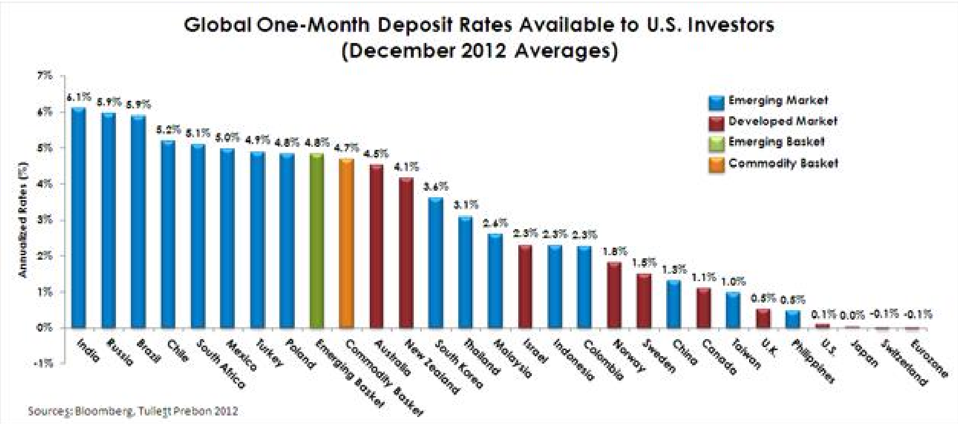
COULD INDIA FINALLY BE TURNING THE CORNER?

Rick Harper — Chief Investment Officer, Fixed Income and Model Portfolios
02/07/2013

With the Indian rupee coming off historic lows, we believe potential foreign direct investment could provide the necessary boost for further currency appreciation. 2011 and 2012 were not great years for the Indian rupee. Persistent concerns about inflation and a slowing global economy created an environment that policy makers and investors found very difficult to navigate. However, 2013 is off to an encouraging start, with strong flows forcing the currency up from its historic lows reached in June 2012. With moderating inflation giving it some flexibility to cut interest rates, and in an effort to revive growth, on January 29 the Reserve Bank of India (RBI) went ahead with a 0.25% rate cut for the first time since April of 2012. While current foreign exchange forecasts are calling for only a moderate appreciation of 2.6%,[1] the high levels of interest carry could be an attractive cushion for investors looking to make an allocation to one of the world's largest and fastest-growing economies.



The deposit rates are historical and do not represent the returns of any WisdomTree ETFs.
Global one-month deposit rates represent the annualized rate of interest offered by banks in exchange for one-month deposits. U.S., U.K., eurozone, Japan and Switzerland deposit rates are represented by the London Interbank Bid Rate (LIBID) for one-month deposits. LIBID rates are the daily reference rates at which a consortium of British banks are prepared to borrow or accept deposits. Bloomberg composite rates for one-month deposits were used for Australia, Canada, Israel, Mexico, New Zealand, Poland and Sweden. The Norway Interbank Deposit Rate and the Johannesburg Interbank Agreed Rate were used to proxy one-month deposit rates for Norway and South Africa, respectively. Each rate is an average of the rates indicated by local and international banks for one-month deposits in the specified currency. For Brazil, China, Chile, Colombia, India, Indonesia, Malaysia, Russia, South Korea, Taiwan and Thailand, the implied yields for one-month non-deliverable forward contracts were used to represent the rates available to U.S. investors. For Turkey, the implied yields for one-month deliverable forwards were used to represent available rates. Given restrictions on direct access to local short-term deposits, implied yields on currency forward contracts are often used to represent the short-term rates available to foreign investors in emerging market countries. Implied yields on forward currency contracts incorporate both the difference between the forward currency and spot currency rates as well as the potential interest earned from investment in the underlying cash collateral.
The yield on the Emerging Basket is simply an average of the yields on the following 15 emerging currencies: Brazil, China, Chile, Colombia, India, Indonesia, Malaysia, Mexico, Philippines, Poland, Russia, South Africa, South Korea, Thailand and Turkey. The yield on the Commodity Basket is simply the average of the yields on the eight commodity-exporting countries Australia, Brazil, Chile, Canada, New Zealand, Norway, Russia and South Africa.

Even among its emerging market contemporaries, India, after largely holding rates steady in the previous two years, now sports an attractive level of carry over most other currencies. Specifically, the WisdomTree Indian Rupee Fund (ICN) has a 5.98% embedded income yield as of December 31, 2012. (For standardized performance, including the SEC 30-day yield for ICN click here.) The combination of exposure to local interest rates and movement in the rupee against the U.S. dollar could provide investors with an attractive rate of return in 2013. However, the health and the perception of risk assets in the global economy are crucial. In 2013, flows could prove to be key. Should money continue to flow into the Indian debt and equity markets, the rupee could finally break its recent bout of underperformance. As our equity group has published in a recent blog, India has an attractive long-term growth story and is a country they consider underappreciated and undervalued. As investor dollars flow into the country, they must be converted to rupees in order to buy locally denominated assets. While the currency is undervalued by nearly 62%[2] on a purchasing power basis, we believe that the path of modest appreciation seems the most likely. Other potential upside surprises could develop as politicians position themselves for the 2014 elections. After a frustrating series of false starts and missteps, politicians may finally come together to push through structural reforms. We believe even minor steps in this direction could have a significant impact on investor sentiment and tolerance for risk. While it is still far too early to call 2013 a victory for investors with exposure to India, a series of positive developments have primed the pump for positive performance. With some stimulative policy from the RBI and a generally positive outlook for emerging markets in Asia, we believe India has the potential to be a solid performer in 2013. [1]Source: Bloomberg, as of 1/29/2013. [2]Sources: World Bank, International Monetary Fund, WisdomTree, as of 12/31/2012.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. This Fund focuses its investments in India, thereby increasing the impact of events and developments associated with the region, which can adversely affect performance. Investments in emerging or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of this Fund, it may make higher capital gains distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.