

## FOREIGN INVESTORS TAPPING INDIA'S GROWTH

JULY 2007

### ASIA'S 2<sup>ND</sup> FASTEST GROWING ECONOMY

#### Rapid economic growth

India has experienced rapid economic growth recently and is currently the second-fastest growing economy in Asia – just behind China. Despite a series of interest rate hikes (the borrowing rate has risen from 4.5% in October 2004 to 6.0% today) growth has remained strong. In the current financial year, fiscal economic growth is expected to expand by 9.4% exceeding the government's initial estimate of 9.2%.

Key drivers of this growth include:

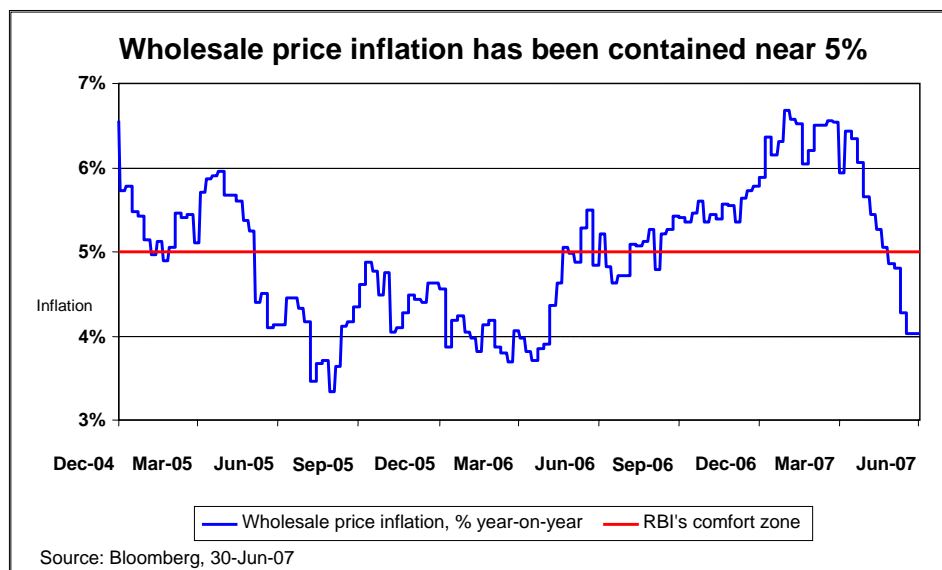
- Increased investment activity on the ground
- Consumption fuelled by strong development in urban areas, retail lending and expansion in industries such as entertainment, high-end fashion and jewellery; and
- New and emerging sectors such as the government's focus on social sectors.

An upwards trend in savings and investment, and expectations that both inflation and interest rates are close to peaking, are also supporting growth.

### INTEREST RATE HIKES HAVE KEPT INFLATION IN CHECK

#### Inflation

Since the Reserve Bank of India (RBI) began to tighten monetary policy, inflation has been contained at around 5% and within the central bank's comfort zone. Consequently, monetary policy tightening appears to have worked and the economy is expected to benefit.



#### Rupee strengthening

The rupee has appreciated 8.1% over the past four months versus the US dollar and it is likely to appreciate further over the long term.

***“Over the next 3 to 5 years, all indicators point to a continuation of the rupee appreciating - steady currency appreciation is good for investors and the overall economy. The economy continues to grow rapidly. Interest rates have gone up but we are now starting to see inflation come back down below 5%” – Arun Mehra, Fidelity Portfolio Manager***

### Market review

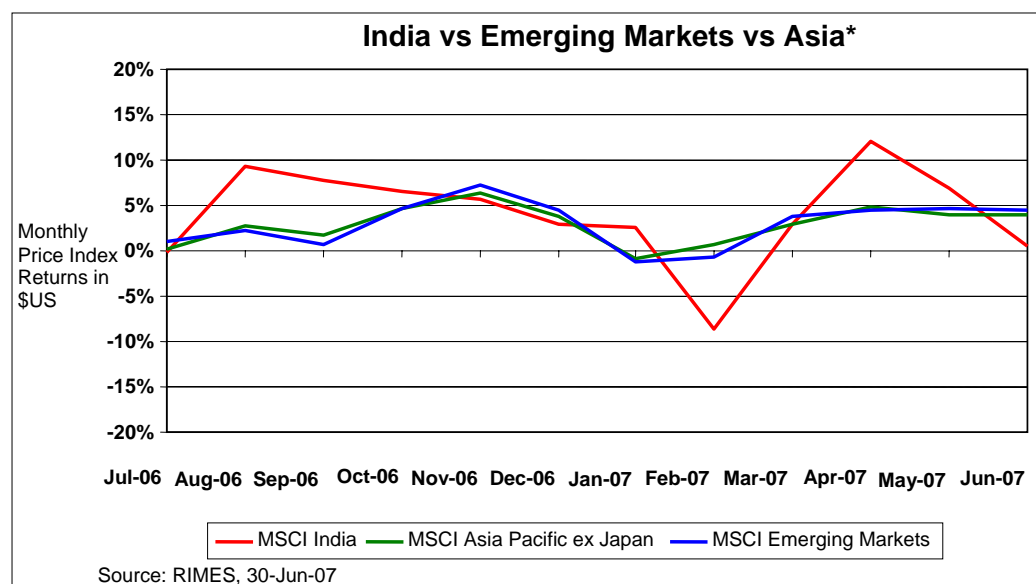
The Indian equity market surged ahead in May, but made only slight gains in June. The MSCI India Index added 6.9% in May and rose by 0.5% in June.

In May, the market was supported by expectations of lower interest rates, after inflation moderated significantly. Wholesale price inflation fell to 5.27% in the week ending 12 May, down from 6.09% a month earlier. Improved corporate earnings results also boosted investor sentiment. In particular, State Bank of India, the nation's largest lender, reported that fourth-quarter profit climbed 75% compared to a year ago, exceeding analysts' expectations.

Profit-taking and concerns about rising interest rates in overseas markets, particularly the US, have moderated gains in June. This counter-balanced the positive effects of lower wholesale price inflation which declined to 4.03% in the week ending 16 June.

### India outperforms other markets in May but not June

The Indian market outperformed other Asian and emerging markets in May, but underperformed in June (see chart). The MSCI Asia Index rose by 4.0% in May and another 4.0% in June. The MSCI Emerging Markets Index added 4.6% in May and 4.4% in June.



Over the 12-months to 30 June, the MSCI India Index has risen by 58.3% against the MSCI Asia Index and MSCI Emerging Markets Index which rose by 41.2% and 41.8% respectively.

INVESTOR FLOWS  
REMAINED POSITIVE  
IN MAY AND JUNE

### Positive investor flows

Foreign Institutional Investor (FII) flows and domestic mutual funds flows were both positive in May and June. After declining moderately in May, the number of FII open-interest futures contracts has risen again in June, to be 1.6% higher over the two-month period.

### Financials perform best in May

The financials sector was the best performer in May and continued to do well in June. Financials climbed a staggering 20.7% over the two months. Meanwhile, information technology stocks were the worst performing in May and remained weak in June. The sector declined 4.5% over the period.

## **Stock market growth set to continue**

The market is reflecting the underlying trend of earnings. Companies that have reported poor profits have been punished, while those that have announced strong results have performed well.

From a valuation perspective, the market is trading at a price earnings ratio of 17x. While this is high, it is supported by double-digit growth, which is expected to continue

## **Fidelity Funds India Focus Fund**

Arun recently presented his views on the Indian economy and stock market. In a market like India, taking a long-term view and selecting businesses with good growth potential are very important. The portfolio is positioned to benefit from this growth potential, with exposure to stocks in the infrastructure industry, emerging new industries, healthcare and retail.

Arun is cautious about valuations. This is why at the beginning of the year the portfolio was very underweight in large IT companies compared to the benchmark – as the Portfolio Manager felt they had become expensive. More recently, this underweight position has been reduced because prices fell with the appreciation of the rupee and valuations are now more attractive.

A key change made to the portfolio recently was to sell stocks that had performed well, such as media stocks, and rotate into those that appear to offer greater potential including healthcare and retail.

***“Activity is very strong. Whether it’s infrastructure-related: telecoms, airports, or retail, there’s absolutely no slowdown in the activity. I think this is positive for particular stocks and also very good for the economy because strong investment on the ground is continuing to create jobs and increase consumption. I think interest rate hikes have worked and that’s going to put the economy on a very solid growth footing.”***

## **Arun Mehra. Portfolio Manager**

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