



DANIEL MEGES, DIRECTOR, RESEARCH

INDIAN EQUITY: AN UNDER-APPRECIATED OPPORTUNITY

BY DANIEL MEGES, DIRECTOR, RESEARCH

Few markets outside of the United States can argue for a dedicated equity strategy. One of these markets is China—see ClearPoint June-2019—and we at Clearstead are actively helping our clients increase their exposure to Chinese equities. A second market that is increasingly worthy of attention is India. Home to 1.3 billion people (about 1/6 the world's population), poised to grow faster than China or any developed economy over the next decade, and featuring more publicly traded firms than the US, India may increasingly become more relevant to the global economy as well as to the savvy investor.

INDIA AS THE NEXT ENGINE OF GLOBAL GROWTH

India currently boasts a myriad of demographic tailwinds which will help propel its economy to be likely one of the fastest growing economies over the next decade. India's working age population—those between the ages of 15-64—will explode over the next ten-years, unlike China, Japan, or Europe, which will all see declines. Urbanization in India is gaining pace, and the share of the rural population is set to decline on par with the gains made in China and has much further to fall than in other large emerging markets. These trends in urbanization are another key aspect of India's growth trajectory, as this dynamic should pull large portions of

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Research and Investment Management team with Mike McLelland.

Mike has joined Clearstead as a Research Analyst. He comes to us from PNC Financial Services where he spent time as an Investment Analyst and most recently as an Investment Advisor. Mike has a Bachelor of Science from The Ohio State University and is a CFA charterholder.

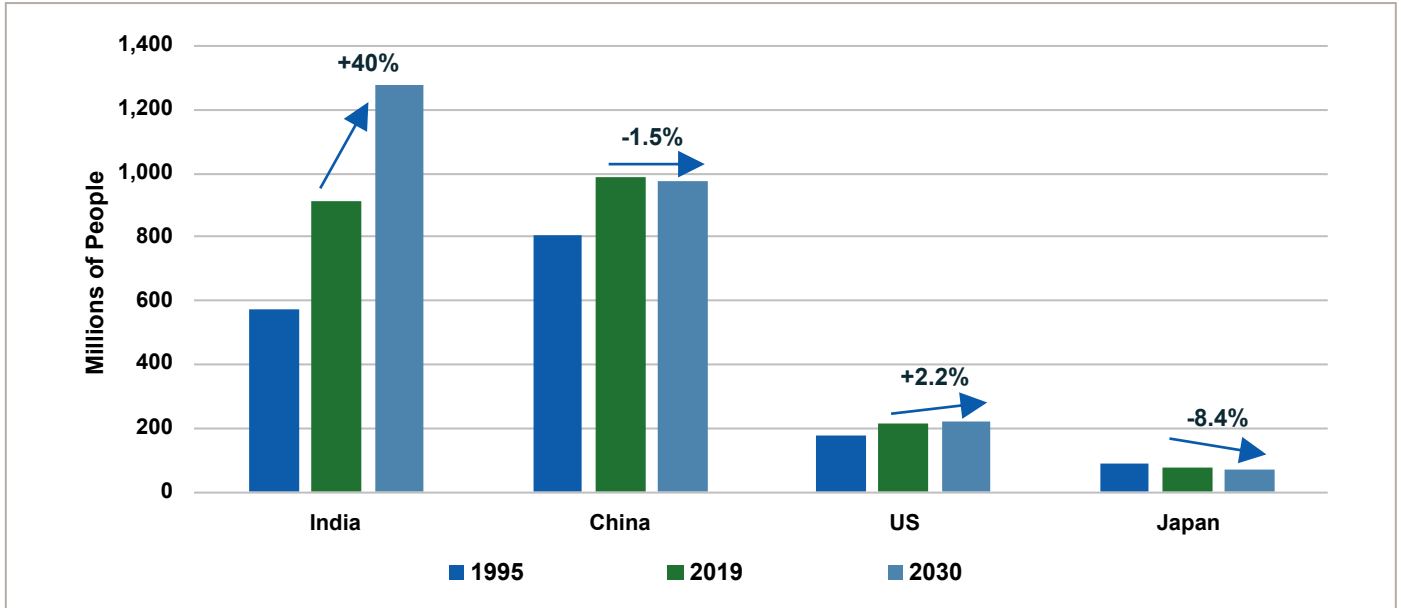
These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

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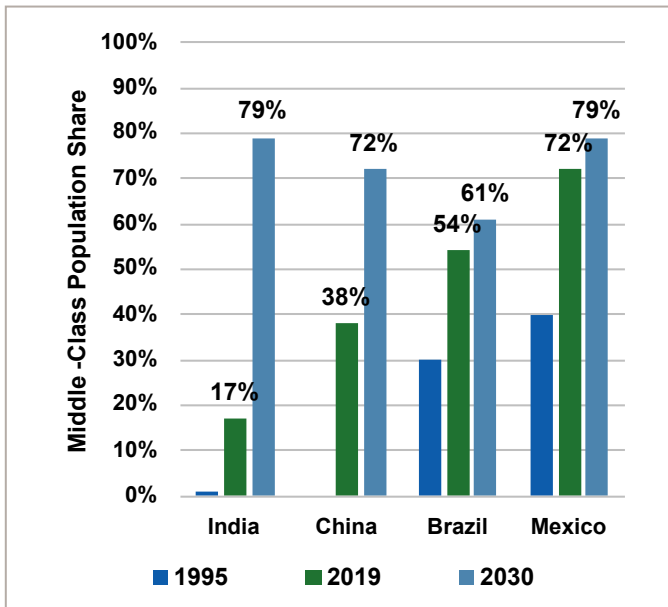
Indians out of near-subsistence farming or the low-productivity informal sector and into the formal global economy. The experience of other countries has shown that these migrations typically spur strong gains in productivity and rising living standards. In addition, Bloomberg Intelligence expects a strong rise in the number of Indians achieving at least high school level schooling, as well as substantial gains in its college educated cohorts.¹ Because of these dynamics, forecasters expect the share of Indians classified as middle class² to quadruple over the next decade.³ These gains in India's middle class are set to dwarf the gains made by other large emerging market countries.

India's Exploding Working Age Population



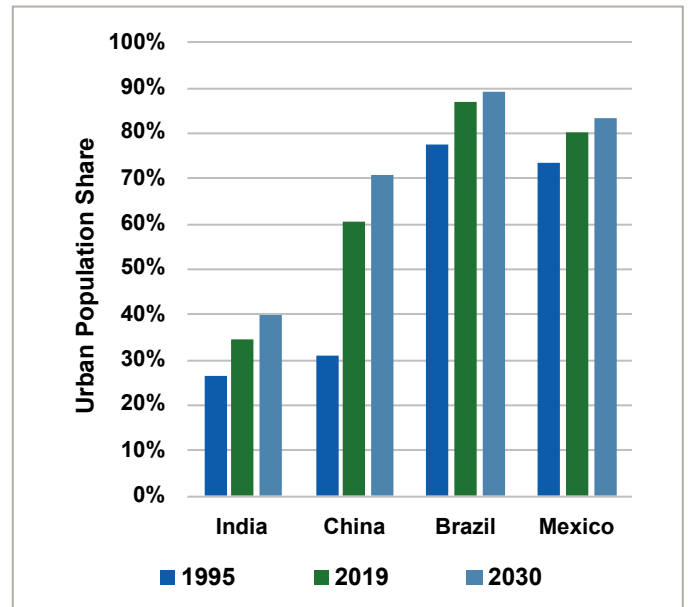
Source: Clearstead, World Bank, OECD.

India's Rising Middle Class



Source: Clearstead, Brookings Institute, JPMorgan.

India is Urbanizing



Source: World Bank, UN Dept. of Econ. & Social Affairs.

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INDIA IS SET TO REALIZE STRONG PRODUCTIVITY GAINS

Buttressing these strong demographic tailwinds are the ongoing reforms of the current Modi government. Prime Minister Modi enacted a series of reforms in his first term (2014-2019) that vastly streamlined and modernized India's bankruptcy procedures, simplified and improved its tax code, invested in key infrastructure, and provided every Indian citizen with a unique bio-metric ID, enabling even illiterate Indians to securely open bank accounts, receive government assistance, and pay bills through the formal banking system. These reforms helped India's economy grow by an average 6.8% per year during PM Modi's first term. PM Modi resoundingly won re-election in mid-2019 and has continued with a series of reforms to further bolster India's economy, including privatizations of state-owned firms, lower taxes for manufacturers, and labor market and agricultural reforms. The global consulting firm McKinsey judges that these reforms, if fully enacted, could create \$2.5 trillion in economic value and unlock economic growth in excess of 8.0% per year over the next decade.⁴ This robust economic backdrop will likely be reflected in the private sector by quickly growing corporate profitability and strong productivity gains.

Significant Reforms Driving Economic Prosperity

Modi 1.0 Reforms

- Bankruptcy code overhaul
- Indirect taxation reform simplification
- Unique ID (UID-Aadhaar) biometrics



Modi 2.0 Reforms

- Agricultural Reforms
- Privatization of SOE
- Labor Market Reform



Increases the Formalization of India's Economic Sectors & Promotes Financialization of the Economy



Economic Productivity & Corporate Profitability

	India	China	Eurozone	US	Japan
IMF: 2021-2025 Average Real GDP Growth Rate Forecasts	7.8%	6.2%	2.7%	2.4%	1.3%

INDIA'S PATH TO A GLOBAL HEAVYWEIGHT WILL BE SLOWER THAN FOR CHINA

At present, India represents close to 18% of the global population, but only 4% of global GDP and 1.2% of MSCI's All Country World Index (ACWI). However, should India continue down its current path, by 2030 India would likely be the third largest economy in the world, behind only the US and China. Given this growth, we would expect India's representation in global equity indexes to rise commensurately—similar to what we have seen for Chinese equities over the past few years.⁵

However, India's rise will not be completed in as linear of a fashion as was the case for China. Unlike China's one-party state apparatus, India is the world's largest democracy. Its politics are messy, and at times its various societal stakeholders are apt to balk at some proposed reforms, which could slow progress. The Modi government faced large-scale protests by farmers earlier this year when PM Modi enacted a series of agricultural reforms in September of last year. While the final fate of these reforms is not fully known, the government has so far been able to diffuse some of this resistance through a series of amendments, while still leaving the bulk of the reforms in place.⁶

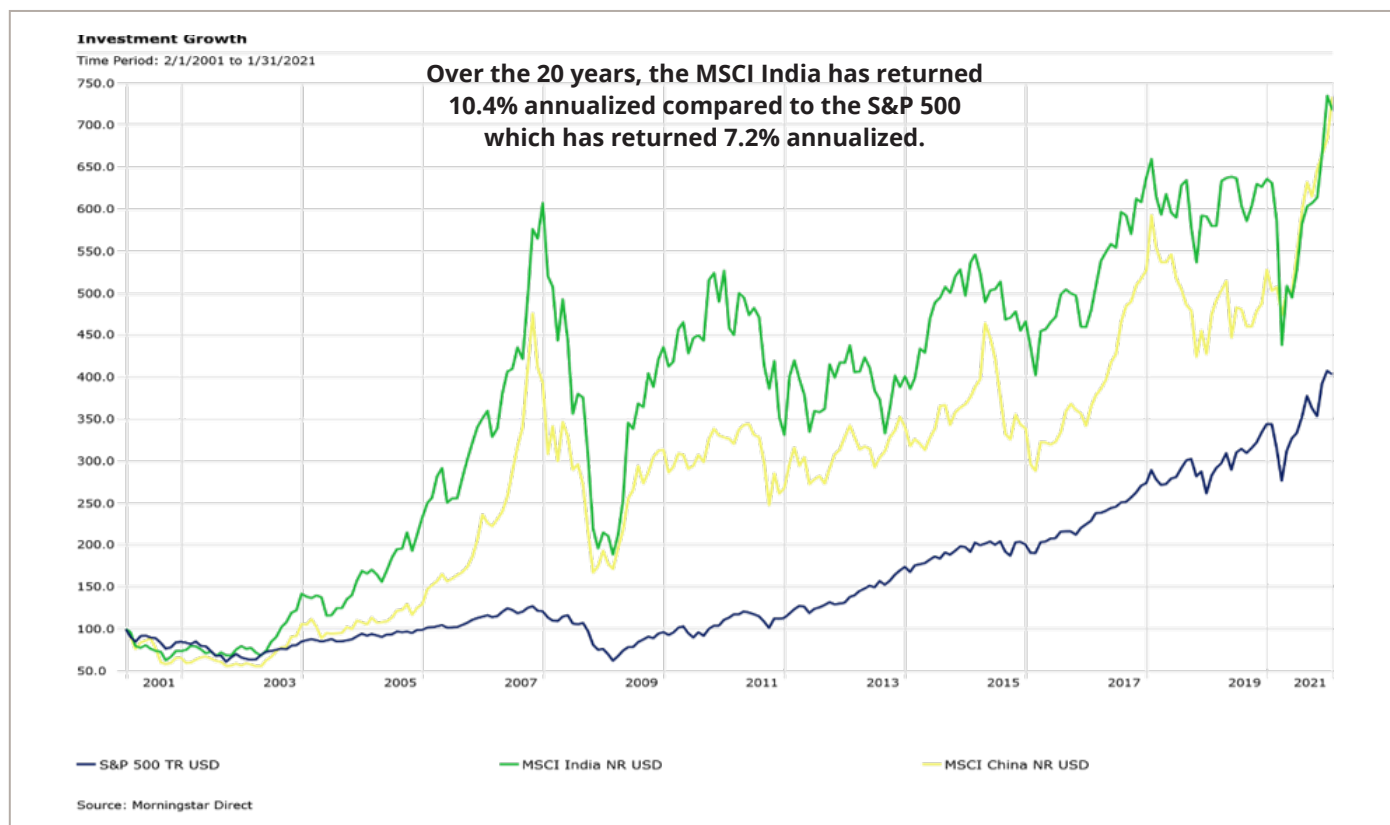
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Even if PM Modi is largely successful with his second term's reform agenda, his term will end in 2024 and a new leader will have to finish out the decade. PM Modi's BJP party is establishing a reputation for its pro-business orientation, while many of the parties in Parliamentary opposition lean more towards outright Socialism. Nonetheless, while India is likely to reform its economy in fits-and-starts, it is becoming increasingly clear that India has turned a corner where most Indians support continued, gradual economic reforms and value the subsequently higher long-run economic growth that should ensue.

INDIAN EQUITY MARKETS ARE DIVERSIFYING AND ALPHA-RICH

What does this mean for Clearstead and our clients? India represents a deep and liquid public equity market. While the number of publicly listed firms has steadily declined in the US over the past twenty-years, they have remained stable in India, which now has more listed public equities than in the US. Furthermore, there is a great deal of diversity in the sectors represented in India's public equity markets. For instance, consumer-oriented sectors—like healthcare and consumer staples—are a larger part of the MSCI India index than they are in comparable indices in China, or the wider EM index. Additionally, because much of India's public equity market is oriented to the domestic Indian market and not the global economy, it has a distinct business cycle that is rather uncorrelated with the cycle of most global multinationals. The result is that the Indian stocks over the past decade have a very low correlation with US equities based on monthly returns—MSCI India Index has a 0.58 correlation to the S&P 500, compared with 0.74 for emerging market equities (MSCI EM Index)⁷ and exposure to this market can be very diversifying for US investors. Lastly, long-run returns for US investors with patience in this market can be strong.

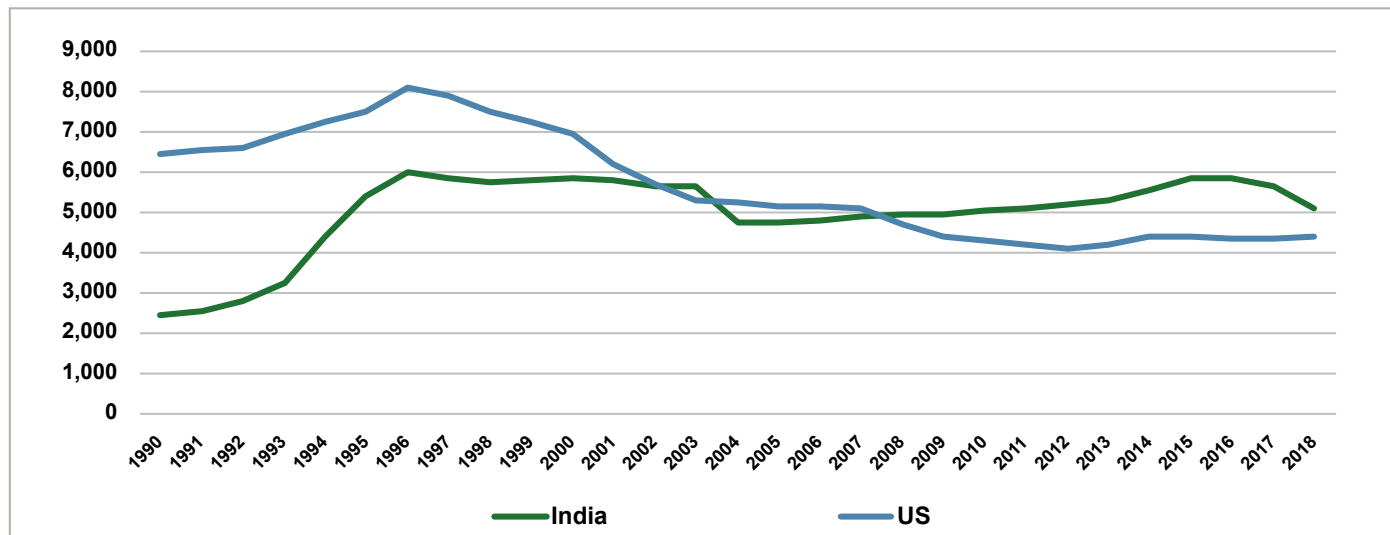


Source: Clearstead, Morningstar 1/1/2001 to 12/31/2020. Past performance is not an indicator of future results.

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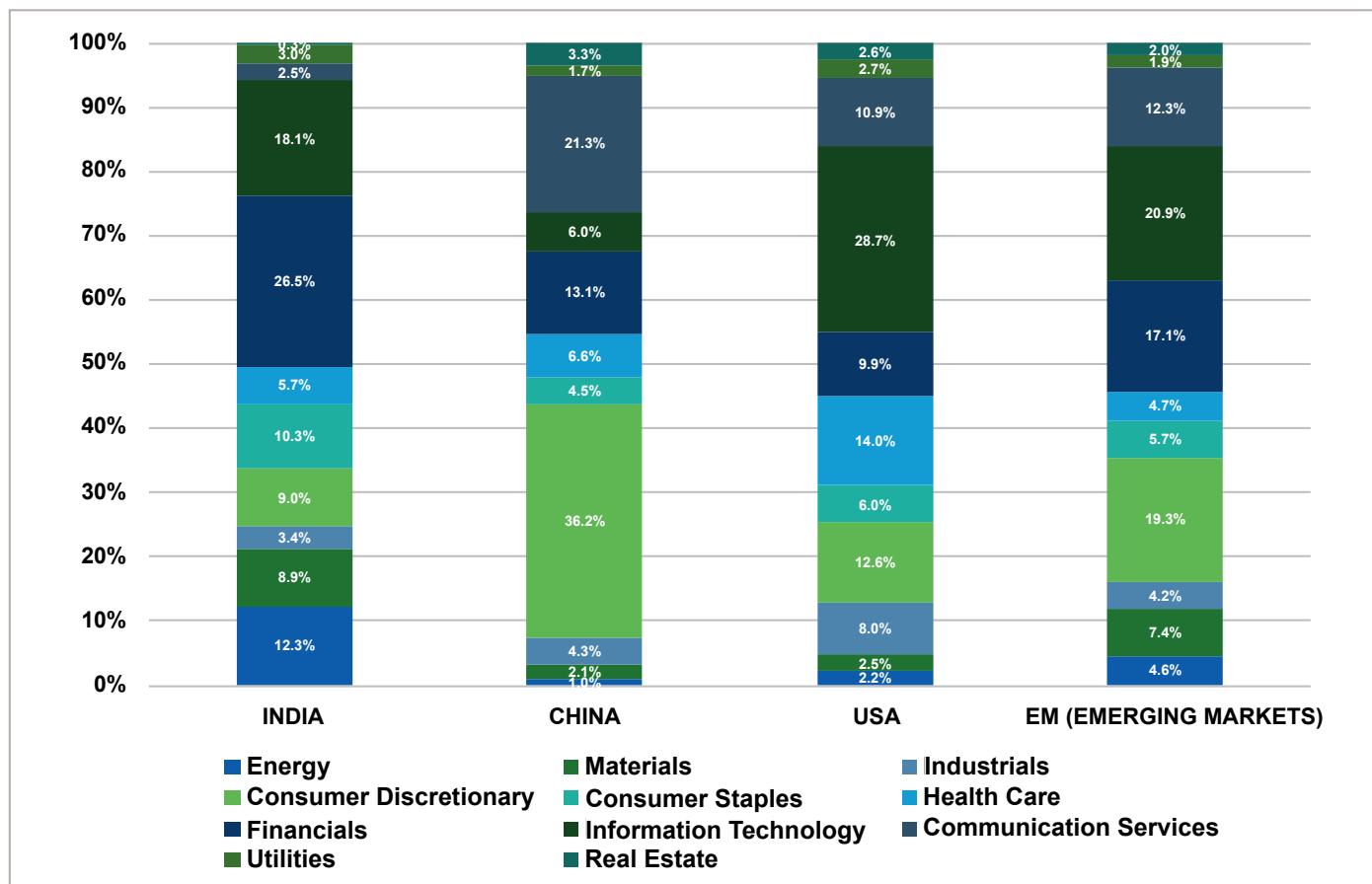
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More Indian Public Equities than US Public Equities



Source: Clearstead, World Bank 12/31/2020.

Index Breakdown by Sector



Source: Clearstead, MSCI 12/31/2020.

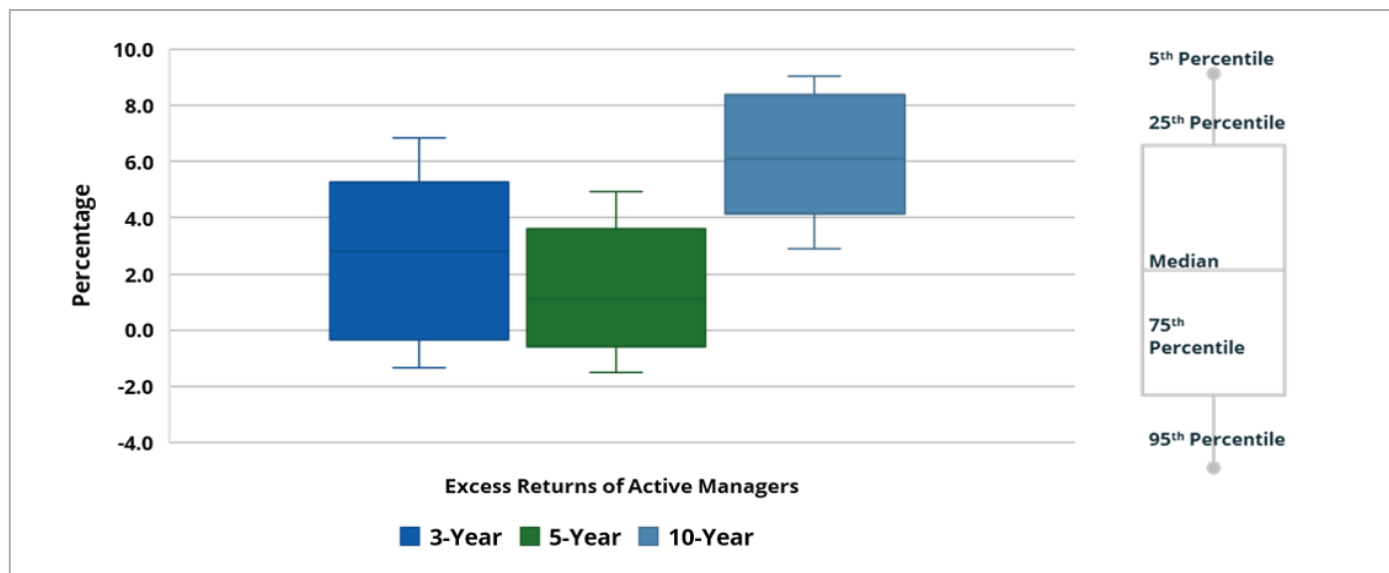
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CLEARSTEAD CAN HELP GUIDE THE WAY TO INVEST IN INDIAN EQUITIES

Investing in India is not for the faint of heart. It is a volatile market and frequently dominated by short-term momentum trades. However, active management has been shown to be adept at generating alpha—returns above that of the benchmark—despite the volatility. In fact, the high volatility inherent within the Indian market is a large part of the reason that disciplined, long-term-oriented institutional investors can beat benchmark returns. Clearstead analysis shows that the median active manager has generated 2.2% in excess returns over the past 3-year period, 1.1% over the past 5-years, and 6.1% over the past 10-years.⁸

Active Managers Thrive in India



Source: Clearstead, Morningstar 1/1/2011 to 12/31/2020. Past performance is not an indicator of future results.

Given the complexities of the Indian equity market, Clearstead is your steadfast partner in the effort to access these markets. We work continuously to identify talented stock pickers, with the analytic resources to cover the large and diverse Indian equity market. We have vetted these firms to ensure there is high degree of alignment between the Portfolio Manager and their analytic team, and the objectives of Clearstead's clients. Finally, by examining their performance over several years, we believe that we have identified firms that we hope will provide above-market returns for our clients. Patience and fortitude are key, but Indian equities are likely to become increasingly important part to your overall global public equity portfolio.

Sources:

- (1) "India Insight: \$10 trillion GDP by 2030? Not Quite, but Almost" Bloomberg Intelligence, Oct-2019.
- (2) Middle class income levels are defined as \$3,600 to \$36,000 in annual per capita income in purchasing-power-parity (ie adjusted for local prices) terms.
- (3) "The Unprecedented Expansion of the Global Middle Class" Brookings Institute Feb-2017.
- (4) "India's Turning Point" McKinsey Global Institute, August-2020.
- (5) "India's Farmers Set for Long Haul as they lay down Modi Challenge" FT 11-Feb-2021.
- (6) "A Sampling of Public Opinion in India" Pew Research Center, March-2019.
- (7) Morningstar – correlation of monthly returns MSCI India Index vs S&P 500 2/1/2011 to 1/31/2021.
- (8) 3-years 1/1/2018 to 12/31/2020; 5-years 1/1/2016 to 12/31/2020; 10-years 1/1/2011 to 12/31/2020. MSCI India Equity Universe Large Cap (de-duplicated)—constituting a universe of 32 funds with a 3-year track record, 31 funds with a 5-year track record, and 23 funds with a 10-year track record.

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Performance data shown represents past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.

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MARKET BENCHMARK RETURNS

February 28, 2021		1M	3M	12M	YTD
US Large Cap	S&P 500	2.8%	5.6%	31.3%	1.7%
US Small Cap	Russell 2000	6.2%	21.2%	51.0%	11.6%
Developed Intl	MSCI EAFE	2.2%	5.9%	22.5%	1.2%
Emerging Intl	MSCI Em Mkt	0.8%	11.5%	36.0%	3.9%
Real Estate	NAREIT	3.1%	5.7%	2.8%	2.9%
Core Fixed	BarCap Agg	-1.4%	-2.0%	1.4%	-2.2%
Short Fixed	BarCap 1-3Yr	0.0%	0.1%	1.9%	0.0%
Long Fixed	BarCap LT G/C	-4.2%	-7.2%	-1.4%	-7.0%
Corp Debt	BarCap Corp	-1.7%	-2.5%	2.4%	-2.9%

Source: Bloomberg

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