Where to from here for India?

Globally markets around the world peaked on February 20th, 2020 and since then have fallen roughly 20% in local currency terms (S&P500). Currencies have also been moving around in a volatile fashion. Typically, in this environment the USD is the most resilient currency. However, the DXY has also fallen 4% over this 2-week period. Safe-haven currencies over this period have been Gold, Yen and Swiss Franc, to name a few hiding places.

In India, markets have fallen approximately the same amount. This has been accentuated somewhat by a fall in Rupee against the AUD (about a 2.5% depreciation). This is disappointing for investors given that there were green shoots emerging after a cyclical slowdown which lasted close to 2 years. India's GDP growth was recorded at 4.7% for the December 2019 quarter. However, a corporate tax cut, bank recoveries, improving GST collections and a pick-up in PMI's indicated most positive news was on the way in FY21 (India's financial year is April-March).

The Coronavirus won't stop India's structural growth resuming its path at some point in FY21, however, it will impact global growth in at least the first half of 2020 and therefore India's growth. Whilst India doesn't have significant links to the global supply chain (exports are only 11% of GDP), it benefits when global growth is strong given comparative advantages in exports of refined petrochemicals/oils, gems/precious stones, textiles, electronics, pharmaceuticals and automobiles.

However, the key risk for India is the virus making itself a home amongst India's significant population of 1.3bn and the potential for it to spread quickly, without appropriate healthcare systems and medication for all. Whilst COVID-19 resembles the common cold / flu, its potential to slow down an economy like India is significant. We cannot estimate what the damage will be to markets, but we see the following positives:

- Central Bank potential to cut cash rates significantly from the current 5.15%
- US$475bn of forex reserves to defend the currency if required
- A substantial fall in the oil price which will reduce inflationary pressures in India (India imports over 80% of its oil usage)
- Fiscal stimulus likely to be forth coming
- Potential to replace China in certain aspects of the global supply chain, given most are now seeking diversity of supply. Foreign direct investment in India has increased significantly over the last 12 months (US$175bn vs US$87bn previous year)

From a valuation point of view the Nifty trades at 17x 1-year forward, after building in a 10% cut in consensus earnings for FY21 (brokers will tend to lag when it's a macro event). Our Fund will be trading closer to 14x. There has been a real shift towards sustainable or low earnings volatility companies and businesses with lesser impact from exports or global supply chain.

For those who have invested in our Fund, the next week or two (which we expect will see heightened panic amongst investors), will be a good time to add some further funds as India is well positioned to rebound as it often does from adversity. However, how much bravery you have will determine when you invest! When safe havens have defended your portfolio, it is not time to load up further, but reinvest your gains into areas which have been decimated.

Our Fund was trading at a unit price of 1.1086 on the 19th of September, prior to the announcement of the Corporate Tax cut reform in India. The unit price recently hit a high of 1.2917 (20th February 2020) – a rise of 16.5% over 5 months given improving profitability and the emergence of green shoots in the economy as evidenced in strong PMI readings in January.

However, the retracement since February 20th, essentially strips out all of that gain (and more) which was built in by markets over the last 5 months i.e. the potential of a recovery in India, 10% better profits from the Corporate tax cuts and a pick-up in private investment (FDI investments into India have doubled last year at US$175bn). Additionally, it is likely the unit price will fall below $1.10 this week given the ferocity of the global sell off, brought on by negative sentiment and expectation of economies brought to their knees globally on account of the virus.

We think it is inevitable that India starts its recovery in in the 2H21 i.e. Sept 2020 onwards. It is not very often that you can identify an investment where you can buy quality growth stocks at P/E's in the teens and cyclical growth for single digit P/E's in a market like India. We are re-aligning our Fund to go overweight in the both these segments.

As we have always articulated to investors, India is a market where you should build exposure during dire times as the structural story will outlast any cyclical events. It's a matter of portfolio construction and investment horizon. When it comes to satellite investments like investing in India, investors typically tend to sell during adversity and buy during euphoria. As a business we seek to improve this experience for our investors by providing our insights of activity on the ground in India.

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