Democracy wins in India

June 2024

India Avenue Investment Management

Modi 3.0, but with a lower majority, is the likely outcome

India held its national elections during the last 6 weeks, with close to 650 million people going to the polls, over seven phases. The counting commenced and concluded on Tuesday 4th of June 2024, and we note the following likely outcome:

National Democratic Alliance (NDA) - Lok Sabha (Lower House comprised of 543 seats)			
	2019	**2024**	**Change**
BJP	303	240	-63
Janata Dal United	16	12	-4
Others	34	41	7
NDA (BJP + Alliances)	353	293	-60

Source: Antique Stockbroking

Today 293 seats are enough to form a government, in unison with alliances. In addition, the NDA will have a working majority until 2025 in the upper house (119 seats in Rajya Sabha of a total of 245 seats). The I.N.D.I.A (major coalition opposition, with Indian National Congress (INC) the prominent party, winning 99 seats – almost double compared to 52 won in 2019) made significant inroads from the last election by winning 115 incremental seats, which resulted in winning 232 seats in the Lok Sabha. This was partially organic, but also due to several new alliances over the last 5 years. Other regional parties won 18 seats.

The Impact

It is our view that the Election results indicate the disparity which has emerged in terms of wealth in India. The bottom of the pyramid has endured a challenging existence pre COVID and this was accentuated post COVID. Rising unemployment in rural India and rising inflationary impact on poorer wealth segments have been lower on the priority list of the BJP majority driven Government. The number one priority has been a focus on capex / infrastructure rather than populist measures (more synonymous with coalition governments in the past).

However, it is important to recognise that despite having a majority or a coalition government, India's real GDP growth has averaged 6.2% over the past 40 years and the biggest driver is in fact the country's demographics and underlying fundamentals, rather than structure of the government.

Party	Term	GDP Growth (lc)	GDP per Capita Growth (lc)	GDP Growth (US$)	GDP per Capita Growth (US$)
Congress (Majority)	1980-84	16%	14%	9%	7%
Congress (Majority)	1984-89	14%	11%	6%	4%
National Front (Coalition led by Janata Dal)	1989-91	16%	13%	4%	2%
Coalition Govt led by Congress	1991-96	16%	14%	2%	0%
UF/NDA (Coalition led by BJP)	1996-2004	11%	9%	7%	5%
UPA (Coalition led by Congress)	2004-14	15%	13%	12%	10%
NDA (BJP Majority)	2014-24	10%	9%	7%	6%

Source: CEIC, Macquarie Research, June 2024

Hence it is likely that we will see limited impact from an economic point of view in the third term for the NDA. However, reform intensity is likely to be slower, and in the upcoming Union Budget (July) we may see tweaking towards populism which focuses more on the poor and middle class, youth, farmers, and on low-cost housing and provision of healthcare. Addressing employment and inflation and providing greater participation in India's growth story for the less wealthy, younger, and emerging middle class will be critical in the third term for the NDA.

What will not be impacted..

Manufacturing / Make in India	This will continue to be a focus for the Government given the need to create jobs and have access to foreign growth capital.
Renewables and Energy	Will be an ongoing focus, given increasing costs of energy and commitments made. The need to develop new technology in energy transition will see significant ongoing investment.
Infrastructure	May be impacted in the short-term but is the need of the hour for improving India's productivity and greater foreign investment. This includes physical and digital infrastructure.
Technology & Innovation	Continue to invest in new technology and develop industry and business organically, including JVs foreign expertise.
Supply Chain	Increase exports infrastructure, policy and reform and favourable taxation. Seek to move up the value chain and increase market share of global economy.

Areas that may be impacted…

- Fiscal consolidation may take longer given the need for more populist measures. This may divert spending on capex / reform initiatives.
- Social, labour, land and agriculture reforms may also get delayed.
- Changes in policy on taxation, particularly long-term capital gain tax increases may be put on hold, which is positive for foreign investors.

Economic and Market Impact

- A shift from capex intensity to rural / populist measures. Capex cycle will take a breather at least from the Government, with a hope that the private sector will add capacity given that utilisation levels have been rising.
- Public sector businesses which the Government planned to divest will be off the cards for now. PSU Banks who have re-rated significantly over the last 3 years and are now expected to consolidate their price action.
- RBI (Reserve Bank of India) to continue to maintain monetary tightness (no rate cuts) to deal with inflationary pressures on the ground.
- Union Budget to examine taxation with potential negative outcome in certain industries and more generically for equity markets if it relates to long-term CGT. However, since the

introduction of the GST and increased digitisation / compliance, tax collections have been rising and the tax base widening.

The chart below indicates that the Nifty 50 has moved upwards by close to 25% over the last 12 months to 03.06.2024. Thus, the drop of close to 6% was shaving off some of the expectations of a continued majority (which exit-polls were predicting on Monday, just prior to the election result). The 6% market fall in the Nifty 50 was a partial unwinding the 3% rally on Monday as the market reacted to incorporating added perceived risk of a coalition government. As outlined above, once the dust settles over the next quarter, this may **potentially** make an attractive entry / additional investment point.

Source: msn.com

The India Avenue Equity Fund

The Fund is well placed to benefit from events. Our stock selection has not been driven by Government Initiatives, but rather companies that benefit in the value chain of increased government spending and investment capex.

We outline some of the reasons why we feel we are well positioned below:

- We hold no exposure to PSU Banks and their rise over the last 3 years has been painful from an alpha perspective. It is likely that the “value-trade” has been played, with a switch now back to India’s Private Banks, which offer higher ROE and are well placed relative to their long-term valuations.
- Whilst we have increased our exposure to some Government owned businesses in the last 12 months, we are significantly underweight the Index weighting due to our general view that there are better allocators of capital available in the marketplace.
- We hold no exposure to Adani Group stocks, which have benefitted from the Government’s focus on infrastructure projects and implementation. These stocks may take a breather.
- We are overweight in both Pharmaceuticals and Information Technology and as major export industries for India, with potential significant supply of jobs and rising market share globally, these industries are poised to deliver good results.
- We have exposure to companies which should benefit from a rural “rising” i.e. Hero MotoCorp (2-wheelers) Kaveri Seeds, Coromandel(fertilisers), Bajaj Finance etc.

Outlook

We expect equity markets to remain volatile over the next quarter. Volatility will be driven by finalisation of the structure of the Government, Union Budget and global events like inflation, geopolitics, and US elections etc. However, it is possible that valuations will become more attractive over this period for long-term investing.

At India Avenue, we believe that it is an ideal environment for active management in India; whilst the one-way beta trade of being structurally long India is still in play on a long-term basis, investment opportunities in equities will be more selective going forward. Whilst foreign investors may continue to be hesitant given increased policy uncertainty / risk, local investors will continue to structurally make additions.

We see this as being a positive for investors who can identify growth segments at good valuations.

Please contact me if you have any questions Mugunthan Siva on +61466624701 or via email on mugunthan@indiaavenue.com.au

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