



Investing in Asia ex Japan

Bulletin 3: India

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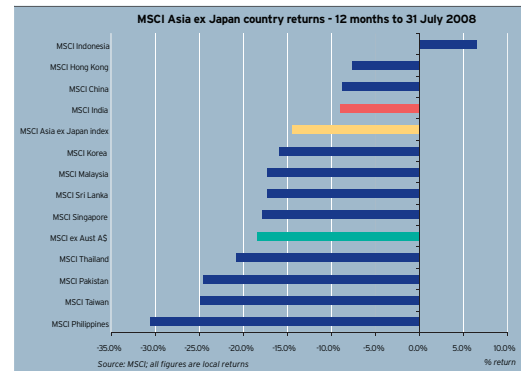
In this series of Investment Bulletins, we review the investment credentials of selected countries in the Asia ex Japan region, in the context of how Invesco manages the Invesco Wholesale Asia ex-Japan Share Fund ('the Fund'), which has exposure to a diverse range of countries in the region. In this edition of Investment Bulletin we take a look at India.



The Fund is managed by Invesco's Asian equity team. Our Hong Kong based team, one of the largest in the region, has investment professionals on the ground undertaking bottom-up research on individual companies as well as top-down macro research on Asian countries. Key benefits of the Fund are the team's experience, its research resources 'on the ground' across the region, and the risk monitoring systems and the risk-aware culture of the team.

How has India's stock market performed?

The chart below shows the 12 month MSCI returns of Asia-Pacific markets (to 31 July 2008) in local currency terms. Over this period India's sharemarket has outperformed, with the MSCI India Index returning -8.94% compared to the MSCI Asia ex Japan Index at -14.49%. Only one market in the region – Indonesia – performed positively over this period.



Key reasons for India's long term sharemarket success

Strong economic growth

India continues to move forward with market-oriented economic reforms, which began in 1991. Recent reforms include liberalised foreign investment and exchange regimes, industrial deregulation, significant reductions in tariffs and other trade barriers, reform and modernisation of the financial sector, significant adjustments in government monetary and fiscal policies, and safeguarding intellectual property rights.

India's real GDP growth for the fiscal year ended 31 March 2007 was 9.4%, up from 9.0% growth in the previous year. Growth for the year ended 31 March 2008 is expected to be between 8.5-9.0%. Moreover, foreign portfolio and direct investment inflows have risen significantly in recent years, and have contributed US\$255 billion to India's foreign exchange at June 2007.

Key reasons for India's long term sharemarket success (continued)

While the Indian economy faces challenges, including an elevated oil price, many of these appear less daunting than they have in the past. Given the stock market has an attractive growth to valuation profile compared to global peers, we believe the Indian equity market can avoid a further significant de-rating provided commodity prices, especially oil, do not rise significantly.

A sound investment environment

India has emerged as a low cost base economy, attractive enough for multinationals to open for business. Indeed, more than 100 of the Fortune 500 companies have a presence in India versus 33 in China. Foreign direct investment (FDI) policies in India are among the most liberal and attractive among emerging economies. Additional FDI and new technology in India will help create new employment opportunities. Moreover, gross capital formation comprises a hefty 37% of GDP, and company earnings have risen at a Compound Annual Growth Rate of 25% over the last few years. Companies are generating free cash flow which is lowering leverage. This is a result of years of capex discipline, cost cutting, efficiency improvement and better working capital management.

Deregulation of India's stock market

The Indian market has experienced an impressive five-year bull market, beginning in 2003 and running until January 2008, fuelled by over US\$50 billion in portfolio inflows.

In recent years, India's share market has become increasingly global, being the fourth largest country in the world in terms of purchasing power parity. Moreover, the Indian government has reduced controls on foreign trade and investment. This has allowed foreign investment of up to 49% into the country's stock exchanges, which has encouraged additional investment.

Share market expansion

The total market capitalisation of all the listed Indian firms passed the US\$1 trillion dollar mark on 28 May 2007, and has grown to near US\$1.9 trillion dollars early this year in January.

For example, nearly 1,000 foreign institutional investors have registered with market regulator SEBI (Securities and Exchange Board of India). Greater participation of foreign investors has also encouraged sharing of technology and trading expertise with Indian exchanges.

There is, however, a need for regional stock exchanges to consolidate to provide for a more regulated stock market, which would make Indian stock markets more accessible to foreign investors. So far, nine exchanges have come together and signed a memorandum of understanding with the National Stock Exchange in order to extend their trading platform.

Growing software sector

India's rapidly growing software sector is boosting service exports and modernising the economy. Software exports passed US\$28 billion in FY 2006-07, while business process outsourcing revenues hit US\$8.3 billion in 2006-07.

The United States is India's largest investment partner, with a 13% share. India's total inflow of US direct investment was estimated to be more than US\$9 billion in 2006. Proposals for DFI are considered by the Foreign Investment Promotion Board and generally receive government approval. Automatic approvals are available for investments involving up to 100% foreign equity, depending on the kind of industry. Foreign investment is particularly sought after in power generation, telecommunications, ports, roads, petroleum exploration/processing, and mining.

FT Global 500 list

Reliance Industries, flagship company of India's biggest corporate house Mukesh Ambani group, is ranked 88th in the latest FT Global 500 list, with a market cap of US\$70.7 billion.

Conclusion

India has not been immune to global developments with equity markets down significantly from peak levels. Oil prices at record highs and the fact that India imports close to 70% of its crude oil requirement, coupled with slowdown in export growth and deceleration in capital flows in the current environment poses meaningful risks to the external account.

Despite these negatives, corporate India continued to surprise positively on the earnings front. Amid talks of slowdown in the economy, surging raw material prices and a high interest rate regime, a large number of corporates have delivered respectable top-line earnings growth during the first quarter 2008.

The market's valuation is around 14.4 times to FY09 and 11.2 times to FY10 earnings and looks attractive compared to the five year historical average.



Look out for Bulletin 4 on Taiwan next month