# The India Fund

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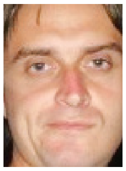

The New India fund was launched in 1994 as a vehicle for achieving long term capital appreciation through investments in Indian equity securities. The Fund is managed by Aberdeen Asset Management Asia, with $53.7 billion in assets under management as of the end of 2011. Investing in Asia since 1985, Aberdeen caters to private clients and institutional investors and is widely regarded as a market leader in the management of Asian assets. With a fixed number of shares offered at initial issuance, Aberdeen's closed-end funds are best-suited for investors seeking to capitalize on the growth potential of the Asia-Pacific region.

Investment Strategy

The investment strategy within the Fund is based on identifying well-run Indian companies with strong fundamentals that are most likely to benefit from India's long-term prospects as one of the world's fastest growing economies. India is one of the global leaders in outsourcing and information technology and differs in some key aspects from other emerging markets. In recent years, India's economic and political climate has seen some significant changes which have helped to create many well-managed companies focused on safeguarding shareholder value.

At a macroeconomic level, both China and India might appear to offer very similar investment opportunities but it is important to remember that there are some key differences in the political and economic infrastructures. China's growth is driven largely by government policy, which has created many state-backed growth companies. India's economy, by contrast, relies more heavily on dynamic entrepreneurship and industrial innovation. It remains clear that India has had a history of confrontational political relationships, both internally and externally, and this has, in some cases, created delays in growth-


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driven economic reforms. The country's relatively poor industrial infrastructure has added to this and created productivity bottle necks.

But even with these factors, India maintains a relatively high level of transparency and corporate accountability to private shareholders as well as a broad availability of investment choices across a diverse set of industry sectors. There is a real possibility India could still face some economic headwinds in the near term, but the economy continues to possess significant advantages over other emerging markets with its huge domestic market, a young and growing workforce, and an expanding middle class.

## Market Outlook

While it is true that equity markets in India tend to be heavily influenced by wider global economic trends, downturns in asset prices can lead to significant reductions in stock values and can provide excellent entry opportunities for investors with long term investment horizons. "Perhaps over the short term Indian equities have a tendency to be volatile but over the longer term they have produced strong returns," says Adrian Lim, Senior Investment Manager at Aberdeen Asset Management. "Indeed, the Indian stock market has been one of the best performers over the last 10 years, reflecting a vibrant corporate sector and strong shareholder culture."

Recent economic data continues to suggest that India is recovering from the global slowdown in growth and this bodes well for the country's stock prices into the end of 2012. Equity markets in India posted a positive performance for the month of February, based largely on the expectation that the country's central bank will lower interest rates in the coming months. Economic data in January showed that food price inflation dropped along with industrial output growth as weaker capital investment slowed productivity, and this is likely to give the Reserve Bank of India (RBI) some breathing room to make necessary changes in monetary policy.

With inflation falling for most of this year and declines seen in quarterly GDP expansion, expectations of a more accommodative monetary policy are leading to stock market gains as traders begin to establish new buy positions in anticipation of renewed stimulus measures. "In December, the RBI paused in its tightening cycle amid a contraction in industrial output," says Lim. "Quite clearly growth has become the focus of attention. Any further deceleration in economic activity will increase pressure on the RBI to relax policy as a means for stimulating markets."

## Industry Developments

In industry-specific developments, the Indian government recently outlined new programs to simplify licensing rules for telecom companies. Government policy is shifting stance to encourage M&A activity and improve transparency in corporate accounting practices, which is another reason for stock investors to have a favorable view this year. These policy changes came after a corruption probe led to the Supreme Court's landmark ruling to invalidate all 2G telecom licenses issued in 2008. The India Fund does have telecom holdings but none of these investments were directly affected by the 2008 ruling. Instead, the event is viewed as a positive for the Fund's telecom assets as the ruling could actually strengthen incumbent companies as it expedites consolidation and will allow competitors assets to be sold-off at cheaper prices.

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In other portfolio-related news, Hero MotoCorp secured a technological support partnership with U.S. motorcycle manufacturer Erik Buell for its new hybrid scooter and high-end motorcycles. This partnership came with new marketing campaigns as the company also entered into the U.S. professional racing circuit as a means for brand promotion. Similar collaborative efforts were seen with Tata Consultancy Services and Mitsubishi Corp., as they expand to provide IT services to Japanese customers.

## Effects of Higher Oil Prices

Although inflation figures have been showing steady declines this year, new risks have emerged in India, where the majority of its energy needs are imported from foreign sources. Because of this, India remains vulnerable to potentials disruptions in global supply if political tensions escalate over Iran's nuclear programs. Oil exports continue to be the largest cost in India's import transactions and a sustained rise in oil prices would weigh on economic growth and stretch the country's fiscal deficit further, as government fuel subsidies amount to approximately 2.0-2.5% of GDP. Another potentially negative effect on stock prices could be seen with declines in foreign investment inflows, as this could drag on the performance of domestic equities. A reverse scenario, however, would be seen if there are continued liquidity injections by major central banks worldwide. This stimulus would likely have the effect of lifting domestic share prices in India and other emerging markets.

## Balancing the Risks

Given that Asian growth prospects are expected to remain healthy relative to the West, long term investors need to assess the risks involved when looking to buy into emerging market assets. The Asian financial crisis 10 years ago forced these regional economies to make radical transformations to address structural weaknesses and promote the underlying strength of the corporate sector. Since then, prudent economic leadership has delivered reliable growth rates and stable currencies.

In the manufacturing, technology and outsourcing sectors, many Indian export companies are leaders in their respective fields and have helped drive the Asian growth engine. But even with most of market attention being placed on the export sector, domestic growth is becoming more and more significant as the middle class continues to become more of a presence. Because of this, sectors such as banking, housing and retail are providing valuable investment opportunities as these new trends develop and take shape.

But even with these recent trends, the Indian economy is far from being considered a "safe haven" and this is most clear during periods of excessive volatility in global markets. Risk needs to be assessed from both a foreign and domestic perspective so that long term opportunities can be identified for investors who are underweight in emerging Asian assets. Some of the key risks come from the fact that Asia's stock markets are still relatively small and vulnerable to liquidity-driven volatility. Large price swings create the potential for both above average gains and losses, so lengthier time frames need to be utilized when approaching these markets.

## Arguments for Continued Growth

The Asian-Pacific region makes up roughly 35% of global GDP, giving it a larger share of annual productivity growth than both the US and the Eurozone. But even with the downturn in equity markets seen in recent years, the Asian-Pacific region provides strong long-term growth opportunities, as developed nations struggle with enormous levels of

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debt. Western countries also tend to lack a clear political consensus when constructing resolutions to these problems, and a regionally diversified portfolio can help to protect against potentially negative outcomes. Balance sheets on both the corporate and government levels remain solid in Asia, coming largely as a result of financial restructuring seen in the last few decades.

In India, the financial infrastructure is being strengthened its growing middle class, with domestic spending power fueling consumption and removing some of the dependence that has historically been placed on the export sector. A wide variety of investment opportunities exist across a large number of industries and given the liquidity levels of Asian bond markets, trading conditions in Indian equities are likely to become increasingly stable and less heavily influence by external economic factors. To capitalize on this, the India Fund has selected a collection of roughly 30 companies with experienced management teams, sound business models and increasing attention to delivering shareholder value. With many markets trading in oversold conditions, opportunities exist to purchase quality companies trading at attractive valuation levels.

## Conclusion

When looking at the Total Risk Index, which assesses credit trends, loan/deposit ratios, debt levels, current account balances, exports and FX reserves, it becomes clear that the Asian region presents low risk investment opportunities for long term investment horizons. Current trends in Indian GDP growth are expected to continue into the medium to long term and the India Fund's track record provides an important competitive advantage for investors who are currently underweight in the region. "As in many of the large emerging market countries, it takes time to develop a deep understanding of where the best investment opportunities lie," says Adrian Lim. "To capitalize on this, it takes a stock-picking approach that leverages this knowledge effectively."

This investment process provides another key competitive advantage, as the Fund's managerial team has worked together for more than 15 years to identify and exploit fully the opportunities as they arise. With emerging Asian markets forecasted to represent nearly 49% of the world's GDP by 2050, growth projections in India create a compelling argument for Asia's long-term viability in both equity and fixed income markets. The combination of these factors gives the Fund the potential to deliver attractive returns to investors and capitalize on the strengthening growth trends unfolding in India. ■

*At the time of publication, the author holds no position, long or short, in the India Fund.*