Investing in India

Aashish Somaiyaa, Managing Director and Chief Executive Officer of Motilal Oswal Asset Management, explains how the rapidly increasing GDP in India has led to the dramatic growth of disposable income, particularly benefitting investment in financial and consumer stocks.

Link to Slides
Link to Article on website
Link to Event Homepage
Link to Content Summary page
Link to Photos
Link to Video Highlights

AASHISH SOMAIYAA
Motilal Oswal Asset Management

SOMAIYAA, SPEAKING AT THE HUBBIS Middle East Wealth Management Forum on January 24 in Dubai, explained that India's Gross Domestic Product (GDP) has been rising so steadily in India that the per capita income has been driven up by about 70% in the last ten years.

"For example," Somaiyaa explained, "when the starting income per capita is equivalent to $1000, and the cost of survival is $900, disposable income is just $100. However, increase the income by 70%, and disposable income suddenly rises to around $700." And that is a 700% rise from $100.

What India is enjoying therefore is an exponential growth in disposable income, which results in a boost for both the consumption sector and for financial services. “This is due,” Somaiyaa elucidated, “to population growth, increasing education levels and urbanization, the lessening of the taboo surrounding loans, as well as a growing economic maturity.”

A cool development

The consumer durables market has seen a major surge in white goods sales, with many companies growing between more than 20% a year, some more than 30%.

With India’s vast population the multipliers are truly remarkable. “There are 1.3 billion people in India,” Somaiyaa noted, “and 270 million households, but only about three million households have air conditioners. When you have rising disposable income added to cheap and plentiful finance options, electronic channels of distribution and 24/7 power availability you have a booming market.”

Somaiyaa added that if an investor was seeking returns of 20% a year compound in a developed stock market, they would have to be chasing technology stocks. at the frontier of innovation.

“In India however,” he said, “it is easy to find basic consumables companies or financial services that are growing apace. Sectors such as automobiles, white goods, or in the financial sector, insurance and asset management, are all excellent opportunities.”

Causing waves

He also explained that the Indian Reserve Bank has now become an inflation targeting bank, with the sole mandate of keeping inflation low and stable.

“This has helped drive a giant shift away from physical assets such as land and gold as the primary method of saving,” Somaiyaa noted, “The beneficiaries have been areas such as financial services - especially insurance and asset management.”

Politics have also become a driver for growth. “For the first time in nearly three decades,” Somaiyaa highlighted, “India has a clear-majority government, which is also likely to see another term. This creates a platform of stability.”

Another factor supporting economic growth in India is the condition of the financial markets. Somaiyaa conceded that the market can tend to run ahead of economic developments, but it is demonstrating a fundamental improvement in the first two quarters which we expect should continue in successive quarters.”

Taking control of the badlands

Somaiyaa also explained that in the last few years the couple of ‘accidents’ -the sharp corrections in 2015 and 2016 - were largely due to strict reforms including tax compliance.

“In India,” said Somaiyaa, “between 40-70% of companies in sectors such as building materials operate in the shadow economy, or what we know as ‘the badlands’. The government is fighting against this by introducing strict compliance orders, and the Goods and Service Tax (GST) which together have led to a shift towards the organised sector, moving it out of the shadows. This is tough in the short term but good for the longer term.”

Nobody expects that the proportion of businesses operating in the shadow economy will reduce to zero, even with these reforms. However, Somaiyaa explained that if even 10% moves into the organised sector, it will translate to a 25% year-on-year growth.

The sweet-spot strategy

To recap, Somaiyaa reiterated that a multi-capitalisation portfolio coupled with a select sector strategy will best serve investors seeking value and growth in the Indian equity market.

In addition, Somaiyaa advised that finding the ‘sweet spot’ for Indian equities will best be served by covering the companies in the $500 million to $4 billion market valuation range, as those companies generally provide an excellent balance between strong growth and a demonstrated history of management success.

Concluding, Somaiyaa suggested investors focus on targets with earnings growth of around 20% first and foremost. He said this was because “stock prices are slaves of earnings and over the long-term, stock prices typically follow a trajectory similar to the earnings growth of a company.”

Investment Opportunity

Next Trillion Dollar Opportunity

Linear growth, exponential opportunity