FinanceAsia

Top Fund Manager Remains India Bull

With the Sensex hitting a new high of 14,129, India has begun the year well. Jon Thorn explains why he thinks that is set to continue.

By Jame DiBiasio

HONG KONG: Jon Thorn is a Director of the India Capital Fund, a $260 million fund dedicated to Indian equities, as well as the $60 million India Institutional Fund, a segregated account for American endowments. The fund began in 1994 as a small-cap India play seeded by a George Soros fund, but was re-launched in 2001 to include companies of any size.

Why did the Indian stock market do so well in 2006?
Because it offered the most accessible earnings growth in the world. Different markets in Asia such as Taiwan look cheaper, but they have problems that you don't have in India. For an Asia-Pacific portfolio that can allocate across the region, India has to look among the best destinations because its earnings growth is spectacular.

What about on a global basis?
Take any major market: America, the United Kingdom, Germany, Brazil, China or Japan, and compare them with India. You'll find India enjoys terrific domestic demand, with one of the lowest level of exports as a percentage of GDP. It's not exposed to exogenous shocks. Compare that immunity and robust domestic consumption with any other market. Tell me: where is it better? I'm open to suggestions. The more people understand this, the more they will want to have exposure to India. It's not rocket science.

What happened last May and June, when the market corrected by 30%?
Everything got ahead of itself. And that goes for Russia, Turkey and other emerging markets too. There has been too much liquidity, and people were allocating too much to these markets. Everything hit the floor. But the good stuff, like India and Russia, got up again. The bad stuff like Turkey hasn't. This reminded people that high-quality assets are lower risk than low-quality assets.

Is India likely to experience another correction?
I don't think so. What you had in May was the world's central banks, particularly the Bank of Japan, out to shrink liquidity. The result was nastier than people had expected. I suspect the liquidity target won't be pursued as robustly for a while by central banks. So much of the growth in the world economy should continue in 2007.

In India specifically, there's a terrific amount of cash that was and still is sitting on the sidelines. So not all the money that can come in has come yet.

What are valuations like in India?
We'd say it's fair value. Indian companies' balance sheets have the lowest debt-to-equity ratios in the world. So our upside outlook looks even better with just a little bit of leverage. In our view, Indian shares are not expensive.

Why hasn't that cash been put to work?
Fear. Both domestic and foreign fund managers have raised several hundreds of millions of dollars' worth for India allocations, but it hasn't been invested because portfolio managers thought there would be another downward leg. They missed their spot. The assumption, the consensus view, was that India's markets would do nothing in the second and third quarters, and would look attractive in the fourth. Those investors who thought that way have left a lot of money on the table. In my view, however, you should buy something when it looks cheap.

When will this money hit the market?
Since November there has been a buying panic. We've seen very heavy volumes. A lot of this money is being allocated. Investors who had been waiting for another downturn have capitulated. Hedge funds are getting excited. Mutual fund companies have raised huge amounts for India stories, but the money has sat in bank accounts; sooner or later it has to be invested. We've been fully invested since July.

Does your earnings outlook include all sectors?
It would pertain to most sectors. There are a few that are a little ahead of themselves, like construction, but nothing stands out as way overvalued. We tend to make big allocations to certain sectors. We like banks, for example. They're cheap. Of course, it may appear this way to me and not to others; it's a top-down asset allocation call.

How much turnover is in your portfolio?
We prefer high concentrations in any sector that we like, and we tend to hold these stocks for three to five years.

Indian management is reputedly very good. What's your view?
The quality varies from world beating to the mentality of robber barons. It's unusual to find that range within a single country in Asia, outside of Japan. But Indian companies file quarterly statements, unlike in Japan, so it's much easier to prove which ones are good in India.

Will earnings growth in 2007 match the pace of 2006?
I have no idea. But earnings will certainly go up. We assume growth won't be radically lower than in 2006.

What about beta or index returns?
Again, I don't know. It seems unlikely that they'll be as good as in 2006 only because 2006 was such a good year. If you asked me purely as a bet, I'd say Indian shares would probably not do as well — but they'll still be strong performers. It all comes down to earnings growth, which has been solid for the past two years.

What kind of economic growth do you expect?
Compared to the rest of the region, I'm not sure. Some other places look as though they also have good prospects for growth. In India, we expect a minimum 15% year-on-year earnings growth over the next two years. Over time, that is what the stock market should do, although whether we see that growth in our pocket is another question.

What are the risks to that growth?
Without a concerted attempt at monetary tightening by the world's central banks, all of these Asian markets can show upside and they should.