INDIAN MARKETS TO TRIPLE OVER FIVE YEARS

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I saw this headline on LinkedIn recently: "Nifty will triple in 5 years."[1] The quote was attributed to Ridham Desai, Morgan Stanley's head of research for Indian equities. Gaurav Sinha, who covers India extensively for WisdomTree, has been making the bullish case for India on our blog, but the potential drivers for the view that Indian markets would triple is something I wanted to learn more about.

I invited Desai onto our "Behind the Markets" podcast to discuss his views with Gaurav and me. At the top of the show, we had the honor of speaking to Viral Acharya, the deputy governor of the Reserve Bank of India (RBI), to hear about policies on which the central bank is focused. You can find the summary of our conversation with Acharya here.

Our conversation with Desai touched on the following points:

- **The Exciting Moment in India's Life Cycle:** We've had a small rise in share prices due to modest changes in earnings. Desai thinks the economic and earnings growth cycle is turning and should support earnings per share growth of 20% per year over the coming five years. During the last big growth cycle from 2003 through 2008, Nifty earnings compounded at 39% per year.[2] While Desai believes growth at that rate isn't likely due to slower global growth conditions, he does see growth at half that rate as very much possible. Desai also sees valuations as being simply "normal" today with potential catalysts to ignite higher multiples that would compound share prices at 24% to 25% per year—which results in his statement that it's possible for 3x gains in India over the next five years.
- **Structural Shift in Equity Allocations:** One of the big supporters of Indian markets, Desai believes, will come from a growing allocation to Indian equities from Indian households. Changes to retirement accounts that previously were allocated only to Indian bonds are increasing equity flows. Desai compares this to the effect of 401(k)'s in the United States in the 1980s; the plans powered one of the greatest U.S. bull markets in history.
    - Four players for flows Desai sees here:
        - **National Pension Scheme and Provident Funds:** Historically, these funds had potential to include equities, but they only used bonds. The Modi government changed this and mandated a minimum 5% and already has increased that to 15%. Desai believes it is possible this number goes as high as 40% in the coming years. There is huge compounding at work here because the number of subscribers to this program, incomes and allocations to equities are all growing.
        - **Asset Allocation:** Insurance is also growing, and insurers are utilizing equities as part of long-term asset allocation.
        - **Domestic Mutual Funds:** More systematic investing programs are being put in place with a lot of education for investors doing consistent, automatic investing, thereby discouraging a trading culture.

- **Desai's Long-Term Forecast for Flows to Equities:** Over the last decade and a half, foreign investors have allocated $150 billion to Indian equities, and Desai expects Indian households to add $400 billion to $500 billion over the coming decade.

- **Formalization of Economy:** Desai sees the Goods and Service Tax (GST) that was implemented as being crucial for bringing informal activities into the formal economy. While this will undoubtedly create setbacks for businesses that were avoiding taxes to compete, the data that comes with GST should create much better credit opportunities for businesses once their cash flows are tracked. Historically, banks only lent money on assets and not cash flows, but this is likely to change.

- **Leverage to Increase with Culture Shift:** Desai talked about how households' non-mortgage debt is only 5% of GDP but that the culture for young people in their 20s and 30s is different than older generations. There is high capacity for households to pick up borrowing, which means estimates for consumption growth may be too conservative, and this can lead to better earnings growth for the local companies.

- **On the NPL Cycle:** Desai emphasized how we are at an interesting moment where the government and RBI are working to fix non-performing loan (NPL) issues at banks. The Modi government generally has been tackling tough reforms that might cause short-term headaches but lead to more long-term success. This banking issue has been a stumbling block for the economy, and we expect the RBI to make progress on it.

Desai discussed a number of really important drivers for the markets—from earnings growth to investor flows—and it was a pleasure to hear his bullish outlook. To listen to the full conversation, you can click here.

[1] India's benchmark index.

[2] Amit Mudgill, "India Inc Seeks to Return to Golden Days of 2003-2008; Can Market Wait?" The Economic Times,

6/15/17.

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DEFINITIONS

Nifty Index : The National Stock Exchange of India’s benchmark index for the Indian equity marke.

Bullish : a position that benefits when asset prices rise.

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Cash flows : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.