

# Advantage India

## The Unrealised Opportunity

October 2018



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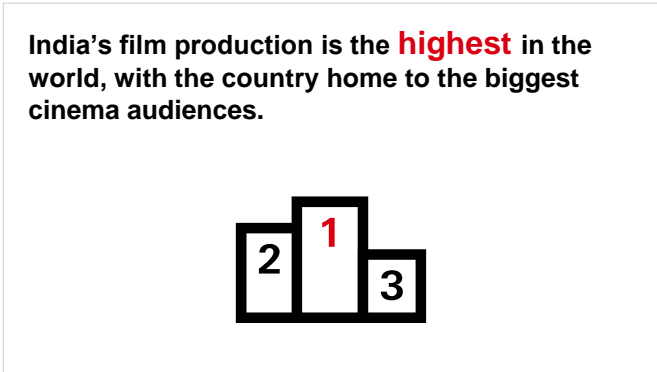
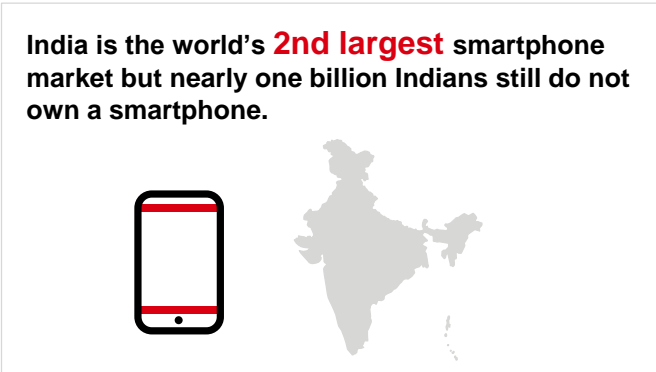
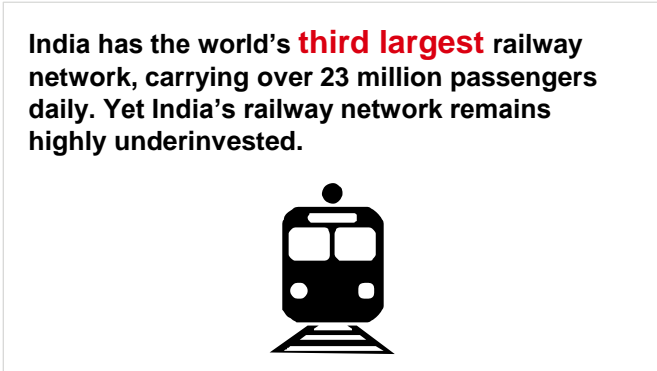
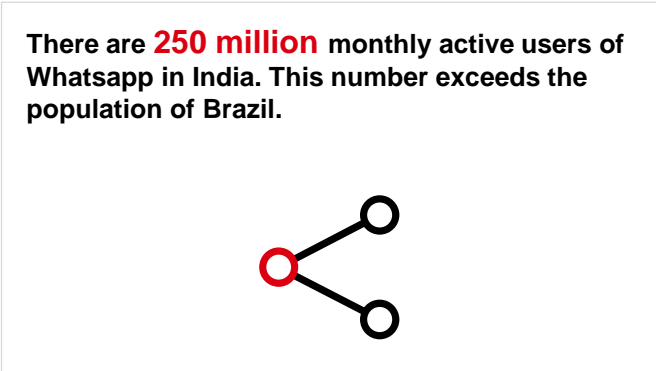
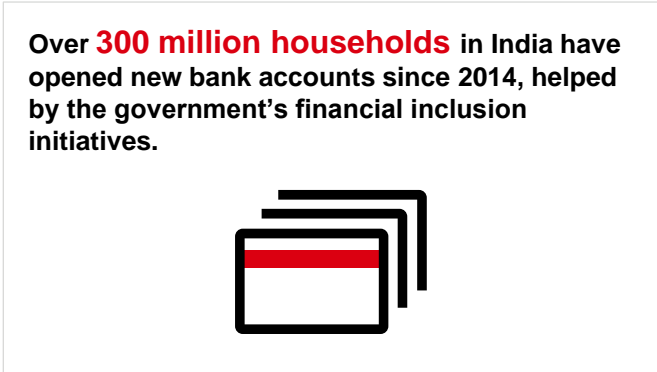
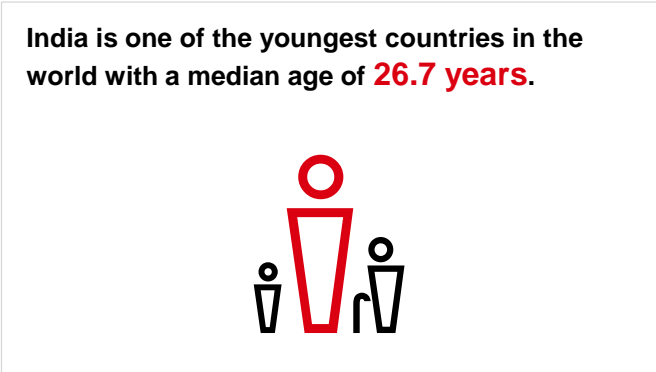
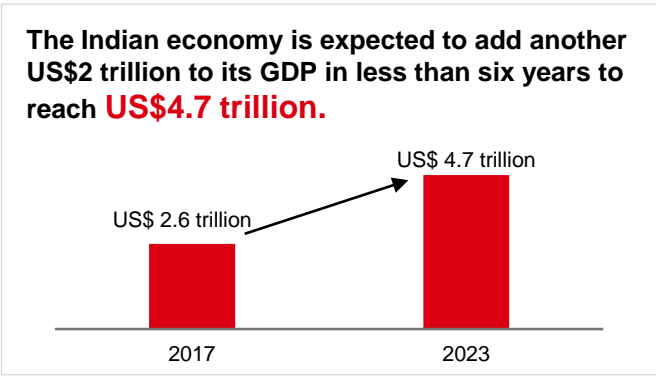
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Indian investment capabilities



# India in numbers



Source: IMF as of September 2018, HSBC Global Research as of March 2018, Morgan Stanley Research as of May 2018, Economic Times as of November 2017, IBEF as of September 2018, Statista as of September 2018

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# India's economic rise

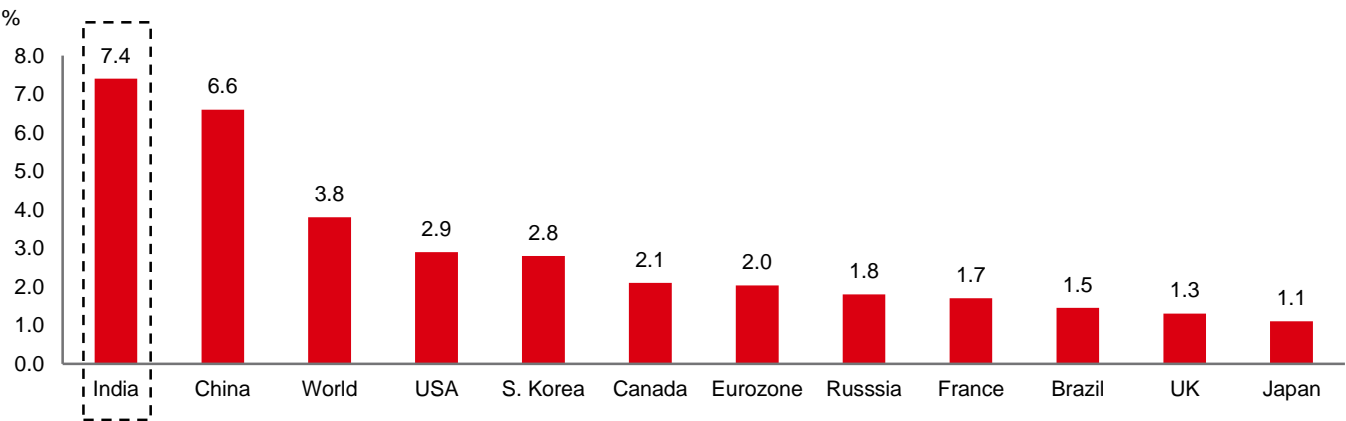
## India is the world's sixth largest economy and growing

The pace of India's economic growth is amongst the highest in the world. India's real GDP has grown at an annual average rate of 7.1% over the last 10 years – double that of the world's 3.4%. India has grown to become the sixth largest economy, having recently surpassed France. In 2019, India is expected to also surpass the United Kingdom to become the world's fifth largest economy.

In recent years, India's substantial focus on structural reforms have significantly contributed to the formalisation of the economy, better transparency in

governance and improvement in ease of doing business in the country. The goods and services tax (GST), implemented in July 2017, was a landmark reform and the strongest evidence of the government's desire to reorient the economy from unorganised to organised. While GST is expected to bring about long-term benefits, it also contributed to the temporary slowdown in the nation's GDP growth, which increased at 6.7% in 2017. Over the next five years, however, the IMF is projecting an average real GDP growth of 7.9% for India, exceeding even the extraordinary annual growth of the last decade.

### Real GDP growth 2018 forecast



Source: Bloomberg, IMF, HSBC Global Asset Management, as of September 2018

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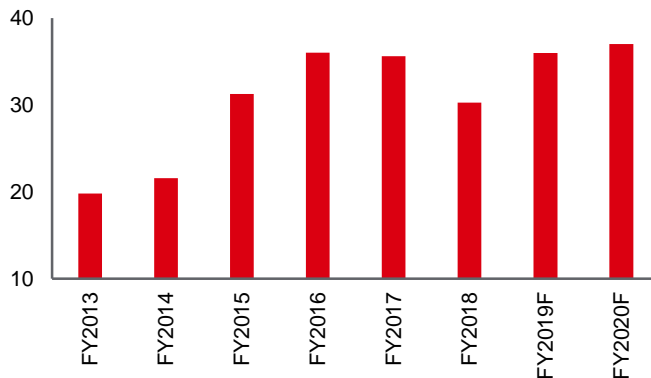
# India to the world

## Preferred investment destination

India is ranked the 10th most preferred investment destination in the world and the 3rd top destination in Asia (China and HK as one economy), as measured by foreign direct investment (FDI) inflows, according to UNCTAD World Investment Report 2018. Although net FDI inflows experienced a decline in growth in FY2018, India still attracted a robust US\$30.3 billion during the year. Improving macroeconomic conditions are also helping India become a preferred investment destination (see page 7).

### India FDI net inflows

USD billion



Source: UNCTAD World Investment Report 2018, RBI, HSBC Global Research as of September 2018

## Improvement in ease of doing business

The government is targeting reforms in all 10 categories of Doing Business, including starting a business, dealing with construction permits, and registering property, in an effort to make India a major design and manufacturing hub and improve ease of doing business. In one year, India jumped 30 places to be ranked 100<sup>th</sup> in World Bank’s annual listing of ease of doing business index.

### India climbing the ranks of World Bank’s ease of doing business index

India's rank	
2016	131
2017	130
2018	100

Source: World Bank Doing Business 2018 report

## The ‘Bollywood’ phenomenon

*Dangal*, a film centered around a man who trains his two daughters to become world class wrestlers, became the top grossing Indian film in international markets, with China playing a key role in the film’s success. In 2017, *Dangal*, was the number one movie at the Chinese box office for 16 consecutive days, earning US\$190 million in box office revenues, a feat that even Hollywood movies have failed to accomplish in China. In recent times, other Indian films, including *Baahubali 2* (fantasy action), *Bajrangi Bhaijaan* (drama), *Secret Superstar* (musical drama) and *PK* (comedy) have also had international success.

India releases over a thousand films a year, making it the largest movie producer in the world. International film appeal can provide economic benefits, including a boost to tourism, and can help shape consumer perception of Indian goods and services as well as generate interest around India and its culture.



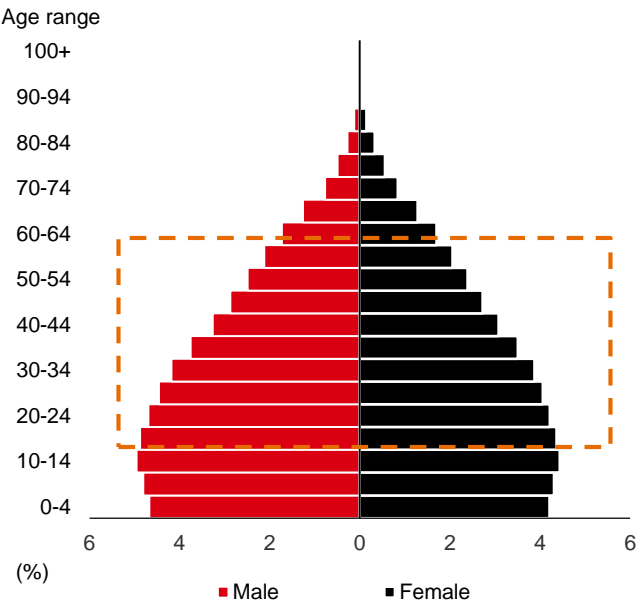
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# Favourable demographics

## Large working age population

The working age demographic in India is large, with 63% of the nation's population aged between 15-60 years of age. Moreover, unlike many developed and developing markets, where the working age population is expected to decrease, India's working age population is still growing.

### India's population division (%)

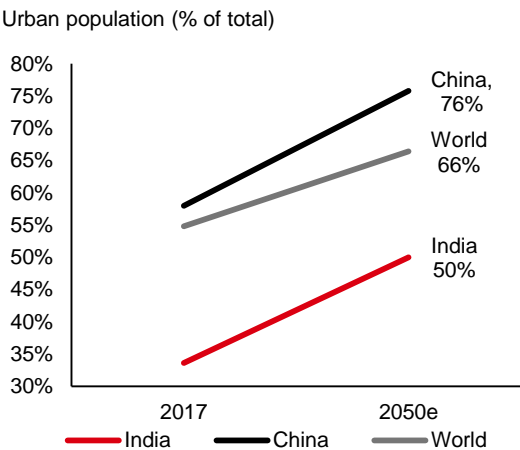


Source: United Nations World Population Prospects 2017

## Urbanisation in numbers

According to the United Nations, India is expected to have seven megacities by 2030. The number today is five. A megacity is defined as an urban area having a population of over 10 million people. But India's urbanisation is not just characterised by megacities – India has a large number of cities and towns that are small but could be counted as urban due to the population density. A McKinsey report estimates that by 2025, India will have 69 mid-sized cities with a population of more than 1 million – and this segment will be a significant contributor to the nation's GDP.

### Urbanisation growth



Source: United Nations, McKinsey, HSBC Global Research as of September 2018

## Indian millennials

*Millennials are broadly defined as people born in 1980s to mid-1990s*

### Sheer size

**30%** of India's population is made up of millennials

### Spend and play

Indian millennials spend **52% of disposable income** on leisure activities

### Love for movies

**90%** of Indian millennials go to the cinema at least once a month

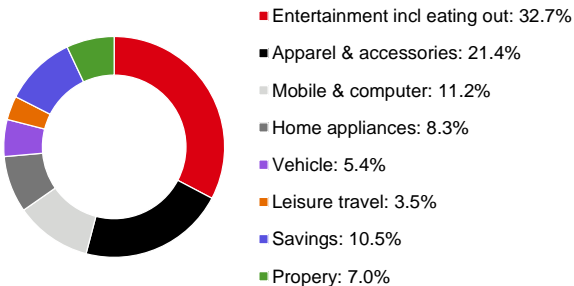
### Looking for the next Zuckerberg

Over 70% Indian start-up founders are under the age of **35 years**

Source: HSBC Global Research as of September 2017, CBRE Global Research as of November 2016

## Millennials as a key force of consumption

Expenses from incremental income of Indian millennials



Source: Deloitte as of February 2018

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# Reform focus

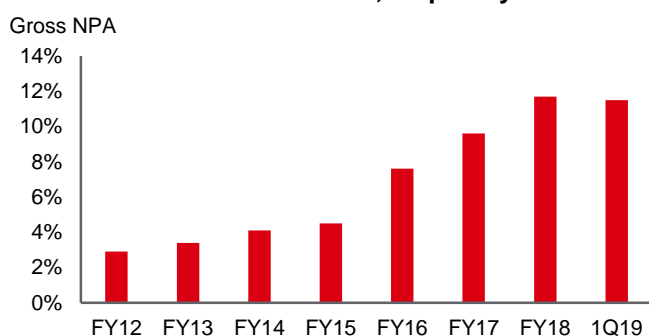
*Since assuming office in 2014, the Modi government has placed substantial focus on structural economic reforms. Highlighted here and in the next page are four sets of key reforms that are impacting the economy and financial markets.*

## Banking sector reforms

The banking system in India has faced challenges brought on by the high levels of stressed assets and non-performing assets (NPA) as a result of corporate lending between 2010-2013. Banking reforms introduced in recent years have played an important role in cleaning up the balance sheets at corporate lenders:

- ◆ The **Insolvency and Bankruptcy Code (IBC)** of 2016 provides an effective and timely process for lenders to restructure NPAs. The IBC is credited as being a game changer for its role in expediting the resolution of bad loans
- ◆ In a bid to bolster the IBC, the Reserve Bank of India (RBI) passed the **Resolution of Stressed Assets – A Revised Framework** in February 2018, harmonising and substituting previous resolution schemes dealing with stressed assets
- ◆ The **bank recapitalisation plan** unveiled in October 2017 involved a record capital injection by the government into public sector banks and was a big step for addressing public sector banks' capital adequacy issues as well as strengthening the overall banking sector

## Gross NPAs have moderated, helped by IBC



Source: Credit Suisse as of August 2018

## Monetary policy reform

The establishment of the Monetary Policy Committee (MPC) in 2016 was a fundamental monetary reform for India:

- ◆ Prior to the establishment of the MPC, the RBI made monetary policy decisions based on a multiple indicator approach
- ◆ The MPC's main responsibility is to keep to the inflation targets set by the RBI. The formation of the MPC has improved the transparency and accountability of India's monetary policy
- ◆ India has been showing improving strength in its macroeconomic fundamentals, particularly compared to the taper tantrum period – inflation, fiscal deficit and current account deficit have all fallen since. Foreign exchange reserves have also increased, insulating domestic borrowers' external debt from currency shocks

## India's key macro indicators now vs. then

	FY2013	FY2018
<b>Consumer price inflation (y-o-y increase)</b>	9.9%	4.3%
<b>Fiscal deficit (% of GDP)</b>	4.9%	3.5%
<b>Current account balance (% of GDP)</b>	-4.8%	-1.9%
<b>Foreign exchange reserves</b>	USD 260 billion	USD 399 billion

Source: RBI, Bloomberg as of September 2018

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# Reform focus (continued)

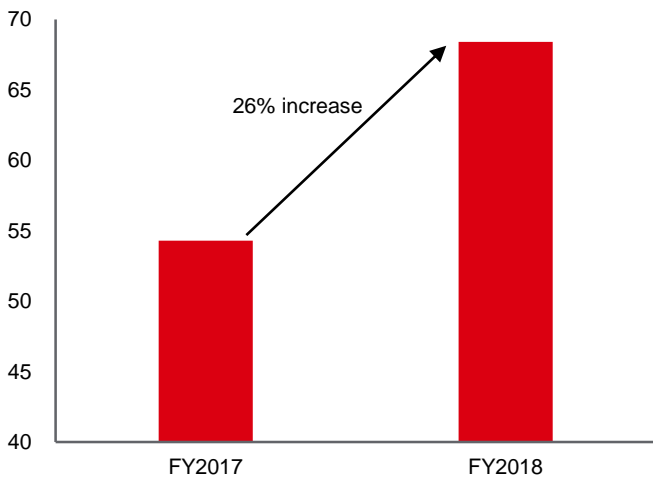
## Goods and services tax (GST)

In July 2017, the Indian government implemented the landmark GST reform, which consolidated the multiple layers of taxes levied by the central government, state governments and local municipalities under a single tax regime. Over a year has passed since GST's introduction, with progress already visible in the economy:

- ◆ **Formalisation the economy:** There are 11.2 million business registrations under GST, while there were 6.4 million under the old regime
- ◆ **Increased tax base:** FY2018 saw a 26% increase in income tax returns filed as compared to FY2017
- ◆ **Reduction of logistics and administrative bottleneck:** Average distance covered by trucks carrying goods have gone up post GST as lines of trucks at checkpoints to enter one state from another have disappeared

### Increase in income tax returns filed

Income tax returns filed (number in million)



Source: Central Board of Direct Taxes as of April 2018

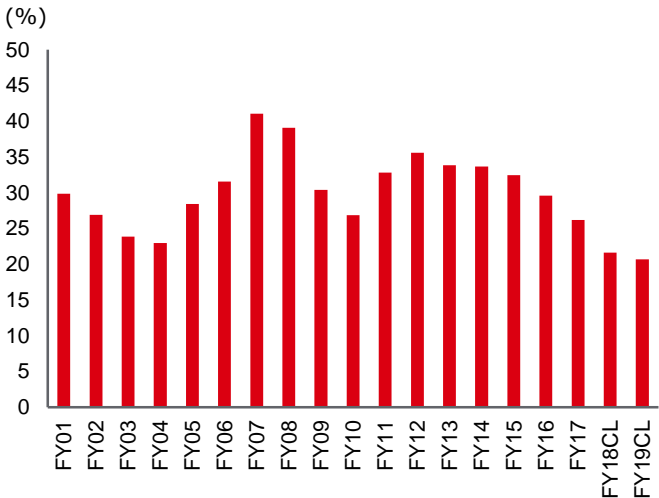
## Construction/housing

The Indian government has placed a focus on reforming the real estate sector:

- ◆ In 2015, the government launched an initiative aiming to provide affordable housing to the urban poor with **"Housing for All"** by 2022. The initiative aims to address the gap between affordable housing demand and luxury property supply
- ◆ The **Real Estate Regulation and Development Act (RERA)** went into effect in May 2016, and into full force in May 2017. RERA is a structural long-term positive reform to promote transparency and fairness in the real estate sector, and regulates project delays, price, quality of construction, title, etc., overall providing an improved regulatory environment and protecting home buyers
- ◆ RERA is a structural change and one of the reforms that will help formalise the economy, benefit organised players and contribute to the consolidation of the real estate sector

### Increasing housing affordability

Mortgage payment to post-tax income ratio



Source: CLSA as of December 2017

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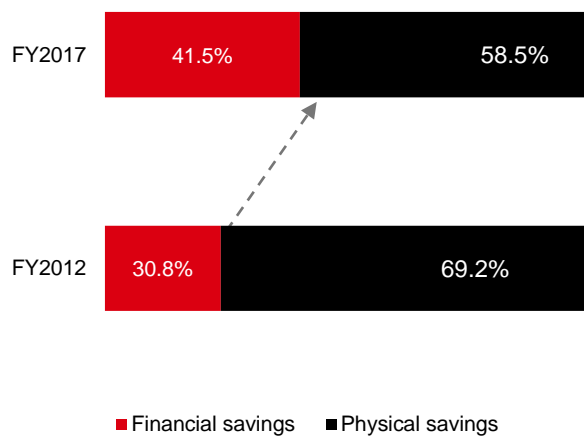


# Spotlight on structural shifts

## Household savings structure: Shift to financial assets

Indian households are reducing their allocation to physical assets such as real estate and gold, given positive real rates. Instead, exposure to financial savings has been on the rise, indicating a shift in the savings structure that is beneficial for economic growth.

### Distribution of household savings



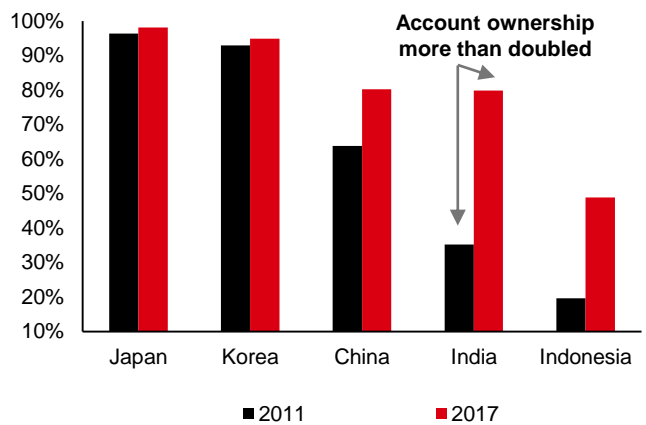
FY = fiscal year from 1 April to 31 March. FY2017 physical savings are based on estimates. Source: Reserve Bank of India, HSBC Global Asset Management, September 2018

## Financial inclusion

India is making progress in financial inclusion, an indicator critical to the social welfare of a country. Pradhan Mantri Jan Dhan Yojana (PMJDY) was a programme rolled out in 2014 with the aim to speed up access to basic financial services for the masses. Increased digitalisation and formalisation of the economy have also pushed the pick up in financial inclusion, as measured by a doubling of bank accounts between 2011 and 2017.

### % of population with bank accounts/mobile wallets

(% of population ages 15+)



Source: The World Bank, HSBC Global Research, Bloomberg, CEIC, HSBC Global Asset Management, data as of May 2018



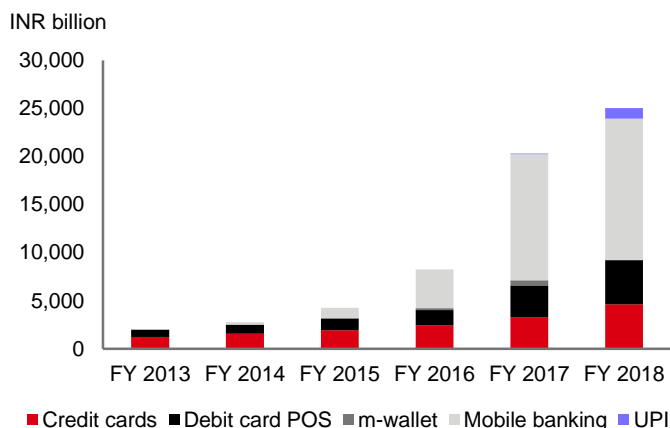
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# Digitalisation of the economy

## Surge in digital payments

Digital payments have surged in India, with transactions increasing at 75% compounded annual growth rate (CAGR) over the past four years. Digital payments have gotten a boost from government initiatives such as demonetisation in November 2016 and GST implementation in July 2017 as well as Aadhaar, which is a biometric citizen identification card, now covering 99% of the adult population in India. The launch of Unified Payments Interface (UPI) in 2016 has also boosted digital payments. (see more below)

### Digital Payments



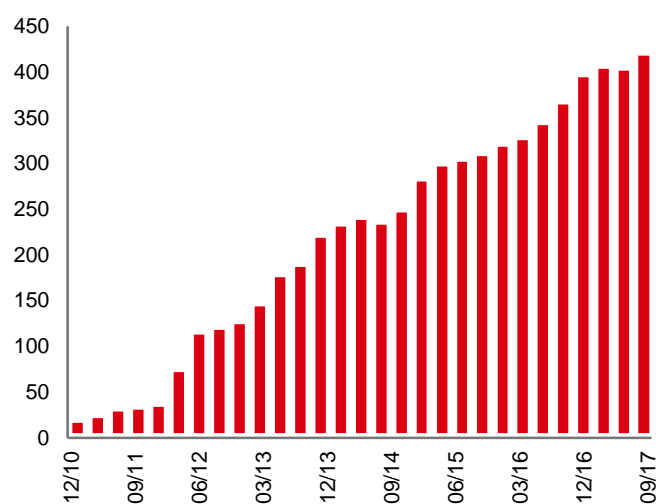
FY = fiscal year from 1 April to 31 March. Source: Reserve Bank of India, CLSA, HSBC Global Asset Management, August 2018

## Data subscription growth

Smartphone penetration has more than doubled in the last three years. Along with this, the number of data subscribers in India has also more than doubled to now about 400 million. Even at these levels, penetration is still low relative to other major nations, creating a huge growth opportunity for the digital space as India continues to develop and catch up with other countries.

### Data subscriber growth

Number in million



Source: TRAI, Morgan Stanley Research as of May 2018

## UPI leads cash-less revolution

### What is UPI?

UPI is an online payment system unique to India, that was launched by the National Payments Corporation of India (RBI regulated entity) allowing instant transfer of money between two parties on a mobile platform. UPI enables peer-to-peer, peer-to-merchant, and business-to-business payments transactions. Aside from the basic money transfer feature, certain apps also allow users to make bookings for bus, train or even plane tickets, order food and pay bills.

### What are the leading platforms?

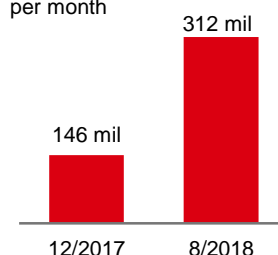
Although it was the Indian government that first launched the UPI app for e-payments (called BHIM), players such as PhonePe by Flipkart, Paytm and Google Tez are benefiting off of the government's digital initiative with their own apps. Whatsapp is also entering the UPI market and is currently in beta mode – Whatsapp is estimated to have about 250 million monthly active users for its chat application.

### Who are the beneficiaries?

While companies with the leading UPI apps are set to benefit, other potential beneficiaries of the surge in UPI include private sector banks. With the UPI interface linking bank accounts, banks can expect to see continued deposit strength. Large private banks with strong digital platforms are set to benefit from this shift.

### UPI transaction volume

Number of transactions per month



Source: RBI, NPCI, as of September 2018

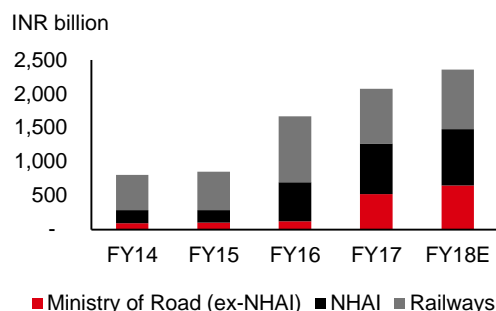
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# Investment opportunities

## Investment opportunities: Pick up in capex

- ◆ India's private investment cycle has been delayed (beyond our expectations) due to leveraged corporate balance sheets and a stressed banking sector
- ◆ We expect a gradual pick up in investment cycle as benefits of government investment cascades into the economy
- ◆ Government investment on infrastructure (roads, railways and urban infrastructure) has been leading the way for now
- ◆ Industrials, cement and metals are beneficiaries of this capex trend

### Road and railway capex picking up

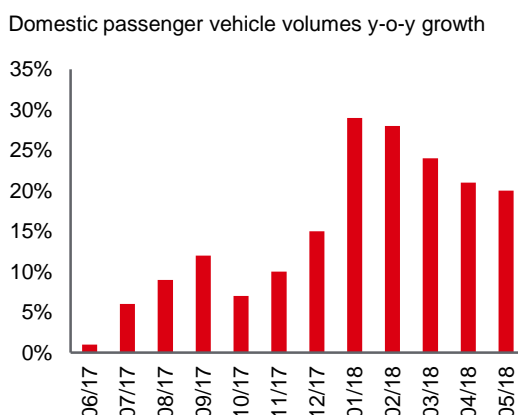


Source: Nomura as of February 2018

## Investment opportunities: Autos

- ◆ Growth momentum for the auto sector is strong with domestic passenger vehicle volume remaining high. Strength in domestic consumption and a pick up in rural demand are driving growth. Other favourable conditions, including a young population, increasing income, and government support, will continue to support the industry's long-term prospects
- ◆ Valuation of the sector is reasonable versus the historical range, particularly following the weakness in the market performance of the sector year-to-date
- ◆ The development of the electric vehicle (EV) segment and the government's target of 30% EV penetration by 2030, will shape the landscape for the auto industry in India. The transition to electric is expected to help reduce air pollution as well as decrease the nation's reliance on imported crude oil

### Strong growth in auto demand

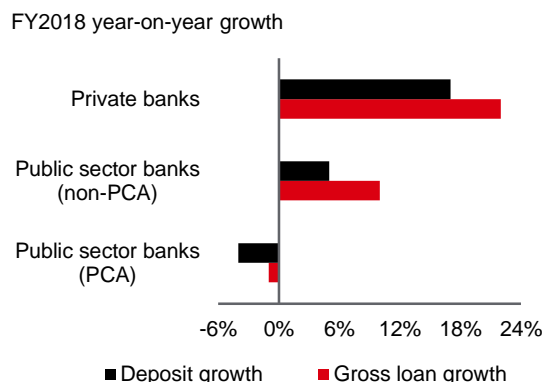


Source: Nomura as of August 2018

## Investment opportunities: Well capitalised private sector lenders

- ◆ Acceleration of non-performing loans (NPL) resolution: Private banks have been focusing on cleaning up their balance sheets. Resolution of NPLs could prompt a re-rating of well capitalized corporate lenders
- ◆ Strong deposit franchises: A key strength of some of the large cap private lenders is their strong deposit franchises as they continually invest in branches, their brand and quality services
- ◆ Loan growth strength: The loan growth for some private banks continues to look healthy as they have been de-risking their corporate loan book and increasing their exposure to the retail segment
- ◆ Valuation: Private sector banks trade at a substantial discount, despite a bottoming out of their asset quality and an improving earnings outlook

### Growth for private sector banks



Source: Credit Suisse as of June 2018. PCA refers to Reserve Bank of India's prompt corrective action

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# India's equity market

## Indian equities: a US\$2.3 trillion market is underrepresented

India's economy is one of the world's largest but its equity market representation in the MSCI AC World Index remains at only 0.9%. This means there is potential for a sizeable increase in the index weight in the coming years.

### Equity representation vs GDP contribution

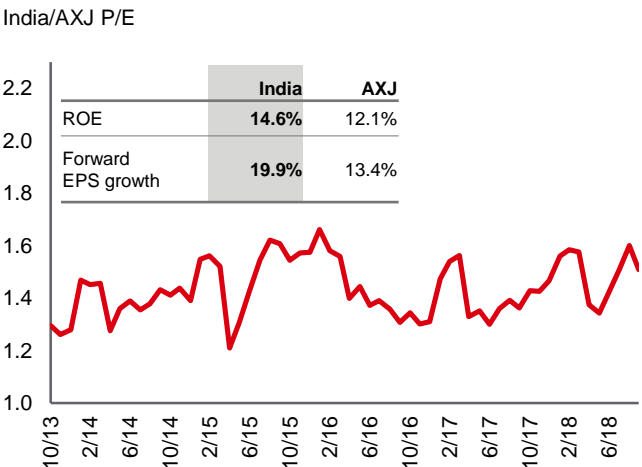
Country	World GDP contribution (%)	MSCI AC World Index weight (%)
United States	24.0	54.0
Japan	6.0	7.6
United Kingdom	3.3	4.9
China	15.2	3.0
Australia	1.6	2.1
South Korea	1.9	1.6
Hong Kong	0.4	1.5
India	3.2	0.9

Note: GDP data is based on 2017 calendar year GDP. Source: Bloomberg, World Bank, MSCI, HSBC Global Asset Management, data as of September 2018

## Relatively higher return on equity compared with other markets

India's equity market has historically had a higher return-on-equity versus the Asia ex Japan region; this factor is one of the reasons why India tends to trade at a premium relative to the region. Return on equity (ROE) of India is now 14.6% versus 12.1% for the region.

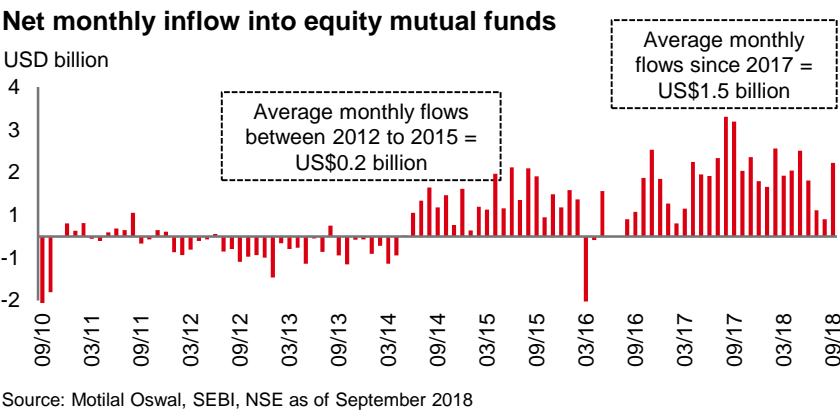
### India's P/E premium vs Asia ex Japan



Note: Respective equity markets are represented by MSCI Indices. Source: Bloomberg, MSCI, HSBC Global Asset Management as of September 2018

## Domestic institutional investor flow into equity mutual funds

- ◆ Domestic inflows into Indian equities are now a lot higher as compared to previous years - average monthly flows since 2017 has been USD 1.5 billion, whereas between 2012 to 2015, it was only USD 0.2 billion
- ◆ This trend can be explained by the increasing financialisation of savings, as domestic households reduce their allocation to physical assets and instead shift them to financial products



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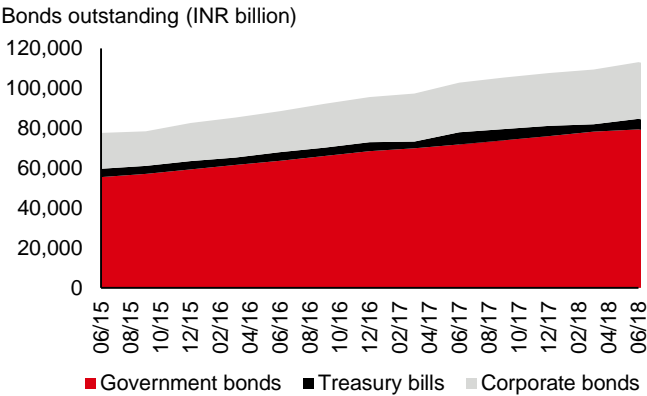
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# India's bond market

## Indian bond market: large and diversified

The Indian bond market has grown rapidly and has surpassed USD 1.4 trillion in size. While about two-thirds of the market is made up of government bonds, the corporate market is likely to grow strong in the coming years. While the offshore Indian bond market, with securities mainly denominated in USD, can be accessed by all offshore investors, the onshore INR market is not freely accessible to foreign investors; the onshore market is accessed through Foreign Portfolio Investor (FPI) license. However, recent reforms have facilitated market access to foreign investors and have helped widen the investor base and increase inflows from foreign investors.

### Onshore INR bond market



Note: Government bonds consist of central and state. Source: HSBC Global Asset Management, RBI, CCIL, SEBI as of June 2018

## Sovereign credit ratings on the rise

Moody's raised India's sovereign rating by a notch from Baa3 to Baa2 in November 2017. The upgrade is underpinned by consistent progress on the government's reform agenda.

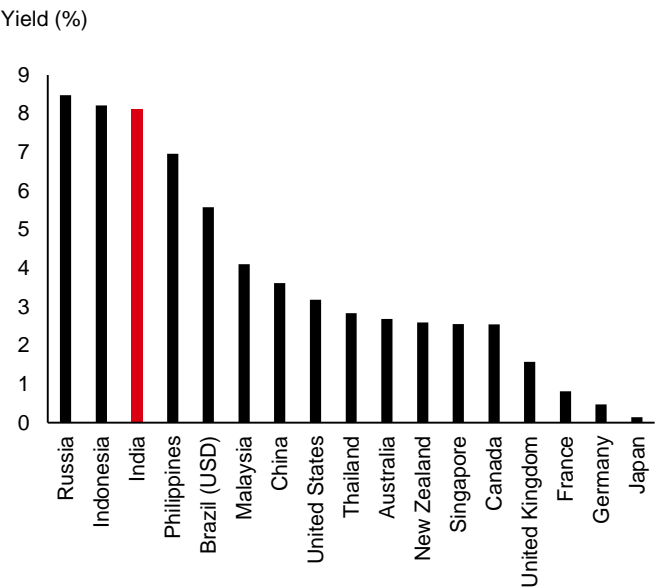
	Long term rating	Economic outlook
Moody's	Baa2	Stable
Fitch	BBB-	Stable
S&P	BBB-	Stable

Source: Moody's, Standard & Poor's, and Fitch ratings, as of September 2018

## Attractive bond yields

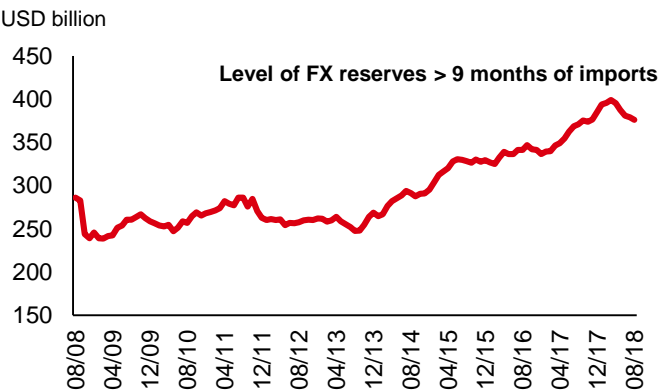
Indian bonds offer a premium to other developed as well as emerging markets, with an attractive 8.1% yield on its 10-year government bonds.

### 10-year government bond yields



Source: Bloomberg, data as of 3 October 2018

## Healthy FX reserves provide a reasonable cushion against volatility



Source: Bloomberg, as of August 2018

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# A country of countries

India is quickly emerging as a major economic powerhouse, fuelled by many important factors, one of which is its incredible population size. With 29 states and a total population of 1.3 billion people, India can be thought of as a country of countries. The below map provides our global audience with an idea of how the people of India are spread out across its states and territories by illustrating population in country equivalent terms.



Source: IIFL, CEIC, The Economist, World Bank, HSBC Global Asset Management as of January 2018

# HSBC Global Asset Management

## Indian Investment Capabilities

Key products	Indian Equity	India Fixed Income
<b>Key proposition</b>	High conviction and diversified Indian equity portfolio with differentiated strategy	Invests in Indian fixed income across the credit spectrum, in both onshore and offshore markets
<b>Benchmark</b>	◆ S&P/IFCI India Gross	◆ None
<b>Approach</b>	<ul style="list-style-type: none"> <li>◆ Bottom-up fundamental approach</li> <li>◆ Concentrated positions with below average valuation for a given level of profitability</li> </ul>	<ul style="list-style-type: none"> <li>◆ Integrated approach towards fundamental research and local insight</li> <li>◆ Robust rate process</li> </ul>
<b>Investment universe</b>	<ul style="list-style-type: none"> <li>◆ Equities of companies domiciled, based on carrying out large part of business in India (minimum 90%)</li> </ul>	<ul style="list-style-type: none"> <li>◆ Investment grade, non-investment grade, and unrated INR bonds, including corporates and government</li> <li>◆ Investment grade, non-investment grade, and unrated bonds in other currencies hedged back to INR, including corporates and government</li> </ul>
<b>Fund AUM</b>	◆ USD1,572 million	◆ USD 855 million
<b>Inception</b>	◆ March 1996	◆ August 2012

Note: In addition to the key products showcased, HSBC Global Asset Management offers a full suite of offshore and onshore products related to Indian investment capabilities, including multi-asset, infrastructure, liquidity, equity small/mid cap, and other equity and fixed income products

### Why active management with HSBC?

<b>Indian equities:</b>	<ul style="list-style-type: none"> <li>◆ <b>Attractive combination of profitability and valuation</b> – Concentration of overweight positions in potentially profitable companies at below-average valuations, enhancing potential returns over the long run</li> <li>◆ <b>Strong fundamental focus</b> – Significant value added with strong fundamental focus, which is supported by high quality research</li> </ul>
<b>Indian fixed income:</b>	<ul style="list-style-type: none"> <li>◆ <b>Rigorous credit selection and risk management</b> – An integrated approach towards fundamental research and local insight that marries rigorous credit selection with stringent risk controls</li> <li>◆ <b>Robust rate process</b> – Investment views formulated through extensive analysis of economic fundamentals, central bank policies and liquidity, to derive appropriate rate strategy for the portfolio; process is fully supported by the on-the-ground investment team in India</li> </ul>
<b>Emerging markets expertise:</b>	<ul style="list-style-type: none"> <li>◆ HSBC Global Asset Management is one of the largest managers of emerging market assets. HSBC Group's longstanding brand equity in the emerging world provides a unique level of access to management teams as well as a nuanced understanding of local politics, cultures, and markets</li> </ul>
<b>Reputation and brand equity open doors:</b>	<ul style="list-style-type: none"> <li>◆ The actively managed portfolios benefit from goodwill and strong relationships that come with being a part of the HSBC Group</li> </ul>

Source: HSBC Global Asset Management, data as of August 2018

# Key Risks

**The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested.**

- ◆ **Exchange rate risk:** Investing in assets denominated in a currency other than that of the investor's own currency perspective exposes the value of the investment to exchange rate fluctuations.
- ◆ **Liquidity risk:** Liquidity is a measure of how easily an investment can be converted to cash without a loss of capital and/or income in the process. The value of assets may be significantly impacted by liquidity risk during adverse market conditions.
- ◆ **Emerging market risk:** Emerging economies typically exhibit higher levels of investment risk. Markets are not always well regulated or efficient and investments can be affected by reduced liquidity.
- ◆ **Derivative risk:** The use of derivatives instruments can involve risks different from, and in certain cases greater than, the risks associated with more traditional assets. The value of derivative contracts is dependent upon the performance of underlying assets. A small movement in the value of the underlying assets can cause a large movement in the exposure and value of derivatives. Unlike exchange traded derivatives, over-the-counter (OTC) derivatives have credit and legal risk associated with the counterparty or the institution that facilitates the trade.
- ◆ **Operational risk:** The main risks are related to systems and process failures. Investment processes are overseen by independent risk functions which are subject to independent audit and supervised by regulators.
- ◆ **Concentration risk:** Funds with a narrow or concentrated investment strategy may experience higher risk and return fluctuations and lower liquidity than funds with a broader portfolio.
- ◆ **Interest rate risk:** As interest rates rise debt securities will fall in value. The value of debt securities is inversely proportional to interest rate movements.
- ◆ **Derivative risk (leverage):** The value of derivative contracts depends on the performance of an underlying asset. A small movement in the value of the underlying can cause a large movement in the value of the derivative. Over-the-counter (OTC) derivatives have credit risk associated with the counterparty or institution facilitating the trade. Investing in derivatives involves leverage (sometimes known as gearing). High degrees of leverage can present risks to sub-funds by magnifying the impact of asset price or rate movements.
- ◆ **Emerging market fixed income risk:** Emerging economies typically exhibit higher levels of investment risk. Markets are not always well regulated or efficient and investments can be affected by reduced liquidity, a measure of how easily an investment can be converted to cash without a loss of capital, and a higher risk of debt securities failing to meet their repayment obligations, known as default.
- ◆ **High yield risk:** Higher yielding debt securities characteristically bear greater credit risk than investment grade and/or government securities.
- ◆ **Contingent Convertible Security (CoCo) risk:** Hybrid capital securities that absorb losses when the capital of the issuer falls below a certain level. Under certain circumstances CoCos can be converted into shares of the issuing company, potentially at a discounted price, or the principal amount invested may be lost.

For more detailed information on the risks associated with the funds presented in this document, investors should refer to the prospectus.

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