CBH | Investment Management

India's Market Momentum: Navigating Global Shifts

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CREATIVITY WITHIN EXCELLENCE

India's Market Momentum: Navigating Global Shifts

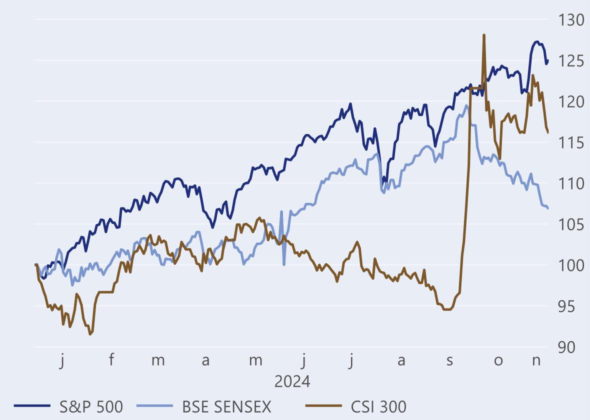
Key Takeaways

- India is the fastest growing major economy, with GDP growth expected to reach 7% in 2024, down from 8.2% in 2023.
- It is expected to become the 3rd largest economy by 2028.
- The country has strengthened its macroeconomic fundamentals and is benefiting from undeniable advantages, in particular its demographic dividend, but it remains weakened by structural constraints.
- Middle class consumption is projected to reach $8.8 trillion in 2030 (up from $32 billion in 1965).
- India was recently included in a JP Morgan benchmark index for global government bonds.
- The equity market is large and attractive, offering opportunities for diversification.
- The recent correction has restored attractiveness and earnings momentum remains supportive.

Since the beginning of 2023, Indian equities have performed remarkably well. India has emerged as a bright spot, driven by strong economic growth, a growing working-age population, and its non-aligned economic stance. In addition, Indian equities have benefited from a shift in international investor sentiment away from Chinese equities, as investors have become increasingly wary of Chinese assets due to regulatory uncertainty, the severity of the real estate liquidity crisis, and sluggish consumer demand. Escalating tensions between the U.S. and China have further exacerbated this outlook, with some investors, including the U.S. federal government's main pension fund, excluding Chinese and Hong Kong-listed stocks from their portfolios.

Equity performance

Index, total return, USD, rebased to 100



Source: LSEG Datastream/ CBH Investment Management

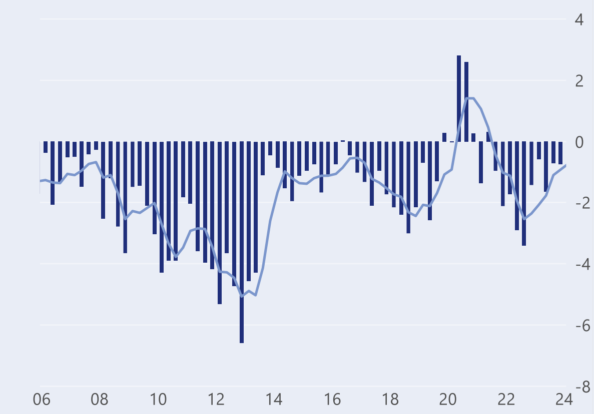
1. Snapshot of the Indian Economy

India is the fastest growing major economy and is projected to become the third largest economy by 2028, surpassing both Japan and Germany. In terms of purchasing power parity (PPP), which focuses on the relative value of currencies within domestic economies, India is already the world's third largest economy. Indeed, India's economy continues to show robust growth. However, the pent-up demand that built up during the pandemic has largely been absorbed and the economy is expected to return to its potential growth path. While activity is expected to slow, it should remain strong in the coming years, driven by increased infrastructure spending, diversified growth drivers, and a large, youthful labor force. Better public debt management reduces crowding out and creates space for increased private investment.

India was hit hard by the 2013 taper tantrum, when markets sharply reassessed their expectations for US monetary policy following Ben Bernanke's congressional testimony on the potential tapering of the Federal Reserve's asset purchase program. This reassessment led to a financial shock that manifested itself in a tightening of global financing conditions. Since then, the current account deficit has narrowed from 5% to 1%, foreign exchange reserves now cover more than 10 months of imports, and the credibility of the Reserve Bank of India has improved significantly. As a result, the country is now less vulnerable to global market volatility.

India: Current account balance

% GDP



Source: LSEG Datastream/ CBH Investment Management

Despite its strengths, the Indian economy remains constrained by structural weaknesses, including protectionism, regulatory uncertainty and constraints, a weak industrial base, inadequate infrastructure, and low productivity. In this context, India is unlikely to replace China as a manufacturing hub in the short term.

2. What Happened Recently

i) Chinese stimulus plan

At the end of September, the Chinese authorities unveiled a substantial stimulus package to revive growth and support the property and stock markets. While this plan did not solve all the problems, it did rekindle interest in Chinese stocks, reflecting renewed optimism in Chinese assets, and triggered a correction in Indian equities. With the Indian Sensex index up nearly 50% over the past two years and Indian growth on a slowing (but still robust) trajectory, foreign investors took profits.

ii) Donald Trump won the presidential election

India's share of international trade is limited, and the country is not expected to be among the hardest hit by the tariffs that Donald Trump is likely to implement.

However, the Indian market reacted to Trump's election through FX and interest rate risk channels. The sharp appreciation of the US dollar and the rise in US yields spooked investors, despite the Reserve Bank of India's regular use of its FX reserves to manage currency stability.

3. Indian financial markets

India is better positioned today than it was in 2013, but Indian companies are still exposed to foreign interest rates and foreign exchange (FX) risk. It is worth noting, however, that this exposure has declined significantly and FX hedging has increased significantly. As a result, the Indian market remains sensitive to fluctuations in the US dollar and expectations about US monetary policy.

i) Fixed income market

In June 2024, India was included in JP Morgan's benchmark global government bond index, marking a significant milestone for the country's domestic debt market. India's initial weight in the index was set at 1%, with plans to increase by 1 percentage point each month until it reaches 10% by March 2025. The index currently tracks a total of US$234 billion in assets. India is also set to join the Bloomberg equivalent index in 2025 and is being considered for inclusion in the FTSE Emerging Markets Government Bond Index. Further development of the Indian debt market will require government action to improve market access and settlement processes. This, in turn, is expected to attract greater foreign participation in the domestic markets, while introducing greater scrutiny and potential volatility.

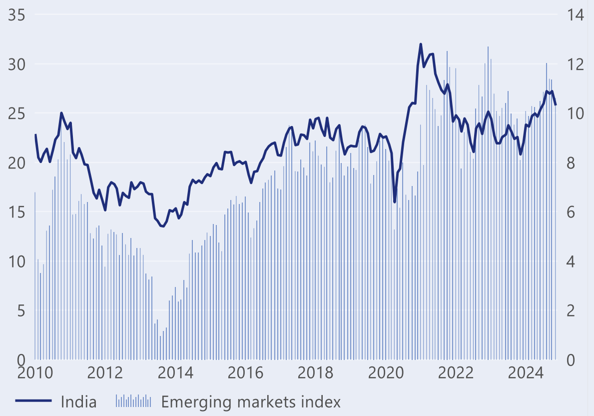
ii) Equity market

The equity market is both large and liquid. The MSCI India Index represents approximately 19% of the total market capitalization of the MSCI Emerging Markets, while the Chinese markets account for over 27%.

The Indian equity market offers diversification benefits, with low correlation to other major and emerging markets. The top two sectors account for 38% of the MSCI India Index. The market is dominated by financials, which make up nearly 26% of the MSCI India Index, followed by consumer discretionary and IT. In India, the IT sector is primarily service-oriented rather than equipment focused.

India's price-to-earnings ratio is structurally higher than other emerging markets, but the spread has widened since 2021, in line with the challenges facing the Chinese stock market. The recent market correction has restored the attractiveness of the Indian market, as previously stretched valuations are now more reasonable in both absolute and relative terms. Meanwhile, earnings momentum should provide some support. Earnings growth expectations for 2024 have been downgraded several times recently, but remain attractive at over 8%. Expectations for 2025 have also been revised higher, with analysts expecting earnings growth to reach 18%, outperforming other markets.

India price-to-earnings ratio
Ratio (both axes)

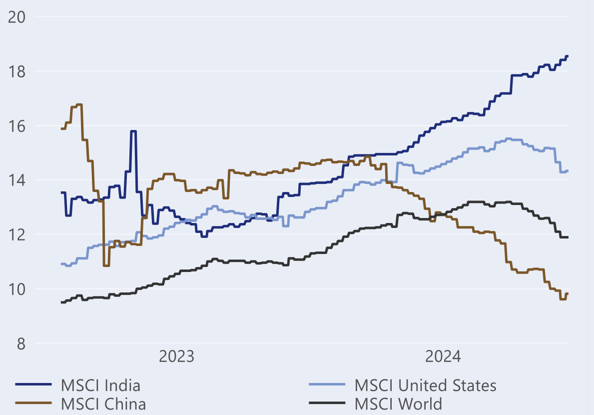


Source: LSEG Datastream/ CBH Investment Management

4. Investment opportunities

Indian equities offer a compelling opportunity for long-term investors and those currently underweight the market. The recent correction provides a tactical entry point to increase exposure to emerging market equities. With strong earnings growth, attractive macroeconomic fundamentals and historically low correlation to both developed markets and many MSCI Emerging Market constituents, Indian equities can complement global portfolios and improve their risk/return profile over time.

2025 Earnings expectations
Annual change, %



Source: LSEG Datastream/ CBH Investment Management

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