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Closed End Funds

Singapore

IFN: Bullish On Improving India Macro Data Into A Post-Pandemic Recovery

Jul. 31, 2021 9:06 AM ET | **India Fund (IFN)** | IIF, INDA, INDY | 2
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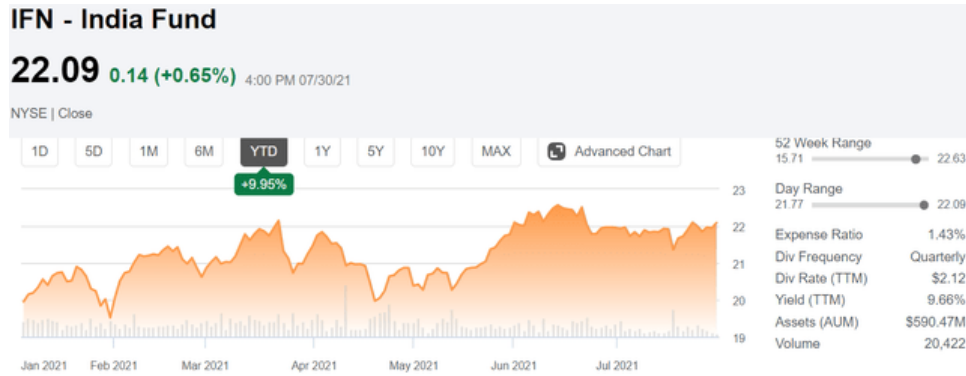
Summary

- The India Fund has outperformed its benchmark since its inception in 1994.
- The Indian economy is well-positioned to recover from the pandemic with world-leading growth as a bullish tailwind for local stocks.
- The India Fund is a good option to capture exposure to Indian equities offering an attractive 10% distribution yield.
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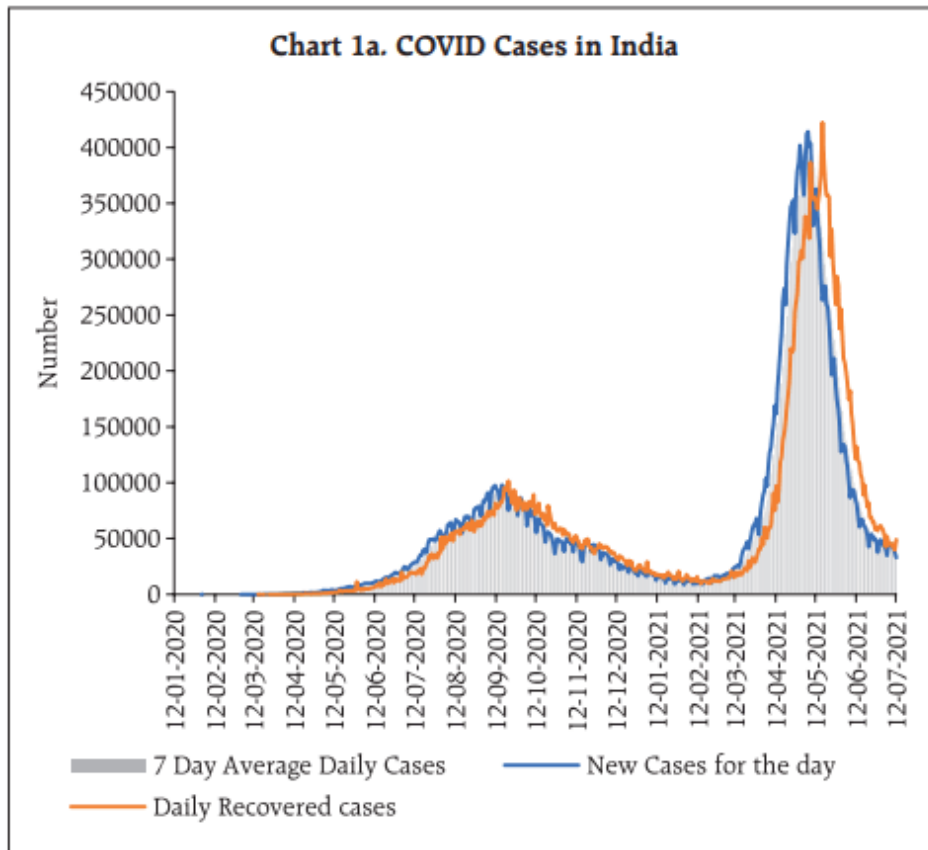
The India Fund (IFN) invests across a basket of Indian stocks through an actively managed closed-end fund structure. The attraction here is that the strategy with a stated objective of capital appreciation has a long-term history of outperforming its benchmark as well as some comparable passive Indian equity ETFs. Income investors will also find the fund's managed distribution policy compelling with a current yield of 11%. While the Indian economy has faced significant challenges during the COVID pandemic, recent data suggest conditions are on a path to recovery supporting a positive long-term outlook. We like the fund's exposure to large-cap Indian stocks including several companies that are not otherwise available for trading on U.S. exchanges. This is a quality fund that can serve a tactical or strategic role within a broader diversified portfolio for investors.



(Seeking Alpha)

India Macro Outlook

Compared to annual GDP growth averaging over 7% per year for much of the past decade, India's economy was no different than the rest of the world last year being significantly impacted by the pandemic. 2020 GDP declined by 8% with a contraction in industrial production and consumer spending. Still, the setup has been more positive in recent months with the key development from India has been the recent sharp slowdown in COVID cases compared to a world record high in Q2. The country leads the world in vaccinations with over 455 million doses administered through July although the country still lags some developed nations in terms of the percentage of full vaccinated individuals.



Source: Ministry of Health and Family Welfare and SUTRA Model.

(source: Reserve Bank of India)

While it's unclear exactly how and why the case count was able to fall so quickly, the result has been a welcomed reprieve to public health and now supports an economic recovery.

According to India's Central Bank "Reserve Bank of India," the forecast is for a 9.5% GDP growth for the current year, buoyed by the improving global economy and stronger trading activity. Higher commodity prices and demand for industrial production have been tailwinds in recent months. One of the concerns is the recent inflationary trends which are blamed on supply shocks and some temporary factors. The monetary policy rate has been held steady at the historically low level of % since last year.

Beyond accommodative monetary policy, the government has undertaken several targeted stimulus measures between pandemic relief, and loan subsidies. The expectation is for the economic recovery to pick up steam into the second half of the year. From the July "[State of the Economy](#)" monthly update:

The tapering of the second wave, coupled with an aggressive vaccination push, has brightened near-term prospects for the Indian economy. While several high frequency indicators of activity are recovering, a solid increase in aggregate demand is yet to take shape. On the supply side, agricultural conditions are turning buoyant with the revival in the monsoon, but the recovery of manufacturing and services sectors has been interrupted by the second wave. A pick-up in inflation is driven largely by adverse supply shocks and sector-specific demand-supply mismatches caused by the pandemic. These factors should ease over the year as supply side measures take effect.

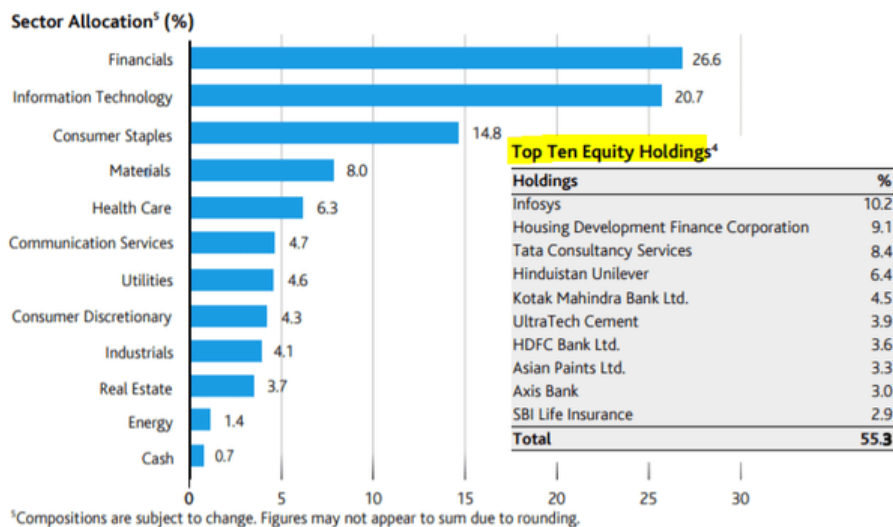
The other important point here is that the external accounts data have been strong supporting a level of macro stability. Considering the decline of imports over the past year and narrowing the trade deficit, India's current account reached a surplus of nearly 1% of GDP last year which supports is positive in averting currency instability or any situation of a capital flight. Indeed, India continues to receive significant inflows of foreign direct investment which is a positive for the macro profile and can also drive the Indian Rupee currency to appreciate against the Dollar.

Our take here is that beyond some of the near-term uncertainties related to COVID, India is well-positioned to emerge stronger out of the pandemic. The large and vibrant economy with a growing middle class can drive strong economic growth for the foreseeable future. This setup at a high level can be positive for the Indian stocks.

IFN Background

The IFN fund with \$645 million in assets under management is one of the largest and oldest of country-specific CEFs with an inception date going back to 1994. The fund is currently managed by Aberdeen Standard with a strategy based on fundamentals-driven bottom-up stock selection.

As of the last quarter-end, the portfolio included 38 equity holdings including information technology giant Infosys Ltd (INFY) as the largest holding with a 10% weighting. While the fund is relatively top-heavy with the 5 largest holdings represent nearly 40% of the total weighting, there is nevertheless good diversification across sectors and industries. Financials and information technology are the two most well-represented sectors together at around 47% of the fund. This is consistent with the composition of the Indian equity market of publicly traded stocks and the importance of banks and IT companies.



(source: [Aberdeen Standard](#))

Other notable holdings include "Housing Development Finance Corp Ltd" and "Tata Consultancy Services" with a 9.1% at 8.4% weighting each respectively. These two major corporations among several other stocks in the portfolio do not have a listed stock available for trading in the U.S. Again, keep in mind that the fund does not track any index meaning the composition of the holdings can change at the discretion of the fund manager.

IFN Performance

IFN has gained 16.4% on a total return basis at the market price year-to-date and 50% over the past year. This considers what was a period of extreme volatility in 2020 when the fund faced a nearly 40% drawdown during the depths of the pandemic selloff. In this regard, the fund rallied alongside global equity markets as global trade conditions have normalized.

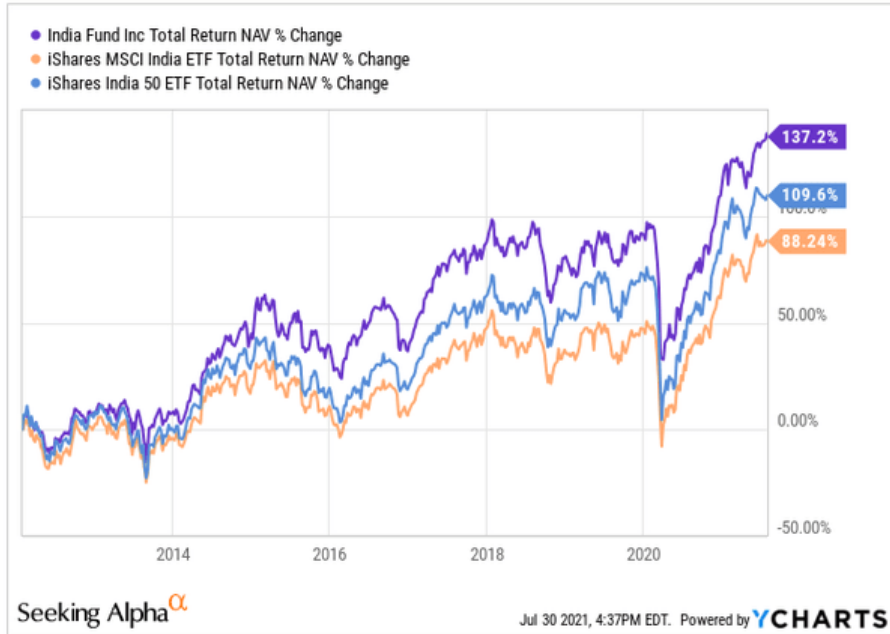
According to the fund's manager, IFN has returned 7.2% at NAV on an annualized basis per year over the past 10 years and above the 5.5% return from the fund's MSCI India benchmark. Indeed, from the chart below we highlight that IFN with a cumulative return of 137% has outperformed the iShares MSCI India ETF ([INDA](#)) climbing just 88% over the period. We also note that the IFN fund also outperformed the iShares India 50 ETF ([INDY](#)) over the same timeframe.

Performance

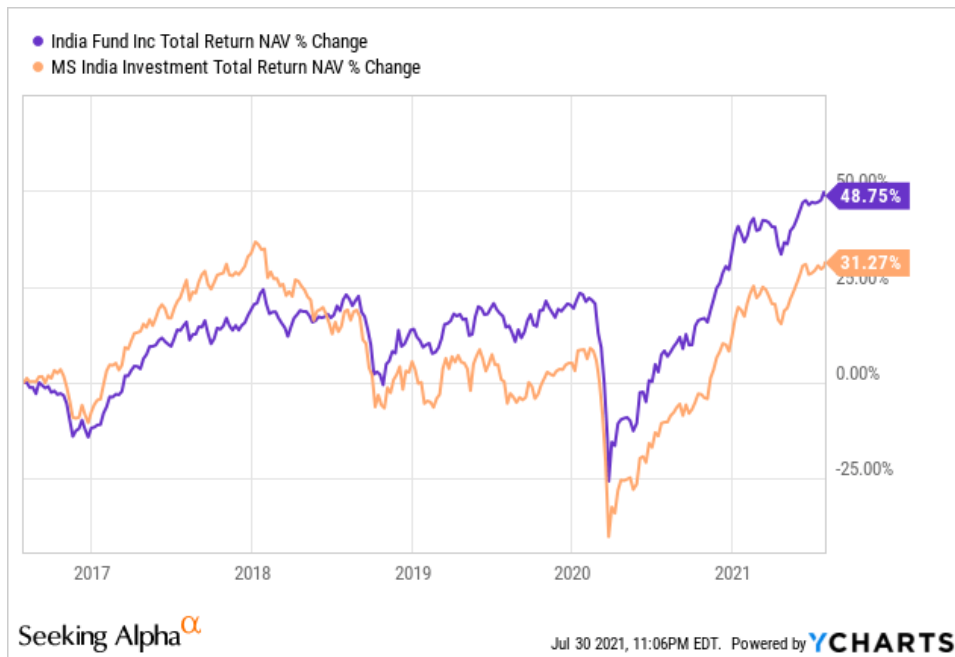
The latest available performance figures have been calculated net-of-fees in U.S. dollars for the period to June 30, 2021.

Total Returns¹ (%)

	Cumulative as of June 30, 2021			Annualized as of June 30, 2021					Since Inception 02/23/94
	1 Mo	3 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs		
NAV	1.6	4.1	8.6	47.9	9.3	10.4	7.2	9.5	
Market Price	3.5	5.1	15.9	57.4	11.1	11.8	7.1	8.9	
MSCI India (Net) ²	-0.7	6.9	12.4	56.4	11.9	11.9	5.5	n/a ³	



To be clear, the performance over different lookback periods between these three funds is mixed but the point is that the India Fund as a CEF has been able to deliver on its promise of capital appreciation relative to the category for long-term investors. Among closed-end funds, there is also the MS India Investment (IIF) with a similar equity strategy as IFN although the fund has tended to be more volatile in recent years. IFN has delivered a 49% total return on NAV compared to 31% from IIF over the last 5 years. That said, IIF has outperformed more recently.

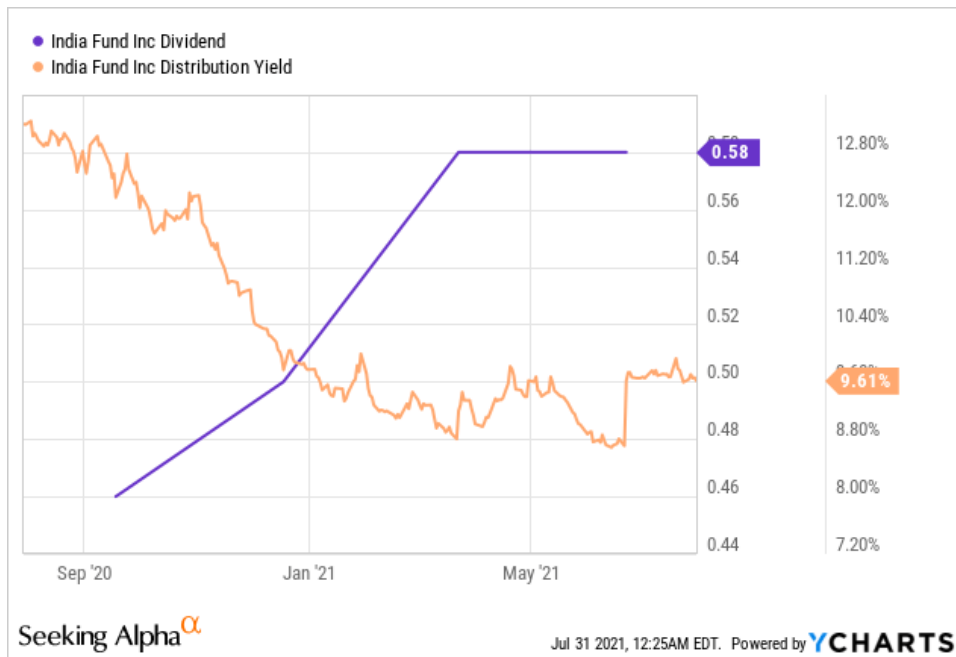


Data by YCharts

A key difference with IIF is that the fund has typically only distributed a small annual dividend yielding less than 1% over the past 2 years. While we're not suggesting IFN is definitively better than IIF or any of the country ETFs, the India Fund is still our pick in the group given its income profile and solid relative performance history.

IFN Yield

IFN currently pays a quarterly distribution at a rate of \$0.58 per share. The annualized payout represents a yield of 10.5% on a forward basis. Within this amount, the percentage classified as a return of capital "ROC" averaged around 45% over the past year. ROC is simply the amount of the distribution above the underlying portfolio income and realized gains. For shareholders, this amount is untaxed but reduces the cost basis of the original investment.

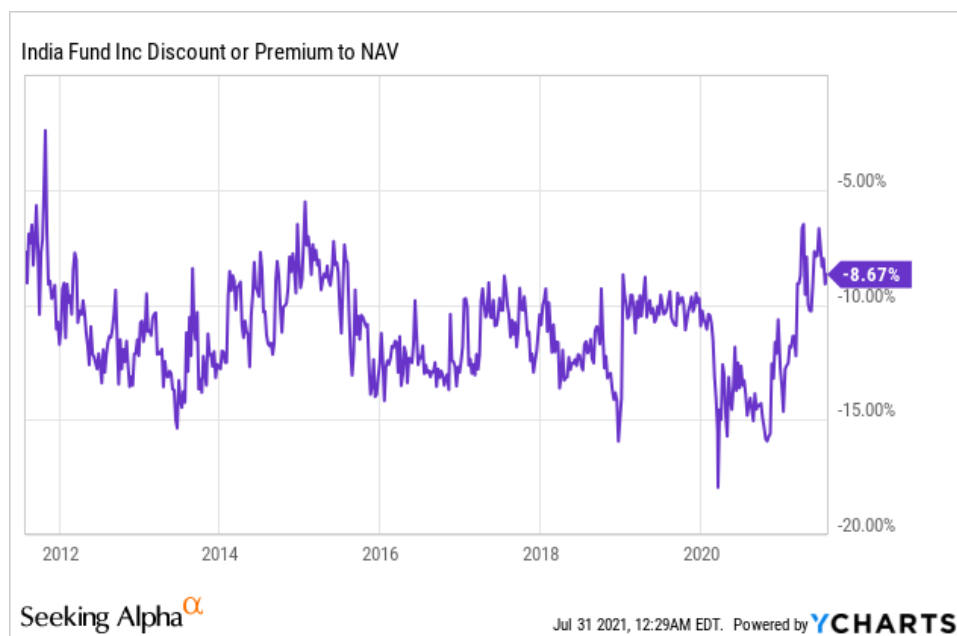


Data by YCharts

While ROC is sometimes controversial among CEF investors, the way we look at it is that it offers some flexibility to the investment strategy. Technically there are some tax efficiency advantages in receiving ROC and holding the shares long term. One strategy we utilize is to rotate between taking the cash option and automatically reinvesting in shares at attractive prices. Either way, IFN can be a powerful income vehicle.

IFN Discount To NAV

One of the features of CEFs is that the share price can often trade at varying spreads to the net asset value of the underlying holdings. IFN currently presents a 9% discount to NAV which is a few points narrower compared to its long-term average closer to 11%. This variability is often based on supply and demand dynamics with the current level likely justified based on the fund's income profile and long-term performance history. Our take is that the current discount for IFN, while slightly narrower to the long-term average, is otherwise at least fair.



Data by YCharts

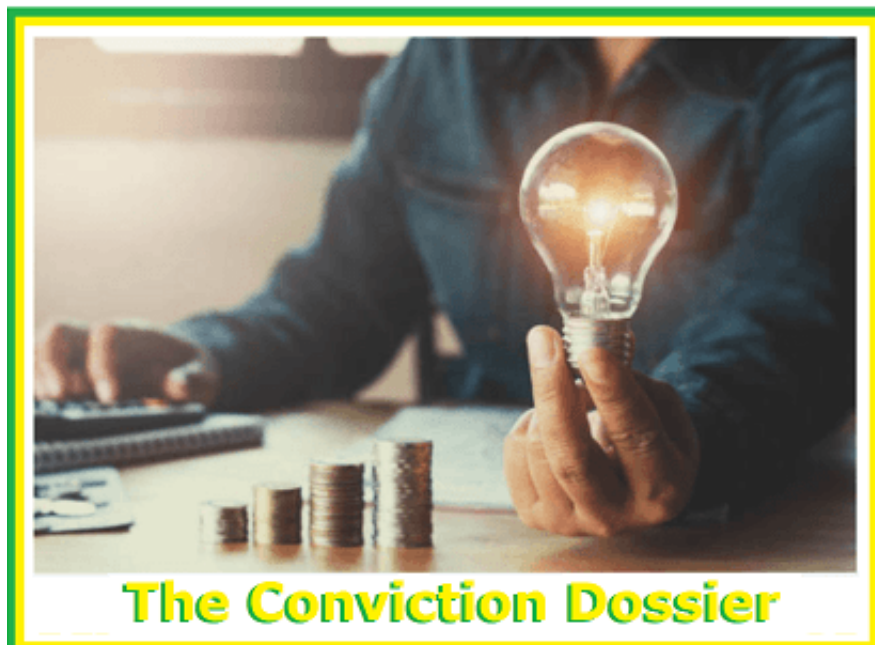
The next regular quarterly distribution is likely to have a record date at the end of September according to the previous year's schedule. While the income component here is significant, we feel the total return achieved to reinvesting the distribution is a more accurate measurement of performance. The choice to elect the cash payment or participate in a reinvestment plan will depend on the investor's circumstances and preference.

IFN Analysis

With the IFN portfolio exposure tilted towards financials and information technology, there is an expectation for the fund and Indian stocks overall to benefit from cyclical growth and positive global macro conditions. While there is some new uncertainty related to the Delta variant of COVID and the impact on global trade as well as conditions, the bullish case is simply that there is light at the end of the tunnel towards the normalization of economic activity. India as the world's second-largest economy, rapidly modernizing with high-level themes like the adoption of digital services can generate significant growth opportunities for companies in all sectors. We believe the setup is for Indian stocks and the IFN can outperform going forward.

In terms of risks, a deteriorating global macro outlook of renewed volatility in financial markets could likely pressure IFN and lead to a correction lower in shares. Monitoring points for investors including COVID data, inflation trends in India, along quarterly economic activity levels.

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Thanks the summery. IFN is the only India focused fund that pays substantially for you to wait for a turn around. In many ways, it is surprising that the Indian market has sustained value this year as it has. SC

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