

India's Missing Rally

Earnings growth has recovered and the economy absorbed this year's oil shock better than expected, but international investors remain hesitant to return

I recently returned from a week of company meetings in India. The broad message was that growth has recovered. Banks are lending again and manufacturing investment is rising; wealthier consumers are still spending.

That outcome was far from certain in late February, when conflict in the Gulf pushed oil prices sharply higher. As one of the world's largest importers of crude, India was expected to be among the economies most exposed. In previous oil shocks, growth would typically have weakened in the following quarter. This time it held up.

Part of the answer is supply: alternative sources of oil and gas were found. India's current account deficit, at around 0.8% of GDP, is also far smaller than in past shocks, and a stronger fiscal position let the government subsidise fuel for most households.

GDP growth keeps surprising on the upside. Nifty 50 companies' profits grew around 18% in the quarter to June, the strongest in ten quarters, and credit growth has climbed from about 14% before the conflict to around 18%. Share prices, however, have yet to follow.

Why earnings are recovering

The recovery rests largely on nominal growth. With inflation moving back towards the Reserve Bank of India's 4% target and real growth steady at 6–7%, nominal growth should return to above 10%. Company revenues track nominal growth closely, so that shift feeds directly into sales, and the outlook for earnings has improved.

The improvement is also broad-based. Profit growth in the June quarter was led by banks and financial services, with metals, technology and carmakers also contributing. Valuations, meanwhile, have fallen. After two years of de-rating, the market's forward price-to-earnings ratio is below its ten-year average. On 2028 estimates, it trades on around 18 times earnings with growth of about 18%.

Where the opportunity lies

Our focus remains the domestic consumer. The top end of the market is particularly buoyant, with sales in the leading malls running strongly. Management teams were clearly more confident than a year ago. Branded chains are taking share from independent retailers in categories such as eyewear and jewellery, beauty retailers are benefiting as customers trade up to premium products, and the leading two-wheeler

makers continue to gain ground. What these businesses have in common is high returns on capital, strong cash generation and sustained earnings growth, characteristics that stock selection, rather than index exposure, is designed to capture.

Manufacturing investment

Manufacturing is where the change since previous visits is most visible. The government's production-linked incentive scheme has attracted around \$28bn of investment across 14 sectors, and 99% of mobile phones sold in India are now made there. Auto component makers are expanding into defence, aerospace and energy, and India is increasingly the main alternative for companies diversifying supply chains away from China.

Waiting for investors to return

The market's underperformance largely reflects where international capital has gone, chiefly into technology-heavy markets such as South Korea and Taiwan. Most large active emerging market funds are underweight India, and foreign ownership is at a 15-year low of around 15%. Domestic investors have partly filled the gap, taking their share of the market to a record 19%.

When technology stocks sold off in July, India outperformed, reflecting its limited exposure to AI. If enthusiasm for that trade moderates, we would expect India to attract a larger share of flows, although the timing is impossible to predict.

The Gulf conflict is unresolved and oil is again close to \$100 a barrel. Even so, India's fundamentals have moved ahead of its share prices. With earnings recovering, valuations below average and foreign investors underweight, patient investors can buy quality domestic growth companies before sentiment turns. For us, that means owning the right companies now rather than waiting for the index to move.

Biography



Rob Brewis – Director & Investment Manager

Rob is a Director of Aubrey, and Investment Manager of the [Global Emerging Markets Strategy](#). He joined the firm in 2014. An engineering graduate from Cambridge University, Rob began his career in 1988 at Thornton Management in London. Then he spent ten years in Hong Kong as an Asian fund manager with Credit Lyonnais International Asset Management. This company was later bought by Nicholas Applegate and then Colonial First

State, where Rob ran the North Asian investment team as well as managing the Asian Special Situations Fund and a number of single country funds investing in India, Pakistan, Indonesia and Thailand.

He then went on to co-found emerging markets investment boutique BDT Invest LLP in London in 2000. Whilst at BDT, Rob co-managed a number of emerging market portfolios as well as the BDT Asian and Oriental Focus Funds.

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