

Investing in India: A Cyclical or Structural Opportunity?

Key Highlights:

- Despite a challenging global environment, India is projected to be among the fastest-growing nations of the next decade.
- Prospects of robust economic growth, solid corporate earnings, and favorable long-term structural tailwinds have boosted India's equity market, which is now the fourth largest in the world.
- While equity valuations may seem elevated relative to history, we believe there are still plenty of attractive opportunities for investors seeking to capture India's growth story.

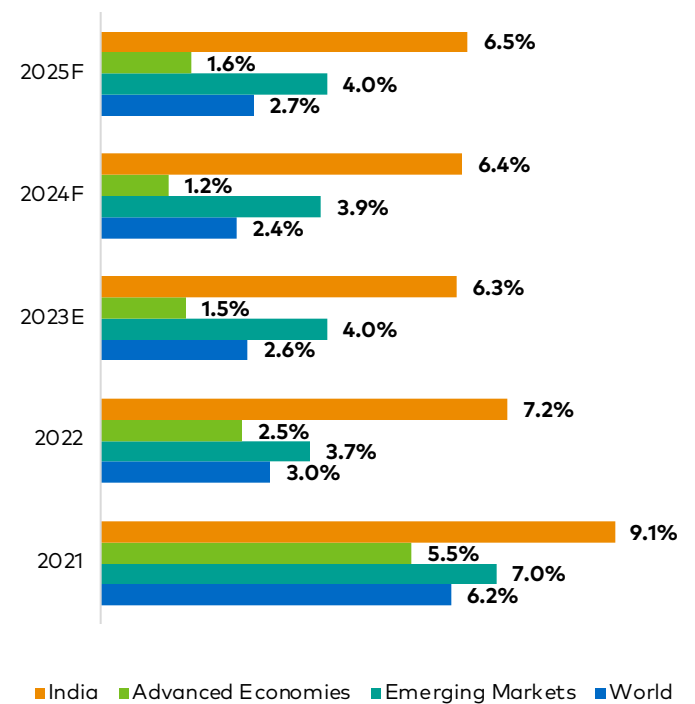
India's Economic Rise

In our view, "Goldilocks" is a fitting way to describe the impressive rise of India's economy. Only a decade ago, India wasn't among the 10 largest economies in the world. Since then, the South Asian nation has swiftly moved up the rankings into the fifth spot—overtaking countries such as the U.K.—aided partly by progressive reforms and a pro-business regulatory environment¹. According to the World Bank's 2024 Global Outlook, India will remain one of the fastest-growing major economies over the following years with growth expected above 6%, as seen on the right.

Over the past two decades, the nation's economic leap has also helped significantly reduce extreme poverty. The World Bank believes that between 2011 and 2019, India halved the share of its population living in extreme poverty². With more than 1.4

billion inhabitants—most aged below 35—the United Nations also highlighted that India overtook China as the world's most populous country last year, presenting a positive demographic outlook.

Figure 1: Real Gross Domestic Product (GDP): Change From Previous Year



Source: The World Bank: Global Economic Prospects Report. As of January 2024. Note: E = estimate; F = forecast.

¹ Top five largest economies include the U.S., China, Japan, Germany, and India (based on GDP). Source: Bloomberg. As of January 2024.

² The World Bank defines "extreme poverty" below \$2.15 per person per day, (2017 PPP). Source: World Bank Poverty and Inequality Portal and Macro Poverty Outlook, Spring 2023.

As a result, we expect India to have one of the largest working-age and middle-class populations in the years ahead, supporting its continued urbanization and industrialization and acting as an engine for consumption and investment. The rapid growth of India's consumer market and rise in disposable income have turned the country into an increasingly attractive destination for multinationals across various industries with foreign direct investment inflows (FDI) likely to reach \$100 billion in the next few years³. In addition, the country has benefited from the post-pandemic diversification of supply chains by multinational companies seeking to increase their resilience to geopolitical shocks.

The Evolution of India's Financial Markets

Supported by robust economic growth, a pause in interest rate hikes, and an influx of capital from domestic investors, India's Nifty 50 index recorded its eighth year of consecutive gains in 2023. The bullish momentum was widespread with large and small caps showcasing solid breadth. According to a report by Bloomberg, India's equity market capitalization surged above \$4 trillion last month, positioning it as the fourth largest equity market—only behind the U.S., China, and Japan⁴. Figure 2 shows that India's equity market is highly diversified, providing investors with a broad, investable universe.

While equity markets took center stage in 2023, we believe credit markets could see billions of dollars in inflows in the coming years. Last September, JPMorgan unveiled plans to include Indian government bonds in its emerging market index starting in mid-2024, which has \$213 billion benchmarked to it⁵. Earlier this year, Bloomberg announced similar plans starting in September 2024⁶. In our opinion, the evolution of India's credit market can be attributed in large part to the country's positive track record of fiscal discipline, sound monetary policy, and price stability.

Figure 2: MSCI India Index Sector Composition



Financials	25.0%
I.T.	13.2%
Consumer Discretionary	11.7%
Energy	11.3%
Industrials	8.4%
Consumer Staples	8.3%
Materials	8.1%
Health Care	5.1%
Utilities	4.6%
Communication Services	3.2%
Real Estate	1.0%

Source: Bloomberg. As of January 31, 2024.



3 Source: Reuters. As of January 2024. <https://www.reuters.com/business/finance/india-eyes-100-bln-annual-foreign-direct-investment-coming-years-it-minister-2024-01-17/>

4 Source: Bloomberg. As of January 2024. India Overtakes Hong Kong as World's Fourth Largest Stock Market - Bloomberg

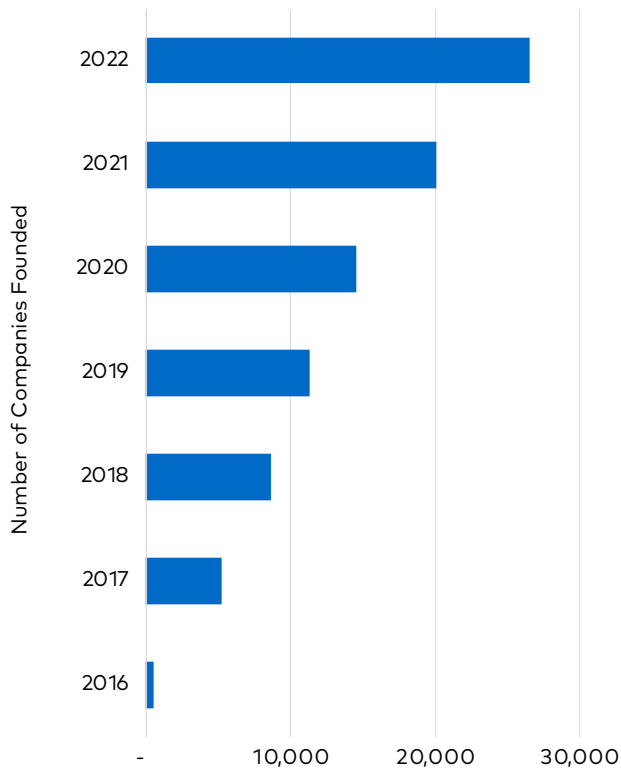
5 JPMorgan Government Bond Index Emerging Markets. Source: JPMorgan. September 2023 Press Release.

6 Under Bloomberg's proposal, the inclusion of India FAR (Fully Accessible Route) bonds in the Bloomberg EM Local Currency Indices is to be phased in over a 5-month period. FAR bonds are securities that have no investment curbs for foreigners.

India Outlook: A Multi-Decade Growth Story

Last year, our investment team visited India, where we experienced the vibrant energy and buoyancy of the local economy. Compared to our past trips to the country, we witnessed a meaningful pickup in entrepreneurial activity and dynamism across the private sector, as illustrated in Figure 3.

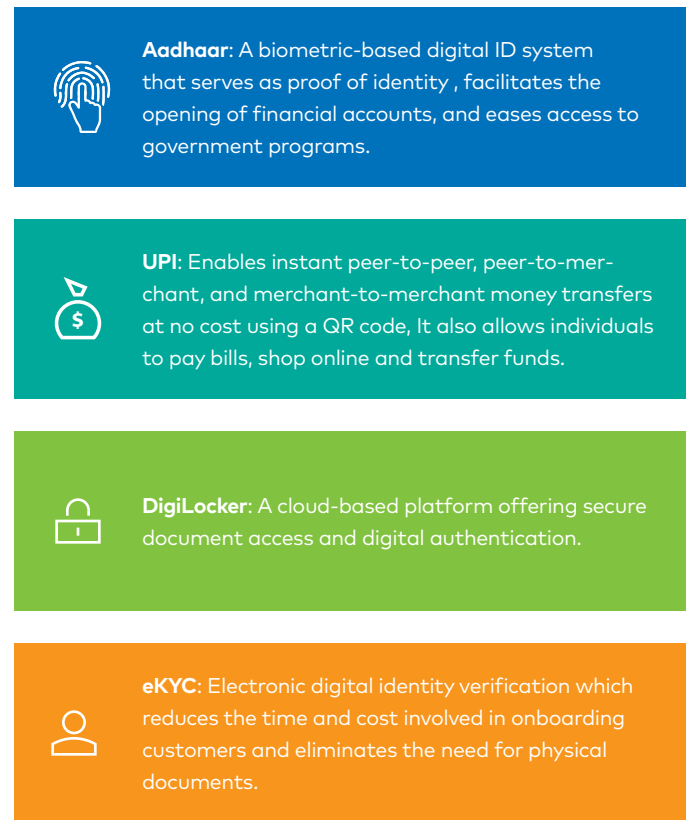
Figure 3: Indian Start-Up Ecosystem – Entrepreneurial Activity in India



Source: India's Department for Promotion of Industry and Internal Trade. As of December 2022. Latest data available.

In the last few years, there have been groundbreaking advancements in India's public digital infrastructure, commonly known as the Tech Stack. As seen in Figure 4, the Tech Stack is built on four key pillars, including Aadhaar's unique identification number, the Unified Payments Interface (UPI), a digital locker, and e-know-your-customer (eKYC).

Figure 4: The Four Pillars of India's Tech Stack

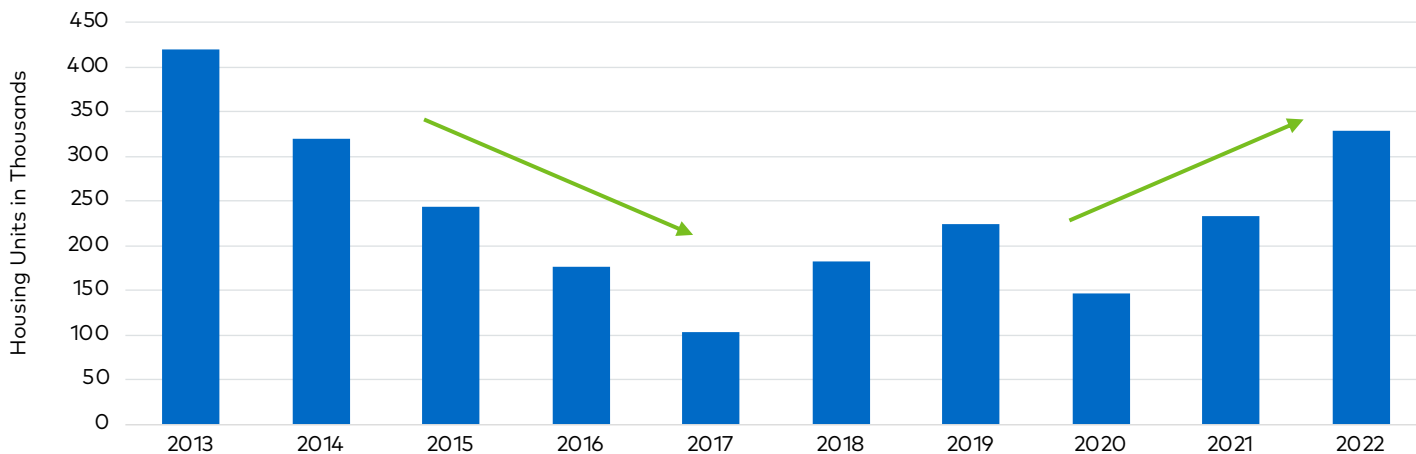


Source: Polen Capital.

India's digital revolution has not only fueled rapid innovation and reduced friction across the economy but also accelerated long-term secular trends, including e-commerce, mobile payments, telemedicine, artificial intelligence, and the democratization of credit. We believe these catalysts will help usher new corporate domestic champions, driving the potential for superior earnings growth.

Furthermore, as seen on the next page, the residential market has resumed its growth trajectory after facing challenges over the past several years. We believe that a pause in interest rate hikes, robust demand for luxury housing, and investments by Indians living abroad boosted developers, marking a stark contrast with many other countries currently facing severe dislocations in the real estate sector.

Figure 5: India's Residential Property Launches

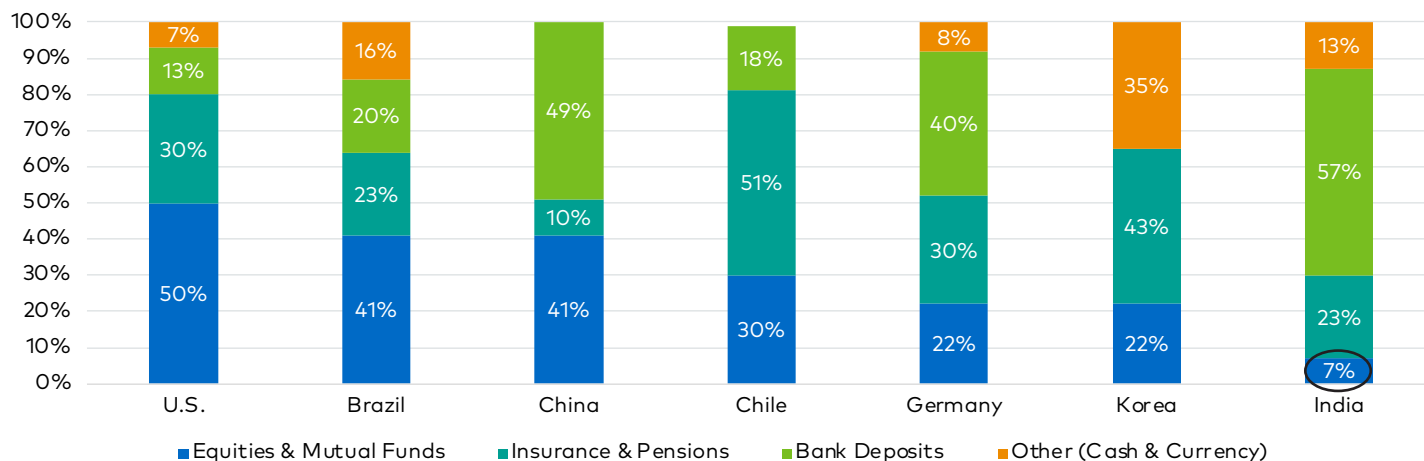


Source: Statista. As of December 2022. Latest data available.

For one, the financialization of household savings, deep smartphone penetration, and the emergence of local trading platforms have helped democratize the investment landscape, enabling millions of retail investors to access the market. Looking forward, we believe that the retail space has ample runway for growth, given that there were only about 40 million unique mutual fund investors in the country of over 1.4 billion people⁷.

As shown in Figure 6, domestic household exposure to equities remains relatively low at 7% of financial assets, compared to an average of 30% for other emerging markets, suggesting considerable room for augmenting equity allocations⁸. In turn, positive corporate results have catalyzed domestic inflows, keeping valuations of Indian equities elevated. According to Bloomberg, earnings for Nifty 50 companies are projected to rise about 15% in 2024, marking a fourth straight year of double-digit profit growth⁹.

Figure 6: India's Residential Property Launches



Source: Statista. As of December 2022. Latest data available.

7 Source: Bloomberg. As of December 2023. <https://www.bloomberg.com/news/articles/2023-12-28/inside-the-record-year-for-india-s-585-billion-mutual-funds-industry>

8 Source: Bloomberg. As of January 2024.

9 Source: Bloomberg. As of December 2023. Record Eight-Year Winning Streak Seen Extending for India Stocks - Bloomberg

Investor Takeaways

While we believe several secular tailwinds support our constructive view on India's economy, our research indicates that some areas of the Indian equity market appear expensive. Hence, we do not dismiss the possibility of bouts of volatility down the road. On the political front, the biggest display of democracy will soon present itself as 912 million registered voters will get a chance to choose if Prime Minister Modi is to remain in office. The consensus anticipates Modi to be re-elected, though, at state-level elections, his party has lost some key states. In a scenario where consensus is proved wrong, we could witness a significant correction in India's premium.

Important Disclosures

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With equity multiples already trading at high levels relative to history, maintaining valuation discipline will be critical to navigating Indian markets. Therefore, our view is that investors should favor higher-quality businesses with sustainable competitive advantages and employ a long-term approach, as we are optimistic that India's best years are still yet to come. At Polen Capital, we believe that India's structural growth story will continue to unfold over the following decades, paving the way for the emergence of many innovative companies along the way.

Definitions:

The **MSCI India Index** is designed to measure the performance of the large and mid cap segments of the Indian market. With 131 constituents, the index covers approximately 85% of the Indian equity universe.

The **NIFTY 50** is a benchmark Indian stock market index that represents the weighted average of 50 of the largest Indian companies listed on the National Stock Exchange. Nifty 50 is owned and managed by NSE Indices, which is a wholly owned subsidiary of the NSE Strategic Investment Corporation Limited.

The **JPMorgan Government Bond Index-Emerging Markets (GBI-EM)** indices are comprehensive emerging market debt benchmarks that track local currency bonds issued by Emerging market governments.

The **Bloomberg Emerging Markets Local Currency Government Index** is a flagship index that measures the performance of local currency Emerging Markets (EM) debt.

Gross Domestic Product (GDP) measures the monetary value of final goods and services produced in a country in a given period of time.