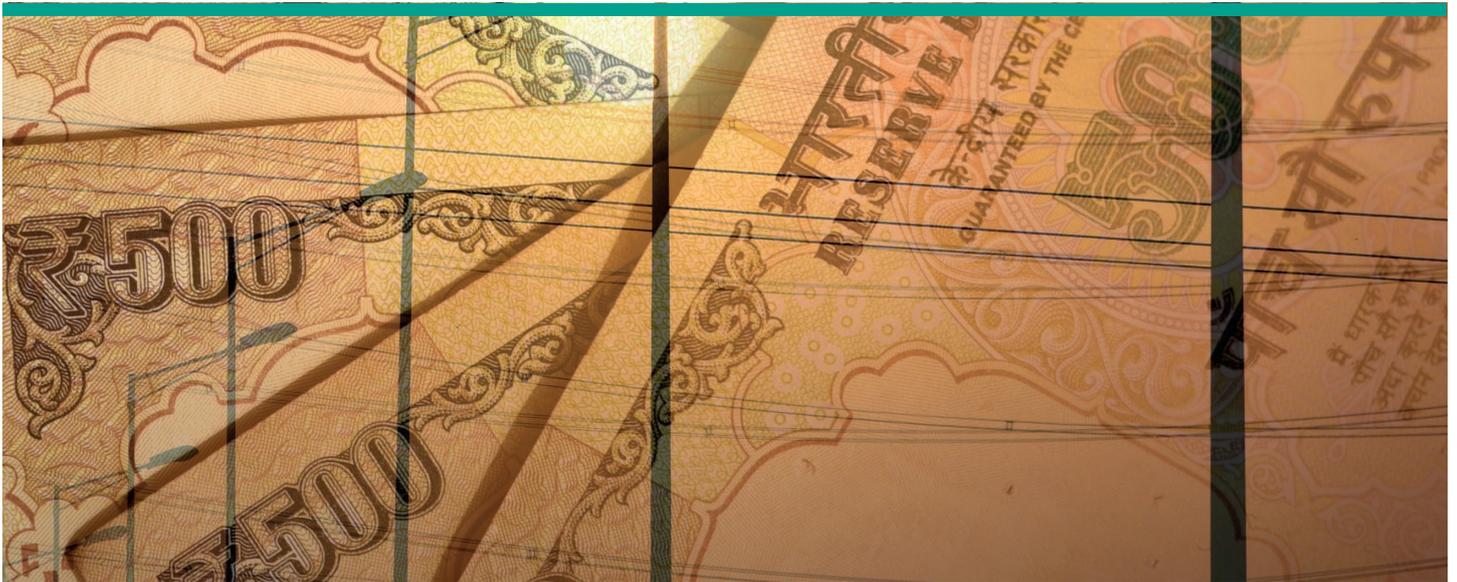


What is next for India's economy?

The **5 Core reasons** to consider investing in **India**

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In a slowing global economy, one country still shines. India is on track to overtake China this year as the fastest growing economy and to widen that lead over the next few years as GDP growth reaches 8% in 2017, according to the World Bank figures.

This momentum has not gone unnoticed by both domestic and foreign investors. India's benchmark Sensex index surged 30 % in 2014 on the election of a reform-minded government and hit an all-time high in late January, while company valuations rose to historic highs. Many investors then pressed pause, reminded of the complexities inherent in running the world's largest democracy and anxious that reforms might stall. The markets have now settled back, with valuations at more defensible levels, making the country again potentially attractive to investors who are looking for evidence of economic growth.

Here are five positive indicators for investors considering India.

1 REFORM

Prime Minister Narendra Modi took office in May 2014 on a strong pro-business platform. Some setbacks followed, including a seemingly reactionary proposal to tax foreign fund managers for previous capital gains, but the overall trajectory of the administration's activity remains positive from the perspective of foreign investors.

A \$39 billion allocation to much-needed infrastructure spending cuts in fuel subsidies, the liberalisation of the coal market, and the near doubling of foreign ownership limits in local

life insurance companies suggest that this government remains committed to economic reform.

As the World Bank noted in its Global Economic Prospects Report, to the extent that credible reform agendas boost investor sentiment, they will also help create a virtuous cycle of strong investment sentiment (including foreign investment) and output growth.

It remains to be seen whether the new government will be effective in addressing the country's enormous social problems: lifting about half of its population out of poverty; stemming still rampant corruption; and

improving life for women and girls. But it does seem to be making a promising start in reforming the economy.

2 A WORLD APART

As any visitor realises within minutes of landing, India has preserved its unique culture in an increasingly homogenized world. That's true for its economy too, which remains largely domestically driven, able to serve its own enormous population, and is relatively uncorrelated to other big developed economies.

There are exceptions, notably India's IT services sector, which derives most of its revenue from overseas. And the new government is anxious to expand the country's still limited trade flows. By and large, however, India is still off the beaten path, which could prove very appealing to investors concerned about the global economy.

3 FOREIGN INVESTMENT

There aren't many markets in the emerging or developed world that hold anything like the promise of India. The country is on track to become the world's third-largest economy by 2025, edging out Japan to follow only China and the United States. But the country has been notoriously difficult for direct investors, who are limited to minority ownership in joint ventures to reach the domestic

markets, notably in transport, retail, and finance and the enormous services sector.

Efforts to liberalise these rules, such as the recent change affecting life insurance, are contentious, as many Indian politicians fear displacing local providers. In the interim, foreign investors are understandably wary of making big commitments to operations outside their full managerial control. Prime Minister Modi seems very keen to change that and his first year in office has been marked by visits to China, the United States and other countries to drum up trade and investment.

A reform-minded democratic government, a relatively stable currency, and a diverse economy that is not reliant on commodities makes it likely that global liquidity inflows to the country, both in direct investment and in the public markets, will remain strong over the next few years.

4 TRAINS, PLANES AND AUTOMOBILES

Indian transport companies have undertaken massive restructuring over the past few years and are considerably more efficient than many of their counterparts in other emerging countries. Both foreign and domestic manufacturers are making significant investments in their local operations, hoping to cash in on the rise of middle class consumers.

While many of the most attractive companies in India remain private, prospective investors can reasonably hope that this government

will simplify listing rules, encouraging companies to seek IPOs. In the interim, there are plenty of well-run companies positioned to benefit further from the country's growth.

The transport sector in particular may have a great deal to gain from government investment in infrastructure, as well as continued low oil prices (India is a large net oil importer) and the increased mobility of the country's population.

5 DEMOGRAPHICS, AT HOME AND ABROAD

Of all the reasons to invest in India, the country's demographics are arguably the most compelling. In contrast to the rapidly aging countries of Japan and in most of Europe, Indians are relatively young, with the average age of citizens just 25 years old. The coming baby boom will make India the world's largest country by 2025, according to the World Bank.

More significant still is the rise of India's middle class at 100 million strong and growing, the product of the third largest education system in the world, after the United States and China, and continues to be arguably the biggest consumer base in the world. At the upper echelons, India is already home to some of the world's most successful entrepreneurs and industrialists. Many others live overseas, from Singapore to London to Silicon Valley, but retain strong personal and business interests in India. The continued liberalisation and growth of its economy should strengthen those ties and the benefit foreign investors in the country.

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Aberdeen Asset Management's Market View

NEW INDIA INVESTMENT TRUST AND OPPORTUNITIES FROM INDIA

KEY POINTS

- India's economy is in much better shape now than it was a few years ago
- We're encouraged by the slow and steady progress of reforms
- Companies aren't yet confident enough to invest in their businesses
- But an upturn in demand could lead to significant improvements in corporate earnings

HOW WILL A US RATE HIKE AFFECT INDIA?

Global markets will be volatile as we move closer to the first US interest rate hike in seven years. We thus expect India to experience short-term outflows alongside the rest of the emerging markets. That said, the country is in a much better position than during the 'taper tantrum' of 2013, given strengthening policy credibility, current and fiscal accounts and climbing foreign exchange reserves.

WHY HAS INTEREST TOWARDS INDIAN STOCKS COOLED THIS YEAR?

The market has been flattish this year partly because it had discounted swift enactment of reforms following Modi's victory in elections last year, when the market rose over 30% in US dollar terms. This mood reflects a more rational assessment of the hurdles surrounding key priorities such as land acquisition and the Goods and Services Tax bill. Modi has not helped himself with a botched plan to tax foreign fund managers. Meanwhile, growth has slowed and hoped for reductions in interest rates beyond the three cuts this year have not materialised.

ARE YOU HAPPY WITH THE PACE OF REFORM?

We would like to see reforms accelerate, but we're encouraged by progress that's best described as 'slow and steady'. Since Modi became premier last year, some 50 bills have been passed into law despite opposition in the upper house of Parliament. Beyond the headlines, quiet progress has been made on the devolution of economic power to state governments and on improving policy coordination between the capital and the regions. That's in addition to measures to boost government efficiency and streamline the approval process for infrastructure projects.

CAN WE SEE THE BENEFITS OF REFORM IN THE ECONOMY?

Yes. The economy is in much better shape than it was even a couple of years ago – inflation is down, as are interest rates, and fiscal consolidation remains on track. Foreign exchange reserves of more than US\$350 billion are at record levels and the rupee has seen better performance versus the majority of G10 and emerging market currencies. While the country has been a key beneficiary of the windfall gains from cheaper oil, policymakers have also taken the initiative to reduce fuel subsidies (subsidies for diesel and petrol were abolished, although those for liquefied petroleum gas and kerosene remain). The number of stalled investment projects has been declining as the government continues to try and clear the backlog, while the value of new projects has been increasing. And foreign direct investment has also been on the rise.

HAS THERE BEEN ANY ANECDOTAL EVIDENCE THAT REFLECTS THE GOVERNMENT'S NEW APPROACH?

Modi has taken a personal interest in the fortunes of Container Corporation of India (Concor) – a relatively small state-owned rail

operator – and has asked for feedback on the growth hurdles the company faces. The rationale for doing so is that the government will then attempt to remove any regulatory obstacles. Furthermore, he also expressed his desire for the company's senior management to learn from the most successful logistics firms around the world, and to bring these 'best ideas' to Concor. This reflects how eager Modi is for India Inc. to succeed. But, it also highlights his propensity to have his eyes in too many places, with the risk that he becomes something of a one-man band.

CORPORATE EARNINGS HAVE BEEN WEAK. WHY?

There are three major reasons. Firstly, exports growth has slowed in recent months and this has weighed on capacity utilisation among the manufacturers. Secondly, falling producer prices – reflected in the declining wholesale price index figures over the last six months – have reduced their pricing power. Lastly, private spending has yet to recover meaningfully and demand has stagnated. Furthermore, slower rural wage growth has led to softer domestic consumption.

WHY HAS THERE BEEN A LACK OF PRIVATE INVESTMENT?

Some companies – particularly in sectors such as industrials – are saddled with too much debt. Their balance sheets are stretched, so they're in no position to boost spending. At the other end, businesses that have been investing heavily over previous quarters are now facing issues of overcapacity and under-utilisation, as demand stagnates. In the near-term, it's difficult to foresee catalysts for improving demand outside of public-sector investment. However, we anticipate an upturn in demand as growth picks up in the medium term. When that happens, companies that are well positioned to benefit from a demand recovery could see significant improvements in earnings.

WHICH STOCKS HAVE DONE WELL?

Standout performers include automotive components maker Bosch Industries, Container Corporation of India, and Lupin, a generic pharmaceutical company. We've taken some profits in Bosch Industries after a run-up in its share price; Container Corporation of India's stock rose after the government committed to a bigger increase in infrastructure spending in the budget; while Lupin has made good progress on its product pipeline and high-margin generic drugs. Meanwhile, not holding energy stocks such as Reliance Industries and Hindalco Industries benefited us.



Adrian Lim

Adrian Lim is a Senior Investment Manager on the Asian Equities Team. Adrian originally joined Aberdeen in 2000 as a Manager on the Private Equity Team, on the acquisition of Murray Johnstone, but transferred to his current post soon afterwards. Previously, Adrian worked for Arthur Andersen LLP as an Associate Director advising clients on mergers & acquisitions in the region.

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New India Investment Trust

July 2015

1. We see opportunities



India's growth rate is expected to rise to **7.5%** in 2015 and 2016, making it one of the fastest-growing economies in the world.



Cement demand in India is set to reach **550 million tonnes** per annum by 2025, driven by infrastructure needs.



India's largest two-wheeler manufacturer aims to achieve annual bike and scooter sales of **12 million units by 2020**.



Rural India's FMCG market will top **US\$100 billion** by 2025, driven by demand from 700 million rural consumers.

Source: World Bank Data, April 2015; Economic Times, April 2014; Company Data, India Brand Equity Foundation 2011

2. Invest in quality stocks

We run a high conviction portfolio of around 40 companies that have strong competitive advantage.

Companies	Leading position in...
ITC	Leading maker of cigarettes with growing FMCG footprint
Hero MotoCorp	Leading manufacturer of scooters and motorbikes
Hindustan Unilever	Maker of personal/home care and F&B products
Godrej Consumer Products	Homegrown personal care products maker
UltraTech Cement	India's largest cement producer

Source: Aberdeen Asset Management, 30 June 2015
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3. Dedicated on-the-ground expertise



Aberdeen has been investing in Indian equities since 1996.



Team approach means investment decisions are made collectively – we don't believe in star managers.



We are long term investors and know each and every company inside out.

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