International investors’ retreat from India less of a problem says David Cornell

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India is fast becoming the emerging market of choice for many investors, even compared to China where the power of a rising middle class population helped propel the country into an economic super power.

But when the tide of global investor sentiment changes and large asset managers reallocate capital to another jurisdiction, India is no longer at the mercy of these large outflows.

“Historically if you'd seen $25 billion come out of India, the market would be down 30 percent and the currency would also be down 10 percent. But [despite outflows] the currency has been very stable and the equity markets been relatively stable. India continues to outperform emerging markets and continues to outperform China,” says David Cornell (pictured), chief investment officer of Ocean Dial, lead advisor to the listed India Capital Growth fund.

The reason why India is less susceptible to outflows from global investors is due to amount of domestic investment going into its market. Domestic mutual funds and individual savers are allocating to equities “in a way that we've never seen before” says Mr Cornell.

This heightened activity in the Indian economy is partly driven by the country's prime minister Narendra Modi's well-documented reforms. This included a financial policy which in part removed certain bank notes form circulation and as Mr Cornell says brought money "from under the mattress and from places like property and real estate, gold, which is where you historically used to hide untaxed income".

Similarly to China, India's population is becoming richer, with a GDP per capital of $2000 (China's is around $6000). What this means is that a smaller proportion on people's wages have to go consumer staples such as food which is reflected in the fund's construction as Mr Cornell says "we've always had a strong bet on the [Indian] consumer".

Given that the banks have been recapitalised, this is also reflected in the fund's top holdings, the country's private Federal Bank being its top position with around 6 percent of assets invested in it. The bank trades on a reasonable 1.3-times book-to-value and despite it being a financial institution enjoys a decent amount of growth as well.

As discussed with Alchemy Capital, India has a booming textiles industry due to its growing production of cotton. This is also reflected in the fund's holdings with Welspun, a company that is up over 12 percent in a year and trades on an undemanding 13-times price-to-earnings. The trust holds KPR Mills which is up by almost 200 percent in a year.

This savvy stock picking is partly down to the bulk of the team of being on the ground in India, including the portfolio manager and the research analysts enabling the firm to go and visit the companies it is interested in investing in.

A high conviction portfolio of just 32 stocks, the entire investible universe for Ocean Dial is just 144 companies once the team have screened the thousands of Indians equities available. Mr Cornell questions what many take as a given, this being the liquidity of ADRs (the usual route to Indian companies for international investors). The reason is the aforementioned exit of foreign investors from the Indian market. If those wishing to hold Indian companies only use ADRs, a reduction in demand would probably see the bid/ask spread blow out, leading to a degree of illiquidity.

Mr Cornell reveals that the fund has produced a CAGR of around 14 percent since 2010, so as its name suggests, is a bona fide growth product. The trust has also recovered well since its continuation vote in 2020 with the discount to NAV narrowing from over 20 percent to its current level of around 10 percent.

As part of the agreement to keep the trust going, investors were offered the chance to redeem their shares at a discount to NAV of just 6 percent, there was little appetite for this. At the end of next year, investors will have the chance to redeem their assets again, this time at just a 3 percent to NAV. If the fund can keep on its growth trajectory and offer investors the relative safety from events in other parts of the world, redeeming shares even at a price closer to NAV may again have little appeal.