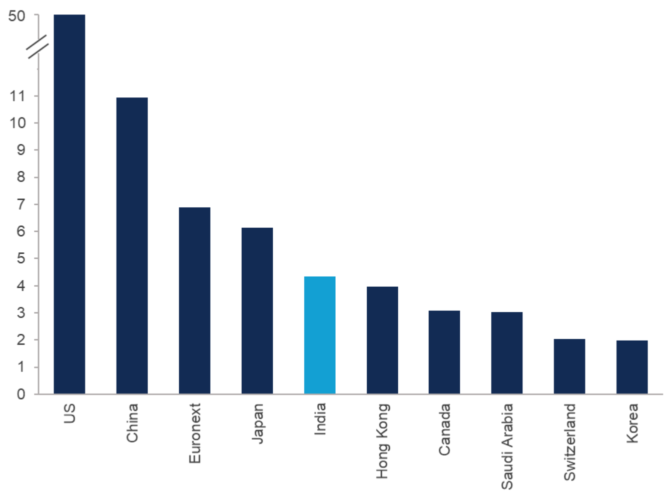
Figure 1: Top 10 largest global markets by market cap (USD trillions)



Source: World Federation of Exchanges, Allianz Global Investors, as of 31 December 2023. "US" consists of NYSE and NASDAQ, "China" consists of Shanghai and Shenzhen stock exchanges.

This impressive trajectory is underpinned by various factors. India boasts the largest young consumer market in the world – by 2030, there will be an estimated 360 million Indian consumers below the age of 30. Fittingly, India's digital infrastructure is being steadily expanded and adapted to the needs of these younger, more urban consumers. 43% of digital real-time payments worldwide are already taking place in India.

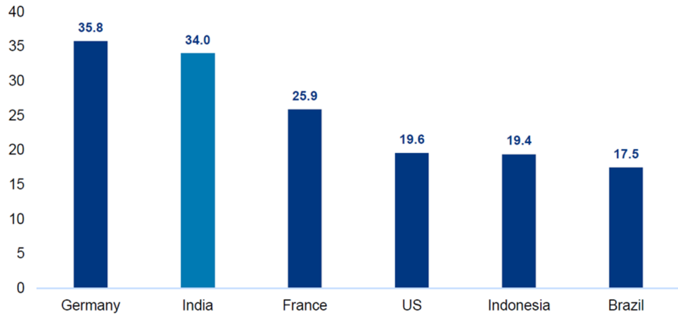
Last but not least, investments in infrastructure are contributing to more fluid trade both inside India and outside its borders. India's national highway network doubled over the past decade to 155,000 km. Likewise, the Indian government's National Infrastructure Pipeline, launched in August 2020, encompasses over 9600 projects across all sectors, including energy, telecommunications and clean water resources. This encourages not only physical mobility, but also enhanced productivity and international competitiveness.[2]

3. A STEM-focused educational system

A key factor contributing to the growing affluence of India, as well as the growth of its digital sectors, is an education system focused on STEM subjects. These account for 34% of Indian graduates, a proportion higher than many other countries, including France and the US (see Figure 2). This educational pedigree leads to a highly-skilled workforce, which, in turn, generates employment opportunities and the potential for wealth creation. In many ways, these graduates are expected to drive an innovation-based transformation of traditional parts of the Indian economy.

It is worth noting that 37% of engineers and 23% of scientists working for US IT/software companies currently come from India.[3]

Figure 2: STEM Graduates as percentage of total



Source: UNESCO Institute of Statistics, Barclays as of November 9, 2023.

4. India's equity markets represent a diverse universe of stocks

The breadth and diversity of the Indian stock markets offer plenty of opportunities for stock pickers. Besides stocks of long-established sectors such as pharmaceuticals (India is the largest supplier of vaccines and generics globally) and IT services (it is estimated that between 50% and 70% of global technology and operations headcount are based out of India).[4]

Indian cyclicals like industrials and real estate are on the ascent, benefiting from the post-covid recovery and geopolitical factors (e.g. the "China+1" supply chain diversification strategy being adopted by many multinationals). Domestic consumer stocks and disruptive innovators are also benefiting from the demographic and digitalisation trends.

Lastly, a reformist and business-friendly government agenda has boosted investments in "sunrise" industries (pharma, solar, electronics) and has supported the monetisation of government-owned assets through a healthy IPO market.

Thus, in India, the top two sectors account for a 38% weighting in MSCI's India index, compared to over 77% for technology in MSCI's Taiwan index at the opposite extreme.[5] With eight sectors having more than a 5% weight in the index, India delivers significant diversification benefits.

5. Corporate governance is improving

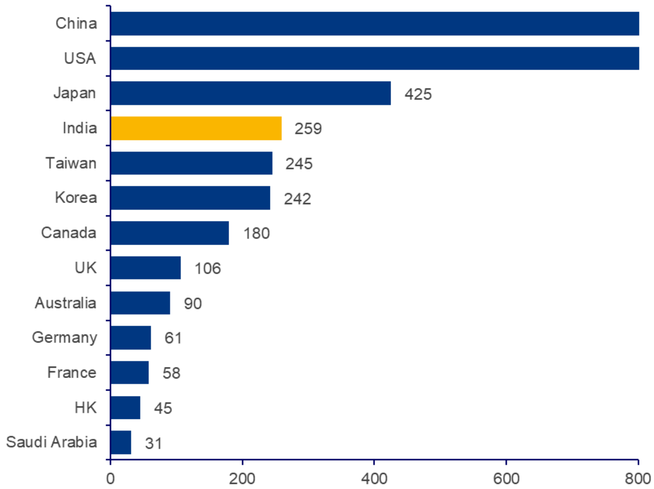
More and more businesses in India are adhering to best practice in financial disclosure, treatment of minority shareholders, and continuous improvement in corporate governance. Better transparency allows the market to assess a company's financial health and weigh the risk factors. As such, this also contributes to a lower risk premium and improved valuations.

There have been high-profile cases involving family-controlled businesses and other forms of litigation that offer telling examples of this shifting mindset: calls for increased powers for independent directors and more protections for minority shareholders have been echoed by swathes of the national financial media.

6. India's markets are highly liquid

The Indian equity markets are not only large, they are also very liquid. Over 170 stocks listed on Indian exchanges enjoy a market capitalisation over 5 bn USD (the fourth-highest figure worldwide). They have a high level of daily turnover. Over 250 stocks average a daily turnover above 10 mn USD – a figure only surpassed by the Japanese, US and Chinese equity markets. (See Figure 3).

Figure 3: Number of stocks with average daily turnover > 10 million USD



Source: CLSA, as of 31 December 2023.

7. India's equity markets don't move in lockstep with others

India's stock markets have traditionally exhibited a low correlation to other major stock markets. Not only is India moderately correlated with developed markets (0.59 with Europe, 0.54 with USA, 0.49 with Japan), its stock markets are equally lowly or even less correlated with many constituents of the MSCI Emerging Markets (0.57 with Korea, 0.44 with China). An increased allocation to Indian equities for a global or emerging markets portfolio may, all things being equal, enhance its risk/return profile.

Figure 4: MSCI India return correlations with selected MSCI markets (weekly USD price returns)

MSCI Indices	India	AC World	Europe	USA	China	Japan	Korea
India	1.00	0.62	0.59	0.54	0.44	0.49	0.57
AC World	0.62	1.00	0.83	0.96	0.58	0.68	0.75
Europe	0.59	0.83	1.00	0.74	0.49	0.70	0.66
USA	0.54	0.96	0.74	1.00	0.46	0.59	0.65
China	0.44	0.58	0.49	0.46	1.00	0.47	0.56
Japan	0.49	0.68	0.70	0.59	0.47	1.00	0.62
Korea	0.57	0.75	0.66	0.65	0.56	0.62	1.00

Source: Bloomberg, Allianz Global Investors, as of 25 January 2024. Correlation data is calculated based on historical return of respective MSCI indices for the past 10 years, using weekly USD return.

8. Low proportion of State-Owned Enterprises

Another important feature differentiating India is that State-Owned Enterprises (SOEs) represent a mere 11% of the equity market, whereas for China A-shares (as measured by the MSCI China A Onshore Index), it's around 46%. It is generally accepted that SOEs typically trade on lower multiples than private peers, as government-owned entities may have social objectives that compete with minority shareholder interests.

9. Local investors are becoming stronger and stickier participants

India's equity market is supported by the development of a local equity culture. Investing in mutual funds has become a key part of financial planning for millions of Indians. In 2023, domestic investors (DIIs) invested 22 bn USD into Indian equity markets, marking their second highest annual inflow after hitting a high of 36 bn USD in 2022. This was the third straight year of DII inflows surpassing foreign investor (FII) flows. [6]

Importantly, systematic investment plan (SIP) inflows continue to touch new highs as this form of regular savings scheme gains popularity. This domestic savings pool is likely to be stickier and less contingent on currency dynamics, global interest rates or geopolitics, for example.

10. Foreign investors are increasingly attracted to India

Much of the recent momentum in Indian equity markets is attributed to local flows given increasing affluency and access for domestic savers; however, this does not mean that foreign investors lack interest in India. In fact, Indian assets have also seen record foreign interest in 2023, with Foreign Institutional Investors (FII) inflows into equities totalling 21 bn USD.[6]

Index providers are following suit, with MSCI adding nine Indian companies to its MSCI Emerging Markets Index in November 2023, raising the weight of India within the benchmark from 15.9% to 16.3%.[1]

Beyond this, 2023 recorded a record number of IPOs in the India market, adding 56 new listings in total. A robust IPO pipeline typically attracts FII flows, especially if the new listings feature in growth sectors like fintech, food delivery, edtech, tourism and retail categories.

Similarly, India's upcoming inclusion in JP Morgan bond indices is widely expected to drive asset flows and market interest, with Fitch estimating USD 24 bn in passive inflows between June 2024 and March 2025.[7]

Conclusion

As with all emerging markets, a degree of caution is necessary when investing in India. Robust risk management guardrails help to navigate volatile times. In-depth knowledge of India and local market specificities also help to select the most promising stocks and avoid pitfalls. At Allianz Global Investors, we believe that an active stock-picking approach is best suited to harness the many opportunities India offers to investors.

[1] Source: MSCI, as of November 2023
[2] Source: indiainvestmentgrid.gov.in, accessed April 2024
[3] Source: Barclays, November 2023
[4] Source: E&Y, January 2023
[5] Source: CLSA, January 2024
[6] Source: MSCI, March 2024
[7] Source: Fitch, September 2023

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