
INDIA ELECTIONS & MARKETS: BEHIND THE MARKETS SPECIAL EDITION

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Last week on a special edition of our “Behind the Markets” podcast, I was joined by Gaurav Sinha, Associate Director of Asset Allocation and Modern Alpha at WisdomTree, and Srinivas Thiruvadhanthai of the Jerome Levy Forecasting Center to discuss India’s current general election.

The 70s and the Opening Up of the Economy

Thiruvadhanthai grew up in India during the 1970s, when shortages of essentials goods like sugar and rice were rampant. People had to wait for 10 years to get a landline phone. Life started improving during the 1980s and 1990s, when, nudged by the IMF, India opened its economy. Since then, India has seen 6%–7% growth for last 20 years.

Sinha discussed how the current election cycle kickstarted on April 11 and is the world’s largest democratic exercise, with almost 1 billion voters and \$7 billion in expenses. Results come out on May 23.

Sinha also mentioned that there are going to be over one million polling stations, ranging from one station in the Himalayan mountains, 15,000 feet above sea level, for the sole hermit who meditates there, to stations in the lush green forests of southern India, where tigers and leopards roam.

Leapfrogging in Technology

India has implemented a number of technologies, including a biometric identity number issued to its 1.2 billion citizens. This unique identification system (UID) is linked to bank accounts and cell phones, and has impacted payments by going directly from cash to mobile payments and skipping credit cards. WhatsApp, which has over 300 million subscribers in India compared to less than 50 million in the U.S., has plans to launch a payment system through its network in India.

We discussed [de-monetization](#), where certain cash bills were suddenly invalidated by Prime Minister Narendra Modi. Thiruvadhanthai emphasized that for a country where most financial transactions are done in cash, de-monetization was a very gutsy move that caused a lot of inconvenience to the people. However, it did help to curb the parallel economy and reduce dark money that was circulating untaxed.

Elections 2019

Thiruvadhanthai mentions that, because India has incredible diversity, it is difficult to predict the outcome of elections. However, he thinks there is a 50/50 chance of Modi coming back to power. Even though some reforms such as de-monetization caused trouble, markets generally like Modi.

India is a young country and Sinha says a lot depends on what young India wants. Based on his recent travels, he feels Modi has the pulse of young voters and connects with them through social media and newer avenues. He thinks that

70/30 odds of Modi getting reelected are fair.

Thiruvadanthai shared his personal experience of being on the ground when de-monetization happened. He thought that average people on the street were inconvenienced but not unhappy, as it helped in cleaning corruption. Similarly, implementation of a goods and services tax bill (GST), though initially messy, is now helping to integrate what were previously fragmented state-by-state taxes in India. This is improving efficiency, and tax collection as a percentage of GDP has been steadily going up ever since.

The main opposition to Modi is Congress and its allies, though they lack a credible face. However, Thiruvadanthai pointed out that Congress can surprise. They announced a minimum income guarantee scheme for the lowest income earning bracket, but their tightrope walk since then could be interpreted by the middle class as a tax increase.

Markets & Valuations

Thiruvadanthai accepts that for the most part, India trades at a premium due to its growth prospects. He also thinks that because of the nature of India's economy, which is export of services and negligible dollar-denominated debt (unlike other emerging markets), it tends to do relatively well.

Sinha highlights that India now has a demographic the size of China, the sixth largest economy and is growing at 7%–7.5% for the foreseeable future, according to the IMF. He also mentions that growing this fast creates enough tailwinds for efficiently run small- and large-cap companies to grow along with the economy, something that is validated by maximum growth across all of EM in the percentage growth of book value and profits of Indian [large-](#) and [small-cap](#) companies respectively. Thus, India's higher valuations can be attributed to its faster growth rates, and Sinha thinks these growth rates are a once in a lifetime opportunity for investors!

Sinha thinks that any election surprises leading to market corrections can create an excellent entry point for medium- to long-term investors, while if Modi is reelected markets would skyrocket, making it favorable tactically. Thiruvadanthai compares this to the 2004 elections when, after Modi's party lost, markets corrected severely but then almost tripled in the next few years.

Sector wise, Sinha thinks that any sector that gives exposure to India's consumers such as private financials with exposure to retail loans, consumer sector and ex-state owned large-cap companies are a great pick. Thiruvadanthai adds that mid- and small-caps, which have lagged in recent times due to election [volatility](#) and other reasons, can massively outperform once India comes out of its election season.

Please listen to the full conversation below.

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DEFINITIONS

Demonetization : The act of stripping a currency unit of its status as legal tender..

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.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Volatility : A measure of the dispersion of actual returns around a particular average level. .