FEBRUARY 2025

10 reasons why Indian equities won’t travel the same path as other emerging markets

When evaluating equities in India, a frequent comparison is to liken the economic fortunes of India today to China in the early 2000s. After all, they are both emerging markets (EMs) with abundant labour pools and large domestic marketplaces. In the context of valuations, while China looks cheap relative to other EMs and its own historical multiples, India sits at the other extreme – appearing among the most expensive in the EM cohort.

Our view is that this is not an appropriate comparison. Limiting India’s peers only to emerging markets does not do justice to its unique investment case. Here, we provide 10 reasons why India should not be assessed solely with reference to other EMs but instead should be compared more closely to the United States and other developed markets.

1 Democracy: a shared governance framework

Both India and the United States are large democracies, offering a stark contrast to many EM countries where autocratic regimes dominate. Democratic governance enables a more transparent legal and regulatory environment, a freer press, and a system of checks and balances – all of which are crucial for long-term investor confidence. Public and private capital typically pursue such attributes in their asset allocation decisions.

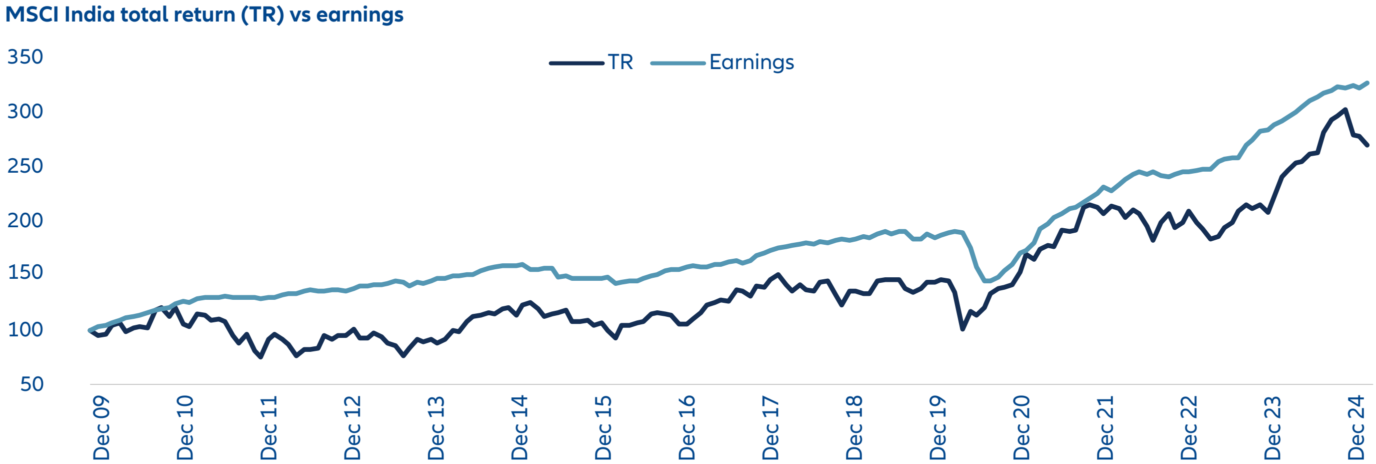
2 Strong and sustained growth prospects

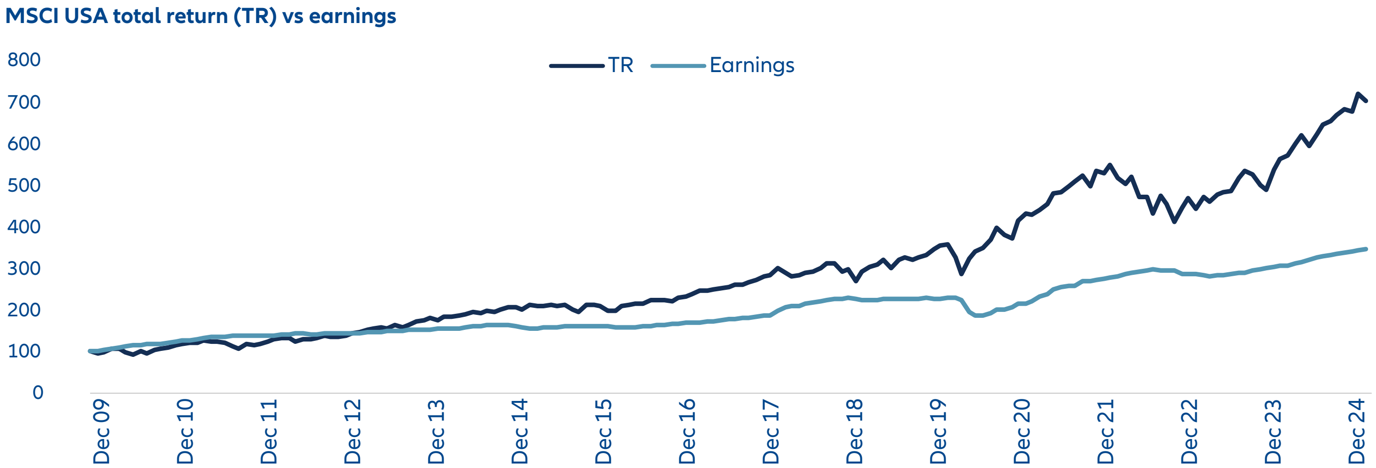
India and the United States have demonstrated robust economic growth historically, and both are forecast to maintain high growth rates over the next five years.

Anand Gupta, CFA
Portfolio Manager

Embracing Disruption

Figure 1: Equity performance and earnings growth for India, US since 2010





Source: Jeffries, FactSet as of 31 December 2024. Note: Earnings index derived from local price index and 12- month forward PE.

India's economy is fuelled by a burgeoning middle class, rapid urbanisation, and ongoing structural reforms, while the US benefits from technology-led advances and a high level of consumption as a percentage of GDP. Both are home to entrepreneurial businesses that are transforming consumer behaviour and economic trends. This growth dynamic, where stock markets returns have largely tracked corporate earnings growth, more closely aligns India with developed markets than with less innovative and rapidly aging EM peers.

3 Limited role of state-owned enterprises

A significant distinction between India and many other EM economies, particularly China, is the limited influence of state-owned enterprises (SOEs). Both India and the United States have vibrant private sectors that drive economic activity, fostering innovation, entrepreneurship, operating efficiency, and shareholder value. This characteristic enhances the quality of earnings, capital allocation in the economy, and the investability of Indian markets compared to SOE-heavy EM counterparts.

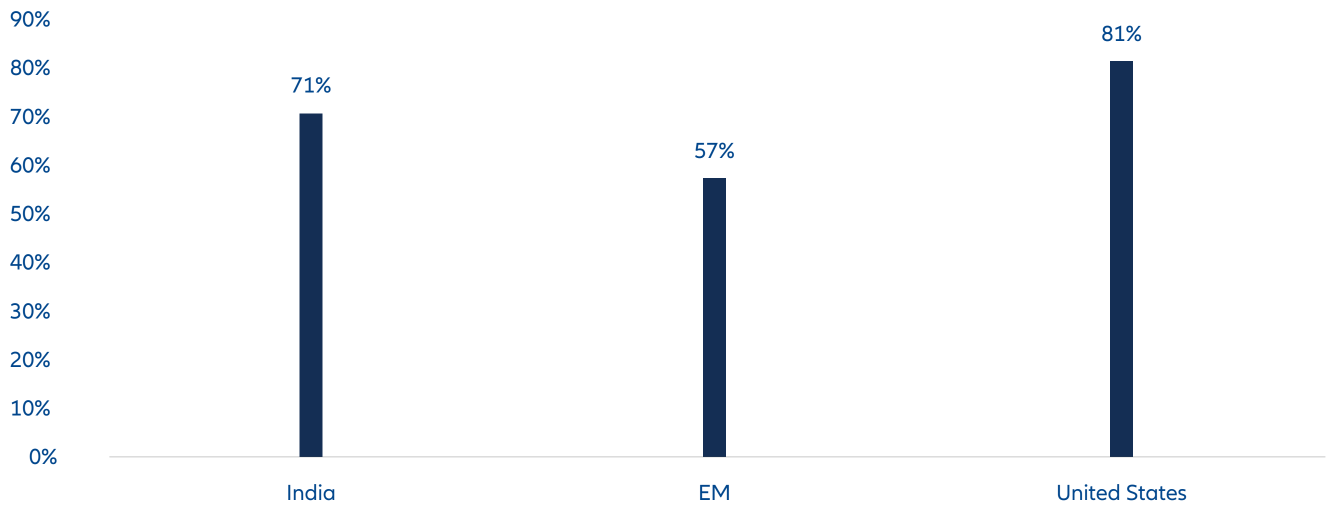
4 Leverage: a resilient financial framework

India's debt-to-GDP leverage level (155%) is not disproportionately high when compared to its peers, including developed markets like the US (264%) and Japan (389%), as well as China (310%).[1] Unlike many EM economies where debt-fuelled growth can pose systemic risk, we believe India's financial system is relatively robust, with prudent fiscal management and a healthy banking sector capitalisation. Moreover, at the consumer level, while leverage has risen alongside higher home ownership and mortgage-related loans, demand for housing has generally not been speculative in nature.

5 Superior profitability and return-on-equity (ROE)

Both India and the United States exhibit superior return-on-equity (ROE) metrics compared to most EM markets. ROE is a gauge of how efficiently a company generates profits. The

Figure 2: Consumption as a percentage of GDP



Source: World Bank, as of 16 December 2024.

formula for ROE can be decomposed into profit margin x asset turnover x financial leverage. Corporates in India and the US have been able to deliver strong profit margin recovery post the Covid-19 pandemic with comparatively low leverage. Investors typically reward this type of financial discipline with higher valuations.

6 Consumption-led economies

Consumption is a key driver of economic activity in both India and the US, distinguishing these economies from many EMs that rely heavily on exports or commodity-driven growth. India's growing consumer base, coupled with increasing disposable incomes, parallels the US's more mature consumer-driven economy. This structural similarity enhances the resilience of growth in both markets.

7 High representation of services in market capitalisation

Services dominate the market capitalisation of equity market indices in both India and the US, underscoring their advanced economic structures. India's thriving IT and software services industry, in particular, mirrors US leadership in technology and professional services. This contrasts sharply with other EMs where manufacturing and natural resources hold disproportionate weights in market indices.

8 Resilience to global shocks

India and the US have demonstrated remarkable resilience to global economic shocks, thanks to their diversified economies and strong domestic demand. India's steady growth during recent global slowdowns further positions it as a reliable investment destination, unlike some other EM economies that have proved more vulnerable to external shocks.

9 Geopolitical stability

While India faces regional and global geopolitical challenges, its democratic government and active engagement with global institutions provide a level of stability comparable to that of the US. India has experienced strong continuity both in its leadership and policy direction over the last decade. This stability is a key differentiator from certain EMs where political volatility can pose significant risks. Beyond this, India is engaging more in global affairs and public diplomacy, developing its independent position in the external environment.

10 Long-term structural tailwinds

India stands to benefit from long-term structural drivers such as favourable demographics, urbanisation, and digitalisation, which are aligned with the growth engines of the US.[2] Yet, its per capita income stands at only 3% of the US's. As India's young population achieves higher educational standards and skills, there is substantial potential for this gap to close. The effects of India's young workforce expanding its lifestyle spending is set to have significant knock-on effects across sectors, sustaining economic expansion over the longer term.

1. CEIC, Haver, Morgan Stanley Research, as of June 2024. Note that India data is on a fiscal year (FY) basis.
2. IMF, GDP per capita, current prices, World Economic Outlook (October 2024) - GDP per capita, current prices, extracted on 23 December 2024.

Conclusion

Comparisons between the Indian and US economies draw out many parallels, but there are also some contrasts. While ageing societies lead to strains in areas like employment and affordable health care, India is at a different stage of development; its demographics mean that the challenge here is to keep creating millions of new jobs each year for more people, especially women, to enter the workforce. Rising to this challenge will mean driving rapid and sustainable economic growth for many years to come.

By combining the growth dynamism of an emerging economy with a structural and institutional stability akin to developed markets, we find that India offers a compelling investment case that transcends traditional EM comparisons and helps to justify the valuation premium. We believe investors should, therefore, adopt a broader lens when evaluating the India equity market – one that recognises its distinct position and unique attributes within the global investment landscape.

February 2025 LDS-250053