

# INDIA CONTINUES OPENING MARKET TO FOREIGN INVESTORS

Gaurav Sinha — Associate Director, Asset Allocation and Modern Alpha  
12/29/2015

India's parliament recently concluded its winter session. As India navigates through its future course of reforms, a lot of emphasis is often placed on key initiatives such as the Goods and Services Tax (GST) Bill, which could simplify taxes and increase mobility of goods and services across the country; a full-fledged bankruptcy code to strengthen recovery mechanisms for the banking system; and a few other key legislative items. While we stay hopeful for the passage of some of these reforms with time, more importantly I wanted to revisit a key and less spoken about step that government already took a few weeks ago towards improving accessibility of 15 sectors to foreign investments. This is a small but significant step towards providing India with needed capital. I also wanted to stress how it could lead to potential expansion of India's market cap in emerging markets (EM) indexes and why certain sectors, such as Financials, stand to benefit from increased foreign fund flows.

**Sectors Opening Up to Foreign Investments—Financials to Be a Key Beneficiary** In the second week of November, prime minister Narendra Modi's government relaxed foreign investment norms for 15 sectors, including construction projects, cable networks, agriculture (coffee, rubber, palm oil) and air transportation<sup>1</sup>, in which the foreign caps have been raised to 100% for [foreign direct investment \(FDI\)](#). Other sectors such as defense and broadcast have been increased to 49% for FDI. Given India's socialist past, such big changes show a significant change of mind and a willingness by the current government to liberalize India's economy. What this means is **more foreign money can flow into India, spurring not only growth but also potentially leading to earnings expansion for these sectors.** While this is good news in general, one sector surely deserves special attention, and that is Financials. In July of this year, the cabinet announced it was removing individual caps for [foreign institutional investment \(FII\)](#) and FDI to create a single composite cap of 74%. While FII is investment in [liquidity](#) market instruments such as equities (or bonds, mutual funds, the way our own exchange-traded Funds purchase shares), FDI, on the other hand, is foreign investment in long-term physical capacity such as setting up a factory. Many investors prefer an investment approach that allows liquidity. For many big financials in India, the FII cap previously was close to being reached, while the FDI cap was largely vacant. The merging of these two thresholds into one created potential for greater FII in these banks.

**Fund Flows and Increase of India's Cap Weights in Benchmark Indexes** A direct effect of this step could be passive flows of foreign money into Indian markets, an increase in weighting of Indian financials in benchmarks tracked by fund investors globally. According to estimates by leading research and brokerage houses in India,<sup>2</sup>

- India's weight in the [MSCI Emerging Markets Index](#) could go up by 74–100 [basis points \(bps\)](#) from its current level of approximately 8%;
- the weight of financials in the [MSCI India Index](#) could increase to 23%–24.5% from its current level of approximately 16%; and
- among big banks, key increases seem to be in YES Bank and Axis Bank.

Below is a detailed breakdown of new investment limits available to foreign investors for large private banks in India.

## Merging of FII and FDI Caps to Free Additional FII Investment for Private Banks in India

	Current FII Holding	FDI	Total Foreign Investment (FII + FDI)	Foreign Investment Limit	New Available Limit	Weight In WisdomTree India Earnings Index	Weight In MSCI India Index
YES Bank	46.3%	0.0%	46.3%	74%	27.2%	0.66%	0.0%
Axis Bank	48.5%	3.7%	52.2%	74%	21.8%	2.23%	0.0%
IndusInd Bank	40.6%	27.4%	68.0%	74%	6.0%	0.58%	0.0%
ICICI Bank	41.7%	29.1%	70.8%	74%	3.2%	3.79%	1.57%
HDFC Bank	33.8%	38.5%	72.3%	74%	1.7%	5.74%	9.74%

Sources: Bloomberg, Credit Suisse, Edelweiss as of 11/27/2015.

We have been emphasizing the importance of the Financials sector within India. Current liberalization provides tremendous opportunity for investors to access a sector that's about 6% of India's \$2.2 trillion [gross domestic product \(GDP\)](#) and is [growing fast](#).

**WisdomTree India Earnings Index** It is important to note that the [WisdomTree India Earnings Index](#) uses an earnings-weighted approach to allocate to profitable Indian companies. At roughly 25% in financials, it is 8% over-weight

compared to the MSCI India Index.<sup>3</sup> Some of the biggest beneficiaries of this current announcement—Axis and YES—are currently included in the WisdomTree India Index but are not yet included in the MSCI India Index. **Putting Everything into Perspective** With several caps limiting investment, full participation in Indian markets and economy has traditionally been a challenge for foreign investors. India currently stands at a crossroads of tremendous wealth-generation capacity. With the government's goal of a GDP growth rate of 7%–8%, India can potentially double its \$2.2 trillion economy over the next decade. Recent measures by the government are allowing greater access for foreign investors to participate in the wealth-creation opportunities. Today, some emerging markets face a host of challenges: falling commodity prices, geopolitical risk, depreciating currencies against the dollar and global headwinds, to name a few. In contrast, India seems to be better positioned. Falling commodity prices have helped cool [inflation](#) in India (India is world's third-largest crude oil importer). Geopolitical risk cannot be denied, but India does have a full majority government and, more importantly, a government that is reform friendly, as evidenced by the above announcements. The rupee, in spite of [four consecutive rate cuts by the Reserve Bank of India](#) this year has been one of the better-performing EM currencies in 2015. And finally, [a consumption-driven model](#) makes India a much better investment destination to withstand global economic headwinds. As with any investment, there are risks. However, in the current macro landscape, as accessibility of Indian companies for foreign investors improves, by allocating to fundamentally sound Indian companies, investors have an opportunity to potentially generate significant positive returns. We continue to stay positive on India in an otherwise challenging emerging market landscape. <sup>1</sup>Non-scheduled air transportation and ground handling services have been increased to 100%. Regional air transportation service has been allowed up to 49%. <sup>2</sup>Sources: Edelweiss, Morgan Stanley and Credit Suisse. <sup>3</sup>As of 11/30/2015. Subject to change.

#### Important Risks Related to this Article

Investments focused in India increase the impact of events and developments associated with the region, which can adversely affect performance.

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](http://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.

## **DEFINITIONS**

**Foreign direct investment (FDI)** : An investment made by a company or entity based in one country into a company or entity based in another country.

**Foreign Institutional Investment (FII)** : An investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge fund, insurance companies, pension funds and mutual funds.

**Liquidity** : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

**MSCI Emerging Markets Index** : a broad market cap-weighted Index showing performance of equities across 23 emerging market countries defined as "emerging markets" by MSCI.

**Basis point** : 1/100th of 1 percent.

**MSCI India Index** : A market capitalization-weighted index designed to measure the performance of the Indian equity market.

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

**Inflation** : Characterized by rising price levels.