James Carthew: India trusts still have questions to answer

By James Carthew / 24 Oct, 2022 at 12:21

A couple of months ago, I highlighted the wide discounts that most of the investment trusts in the India sector were trading on. These have not gone away.

However, in terms of underlying returns and net asset value (NAV), until recently, Indian funds had largely bucked the trend of declining global markets. That situation changed around a month ago and, since then, we have seen NAV falls of 3-5% and share price falls of 3-10%. Nevertheless, this is small beer relative to the falls that other markets have experienced.

Indeed, with the exception of **Aberdeen New India** (ANII), the funds in the sector stand out for having made positive NAV progress over the past 12 months. **Ashoka India Equity** (AIE) leads the pack with an NAV return of 7.4%. As far as general equity funds go, only **Gulf Investment** (GIF), the two Latin American funds and **Murray International** (MYI) have done better in NAV terms than Ashoka.

Historically, a period of higher energy prices would be bad news for the Indian economy (most oil is imported) and would be associated with rampant inflation and a weak currency. However, this time India appears to have escaped the worst of this. Indian consumer price inflation is running at 7.4% and the rupee is up about 10% relative to the pound over the past 12 months.

Back in August, Ocean Dial, investment managers to **India Capital Growth** (IGC), noted that foreign ownership of Indian equities was close to a decade-low (at about 17.4% of the market). However, White Oak (investment managers of Ashoka) say that over the third quarter of 2022, foreign investors poured a net $6.1bn into Indian equities. As China has disappointed, largely because of its zero-Covid policy, investors appear to have decided that India is the better bet. Money has been flowing into the country, buoying the stock market, and there could be more to come.

Valuation questions

Some investors might be put off because the Indian market is relatively expensive. At the end of September, the MSCI India index was trading on a price/earnings ratio of 23.6x which compares with 11.5x for the MSCI Emerging Markets Index and 16.3x for developed markets as represented by the MSCI World index.

Historically, Indian companies have justified their relatively expensive valuations by delivering much faster earnings growth than those in developed markets. White Oak notes that for the financial year ended March 2022, India's Nifty 50 companies (the 50 largest companies listed on the National Stock Exchange) grew their earnings by 33% and their earnings are projected to grow at 16% compound for the next two years. Over the long term (10 or 20 years) the Indian market has outperformed almost every other emerging market (including China) and most developed markets too. Its mid- and small-cap companies have done even better.

It has not been a smooth ride. In recent years, momentum has been derailed by the short-term impact of reforms enacted by the Modi government and a banking crisis, as well as external shocks such as Covid and now the effects of the war in Ukraine. However, one of the reforms was to slash fuel subsidies so that the rising oil price did not devastate government finances. These are healthier anyway as the tax take rises, aided by the recently introduced goods and services tax. In addition, Ocean Dial notes that the success of India's IT industry means that currency inflows from this sector are offsetting the impact of rising fuel import bills, helping to keep the rupee relatively stable.

Ocean Dial reckons that the banking sector has put its bad debt problems behind it and is ready to grow again. It also thinks that the property sector is on a recovery path as housing is now more affordable. According to HDFC Limited, the ratio of average house prices to incomes in India is just over 3x, down from almost 6x in 2000; for contrast, at the end of 2021 the ONS reckoned the ratio was 8.9x for England & Wales and 13.7x in London.

Are returns up to snuff?

Over the past three years, AIE (+95%) and IGC (+61%) have outperformed ANII (+36%) and **JPMorgan Indian** (JII) (+34%) by a sizeable margin. This has largely been driven by the long running trend of outperformance from small and mid-caps.

AIE, whose portfolio spans both large and smaller companies, is benchmarked against the MSCI India IMI (investable market index) and has managed to outperform that by 6.5% since it launched in July 2018. IGC's absolute returns are very good, but it has not matched its BSE Mid Cap Index performance benchmark in recent years. Both are stock-picking funds, but IGC is run with a higher conviction portfolio and its returns relative to its benchmark sometimes reflect that.

JII and ANII both benchmark themselves against the MSCI India Index. JII has lagged that by about 46% over the past five years, while ANII is about 26% behind. This begs the obvious question. Wouldn't investors be better off just buying a tracker fund following the MSCI index?

The JII board acknowledge the problem. In the annual report published last December, chairman Rosemary Morgan said that the board was keeping the manager's performance under constant scrutiny and highlighted both the continuation vote due at the annual general in 2024 and the performance-triggered tender offer in 2025 for 25% of the fund at NAV. That could mean that for an investor buying at today's 21% discount, there's an opportunity to capture most, if not maybe all, of the return from the Indian market plus some discount narrowing if the fund either liquidates in 2024 or triggers the tender offer a year later.

For ANII, where the long-term returns are better but the short-term performance has struggled, the board instituted a performance-triggered tender offer for a five-year period commencing 1 April 2022. It also has an annual continuation vote, which passed in September 2022 by 99.5% to 0.5%, perhaps suggesting investors believe returns will improve.

AIE and IGC's returns suggest that both the Abrdn and JPMorgan funds could do well to consider spicing up returns with more exposure to smaller companies. I would much rather see a return to form for these companies than for them to shrink or disappear. If anything, it would be great to see more managers offer India-focused investment companies. Quite a few open-ended India-focused funds have beaten ANII and JII over the past five years. Perhaps the likes of Stewart Investors, UTI and Fidelity might consider giving it a go.

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