HSBC Asset Management

Navigating the New India: A giant in the making

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Key takeaways

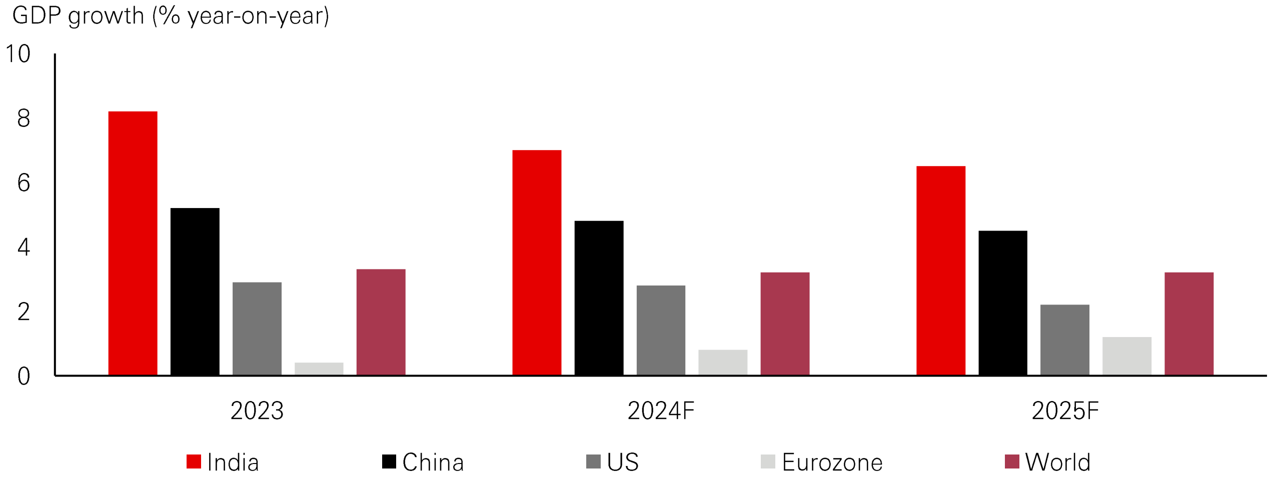
- Against a slowing global economy, **India's GDP growth is likely to stay resilient and expand around 6.5-7.0%** per annum in the medium term. Given its ongoing structural reforms, infrastructure build-out, growing domestic consumption driven by favorable demographics and tailwinds from unique positioning in a complex global geopolitical landscape, India stands out as a relative outlier among large economies.
- Under Trump 2.0, the potential impact of tariffs on India's economy is expected to be minimal, as exports to the US account for only 2.1% of GDP
- **Net domestic inflows into Indian equities are robust and reached USD56 billion year-to-date** (as of 15 November 2024), far exceeding the USD22 billion recorded for the entire year of 2023 and more than offsetting the foreign outflows experienced year-to-date / October 2024. Divergence of flows has become more pronounced as seen in the domestic ownership of the Indian equity market, which has risen to 25% in September 2024 versus 21% in March 2020, while foreign ownership has fallen to a trough of 16% from 22% over the same period
- Indian equities **offers significant diversification benefits** to global portfolios with the market becoming less correlated with other major markets as well as less volatile, thus potentially helping achieve better risk adjusted returns
- **India is now the world's fifth largest stock market, with a diverse sector composition and stock concentration.** Market cap growth drivers such as strong earnings growth and expansion via new listings/IPOs remain intact in the medium-term and should continue to support India equities' increased representation in key global indices
- Valuations of Indian equities may appear high and seemingly warrant some consolidation in the short term. While one may argue about the valuation premium it deserves, superior earnings growth and **higher structural profitability** of underlying companies support the premium argument

Source: Bloomberg, NSDL, Macrobond, HSBC Asset Management, November 2024.

India's GDP outlook: peak goldilocks?

India's GDP growth rate has been consistently robust, far outpacing other major developed economies like the US and even surpassing the pace of China (Fig. 1). In our view, GDP growth is likely to stay at the 6.5-7.0% level, given the ongoing structural reforms, infrastructure build-out, growing domestic consumption driven by favorable demographics and tailwinds from unique positioning in a complex global geopolitical landscape. A rapidly growing middle class and a digitally connected population continue to present vast opportunities for businesses to thrive. While a US/global growth slowdown is expected**, India is likely to stay resilient given its domestic demand-orientation and lower share of exports to the US as percentage of its GDP**.

Fig. 1: India's GDP growth vs rest of the world



Source: IMF World Economic Outlook, data as of October 2024

Momentum of structural reforms and policy stability, which we believe form the bedrock of India's long-term sustainable growth, are continuing given Prime Minister Modi's re-election in June. The Production Linked Incentive (PLI) scheme, for instance, under the "Make in India" initiative is one of the strategic programmes aimed at promoting domestic manufacturing across various key sectors (i.e. electronics, semiconductors, solar modules, pharmaceutical APIs, defense equipment etc.), which can help to reduce reliance on imports, foster the domestic economy and create jobs. PLI also serves as vital component in transforming India into a competitive manufacturing hub by attracting foreign manufacturers as well as encouraging domestic companies to innovate and enhance their production capabilities, overall positioning India as an appealing alternative for global businesses looking to diversify their supply chains. Another growth driver that increases the appeal of India internationally is the rapid development of its startup landscape – a robust ecosystem that nurtures a culture of innovation and productivity (see more on page 4).

Is there any impact on Indian markets from the US elections?

Trump's victory in the US presidential elections means that policy uncertainty globally has risen. At present, it's difficult for investors to gauge the impact of the potential shift in US fiscal, trade policy and immigration. The impact of potential tariffs on India's economy should be limited, as **India's exports to the US is small**, at only 2.1% of GDP (in 2023).[1] In fact, **India remains one of the least exposed major economies**. India's services exports is significant, with a growing strength in areas including IT services and Global Capability Centers (GCCs), which may have potential implications if there is any tightening of US immigration laws.

There may also be implications for foreign direct investment (FDI) under Trump 2.0 if there is a push for investments to go back to the US. However, this trend could potentially favour India as we could see relocation of some manufacturing to India to take advantage of relatively lower tariffs.

Note1: Source is Macrobond, HSBC Asset Management, November 2024
Source: HSBC Asset Management, November 2024.

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Another factor to consider is the US dollar under a Trump administration and the resulting implications on emerging market currencies such as the INR. In the last month, the INR has seen a depreciation against the USD of 0.38% given the rise of the USD, but **the INR has generally outperformed Asian currencies** – the Asia dollar index (which tracks the performance of a basket of Asian currencies against the USD), has fallen by 1.9%. Further, in the same period, 10-year US Treasury yields have been volatile, rising by 71bp, while the 10-year India government bond yields have been more stable only rising at 7bp to 6.86%.[2] Overall, the INR has been less volatile than other major currencies, though it is noted that currency volatility may increase. With this, it is important to remember that India's central bank has a record high level of foreign exchange reserves that can help cushion currency volatility. Additionally, structural reforms over the last ten years has brought the INR to a much stronger position today than in the past – with beneficial developments including keeping inflation in check, progressively improving fiscal and current account deficits as well as opening more sectors to FDI thus leading to increased foreign flows.

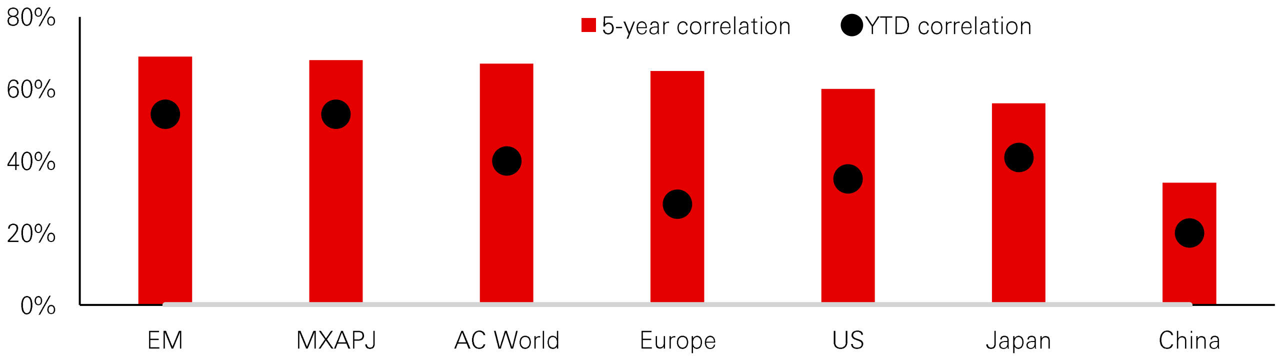
How do the recent outflows from foreign investors affect Indian equities' diversification story?

Foreign investors have been net sellers of Indian equities in the last few months. Partially, this can be explained by the improvement in **foreign investor sentiment shifting from India towards China**, particularly with China's slew of stimulus announcements since September, on both the fiscal and monetary sides. Additionally, some moderation in high frequency indicators and expectation of softer earnings season triggered the reversal of tactical inflows seen earlier. While near-term foreign flows will be driven by multiple moving factors – such as further stimulus in China, announcement of key polices of the new US administration, relative valuations and the outlook on the Indian Rupee – in the long run, the flows should follow the trajectory of corporate earnings growth. It should be noted that net domestic inflows into Indian equities remain robust, reaching USD 56 billion year-to-date (as of 15 November 2024), far exceeding the USD 22 billion recorded for the entire year of 2023 and more than offsetting the foreign outflows experienced year-to-date / October 2024. Divergence of flows has become more pronounced as seen in the domestic ownership of the Indian equity market, which has risen to 25% in September 2024 versus 20.9% in March 2020, while foreign ownership has fallen to a trough of 16% from 21.9% over the same period.[3] Though year-to-date foreign outflows has amounted to USD 1.9 billion, MSCI India (USD terms) has still risen by 11.2%.

Despite the short-term foreign outflows, the Indian equity market continues to present an opportunity for asset allocators to diversify their portfolios. Importantly, India's economic and financial markets have been experiencing a gradual decoupling from major global markets, such as the US, Europe, and Japan. **MSCI India is exhibiting lower correlation year-to-date against major markets** as compared to a 5-year period, suggesting that India is becoming less correlated with major markets (Fig. 2).

Fig. 2: India is becoming less correlated with other major markets

MSCI India correlation with respective markets



Correlation is based on weekly price returns in USD terms. MXAPJ refers to MSCI Asia ex Japan Index. AC World refers to MSCI All Country World.
Source: MSCI, HSBC Asset Management, data as of 16 September 2024.

Asset allocators can leverage this diversification benefit to create a more resilient investment strategy, improving their chances of weathering market fluctuations. India's diminishing correlation with leading markets is particularly appealing in the face of an increasingly interconnected and often unpredictable global economy.

Note 2: Source is Bloomberg, 18 November 2024. Note 3: Source is NSDL, Motilal Oswal, November 2024
Source: HSBC Asset Management, November 2024.

India is now the world's 5th largest stock market, where does it go from here?

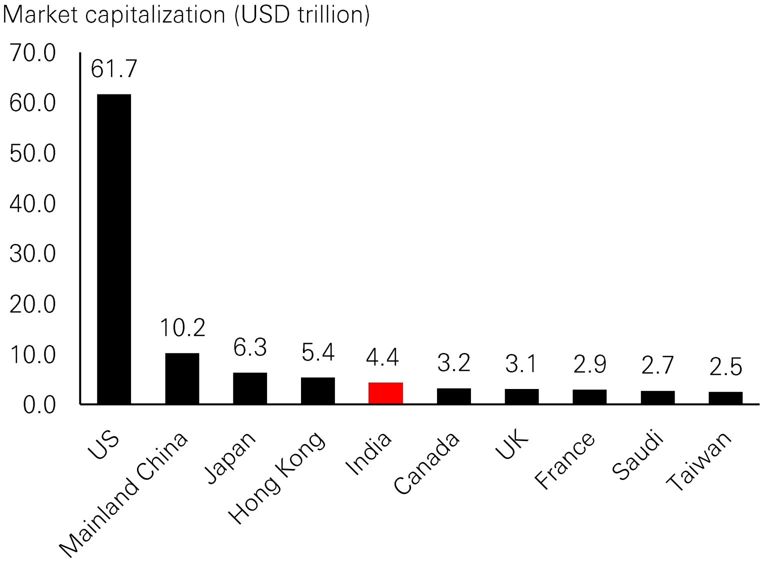
India's stock market capitalization now stands at USD 4.4 trillion, having tripled by over three times in the last decade. This remarkable achievement means India now has the world's fifth largest stock market, giving it **increased depth, diversity and size**. This is an important transformation that greatly improves the investible universe and gives rise to increased **investment opportunities across the market cap spectrum and sectors**. For instance, there are now 11 "mega-sized" companies – or companies with market capitalization exceeding INR 5 trillion (USD 59 billion) – 10 years ago there were none; there are also now 209 mid-sized companies compared to 50.[4] Such an evolution has also translated to MSCI India, a widely tracked benchmark for global investors, increasing the number of constituents from 84 in March 2020 to 151 in September 2024.

Of note is the **surge of new-age businesses such as e-commerce companies** and/or venture capital backed tech companies (Fig. 4), illustrating the vibrancy of India's start-up ecosystem, which is also expected to fuel a steady supply of initial public offerings (IPOs) and present diverse investment opportunities to both domestic and international investors. This ecosystem is characterized by an exciting startup culture, robust access to venture capital, and supportive government initiatives aimed at fostering innovation and economic growth.

India had even surpassed China briefly in September to become the largest emerging market by weight in the MSCI AC World IMI Index, though the weight has come down given the correction in the market (Fig. 5). Despite this, there is a clear converge between China and India as well as a notable increase in India's index representation, which have positive implications for global capital allocation particularly as MSCI AC World IMI Index has significant tracking assets of USD 4.6 trillion.

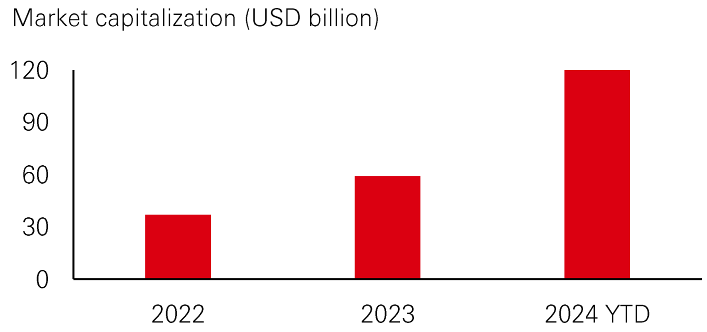
There is a strong likelihood – going by the past trend of rising weight of India in key global indices which is following India's rising share in world GDP – that India could reach an index weight of around 4-5% in MSCI World ACWI IMI Index. This would be a critical movement for Indian equities as it will reach a weight that would warrant attention from global portfolio managers.

Fig. 3: Largest stock exchanges



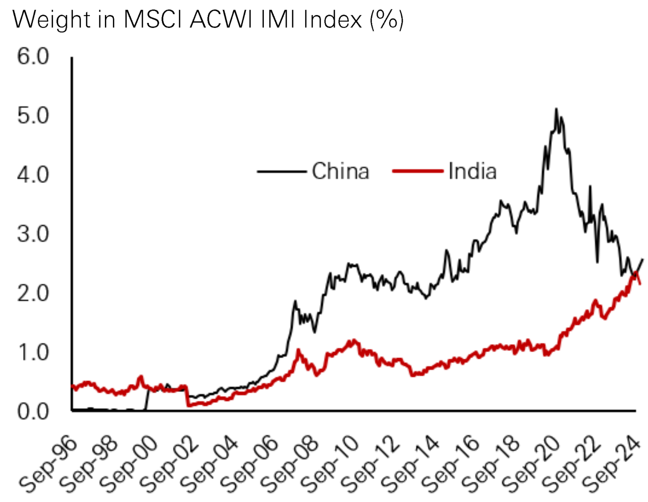
Source: Bloomberg, 15 November 2024

Fig. 4: Increasing market cap of venture capital backed tech companies



Source: Bloomberg, HSBC Asset Management, data as of 13 November 2024

Fig. 5: India's increasing index representation



Source: MSCI, Morgan Stanley, data as of October 2024

Note 4: Source is Motilal Oswal, November 2024
Source: HSBC Asset Management, November 2024.

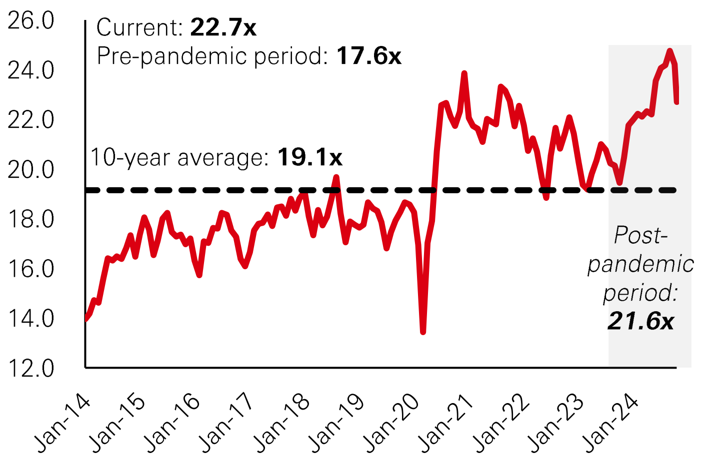
Is the price right for buying into India's growth story?

Indian equities are trading at valuations that exceed their long-term averages, with the 12-month forward P/E now standing at 22.7 times (Fig. 6). Valuations may appear high and seemingly warrant some consolidation in the short term but are supported by superior earnings growth in the medium term and a longer runway for growth. The **valuation premium is primarily backed by strong underlying earnings growth and return on equity (ROE) profiles** compared to other markets. In 2023, for instance, earnings per share (EPS) growth of MSCI India came in at an impressive 20%.[3] While the magnitude of earnings growth is expected to ease to 16% in 2024 and 2025,[5] the longer-term trend is should remain solid. India's earnings have grown by 3.4x over the last 20 years, slightly better than the US market and substantially ahead of its Asia and emerging market counterparts (Fig. 7). Having said that, there are areas of the market where valuations and implied growth expectations are excessive and it is prudent to moderate return expectations in the medium-term.

While the 2Q FY2025 (July-Sep 2024) earnings results have seen some weakness, impacted by commodity prices (especially oil) and heavy rainfall in some areas impacting demand, the medium to longer term earnings outlook remains intact. Additionally, the India market already has a foundation that sets it up for **high quality growth**, backed by reforms, strong demographics, deepening investment cycle and tailwinds from global geopolitics.

Fig. 6: Valuation of Indian equities

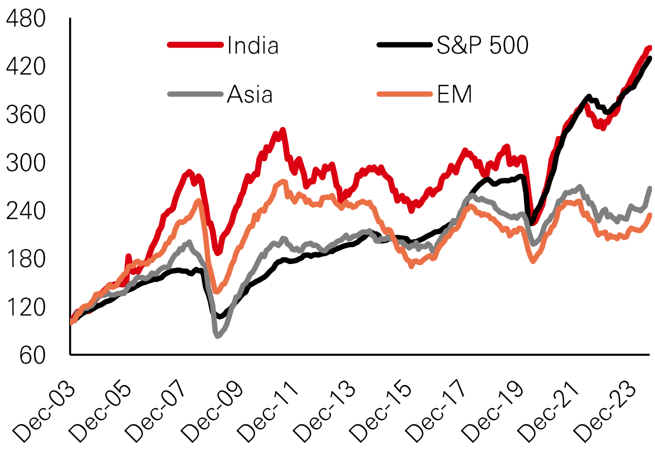
MSCI India P/E (x)



Source: MSCI, Goldman Sachs, 15 November 2024. Note: Post pandemic period refers to May 2023 to now, pre-pandemic period refers to May 2014 to Dec 2019

Fig. 7: EPS: India vs EM, Asia and US

India vs EM, Asia, S&P500 NTM EPS (US$) (indexed to 100)



Source: Goldman Sachs, August 2024

How is the HSBC Indian Equity strategy positioned?

The HSBC Indian Equity strategy has a **reasonable cyclical and growth tilt** via sectors like real estate and financials. Real estate is one of the top active weights in our portfolio as demand for residential real estate is currently experiencing an upcycle on the back of favorable demand-supply dynamics; the sector is also witnessing tailwinds from the growing need for new office space to support the GCC expansion in India and the expected interest rate cuts. Healthcare is another active overweight – our positioning here is a play on structural increase in domestic healthcare spend by both the government and the private sector; exposure here is spread over pharmaceutical companies and healthcare service providers like hospitals. We are increasing our positions in consumer staples due to recent shifts in government policy. Additionally, we plan to add more consumer-oriented investments, both discretionary and staples, during market weaknesses, along with select non-bank financial companies (NBFCs). Financials is our largest sector overweight; financials exposure is well diversified between lending and non lending business. Among banks, we prefer major private sector banks and are underweight government-owned banks. The ongoing digitalisation and increased participation of Indian savers continue to support service providers & platforms.

We maintain a **positive outlook on India's medium to long-term structural growth**, driven by themes such as favorable demographics, rising per capita income, manufacturing diversification through supply chain shifts, and a capital expenditure boom.

Note 5: Source is MSCI, Goldman Sachs, September 2024.
Source: HSBC Asset Management, November 2024.

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