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India: An Insider's View

2014 was the year of the Indian market with MSCI India up 26.5% YTD. Unfortunately we did not have direct India access until recently. So far we had played this market through indirect exposures in the ADR market. Now our access product has been worked out and hence clients of RVAM can get direct access to India. Therefore we expect our direct India exposure to slowly ramp up.

Considering the above I thought this would be a good moment to introduce Jeetu Panjabi. He is a director on the board of the River Valley Core Compounding Fund and is increasingly acting as a valuable input in our investment process. Jeetu recently left Capital International (one of the largest active money managers in the world) after a career of nearly 20 years with them in Singapore and Mumbai. He was a part of the global macro team and a valuable part of their India investment process; when he left, he was also the head of the India office for Capital.

I requested Jeetu to pen down his thoughts post a recent investment trip he made. This nicely encapsulates an insider's view on both the macro and micro fundamentals in India. Our views at RVAM on India might not be as strong as Jeetu's but the broad direction remains the same.

We hope this is just the first of many contributions Jeetu will make to our monthly commentary.

India: A Geography Where the Internal Rate of Change Is Higher Than That in Most Others - Jeetu Panjabi

India in recent months has seen expectations rise meteorically after Mr. Modi was elected Prime Minister. There is concurrently a whisper in the financial world disappointed by the lack of big bang reforms. I spent a week meeting CEO's of traditional companies as well as policy makers, coupled with meetings with some high energy e-business companies, as part of a small group CIO tour. My focus was to calibrate expectations on India's ability to create value over the coming decade and the opportunity sets to focus on through this journey.

The key themes that were very visible were:

1. **The pipeline of potential Government actions is huge and not very visible to the financial world:** For many years, the dis-saver in economic parlance has been the Government sector. It has run a negative savings rate and simultaneously has been the biggest bottleneck for growth in recent years. We could now see how busy the Government offices were and bureaucrats working twelve hours a day with their attendance on view in the public domain at www.attendance.gov.in. One of the senior ministers explained that tasks on his dashboard exceeded 260 'To Do's' which were digitally monitored right up to the top. A bank CEO said that his meetings with the Ministry of Finance were scheduled at 8.30 am and 6 pm and that they are extremely productive unlike in the past. The new coal secretary explained the game plan to double India's struggling coal output from 528 mn tons to 1 bn tons in five years. A young 27-year old officer on special duty in the power ministry joined us for dinner and excused himself at 10 pm as he had to go back to the office to work. This pipeline and energy has clearly not been appreciated in the financial markets as reduced media access has resulted in Government background work not being spelled out on a regular basis. This makes me feel constructive as the expectations on Government policy in many pockets are still quite low.

2. **The corporate sector is enthusiastic and ready to invest, but do not see any significant movement on the ground so far:** Almost every single company we met was extremely enthused by the change in the Government driven by the optimism in the air. They however had not seen a significant change in the demand environment on the ground. It seemed pretty clear to me that the accumulation of many small measures would result in the turn of the cycle. Two wheeler demand growth running in the teens was an early cycle indicator while heavy commercial vehicles should turn by early 2015. A revival in the mining sector driven by Government policy would be concurrent with this turn. This should see pockets of tight capacity in the non-tradable basket of goods and this is where pricing power would emerge. That would lead capex and credit demand over the coming 18 months. I sympathize with the bears on wanting to wait to see the turn, but history suggests that the market cycle clearly leads the business cycle at the early stages of the cycle.

3. **The disruptive opportunity set businesses in the e-business world are on another planet:** The other set of companies we met included those in the Internet world like Snapdeal, Flipkart, Ola Cabs, etc. Growth rates were in the 200% p.a. range with VC's funding a chunk of their losses. This seemed like China in 2007 where broadband penetration had just crossed 20%. Current beneficiaries of this boom in India include Google, courier companies, the consolidating supply chain and digital marketing companies. I believe that mortality of businesses and value creation would run concurrent, both at a heady pace. I would believe it is a great trend for India and one that neutralizes some of the inflationary pressures that it was grappling with.

To filter out the noise and look at the opportunity landscape for India broadly, I am reminded of China in 2002. A US$1.5 trillion economy heading up to US$9 trillion with no bulls on the ground at that point. MSCI China had been down 88% over a decade. The demand side was slowly picking up and snapping up supply. MSCI RoE's turned from 7-8% in 1999 to 11-12% by 2002 trending to 16% over the next few years. And the rest is history - equity markets were up 600% in the next six years. India is somewhere there right now with just over US$ 2 trillion in output, potentially doubling to US$4 trillion in the next five years, growing at 15% per annum. The discretionary segment of demand in India should see the demand side staying robust as the 24 mn young people turning twenty each year find themselves gainfully employed in a vibrant economy. The robust 16-17% RoE in a historically capital-starved economy should ensure that minority investors have serious wealth created through stock prices.

I would well allocate a large part of my savings here for at least the next few years which I believe is the early part of the cycle.

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