

# Which India index offers the best equity market strategy?

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## WisdomTree

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The Indian equity market, we believe, represents one of the most exciting opportunities in emerging markets with a dynamic, fast growing economy underpinned by structural reforms. Improving the business climate is a priority of government policy, with a focus on ease of doing business, bridging the skills gap through training, a domestic investment initiative and reducing bureaucracy. Recently the move to a new goods and services tax creating a national unified market for the first time is a further example of growth oriented policies. This commitment to positive change also has implications at a structural level for the economy and the sectors that are likely to benefit.

Many reforms have started with the financial sector and importantly the impact is likely to feed through into private sector consumption. Key measures such as those to incentivise credit and debit transactions, and the boost to mortgage lending and retail credit should combine positively with demographic trends such as the expanding population. Over the past five years, household consumption has remained at elevated levels, typically close to 60% of GDP. As the population continues to expand and, with policy and financial measures favouring consumption, it is likely that consumer-oriented sectors will benefit.

Another supporting feature at a macro-economic level is that India's private sector is substantially under-leveraged. This is relative to both other BRIC economies and other Asian countries. The key here is that ongoing financial reforms suggest potential for continued expansion in domestic credit leading to a positive impact on growth.

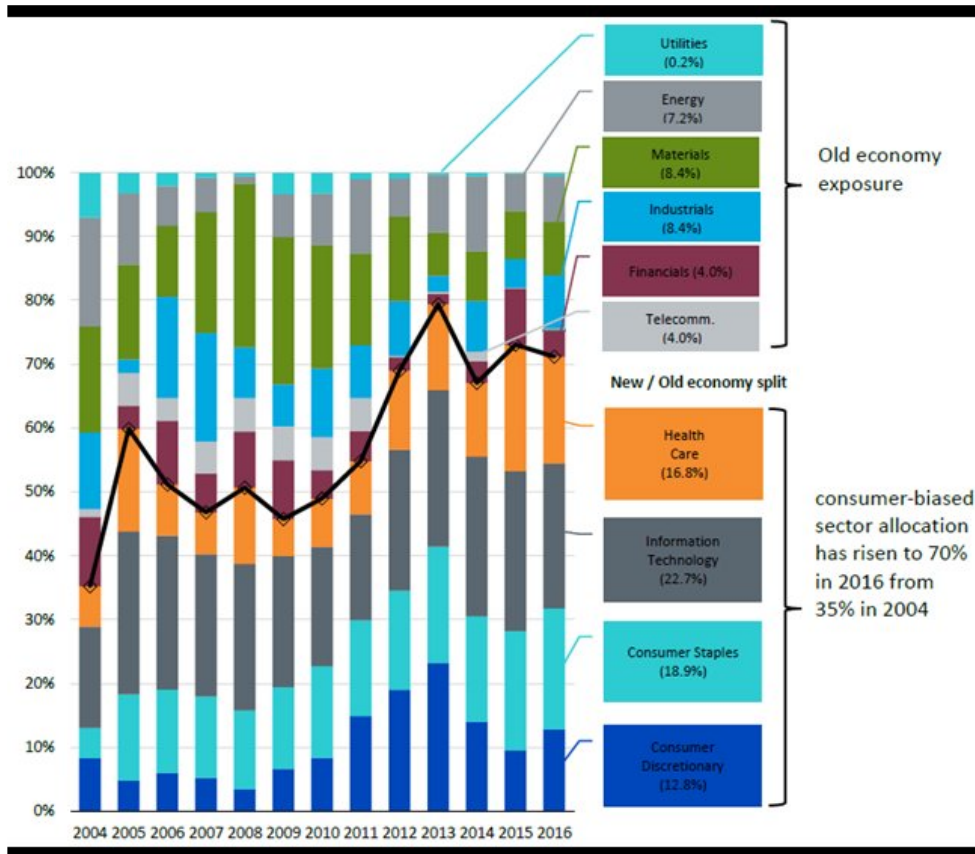
Traditional indices, such as MSCI India, have trodden a well-worn path of offering market capitalisation, adjusted for free float and foreign ownership restrictions. Whilst it is a representative benchmark of the listed equity market, it remains firmly entrenched in sector weights that reflect where the economy has been—rather than the direction of travel as the economy evolves.

WisdomTree has been developing smart strategies for over ten years, and has built a unique approach to the Indian equity market with a focus on quality companies. Key features of the WisdomTree India Quality Index include:

1. As dividends have historically been eschewed by Indian companies we designed the index to be more closely aligned to quality earnings.
2. In addition to a minimum market capitalisation of \$200m and liquidity criteria, companies need to have earned at least \$5m in the previous fiscal year at the time of the annual screening and rebalance.

3. The key element of the index’s design is its stock selection based on rankings using three years of historic data for return on equity and return on assets, taking the top 33% or at least 50 companies.
4. The constituents are then weighted by free float adjusted market capitalisation with concentration risks managed through a 5% cap on single stock weights and 25% at a sector level.

**Chart 1: WisdomTree India Quality Index sector allocation weights**



Click to enlarge

Source: WisdomTree, MSCI Factsheet. Please note you cannot invest directly into an index.

As at September-month rebalance

The end result of this focus on quality is a sector allocation that is substantially tilted towards “new economy” exposure compared to traditional “old economy” sectors. Since 2004, the WisdomTree India Quality Index has seen its allocation to new economy, technology and consumer-oriented sectors rise from 35% to 70%—in contrast MSCI India has only a 50% exposure to new economy sectors.

Another benefit of this methodology is the diversification that it offers from a size perspective with only 44.5% in large cap stocks, a slightly higher proportion in mid-cap stocks at 44.7% and close to 11% in small caps. The index features a focused basket of 105 constituents that allows for ease of replication by a unique physical UCITS ETF.

## Conclusion

Investors wanting to gain a forward-looking exposure to the Indian equity market may find the WisdomTree India Quality Index a uniquely positioned strategy. The index constituents have had historically above average return on equity over the past ten years. In terms of performance, the index, over both the medium and long term, has delivered above average annual returns with typically lower volatility.

### Table 1: WisdomTree India Quality Index methodology summary

#### Eligibility

#### Weighting & Capping

- + 250,000 shares per month traded at least for each of the six months preceding the “Screening Date”
- + Average daily dollar volume of at least US\$200,000 for each of the six months
- + Market cap of at least US\$200 million
- + At least earned US\$5 million in their fiscal year prior to the annual reconstitution
- + Indian companies with positive Net Income, and P/E ratio of at least 2x
- + Selection by quality (3Y RoA and RoE) ranking: Top 33.3% or at least 50 names
- + Sector diversification rule: Top 10% or at least one name from each GICS sector, will be selected
- + Free-float adjusted market cap
- + 5% single stock cap
- + 25% sector cap
- + Annual, in September

*Source: WisdomTree*

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