October 02, 2024

INDIA REWIND

India Rewind is a monthly update from DSP's Investment desk. It separates the alpha from the noise and aims to deliver key insights to readers, packed within a 2-minute reading time.

India's current market environment, where valuation remains expensive, (MSCI India Index trading at 24.6x NTM P/E +2.4SD above 10y avg), finding opportunities with margin of safety has become true test of active fund management. MSCI India hit fresh highs last week, up ~25% in YTD24. While ~42% of MSCI India stocks are trading at 52Week high, about ~54% have also underperformed the index. Across sectors Consumer Discretionary and Industrials have been the key contributors of growth while Consumer staples and Materials has been the bottom performers.

India's earnings trajectory @ 2030 shows MSCI India profits projected to compound at ~12-14% CAGR over the next six years. This growth reflects India's robust domestic economy, driven by over 6% growth in investments and consumption, even as global conditions moderate. Domestic growth is increasingly vital for supporting India's earnings.

The profit pool is set to shift toward Investment Cyclicals encompassing Autos, Real Estate, Chemicals, and Industrials—projected to capture 25% of overall profits, making. This shift will come at the expense of declining Infotech and stagnant Financials. Key drivers include robust performance in autos, ongoing real estate recovery, and a potential boost in private capex supported by favourable supply-side conditions.

Consumer Cyclicals are set for the highest growth, with discretionary sectors like premium retail, new economy firms, and restaurants thriving on a rising consumer base. An investment upcycle will supercharge asset-heavy segments such as retail, restaurants, and hotels.

The sustainability of MSCI India's higher valuation hinges on both demand and supply factors. On the demand side, concerns include high household leverage, slowing retail credit growth, weak IT hiring, stagnant salary growth, and moderating government capex. On the supply side, larger companies are focused on market share protection, while mid-sized and small firms aim to reclaim lost ground, increasing competition and likely recalibrating valuation expectations. **Hence, more supply means lower multiples.**

Despite ongoing demand concerns, key factors are impacting the macro environment are improved liquidity from a stronger balance of payments and stabilizing credit growth, alongside rising deposit growth, are crucial. Recovery in agriculture, soft commodity prices, and a strong pipeline of private sector capex further support resilience. Additionally, buoyant equity markets are boosting capital gains and transaction tax collections (*please see chart of the month).*

With valuation multiples trading at elevated levels, earnings delivery is critical for further returns.

Earnings have been the main driver of India's strong equity returns, making earnings performance crucial as valuation multiples remain elevated. **Over the past decade, Indian equities have significantly outperformed regional markets,** MSCI India ~+9% USD returns compared to just ~0-2% from MSCI EM and MXASJ indices (*please see chart of the month*). **Earnings have contributed about ~90% of price returns,** following a stabilization after a decade-long decline from 2012 to 2020. Domestic sectors have driven the recovery, achieving double-digit growth in the last five years. The profit share of these sectors has increased, particularly in Financials and Investment Cyclicals. Over the past two years, Financials, Commodity Cyclicals, and Investment Cyclicals have dominated profit shares.

We expect India's GDP growth to remain robust, with a projected rate of ~6.8% from CY24E to CY30E, making it one of the **fastest-growing economies globally.** This growth will be driven by strong domestic demand, particularly in **investment and consumption**. The high-end consumer market is expanding, rural demand is recovering, and the real estate sector is rebounding. Additionally, favourable supply-side conditions suggest potential for increased private investment.

Chart 1: Capital gain tax collections ($ Bn)

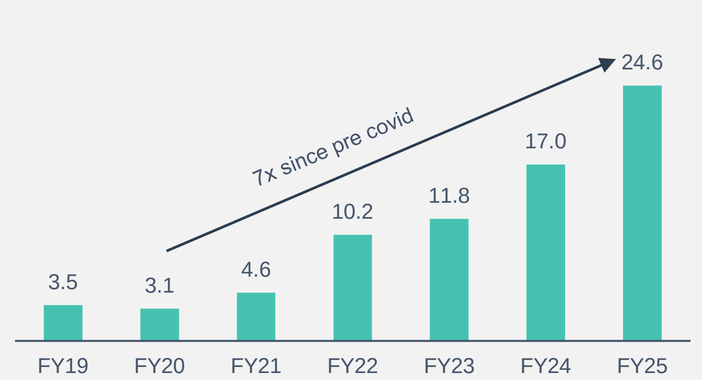

Chart 2: MSCI Index Performance vs. Earnings Growth (Annualized, 2011-23 % CAGR)

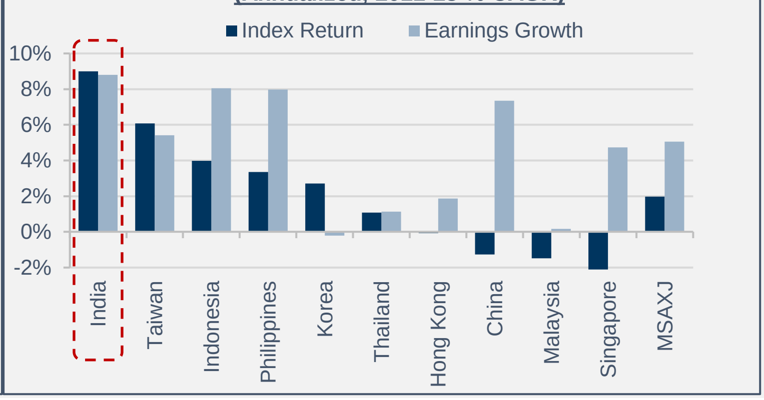

Chart Source: Avendus Spark, Goldman Sachs. Info Sources: Goldman Sachs Research, UBS, Morgan Stanley. MXASJ – MSCI Asia Ex-Japan, FII - Foreign Institutional Investor, DII - Domestic Institutional Investor, FY - Financial Year, CY – Calendar Year; YoY is Year over Year, YTD- Year to date, EM- Emerging Markets, DM- Developed Markets.

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For past Issues, please see below:
India Rewind September 2024
India Rewind August 2024
India Rewind July 2024
Older Issues

We hope you found this note interesting and welcome your feedback on InvestmentStrategists@dspim.com

India at a Glance

	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25E
Economic Activity and Employment								
GDP, USD bn	2651	2701	2871	2668	3176	3390	3568	3906
GDP per capita, USD	2018	2036	2141	1969	2321	2451	2554	2769
Real GDP growth, %	6.8	6.5	4.0	-6.6	8.7	7.2	8.2	6.8
Prices, interest rates and money								
CPI inflation, % y/y (average)	3.6	3.4	4.8	6.2	5.5	6.7	5.4	4.3
Repo rate, % (year-end)	6.0	6.25	4.4	4.0	4.0	6.50	6.50	6.25
10-year bond yield, % (year-end)	7.4	7.4	6.1	6.2	6.8	7.3	7.1	6.6
USDINR (year-end)	65.0	69.2	75.4	73.5	75.8	82.3	83.0	83.0
Fiscal accounts								
General government budget balance, % GDP	-5.9	-5.9	-7.8	-13.9	-9.5	-9.4	-8.5	-7.9
Balance of payments								
Trade balance, USD bn	-160	-180	-158	-102	-189	-266	-243.2	-272.5
Exports, USD bn	309	337	320	296	429	456	440.2	449.7
Imports, USD bn	469	518	478	398	619	720	683	722
Current account balance, USD bn	-49	-57	-25	24	-39	-67	-25	-46
Foreign direct investment (net), USD bn	30.3	30.7	43.0	44.0	38.6	35	18	15
Total FX reserves, USD bn	425	413	478	577	607	578	646	674
Total external debt, % GDP	20.0	20.1	19.5	21.4	19.1	18	18.1	18.2
Credit ratings								
Moody's	Baa2	Baa2	Baa2	Baa3	Baa3	Baa3	Baa3	Baa3
S&P	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-
Fitch	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-

Source: CEIC, Haver, UBS estimates; Note: Data is for FY ending March, E - Estimates