Dalton Investments

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Time to Consider a Dedicated India Allocation? – Venkat Pasupuleti and Siva Thiravidamony

For many years, India has been somewhat of an afterthought for many asset allocators. Unlike China, which saw its meteoric growth coupled with a rapid increase in its weight in global stock market indices (and hence the asset allocation benchmarks used by large institutions), the Indian market has often been seen as too small and illiquid to warrant serious attention. While it became common place to appoint a dedicated China specialist, when it came to India, allocators were generally satisfied with a Global Emerging Markets manager purchasing a few well-followed stocks. In this short update, we discuss the rapidly changing situation in India, and why it makes sense to consider hiring a dedicated Indian manager.

Index representation

When key index provider MSCI undertook its February 2024 review, it added five new Indian stocks to its standard range of indices, following a pattern that has seen a net addition of 17 Indian stocks over the past four reviews. This reflects, in MSCI's view, the increasing investability of these Indian securities, whether in terms of market capitalization, liquidity or foreign ownership limits. The move takes India's weight in the MSCI EM index to an all-time high of 18.2% (Figure 1), more than doubling over the last four years.

We can contrast this rise in India's weight with the fall in China's. Following the recent review, China's weight fell to around 25%, down from its peak of around 40% in 2020. This represents a combination of poor market performance, as well as the removal of many Chinese stocks due to investability concerns. Should this pattern continue, there is a real possibility of India overtaking China in the coming years and becoming the single largest weight in the emerging markets index. India's weight today is similar to that of

China's in 2014/2015 – a period when many allocators began to seriously consider a dedicated China allocation.

Figure 1 – India weight in MSCI EM index over time

Investability

While India has a very deep stock market (around 5,000 listed companies), the fair criticism has been levelled that most of the Indian market capitalization and liquidity is represented by the top 100 stocks. Historically, this meant that the "true" universe for many Indian fund managers was much more constrained than that of their Chinese counterparts. As previously mentioned, the situation has been changing rapidly in recent years, with the number of medium, large and mega-cap stocks increasing accompanied by rapidly increasing market liquidity. The tables below contrast the current market capitalization (Figure 2) and liquidity (Figure 3) of the Indian market with the situation in July 2014, when the Dalton India Fund was launched. As you can see, the figures show a marked increase in viable targets for investment by major asset managers. While Dalton can invest in smaller and less liquid stocks, many managers might consider \$1bn market capitalization and \$1m average daily traded volume as minimum requirements. Using this screen, the number of investable securities would have increased from ~160 to ~490 over the period, or a 3-fold increase!

Figure 2 – Market capitalization breakdown of the Indian Market

Category	February 2024		July 2014	
	Number of Stocks	% of listed stocks	Number of Stocks	% of listed stocks
Mega Cap (>$20bn)	44	0.9%	16	0.4%
Large Cap ($5-20bn)	138	2.9%	43	1.1%
Mid Cap ($1-5bn)	355	7.4%	138	3.5%
Small Cap (<1bn)	4,264	88.8%	3,792	95.1%
Total	4,801	100.0%	3,989	100.0%

Figure 3 – Liquidity breakdown of the Indian Market, by Average Daily Volume (ADV)

Category	February 2024		July 2014	
	Number of Stocks	% of listed stocks	Number of Stocks	% of listed stocks
> $10m	275	5.7%	116	2.9%
$5-10m	147	3.1%	35	0.9%
$1-5m	441	9.2%	154	3.9%
<$1m	3,938	82.0%	3,685	92.4%
Total	4,801	100.0%	3,989	100.0%

Conclusion

We believe that India is now of a sufficient size and importance that it warrants a dedicated place in investors' portfolios. The country's economy is the world's fifth largest, its total market capitalization is the fourth largest and, of course, India represents the largest country in the world by population. Moreover, India is generally considered as the fastest growing large economy today. However, what is less commonly discussed is the escalating investability of the country's stock market, fueling the rapid rise in India's weight in global indices (along with strong underlying stock performance). Indian fund managers now have a large and expanding pool of viable targets from which to build a portfolio.

Beyond the rising importance of the Indian stock market, Dalton also believes the country deserves a dedicated allocation based purely on investment merit. While critics may argue that the Indian market looks expensive, we would counter that comparing the Indian benchmark to those of rival emerging markets is not an apples-to-apples comparison. The Indian benchmark comprises a set of high-quality companies, in most cases managed by aligned entrepreneurs, who are seeing rapid and structural growth in their businesses. By contrast, a typical emerging market country benchmark would include companies of varying quality, prone to economic fluctuations, and often under state control or ownership. In our view, it would be unreasonable to not expect the first set of companies to trade at a structural premium to the second. When we take a step back and consider where we want to place our money for the next decade plus, the combination of India's outstanding demographics, its "sweet spot" position in terms of potential consumption growth, and its growing geopolitical importance, places the country right at the top of our list.

Venkat Pasupuleti, Portfolio Manager

Siva Thiravidamony, Director of Research