Indian equities align to long-term expectations...so far this century

Given India's pace of economic growth, reforms and infrastructure development and its youthful, entrepreneurial and large population, investors typically look to achieve and to benefit from capital growth by investing in the region. Unfortunately, investment returns don't always work out as hoped, usually due to "unplanned" adversity. This might include events like the Global Financial Crisis, the COVID-19 pandemic or India specific issues like rising oil prices, political instability, stagflation and a volatile currency.

We can study historical returns to observe if they have aligned to expectations and if investment returns changed as the environment has evolved. India has been on an economic journey since 1991, when it first liberalised its economy. Several changes have occurred over the last 32 years which have impacted on investment returns and the volatility of those returns.

CAPITAL GROWTH

Equity (share market) investments which produce a compounded rate of return equivalent to GDP growth plus inflation, (e.g., nominal GDP growth) should typically resonate with capital growth seeking investors where GDP growth has been, and is expected to be higher. Another way to look at this is to look at the risk-free rate of an investment market and the risk premium of investing in equities for that market (economy). In essence, the risk-free rate is the return that an investor would

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get by investing in a government bond in that economy; and the risk premium is the additional return one might expect by investing in equities in that market (inherently, equities are riskier than bonds, hence the equity risk premium).

A typical risk-free proxy is the US 10-year government bond yield (currently with a yield of 4.53%) for developed market domiciled investors. Assuming that investing in Emerging Market equities requires a higher risk premium to be earned of say 7.25%[1], this implies a return expectation of close to 12%. This is of course in no way a prediction of what future returns might be, but more so an indication of how higher growth and more risky equity markets can lead to greater return (and riskier) outcomes over time. Currency movements can impact the expected outcome for foreign investors.

Investor behaviour unfortunately tends to lead to "buying" at points when prices are high and "selling" at points when prices are low. This tends to impact the achievement of long-term robust returns as the "starting point" can have a significant impact on the compounded rate of return achieved over the investment horizon of the investor.

Rolling 5-year returns to measure success rate

A good way to measure the success of an investment strategy which seeks to provide growth over the long term is to look at its rolling 5-year returns. This essentially looks at every investors' return over history from point to point over 5 years (dependent on the day they invested and assuming they reinvested their dividends/distributions). Of course, history is very unlikely to repeat, but it does give those researching where to invest their money, an idea of the type of return profile one can expect from an asset class.

In the example below, we compare the statistics from various major equity markets around the world using **rolling 5-year period data**. The data is built from **monthly returns of MSCI Indices for each country** (including dividends, net of taxes) and is from **a period of December 2000 – August 2023**, covering 213 rolling 5-year periods.

Last 23 years...

	Aust	Can	China	Fr	Ger	India	Jap	NZ	UK	USA
Average Return	8.8%	7.5%	11.4%	5.7%	6.4%	12.2%	4.7%	8.5%	4.7%	8.7%
Minimum	-3.4%	-6.2%	-9.7%	-11.1%	-7.6%	-7.2%	-7.5%	-8.7%	-5.6%	-6.9%
Maximum	33.8%	33.6%	53.2%	25.9%	32.4%	53.2%	16.8%	26.8%	21.7%	22.3%
Std Dev	8.3%	8.1%	11.9%	6.9%	7.8%	12.9%	5.7%	8.4%	6.1%	6.3%

Source: MSCI

The highest average return over the 23-year period was from India at 12.2% p.a. over rolling 5-year period (in USD terms), closely followed by China at 11.4%. Australia, New Zealand, USA and Canada follow in the next group, averaging between 7.5% and 8.7%. The laggards are Europe and Japan. Despite the returns of India and China being much higher on average, there was also a greater degree of volatility in the 5-year outcome (as measured by the standard deviation) relative to the

[1] https://incwert.com/india-equity-risk-premium-2022/

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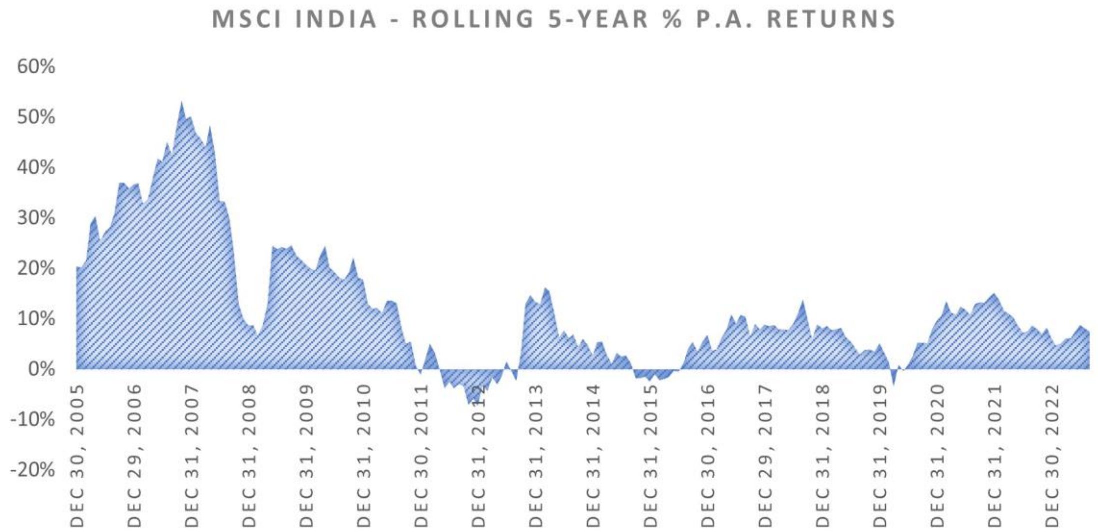
rest of the pack. Mind you most of this was upside volatility, given the minimum 5-year returns are similar to major markets.

The Indian experience of rolling 5-year returns



Source: MSCI

Over this period only 13.5% of rolling 5-year periods are below zero. Whereas over 53% of rolling 5-year periods were over 8% p.a. The returns used for this illustration are in USD terms for consistency across all countries. This is in a period where the USD has been a strong currency in general and underpins the strength of Indian equities long-term return profile in the past.

Greater alignment with expectations, over a 5-yr horizon

It is important to note that volatility over 12 months is much higher than it is over 5-year periods. The following chart depicts the tighter range of outcomes over longer term periods. For growth investors, these are key considerations when applying a long-term horizon.

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	Aust	Can	China	Fr	Ger	India	Jap	NZ	UK	USA
1-Yr Vol	23.6%	21.7%	32.9%	21.8%	24.9%	32.5%	18.1%	22.9%	19.0%	16.8%
5-Yr Vol	8.3%	8.1%	11.9%	6.9%	7.8%	12.9%	5.7%	8.4%	6.1%	6.3%

Source: MSCI

The drop in volatility when the investor horizon shifts from 1-year to 5-years is significant for markets like India and China. Given India's underlying fundamentals, it is likely that GDP growth will continue to be relatively robust, but with bumps along the way as global and local events and issues occur. However, in the longer-term investment returns tend to be more aligned to fundamentals rather than sentiment.

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