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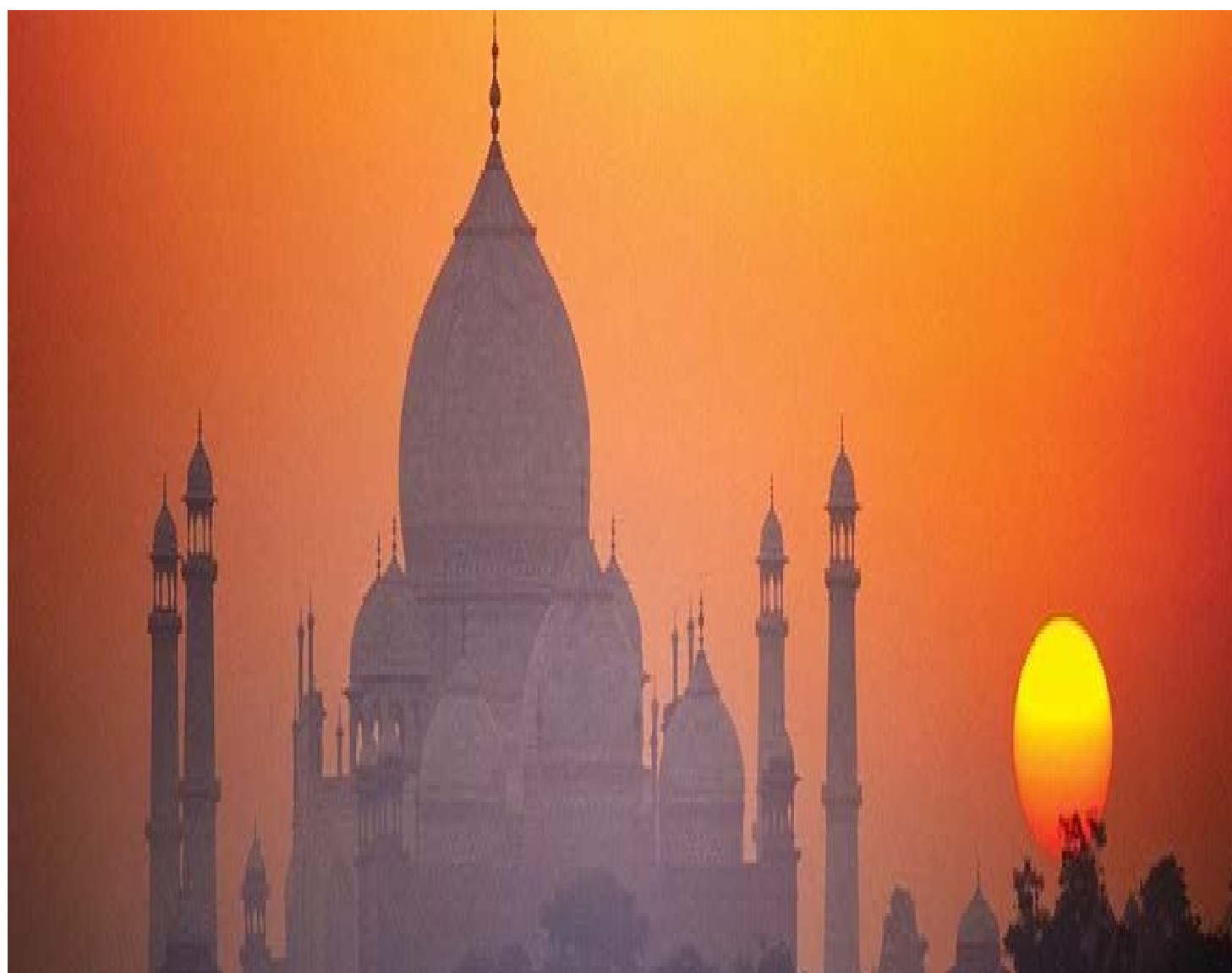
Investing in India is gaining appeal with advisers

Investors are salivating over the country's rich demographics

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By **Jeff Benjamin**  

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When investment pros look at India, they point to a number of positive factors. At \$2.2 trillion, the country has the world's seventh-largest economy, which is projected to grow this year by 7.3%. That's better than any other large and developing economy in the world.

But what really gets them licking their chops are the country's demographics.

More than a third of India's 1.3 billion people are between the ages of 15 and 34. The median age is 27, compared with 37 in China, 38 in the United States, 41 in developed Europe and 46 in Japan. Over the next five years, India's population is projected to grow by 1.4%, compared with 0.5% in China, 0.9% in the U.S., 0.3% in Europe and no growth in Japan.

“India has the youngest population in the world. That's why it's a story of a rapidly growing consumer economy,” said Ed Kerschner, vice chairman at Emerging Global Advisors, a \$1 billion asset management firm that specializes in emerging economies.

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“The middle class is not just a statistic. It’s an aspirational benchmark of when and how an economy begins to consume,” he added.

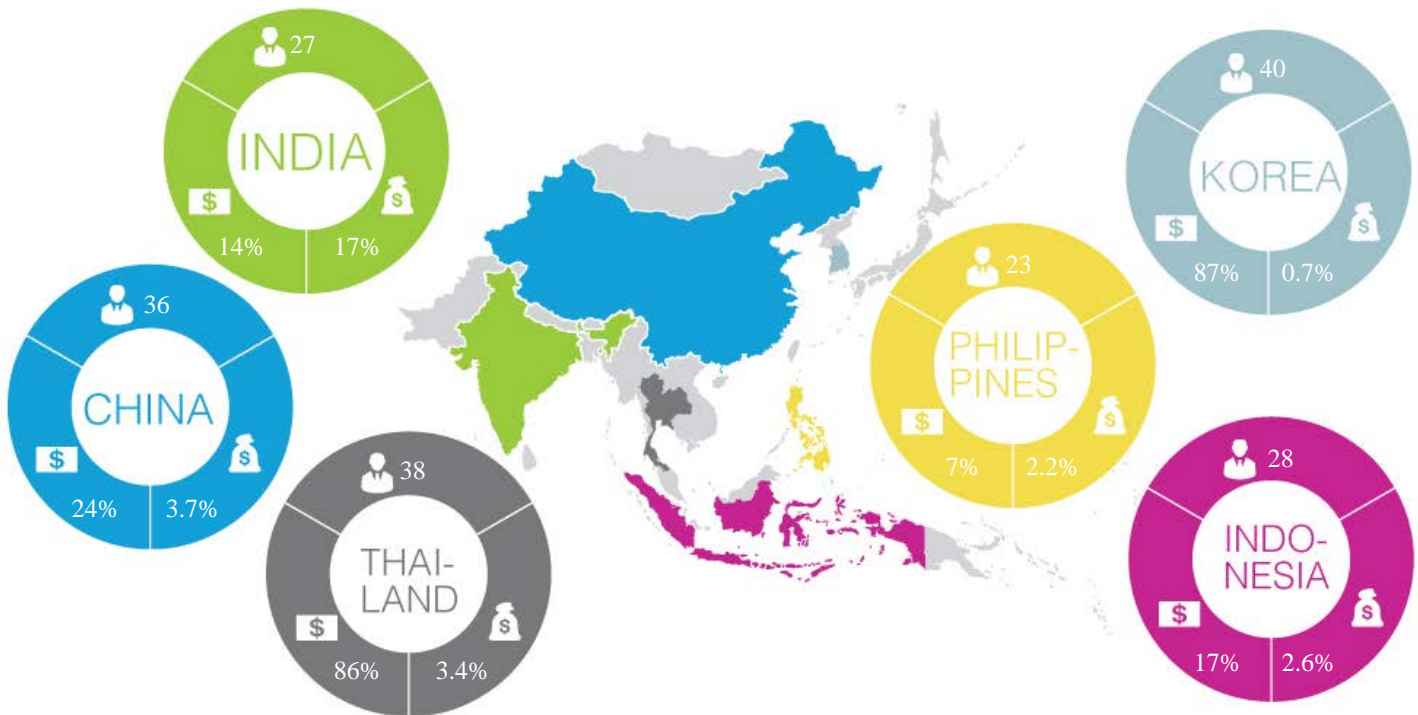
Near term, as a net importer of energy commodities, India is benefiting from cheap oil, which is helping propel an economic boom that has been decades in the making. But the medium- and longer-term India story includes macroeconomic trends and the hopeful leadership of reform-minded Prime Minister Narendra Modi, who supports a more business-friendly and growth-oriented economy.

India in Asia

Population median age

Household debt % GDP

Foreign direct investment % GDP



Source: UN, World Bank, CEIC, Haver, IMF, Morgan Stanley, Mirae Asset (July 2015)

“India is almost the complete package,” said Mr. Kerschner, who sees the country leading the world in what he describes as the “world's third great growth wave of the middle class.”

The first two waves included a middle-class growth spurt in Europe following the Industrial Revolution and the middle-class boom in Europe, the U.S. and Japan after World War II.

It is against such a favorable backdrop — illustrating not only robust economic growth, but solid potential for future growth — that India continues to gain appeal among financial advisers and investors.

“It's a great place to be as far as potential growth, but it's still a very long-term play, and you have to be patient,” said Theresa M. Rosen, founder and chief executive of Prudence Financial Inc.

Ms. Rosen, who describes herself as a “big fan of India and the emerging markets,” allocates between 5% and 20% of clients' assets to emerging market investments.

“I know the emerging markets, in general, are out of favor at the moment, which is mostly due to the slowdown in China and lower commodity prices, but I'm still a big fan,” she added. “India probably has the most progressive government, with leadership that seems at least interested in capitalistic ways of growing, even though there are still a lot of issues that could slow things down.”

Leon LaBrecque, chief investment officer at wealth management firm LJPR Financial Advisors, also places himself in the “pro camp” regarding the investment potential in India.

Top 5 nations in middle-class growth

2009

1. United States: 21%

2. Japan: 8%

2030E

1. India: 23%

2. China: 18%

3. Germany: 6%

4. France: 4%

5. United Kingdom: 4%

3. United States: 7%

4. Indonesia: 4%

5. Japan: 4%

Source: Brookings Institution, "The Emerging Middle Class in Developing Countries" (2011); Note: middle class is defined as USD 10 < X < USD 100 at 2005 PPP\$

INGREDIENTS FOR MEGA-GROWTH

"India has all the ingredients of a mega-growth market: good demographics, good technology, good consumers and a huge, affluent expatriate community that represents potential investors," he said. "And in a new pro-business government, we think India will be a dominant emerging market."

What makes the India investment story so interesting is that, unlike most markets coming into the spotlight, this is not a case of chasing performance.

In 2015, India's stock market, as represented by iShares MSCI India ETF (INDA), was down 7.12%. That is still relatively attractive compared with the 16.8% drop in the broader emerging market exposure of iShare MSCI Emerging Markets ETF (EEM), but it lags badly behind the 1.38% gain by the S&P 500 Index.

"We're buying emerging markets because of the value," Mr. LaBrecque said. "China has had two decades of tremendous growth, and I think India is China two decades ago."

A major difference between China's economic growth and what some are seeing for India is that India's is expected to be more consumer-driven, while China's growth has been more dependent on government infrastructure projects and government spending in general.

With about half its economy pegged to consumer spending, India's growth is viewed as more organic, similar to that of the U.S. economy, 70% of which is generated by consumer spending.

“India has been disappointing me for a long time, and I've been thinking of it as a giant consumer base,” Mr. LaBrecque said. “But finally with Prime Minister Modi's election [in 2014], now there's some potential and political will, and we think it's going to be one of the stronger emerging markets.”

Even with so many signs pointing toward a massive middle-class migration, followed by a wave of consumer spending, the financial services industry has been uncharacteristically cautious with regard to new investment products and investment opportunities.

India-focused mutual funds

Name	Ticker	Fund Size	Total Ret 1 Yr	Total Ret Annlzd 3 Yr	Total Ret Annlzd 5 Yr
ALPS Kotak India Growth A	INDAX	\$15,570,866	-3.389	10.625	N/A
DMS NASDAQ India Midcap Index Investor	DIIMX	\$986,387	-1.232	3.674	N/A
Eaton Vance Greater India A	ETGIX	\$233,720,883	-4.960	5.993	-1.253
Franklin India Growth A	FINGX	\$122,094,670	-4.411	9.651	1.898
Matthews India Investor	MINDX	\$1,488,281,796	0.901	15.839	5.368
Wasatch Emerging India	WAINX	\$68,125,283	4.156	14.277	N/A

India-focused ETFs

Name	Ticker	Fund Size	Total Ret 1 Yr	Total Ret Annlzd 3 Yr	Total Ret Annlzd 5 Yr
EGShares India Consumer ETF	INCO	\$83,002,841	-0.062	10.650	N/A
EGShares India Infrastructure ETF	INXX	\$40,538,720	-15.591	-5.717	-9.895
EGShares India Small Cap ETF	SCIN	\$21,886,382	-8.528	2.956	-5.594
iPath® MSCI India ETN	INP	\$254,375,549	-7.456	3.045	-3.336
iShares India 50	INDY	\$765,323,026	-7.822	4.217	-1.965

iShares MSCI India	INDA	\$3,451,978,565	-6.624	3.313	N/A
iShares MSCI India Small-Cap	SMIN	\$78,808,206	2.019	10.444	N/A
Market Vectors® India Small-Cap ETF	SCIF	\$170,722,343	1.122	1.139	-10.479
PowerShares India ETF	PIN	\$429,014,901	-5.911	3.208	-4.236
WisdomTree India Earnings ETF	EPI	\$1,550,223,265	-8.681	2.640	-4.480

Source: Morningstar, Inc; Note: N/A = not applicable

Morningstar counts just six India-focused mutual funds and 10 India-focused ETFs, the largest of which is the aforementioned \$3.5 billion iShares MSCI India ETF, which was launched in February 2012.

The largest mutual fund in the group is the \$1.5 billion Matthews India Investor (MINDX), launched in October 2005.

The oldest fund in the group is the \$234 million Eaton Vance Greater India A fund (ETGIX), launched in May 1994. There hasn't been an India-focused mutual fund or ETF launched since 2012.

By comparison, there are 22 mutual funds and 36 ETFs focused on China, and 13 mutual funds and 28 ETFs focused on Japan.

Bill Rocco, Morningstar's international equity fund specialist, said the relative dearth of concentrated India funds is probably the result of supply-and-demand fundamentals, as well as what he hopes will be a trend toward fewer concentrated investment products.

BROAD APPROACH

“We're generally skeptical of the idea of single-country emerging market funds, and we don't cover them anymore because our readers and clients aren't really interested,” he said. “We think the better way to get exposure to India is through a broader emerging markets fund.”

Part of the risk associated with investing in a single-country emerging market fund, Mr. Rocco added, is that the country concentration can also become a sector concentration.

He cited Russia as an extreme example, with its heavy exposure to energy-industry stocks.

“India is a little broader, because they have healthcare and software industries, but people don't ask themselves what's the worst a Russia or India fund could do,” Mr. Rocco said. “In a geopolitical event, an India fund is going to get hurt worse than a broader emerging markets fund.”



Mr. Rocco said the best case for diversifying exposure to emerging markets can be made by considering what you're getting in a single-country fund.

“Do you really want to own the 45th best stock in India, as opposed to 10 really good India stocks and 10 really good China stocks, and so on,” he said. “Diversified emerging markets managers aren't investing by country, they're looking at stocks. They don't say, 'It's a big population with rising income and a pro-business government,' and then add exposure. They're not making macro calls, but for individual investors buying an India fund, you're making a macro call.”

Todd Rosenbluth, director of mutual fund and ETF research at S&P Capital IQ, said part of the reason investors have been drawn to India-focused strategies recently is that it looks like the best hope in the emerging markets.

“Investors used to think of BRIC as a group, but Brazil and Russia have struggled more



Golden opportunity: Investors believe India's large and growing population could create a huge consumer market.

economically and their stock performance has differed from China and India,” he said. “That's why investors are increasingly looking to single-country funds.”

The ultimate riddle of India is that much of what makes the country appealing to investors can also be seen as deterrents.

“I think India is a great long-term story, and on paper it looks good, with low global interest rates, low oil prices and a pro-reform government,” said Sammy Simnegar, who

manages emerging markets portfolios at **Fidelity Investments**.

NOT LIKE CHINA

“But when you're talking about the largest democracy in the world, it's hard to get things done,” he added. “In China, where you've got a one-party system, they can move a village of a million people to build a dam. You can't do that in India.”

Mr. Simnegar is bullish on India, but he doesn't expect it to take off like the next China, which is why he's discouraging concentrated investment exposure to India's \$1 trillion stock market.

While some argue against investing in India through single-country funds because of the potential volatility, Mr. Simnegar argues against it because the index exposure is less of a pure play than some investors might assume.

Of the 10 hottest stocks in India, for example, five are multinational companies that derive 80% of their revenue from outside India. Based on that kind of data, Mr. Simnegar said he thinks investors can get better exposure to what is really driving India's economy with bottom-up stock-picking.

While a more diversified actively managed emerging markets fund might be less sexy than an India-

focused ETF, it might be the best way to avoid some obvious and less obvious pitfalls.

“True, India has lots of success stories, but what you don't hear a lot about is the massive bureaucracy, a legacy of colonial rule, poor to no infrastructure, and of course, enormous religious strife,” said Kashif A. Ahmed, president of American Private Wealth.

“All of those issues are not conducive to propelling India forward as a progressive, business-friendly state,” he added. “For the retail investor, there is massive risk in investing in India, and you have to fully understand what level of risk and volatility you are willing to tolerate before you make the jump.”

BULLISH BUT CAUTIOUS

Similar to Mr. Simnegar, Van Eck Global emerging markets portfolio manager David Semple is a fan of the India story but strategically cautious.

With the backdrop looking so favorable, especially since Prime Minister Modi came on board in 2014, Mr. Semple said the market has already tapped out most of the interested investors and will need some kind of catalyst to drive another wave of investment into the country.

“India is already over-weighted in most emerging market indexes, so the question is, Where are the marginal buyers going to come from?” he said. “There's no new money coming into the asset class right now. So you need to have either significant tangible progress that exceeds expectations in terms of reforms, companies beating expectations, or everything else in the emerging markets just gets worse.”

Ultimately, India is no different than any other trending asset class or investment category.



“No doubt there's money to be made in India, but you need a very good understanding of the kind of volatility we're talking about.”

— Kashif A. Ahmed, president of American Private Wealth

Looking past the imposing population patterns and potential macroeconomic girth of the world's largest democracy, India is best viewed as a satellite allocation alongside similar risky bets.

“Everyone wants to make money, but they're the first ones who call when they see parentheses on their statement,” said Mr. Ahmed. “No doubt there's money to be made in India, but you need a very good understanding of the kind of volatility we're talking about. Because when you're making money in India, you're making money, but when losing it, you're losing it faster than you want to talk about.”



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