Gateway to India Fund

2022 Outlook and Portfolio Strategy - January 2022

2021 was quite the test for India but one that was passed successfully. The economy has recovered to pre-Covid levels and the BSE500 Index has risen 28% in US Dollar terms since the beginning of the year, making it one of the best-performing markets in the World. Such resilience looks set to continue this year but another observation of note is the acceleration of digital adoption both by companies and consumers.

A second wave of Covid infections hit India in March 2021. It was a brutal one that had every chance of derailing the economy. Unlike the first wave, though the Government chose not to have a blanket shutdown of the country. This time around lockdown was more local allowing the continuation of economic activity albeit at a curtailed level. Vaccinations were undertaken at a furious pace. As we write, India has achieved 1.5bn vaccinations, a level which was expected to be achieved only later in 2022. With this, the recovery of economic activity has been quite sharp. All through this, Indian markets have been steadily rising, helped mainly by consistent forecast earnings upgrades for the next three years. Domestic investor inflows have also been resilient and growing, more than offsetting secondary market outflows from Foreign Portfolio Investors (FPIs). Mutual Fund Systematic Investment Plans (SIPs) (mainly equities) have now reached a record high of US$1.5bn per month.

The second highlight of 2021 is the 'mainstreaming of digitalisation' and its impact on the economy and investment opportunities. While ~57% of India's population uses the internet, only 12% of the population are online shoppers. Both internet users and online shoppers are rising rapidly following China's trajectory in the past few years. The only difference is that the pace is faster. A per capita GDP of ~US$ 2,100, surpasses the threshold required for more discretionary consumption and India is at a digital break-out level. Also, for traditional businesses, digital adoption has turned from 'nice to have' to 'must-have'.

2021 saw India's start-up economy come of age, with a record 44 new Unicorns, a more than doubling from ~30 Unicorns at the beginning of 2021. Many of them are maturing enough to come up for public listing. Already, in 2021 ~US$50bn of market capitalization has been added to public markets by these tech-first company IPOs. We expect another ~US$250-300bn of market cap (at current business value) to be added by way of IPOs of these digital/e-commerce companies. This will dramatically expand the set of investible opportunities, of course, subject to valuations.

In 2022, we look forward to the continued resilience of the Indian economy and markets in the light of persistent risks related to Covid, especially Omicron. As we write, the ability of Omicron to disrupt economic activity appears quite low.

However, after two years of strong stock market performance, concerns are building up on valuations. Although market valuations appear high in comparison to historic averages, we think market valuations are reflecting the following:

1. Rebound in overall economic growth with normalisation of economic activity post-Covid. As the benefit from many 'disruptive' economic reforms now starts flowing in, we think GDP growth in the next few years should be much stronger now.
2. Strong corporate earnings growth cycle in the next few years. BSE 500 Corporate Profit to GDP ratio fell to 2.4% in 2020 from 4% in 2011. With higher top-line growth and thus operating leverage, cost rationalisations, and lower interest rates, corporate profit to GDP will rebound

smartly from here. We expect Nifty 50 companies to average a PAT growth of around 27% p.a. over FY22-FY23.

3. Corporate profitability is also improving. The average Return on Equity (RoE) of BSE500 companies fell from 15% in 2011 to around 9% in 2020. This has bottomed out now with higher profit growth and asset utilisation.
4. Corporate India has deleveraged substantially in the last few years and Balance Sheets have improved in quality comparatively. We appear to be at the bottom of the business cycle from a debt perspective which should also boost ROEs.

While the beginning of Quantitative Tightening (QT) in 2022 is a risk to markets, India is better placed to navigate it this time around. Unlike the 'Taper-tantrum' phase of 2013, India's macro-economic stability has vastly improved as fiscal deficit, current account deficit and inflation are at much lower levels and are broadly under control. Inflation has remained under control in India in 2021. Nevertheless, as economic activity picks up more, inflation will rise and along with it the need for rate hikes. This will be a good sign about reaffirmation of growth. Overall, we believe, the monetary policy stance in 2022 will continue to prioritise growth.

The Union Budget, to be announced on February 1, 2022, will continue to build on the earlier change in stance last year in favour of fiscal accommodation and investments to reinvigorate growth. The Government has successfully avoided populist measures in the past, which we think will be so in the future as well.

From a portfolio strategy perspective, there is a diverse set of opportunities available in the market. We continue to be bottom-up stock selectors and are well entrenched with our portfolio stocks from a long-term view. Our focus remains on identifying quality businesses which we believe have capital efficiency with sustainable growth and are available at attractive valuations considering the underlying business. Our portfolio is well-positioned in the consumption, financials, and IT services space. Within consumption, we prefer consumer discretionary especially 'Food Tech' companies. Within financials, we prefer large private banks, such as ***ICICI Bank, HDFC Bank***, and ***Indusind Bank***, and ***Can Fin Homes***, an affordable mortgage financer. Here, we see higher credit growth and peaking of the NPA cycle at a time when they are over-provisioned. We also prefer large-cap IT services companies.

We have pivoted towards identifying businesses that benefit from megatrends such as the 'mainstreaming of digitalisation' and 'China plus 1'. For instance, we are positive on the 'Food Tech' sector where we see an acceleration of market share gains from the informal sector, thanks to smart phone adoption. Of particular mention, here are ***Jubilant Foodworks*** (Dominos franchise), **Westlife Development** (Mcdonald's franchise), and ***Zomato*** (India's largest food delivery company). This is over and above, our exposures to ***Affle India*** (an ad-tech company involved in 'targeted' digital marketing), IT services companies such as ***Wipro*** and ***HCL Tech*** (enablers for digital transformation globally), and ***Reliance Industries*** (upcoming e-commerce 'horizontal' with an omnichannel experience). 'China plus 1' or supply chain de-risking is captured in our portfolio through ownership of ***Dixon Technologies*** (outsourced electrical equipment manufacturing), ***KPR Mills*** (textile manufacturing), and ***Neuland Laboratories*** (API manufacturing and Custom manufacturing).

We continue with the ***'All Cap'*** character of our strategy with an exposure of ~50-60% to large caps and the rest being mid and small-cap companies. 2022 will prove to be a stock selectors market and we believe our Portfolio is positioned well enough to be a ***'Core India Portfolio'***.

Tridib Pathak
Principal Advisor,
Gateway to India Fund

Regulatory Information

This document and any related documentation provided herewith (this "Document") is given on a confidential basis for informational purposes only and does not constitute the provision of investment advice. In addition, the information in this Document does not convey an offer of any type and is not intended to be, and should not be construed as, an offer to sell or a solicitation of an offer to purchase any interest in the Gateway to India Fund or India Capital Growth Fund (each a "Fund" and collectively, the "Funds"). The Fund is not a non-mainstream pooled investment pursuant to the rules of the Financial Conduct Authority. In any case, this presentation does not constitute "marketing" in the UK pursuant to the Alternative Investment Fund Managers Regulation 2013. Any such offer or solicitation may be made only pursuant to the prospectus, key investor information document and relevant supplement of each Fund (the "Prospectus") and not on the basis of the information contained in this Document. This Document is qualified in its entirety by the relevant Prospectus. In the case of any inconsistency between the descriptions or terms in this Document and the Prospectus relating to a Fund, the Prospectus shall control. Nothing herein shall imply that information contained herein is correct as of any time subsequent to the date of this Document. The information in this Document does not constitute or contain an offer or invitation for the sale or purchase of any shares in any Fund in any jurisdiction, is not intended to form the basis of any investment decision, does not constitute any recommendation by any Fund, its directors, agents or advisers, is unaudited and provided for information purposes only and may include information from third party sources which has not been independently verified. Interests in the Funds have not been and will not be registered under any securities laws of the United States of America or its territories or possessions or areas subject to its jurisdiction, and may not be offered for sale or sold to nationals or residents thereof except pursuant to an exemption from the registration requirements of the U.S. Securities Act of 1933, as amended (the "Securities Act"), and any applicable state laws. In addition, none of the Funds is and nor will be registered as an investment company under the U.S. Investment Company Act of 1940, as amended. This Document is not intended for public use or distribution. It is the responsibility of every person reading this Document to satisfy themselves as to the full observance of any laws of any relevant jurisdiction applicable to such person, including obtaining any governmental or other consent which may be required or observing any other formality which needs to be observed in such jurisdiction. While all reasonable care has been taken in the preparation of this Document and all the information prepared in this Document is believed to be accurate, no warranty is given on the accuracy of the information contained herein, nor is any responsibility or liability accepted for any errors of fact or any opinions expressed herein.

This Document may include indications of past performance of certain investments or asset classes. All performance information contained herein relates to the activities of each Fund as a whole. Information presented may not take into account (i) variations in fees, investment restrictions or other differences between various classes of interests, (ii) the impact of any contractual arrangements between a Fund and an investor and (iii) the impact of the timing of subscriptions and redemptions. As a result, the information may not reflect actual performance for any specific investor. Rather, the information is intended to provide investors with generalized performance and exposure statistics for each Fund. All information provided herein is for informational purposes only and should not be deemed as a recommendation to buy or sell the securities referred to herein. All performance results are calculated net of all fees and expenses, including an investment management fee and, where applicable, a performance fee, and assume the reinvestment of all capital gains, interest, dividends and other earnings, and should not be regarded as final until audited financial statements are issued covering the period shown. Current performance may be lower or higher than performance quoted. Past performance is not a reliable indicator of and is no guarantee of future results. Investment returns may fluctuate with market conditions and every investment has the potential for loss as well as profit. The value of investments may fall as well as rise and investors in the Fund may not get back the amount invested. Emerging market equities can be more volatile than those of developed markets and equities