

Equities. Soaring prices

India nears China as largest country in key EM index



Rise to almost a fifth of global stock benchmark raises fears over expensive valuations

ALAN LIVSEY AND JOSEPH COTTERILL
LONDON

India is catching up on China's spot as the largest country in a benchmark emerging market index, underlining a quandary for global investors who are becoming increasingly exposed to its ebullient but expensive stock market.

Soaring share prices, stock sales and earnings growth by Indian companies have pushed India to just under a fifth of the MSCI emerging markets index while China has fallen to a quarter — from more than 40 per cent in 2020.

An MSCI index review scheduled for next month could elevate India to above 20 per cent, eclipsing Taiwan and putting India's weighting directly behind China's, investors said.

The narrowing gap has become of the biggest issues for investors in EMs this year as they debate whether to put capital into an already red-hot Indian market or into Chinese stocks that are relatively cheap but are being hit by an economic slowdown.

"The two consensus trades in emerging markets today are 'long India, short China,'" said Varun Lajiwalla, emerging markets portfolio manager at Ninety-One, the asset manager.

"The valuation spread between these two markets is as wide as it's ever been," he added.

Indian stocks are trading at 24 times their expected earnings next year while China is at just 10 times.

The shift has also underlined the power of indices in EMs, whether by

directing billions of dollars in index-tracking passive flows or leading active managers to calibrate their exposure relative to established benchmarks.

"Ten or 11 years ago, India was 6 to 7 per cent of the index," said Kunjal Gala, head of global emerging markets at Federated Hermes. "Now it's close to 20 per cent."

Because Indian shares are already relatively pricey, the index shift "poses an interesting dilemma for long-term investors like us or investors who are more focused on 'margin of safety' valuations", Gala added.

"We are slightly underweight India at the moment, not because we don't like India as a country from a top-down, macro perspective" but because of that focus on margin of safety or trying to buy up stocks at prices much less than their intrinsic value, Gala said.

Domestic inflows into equity funds have been a critical factor. Average annual net domestic flow into equities was \$12bn between 2016 and 2020. Between 2021-23, these annual flows had swelled to \$29bn, Lajiwalla said.

Despite scepticism about the sustainability of these flows and valuations, part of the dilemma for investors is that it has been very costly in the past to miss out on Indian stocks.

India has been among the best-performing markets in the world in local currency terms and kept pace with US markets in dollar terms in recent decades.

It has also been the world's best market for so-called "multi-baggers" or stocks that have risen at least tenfold, according to Vikas Pershad, a portfolio manager at M&G Investments.

"One of the least relevant financial indicators anywhere but especially in India is the one-year forward price-to-earnings ratio," Pershad said. "This is why, for 20 years, investors have missed out on returns in India."

Consensus forward earnings per share estimates for Indian constituents in the MSCI emerging markets index are in the mid-teens for this year and next, according to Bloomberg data, similar to other EMs.

While Indian company earnings are

Red-hot market: Indian stocks are trading as much as 24 times their expected earnings next year — Anindito Mulherjee/Bloomberg

climbing, the pace is not faster than other EMs.

"The profit growth in India is actually ordinary," said Sunil Tirumalai, global emerging markets strategist at UBS.

But while Chinese company valuations have deflated in the last couple of years, India's have done the opposite — in part driven by a retail investment boom.

Many Indian households are pouring money into domestic equities to offset what are seen as low interest rates, which at best only equal official inflation.

Domestic buying, often via automated monthly transfers to funds run by large banks such as ICICI, has easily countered the shift away from India by foreign institutions.

"Foreign ownership has fallen to a 11-year low," according to Tirumalai.

"On an aggregate basis, global investors are still underweight India," partly because of valuations, said Vivian Lin Thurston, a portfolio manager at William Blair Investment Management.

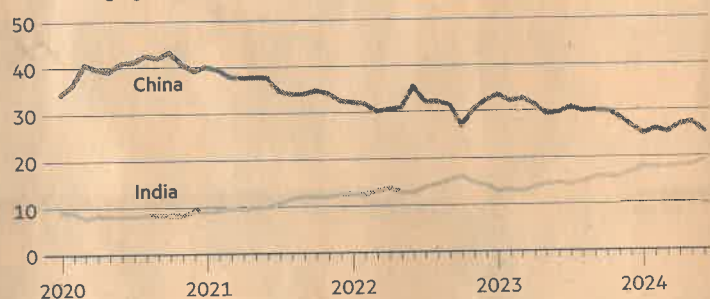
"As the Indian weight is increasing, it gets harder for them to find attractive value stocks in India, or they will need to rethink their valuation metrics," she added.

After the expansion of mainland listed companies in 2019, China's weighting soared in the index soared the following year. Even then, mainland stocks are still not fully included.

"Historically, whenever countries have hit a 25 per cent weight in the MSCI EM Index, they have tended to fall back from their highs," said Jitania Kandhari, managing director on the emerging markets equity team at Morgan Stanley Investment Management.

India's weighting has surged

MSCI Emerging Market index weightings (%)



Source: MSCI

The valuation spread between these two markets is as wide as it's ever been

FT

Our global team gives you market-moving news and views, 24 hours a day [ft.com/markets](https://www.ft.com/markets)