Global Equity Strategy

Market outlook

Alexander Redman
alex.redman@clsa.com
+65 6416 7804

Wei Sheng Wan
+65 6416 7896

14 November 2024

Asia Pacific
Market Strategy

Pouncing Tiger, prevaricating Dragon

We reverse our earlier tactical allocation shift from India to China

Misfortune can happens in threes. So it has played out for Chinese equities over the past week. Trump 2.0 heralds a trade war escalation just as exports become the largest contributor to China's growth. The NPC stimulus amounts to de-risking with little reflationary benefit. Finally, higher US yields and inflation expectations sap scope for the Fed and thus PBOC to ease. We are anxious that these concerns lead to a buyers' strike by offshore investors who built China exposure post the initial PBOC stimulus in September. We therefore reverse our tactical allocation in early October, returning to a benchmark on China and a 20% overweight on India.

We maintain that policymakers remain incentivised to stimulate, but when..?

Prevaricating Dragon: Policymakers still face a unenviable blend of deflation, falling property prices, rising youth unemployment, poor household confidence, stagnant real estate investment and growth in real retail sales at half the pre-pandemic rate. Post PBOC easing, real interest rates remain +2.8%. Finance Minister Lan Fo'an hinted at further measures to recapitalise banks, absorb excess property inventories and stimulate consumption, with the next waypoints being the December Economic Work Conference and March 'Two Sessions'. We are concerned that investors have lost patience and are assuming policymakers will lowball further stimulus, and thus may use the advent of those two occasions as an opportunity to reduce exposure.

India benefits from an appreciable moat should trade hostilities heat up again

Pouncing Tiger: By contrast, India appears as among the least exposed of regional markets to Trump's adverse trade policy. Moreover, so long as energy prices remain stable, India may offer a relative oasis of FX stability in an era of a strengthening US dollar. Paradoxically, India has seen strong net foreign investor selling since October, while investors we met this year have been waiting specifically for such a buying opportunity to address Indian underexposure. Domestic appetite remains strong, offsetting foreign jitters, and valuation, though pricey, is now a little more palatable.

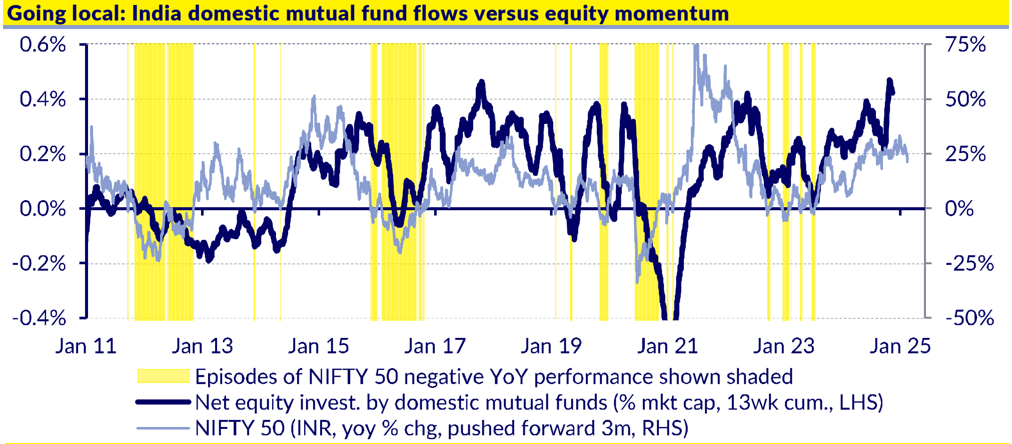
From the outset we were sceptical on the endurance of the China equity melt up

Our initial reaction was to rent rather than buy the rally, yet we committed funds at the start of October by tactically deploying some of our over exposure on India to China We now reverse that trade. Both MSCI China and India have corrected by c.10% in US dollar terms over the duration so we did not lose on making the switch.

The chief risk to Indian equities is a frenzy of issuance swamping the market

Cumulative 12 month issuance is 1.5% of market cap, a historical tipping point.

Going local: India domestic mutual fund flows versus equity momentum



Source: CLSA, Securities & Exchange Board of India, WFE

We take China back to a benchmark allocation and return India to a 20% overweight stance in our APAC regional portfolio

Pouncing Tiger, prevaricating Dragon

From the outset we were sceptical on the endurance of the China equity melt up. Our initial reaction was to rent rather than buy the rally (see: *That Mario feeling*). Yet we committed a little more at the start of October by tactically deploying some of our over exposure to India towards China (see: *Crossing the Karakoram*), at the time reducing our Indian overweight to 10% from 20% and raising our China allocation to a 5% overweight from benchmark.

We now reverse that trade. Both MSCI China and India have corrected by c.10% in US dollar terms since early October, so we have not gained or lost on performance as a result of the temporary switch. But in the light of recent developments we no longer have sufficient conviction to maintain an above benchmark exposure on Chinese equities heading into 2025:

Three developments which have sapped our conviction

- **Trump 2.0 promises to be especially challenging for China.** Even if for fear of stoking US inflation Trump's administration does not apply the full 60% threatened tariff schedule to Chinese imports, any escalation in the trade war would likely prove disruptive for Chinese equity assets and the renminbi, given that China's economic growth has become far more dependent on exports than in 2018.

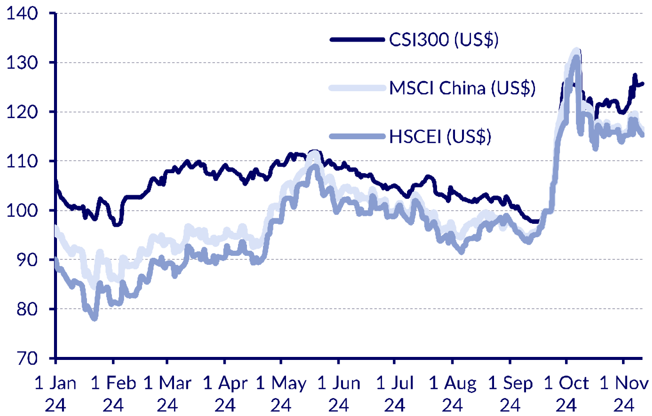
- **China's stimulus suggests risk management rather than expansionary policy.** Finance Minister Lan Fo'an has left the door open into the new year for further measures to recapitalise banks, absorb excess property inventories and stimulate consumption, but we lack confidence that the magnitude would be sufficient to warrant China's outperformance.

- **US 10-year yields and inflation expectations have markedly risen with a commensurate drop in rate cut expectations implied by Fed funds futures.** This restricts the room for manoeuvre by the PBOC to reflate the economy for fear of amplifying RMB weakness. China policymakers are partial to currency stability to facilitate the internationalisation of the renminbi with BRICS+ and global south trade partners.

Click to rate this research
Great
Solid
Meh

Figure 1

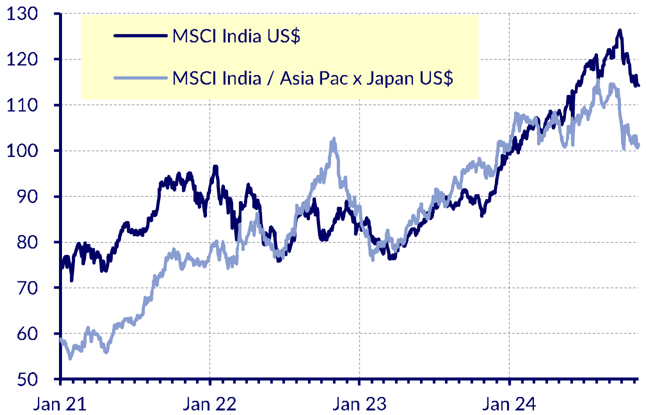
CSI 300 vs HSCEI vs MSCI China (US$, 24/9/24=100)



Source: CLSA, MSCI, Refinitiv

Figure 2

MSCI India absolute and relative performance (US$, 1/1/24=100)



Source: CLSA, MSCI

We return China to a benchmark weight

Not yet stimulating enough

For us the most fundamental requirement in determining our China allocation was to understand policymakers' motivation. Is this economic window dressing to achieve the government's next GDP target, or is it born of a braver more innovative and determined initiative to redirect the economy towards a more sustainable and consumption-balanced model?

After Friday's NPC plan to bail out local government debt, we have been left wanting, anxious that the motivation is more aligned with the former than the latter. CLSA's Chief Economist Leif Eskesen succinctly summarised the outcome of the NPC announcement as more risk management than expansionary policy.

Initially, the end-September moves by the PBOC and financial regulators held promise (interest rate and RRR cut, harmonisation of mortgage rates, and Rmb800bn for loans to buy shares). But the proof of the pudding was always going to be the scope and deployment of a supplementary fiscal package, as the PBOC is restricted in its monetary stimulus by a preference by policymakers for a stable currency. The real interest rate (one year loan prime) remains +2.8% (it was -1.25% in 2008 and 2020). Money must be practically free for a rise in household credit demand in the prevailing conditions.

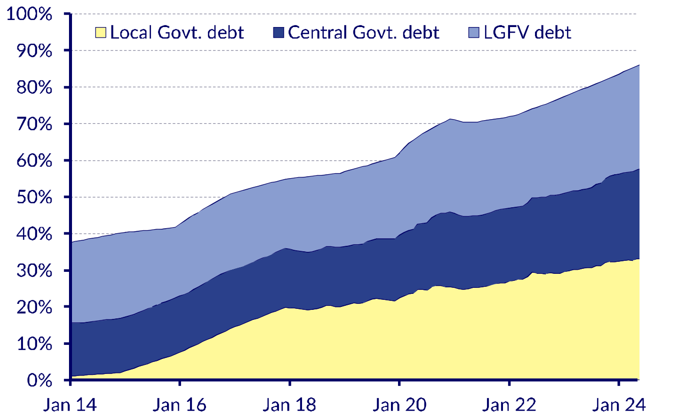
Why the hesitation?

Firstly, there may be a temptation to hold fire until the extent of Trump's trade hostility towards China (and elsewhere) is more discernible. Initial Trump cabinet appointees appear consistent in their China hawkish credentials, but the impact of their actions will not be felt for more than another two months. The concern with this approach being that the market will be essentially directionless if there is a policy air pocket until Trump's intentions are better formulated.

Secondly, given more stretched public sector debt dynamics, policymakers will be wary of any capital misallocation, similar to that made in the 2008 stimulus package which was the genesis in the shift to a higher pace in accumulation of government debt. China's public sector debt to GDP ratio has risen by 47ppt in the last decade, more than any other major global economy.

Figure 3

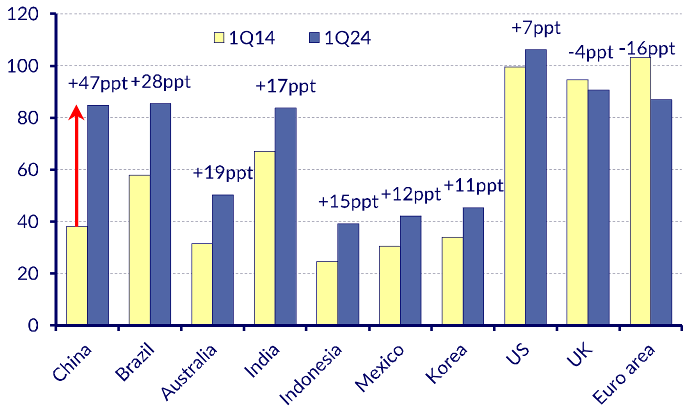
China general government debt (% GDP)



Source: CLSA, China Ministry of Finance, BIS

Figure 4

General govt debt to GDP (1Q24 vs 1Q14, sorted by desc. ppt chg)



Source: CLSA, BIS

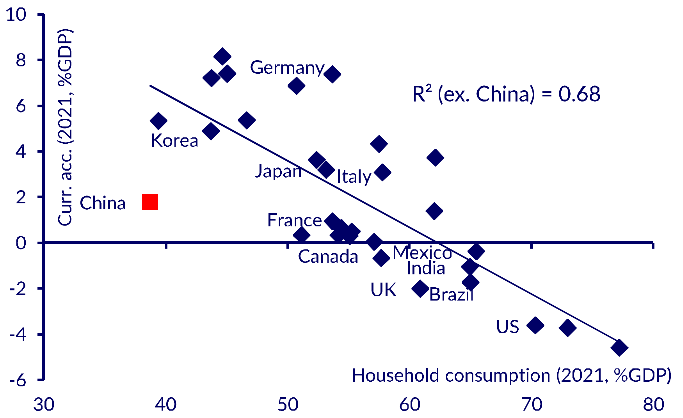
Thirdly, policymakers appear to remain conflicted in their commitment to boosting household consumption as typically its increase as a share of GDP leads to greater imports and—ceteris paribus—an erosion of the trade balance. Across the 30 largest global economies, there is an intuitive link between higher household consumption shares of GDP and lower current account balances.

In China's case the gradient by which the current account position is eroded by increased consumption may well be far shallower than for other countries as a greater proportion of that increased demand could be met by domestic supply of goods and services. Nevertheless, there would be some downward shift in China's current account with a ramping up of the household consumption share of GDP.

CLSA forecasts China's 2024 current account surplus at just 1.4% of GDP, nudging up to 1.5% in 2025. China has shifted to net FDI outflows, taking our 2025 basic balance estimate to a slender 0.7% of GDP surplus. Frankly, we argue it would be unconscionable for China's policymakers to allow the country to run a structural basic balance deficit on account of greater consumption, funded by borrowing (from foreigners), net portfolio inflows (from foreigners), or FX reserve depletion.

Figure 5

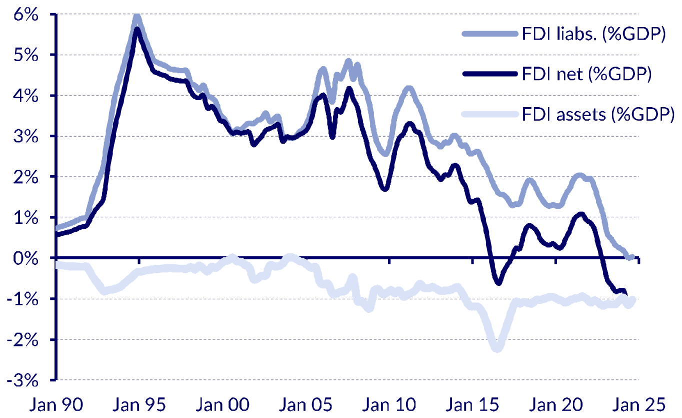
Largest 30 economies: Household consumption vs current account



Source: CLSA, IMF, Our World in Data

Figure 6

China FDI decomposition (% GDP)



Source: CLSA, SAFE, Oxford Economics

Furthermore, ideologically President Xi does not espouse a Western-style consumerist culture or "Welfare-ism" as being consistent with his vision of common prosperity. Yet without an expanded social security safety net, there is likely less prospects of unlocking China's vast pool of precautionary savings to drive the economy. Also, for a nominally socialist society, China's Gini coefficient at 47% (the same as the US) is indicative of a highly disproportionate income distribution. It is clearly a concern that the most common denominator of social unrest globally is wealth inequality, a feature that would become more evident with increased levels of consumption.

Moreover, economic transitions from investment to consumption-led could involve a hiatus in headline growth, such as that experienced by Japan, which may be off-putting for policymakers concerned by knock-on social implications.

Yet policy inaction is also not an option

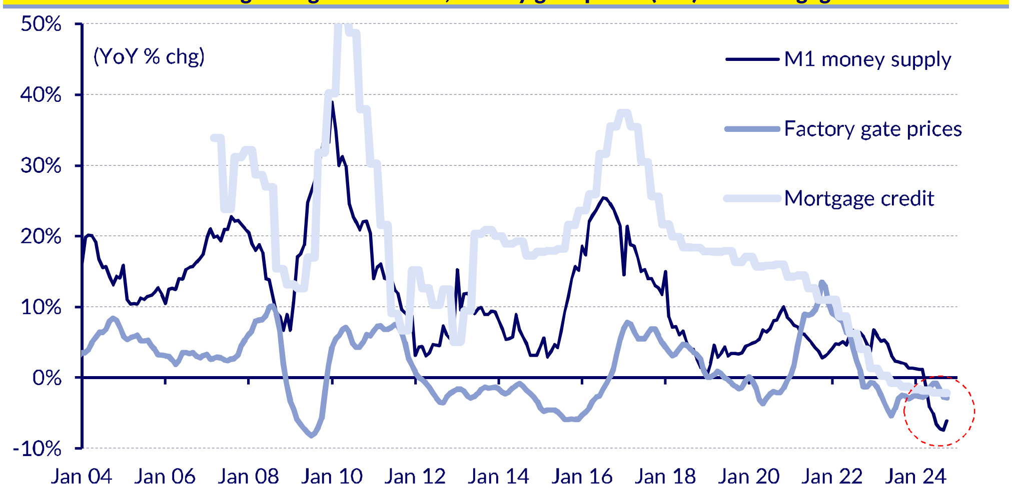
The 8 November Rmb10tn fiscal plan is basically a debt swap for local government off balance sheet liabilities, yielding savings of just Rmb600bn, or 0.1% of annual GDP, over five years. This will relieve local government financing stresses, allow debts and wages in arrears to be made whole, and potentially reduce the imposition of arbitrary fees and fines used as supplementary revenue collection. But it does not tackle deflation or China's other economic challenges.

Policymakers still face a unenviable blend of deflation, falling property prices, rising youth unemployment, decaying household confidence, stagnant real estate investment and consumption (growth in real retail sales) running at half the pre-pandemic rate. Coupled with incidences of unpaid wages by cash-strapped regional government, absent a further meaningful stimulus package there is a palpable risk of unrest.

Defeating a deflationary spiral (there is a veritably unholy trilogy of negative growth in narrow money, PPI and mortgage credit) is essential to avoid the "Japanification" of China's economy. Enterprises struggle to expand revenue in an environment of declining nominal GDP growth and falling prices. Flat HSCEI YoY revenue growth is the weakest in four years, and given current CLSA estimates for China's GDP growth and factory gate prices, it is unlikely to meaningfully improve this year or next, absent a substantive fiscal intervention.

Figure 7

Deflation deadlock: Negative growth in M1, factory gate prices (PPI) and mortgage credit



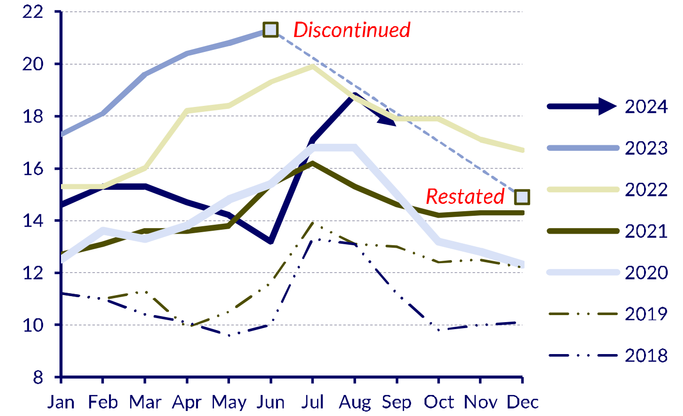
Source: CLSA, PBOC, NBS

Youth unemployment (having been restated to 14.9% in December from 21.3% in June last year) had risen—on the new methodology—back up to 18.8% by August before rolling over on the latest September print to 17.6%, aided by seasonality.

The Chinese government is targeting the creation of 12m new jobs in urban areas for 2024, which it appears on target to deliver (the September run rate is 10.5m, marginally ahead of this time last year with 2023's total being 12.4m). However, the surge in fresh graduates (11.8m in 2024) means that there is only sufficient urban employment to accommodate those with degrees. China's labour surveys (services and manufacturing PMI employment and consumer employment sentiment) remain at distressed levels versus history.

Figure 8

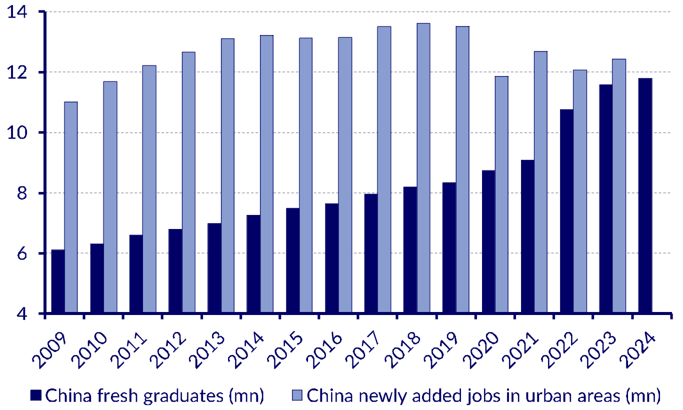
China youth (age 16-24) urban area unemployment rate



Source: CLSA, China National Bureau of Statistics

Figure 9

China new graduates versus new jobs in urban areas



Source: CLSA, China Ministry of Human Resources and Social Security, China Ministry of Education

China's real growth in retail sales has progressed at half the pre-pandemic pace since 2020 as household confidence has been eroded by the outlook for the labour market and property prices (real estate still accounts for 51% of net household wealth, down from 63% in 2010).

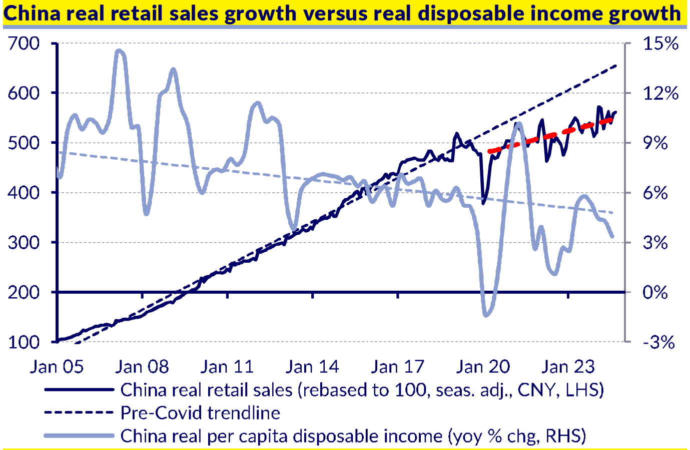
To that point, we argue the absorption by local governments of excess real estate inventory is critical to remove the perception of a market largely in oversupply, and put a floor under pricing and thus confidence.

On our calculations, there may be anything up to a decade of inventory to clear when including digesting developers' housing projects already started at the current (12-month rolling) rate of transactions, together with investment properties that owners may have a propensity to offload if the market improves.

In total, we calculated in earlier work (see: *That Mario feeling*) that there are up to 100m empty housing units in China, made up of 26m unsold housing starts sitting with developers (of which around 15% are completed) and a further 74m units purchased as investment properties, which for the most part lie vacant without fixtures and fittings.

Figure 10

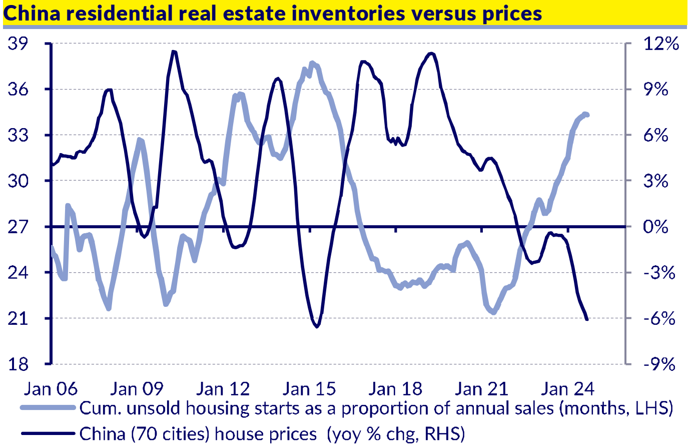
China real retail sales growth versus real disposable income growth



Source: CLSA, China National Bureau of Statistics

Figure 11

China residential real estate inventories versus prices

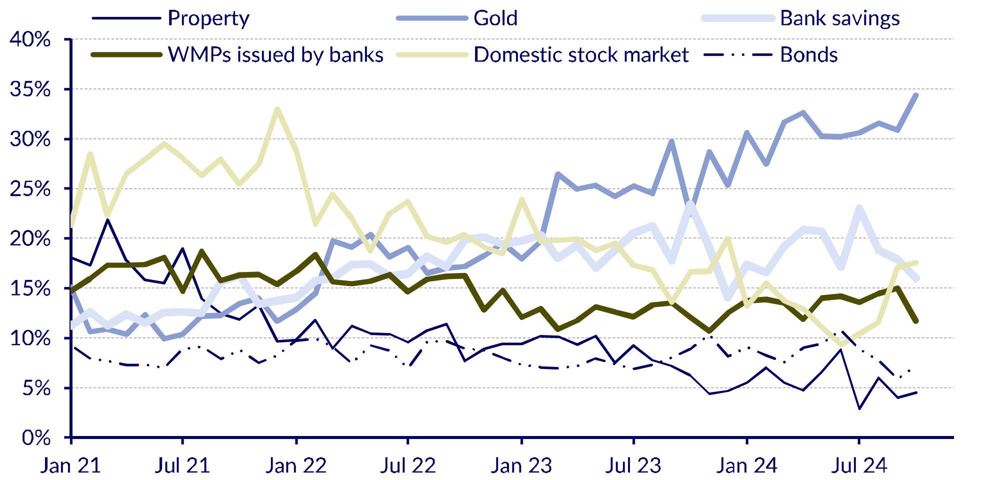


Source: CLSA, China National Bureau of Statistics

Property still languishes in last place among investment options considered over the next year by households, although domestic equities have undergone a bit of a rehabilitation with households and are now favoured (just) versus bank deposits. Yet indicative of the loss of domestic risk appetite in China, gold remains in top spot as the most popular choice ever in our survey conducted since January 2021.

Figure 12

During the next 12 months, the best investment options in China are:



Source: CLSA China Reality Research

Yet we argue the government can and needs to do more. Monetary conditions are still towards the tighter end of the 20-year range and household savings at 116% of GDP have moved from their typical (albeit elevated) precautionary levels to truly excessive in the past few years. Finance Minister Lan Fo'an has left the door open for further measures to recapitalise banks, absorb excess property inventories and stimulate consumption, with the next logical waypoints being the mid-December Central Economic Work Conference and the March 'Two Sessions' NPC meeting.

We are concerned that investors are losing patience and are assuming that policymakers will lowball any further stimulus, and hence they may use the advent of those two occasions as an opportunity to reduce exposure.

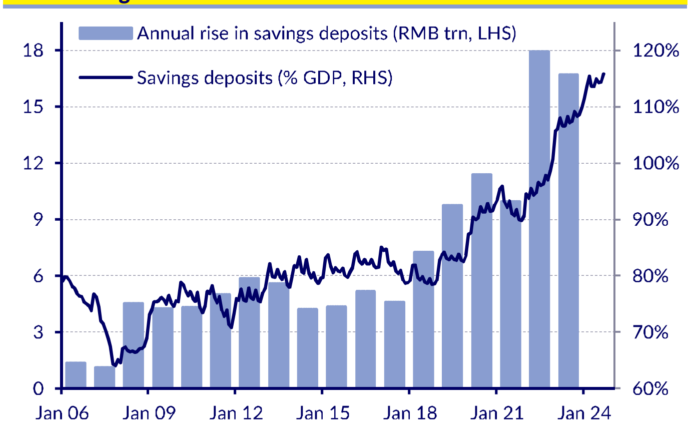
Figure 13

China Monetary Conditions Index

*Note: 60% real interest rate; 15% REER; 25% loan growth
Source: CLSA, Bloomberg

Figure 14

China savings



Source: CLSA, PBOC

Trump 2.0 applies additional stress to the growth outlook

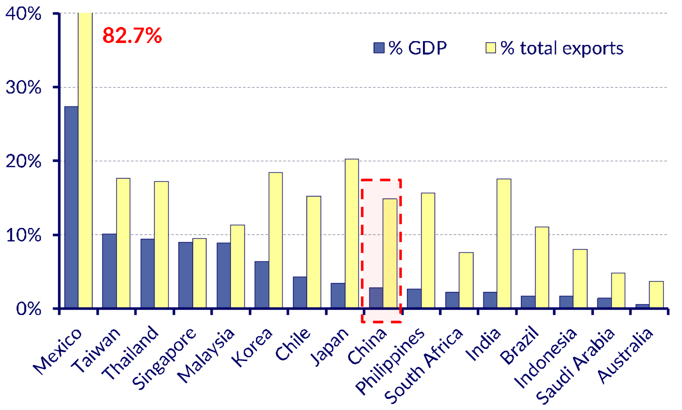
Robert Lighthizer, Donald Trump's protectionist US Trade Representative from his previous administration, has been re-designated to assume the same role in Trump's next cabinet. Lighthizer and Trump have been unequivocal during the presidential campaign in their wish to implement a punishing tariff schedule (60% or above) on Chinese goods imports.

China's assumed retaliatory measures (like for like tariffs on US goods imports, albeit asymmetric in scale, ceasing US agricultural imports, potential RMB devaluation) in conjunction with the inflationary impact of tariffs in the US (see: *47 = 45 ?*) may persuade Trump to seek a trade deal rather than trade war. But in the first instance, before the negotiations begin, the initial imposition of tariffs would be disruptive for Chinese growth.

On first inspection, China's *direct* trade exposure to the US appears relatively slim (just 2.9% of GDP is gross exports to the US and only 14.4% of revenue is generated offshore, a portion of which is from the US).

Figure 15

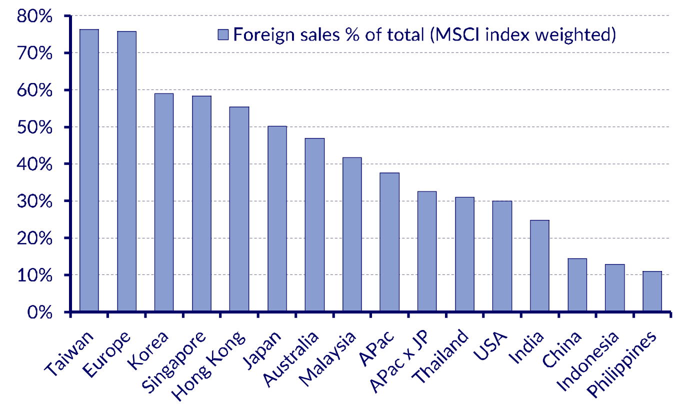
Exports to US (% of total and % of GDP, 2023)



Source: CLSA, IMF DOTS, Oxford Economics

Figure 16

Foreign sales as % of total sales (MSCI index weighted)



Source: CLSA, MSCI, Worldscope, Bloomberg

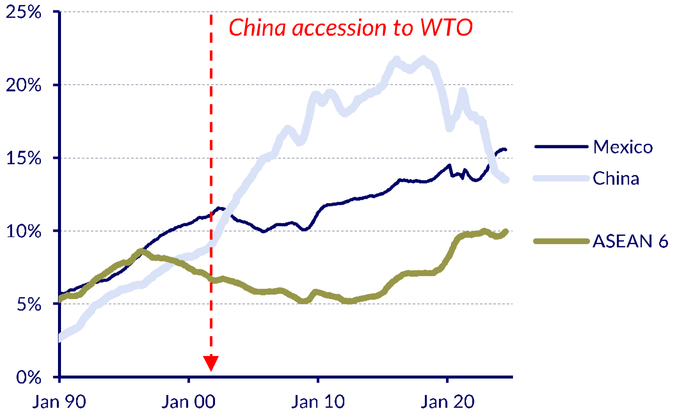
Yet China has increasingly shifted towards models of indirect trade with the US—routing goods via third party countries, principally Mexico or across Asean—such as so-called 'Singapore washing'.

Moreover, Chinese policymakers have been targeting greater manufacturing sector export volumes (as part of President Xi's initiative for "new quality productive forces") as a strategy to at least partially offset the decline in the contribution of residential real estate investment and household consumption to economic growth. Indeed, net exports have become the largest single contributor to Chinese GDP growth in the last quarter, which is almost unprecedented in the period since 2016, highlighting China's economic vulnerability to Trump's adverse trade policies.

Yet it is not just the US that is responding with the imposition of additional tariffs and other regulatory trade barriers in response to the perceived Chinese dumping of goods. The EU and a number of China's EM trade partners have been pushing back especially on volumes of Chinese EV and steel exports.

Figure 17

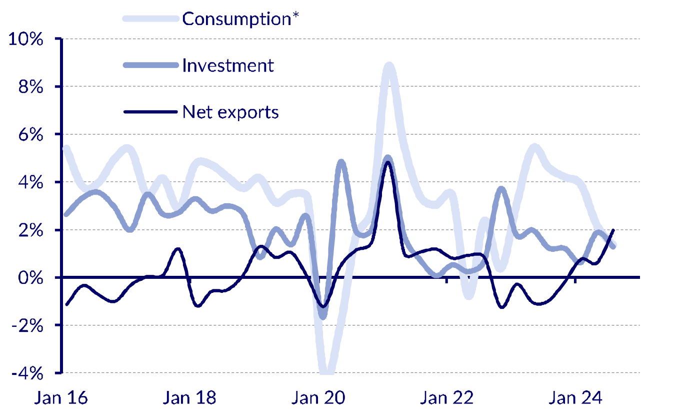
Global share of imports into the US (CIF)



Source: CLSA, IMF Direction of Trade Statistics

Figure 18

Contribution to quarterly YoY China real GDP growth



*Private and government
Source: CLSA, NBS, Oxford Economics

Our scorecard to quantitatively rank the sensitivity of Asia Pacific and emerging markets to Trump's tariff proposals, higher interest rates and foreign divestment places China in second place after Mexico (it is not clear if Trump intends to honour his signature trade deal, USMCA, from his previous administration or similarly apply tariffs to Mexican goods as he intends to on imports from elsewhere).

In comparison, India appears as the most insulated market on this framework, benefitting in this case from relatively low trade exposure with the US, manageable leverage and a particularly low level (and declining) in foreign equity ownership.

Figure 19

Scorecard for market sensitivity to adverse US trade policy with Trump 2.0 tariff proposals

	Tariff proposal	Foreign sales as % of total	Exports to US (% of GDP)	Corporate net debt/Ebitda	Foreign ownership	Ranked weighted
Weight	**1.5**	**1.0**	**1.0**	**0.75**	**0.75**	**z-score**
Mexico	10%	34.8%	27.3%	145%	39.8%	2.9
China	60%	14.4%	2.9%	158%	4.3%*	2.1
Thailand	10%	31.0%	9.4%	291%	36.1%	1.3
Taiwan	10%	76.3%	10.1%	(24%)	41.6%	1.3
Korea	10%	58.9%	6.3%	142%	27.7%	0.6
Malaysia	10%	41.7%	8.9%	215%	20.1%	0.3
Japan	10%	50.2%	3.4%	156%	31.8%	0.1
Brazil	10%	23.3%	1.7%	164%	58.2%	(0.1)
Australia	10%	45.8%	0.6%	117%	33.3%	(0.8)
Philippines	10%	10.9%	2.6%	292%	20.5%	(1.4)
Indonesia	10%	12.8%	1.7%	85%	48.1%	(1.9)
Turkey	10%	22.4%	1.3%	81%	34.0%	(2.2)
India	10%	24.8%	2.2%	146%	17.5%	(2.3)

*Note: For A shares. Source: CLSA, Worldscope, Bloomberg, IMF DOTS, Oxford Economics, Stock exchange data

In addition, it is likely that US investment flows would continue to diversify away from China under a Trump administration as "China plus one" strategies continue to formalise. Yet this is not just a consequence of real or perceived supply chain vulnerabilities owing to the deterioration in relations between the US and China. It is also a realisation of an erosion in China's labour competitiveness as relative wage costs (in US dollar terms) have grown meaningfully for Chinese workers from the days of China's first accession to the WTO.

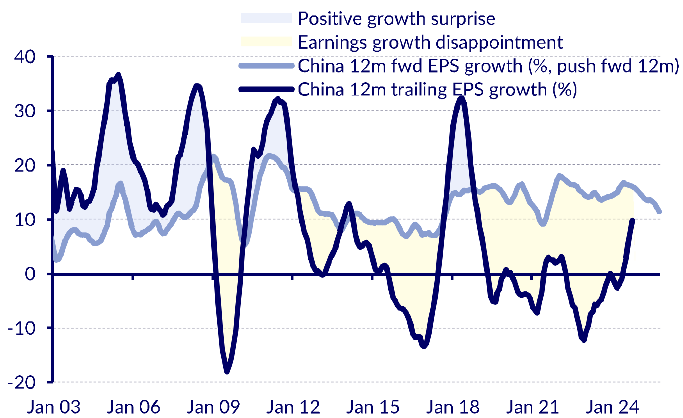
The nascent earnings recovery remains at risk of deflation

The progression of China's aggregate earnings has looked more respective of late. Trailing (12-month) EPS growth at 9.8% is the strongest since 2018 and the spread between EPS growth expectations (as per sell-side analyst consensus from 12-months prior) and EPS growth actually delivered has narrowed to 6.3ppt, which is the least disappointing outturn (relative to projections) since 2018 as well.

Yet, as discussed above, companies struggle to grow their top line in a deflationary environment, with the outlook for currently flat HSCEI revenue growth dependent on the success of policymakers' efforts to reflate the economy.

Figure 20

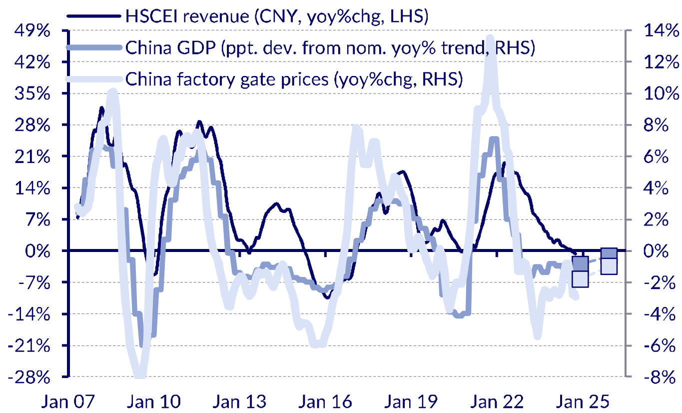
MSCI China earnings growth: forecast versus delivered



Source: CLSA, MSCI, IBES

Figure 21

China: HSCEI revenue growth versus deviation from nominal trend GDP and factory gate prices

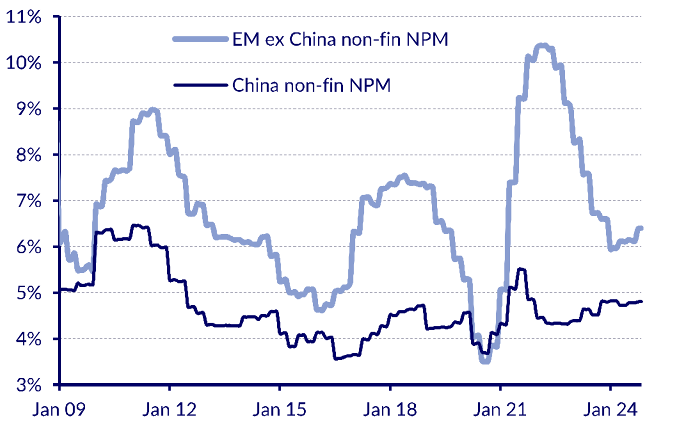


Source: CLSA, IBES, China National Bureau of Statistics, CLSA forecasts

Instead, this uptick in EPS growth has been driven by an improvement in margins, yet China's non-financial net profit margin at 4.8% is already approaching the upper end of the post 2012 historical range, hence the importance of an acceleration of the top line. Moreover, sell-side analyst 2025/26 EPS growth projections for China across sectors (with the exception of energy) remain exceptionally demanding versus what was delivered over the past five years.

Figure 22

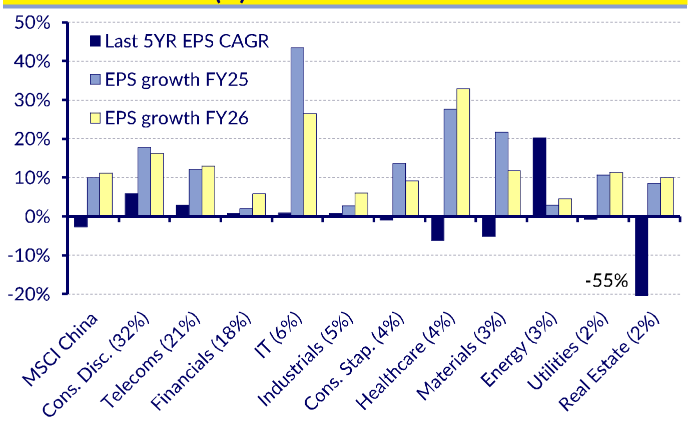
China vs EM ex China non-financial sector net profit margins (%)



Source: CLSA, Refinitiv - Datastream

Figure 23

China sectors* FY25 and FY26 consensus EPS growth versus L5Y delivered EPS CAGR (%)



* % in brackets refers to proportion of total MSCI China index weight
Source: CLSA, MSCI, IBES

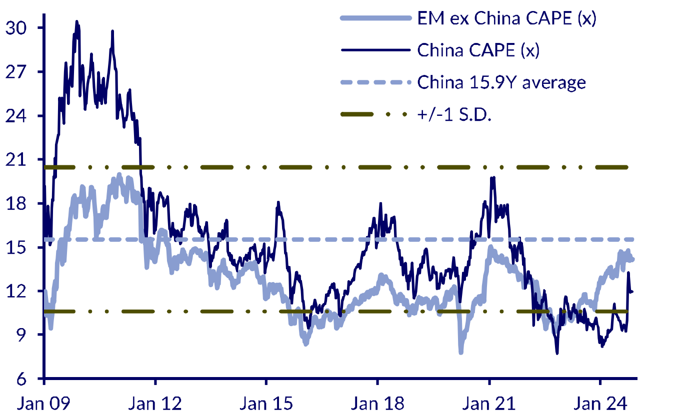
Valuations are slightly less of the steal they used to be

China is now trading on a cyclically adjusted earnings multiple of 12.0x, versus 9.2x in early September or 8.2x at the start of the year. That is still a discount to the rest of emerging markets—EM excluding China trades on a CAPE of 14.0x—but not as extreme as the 36% discount on offer in early September.

China's market-implied equity risk premium at 9.8% is now at the post January 2022 average level, down from 10.8% in early September, just off the highest ever risk premium placed on Chinese equities by the market since 2006.

Figure 24

China versus EM ex China CAPE



Source: CLSA, MSCI, Refinitiv

Figure 25

China market implied equity risk premium

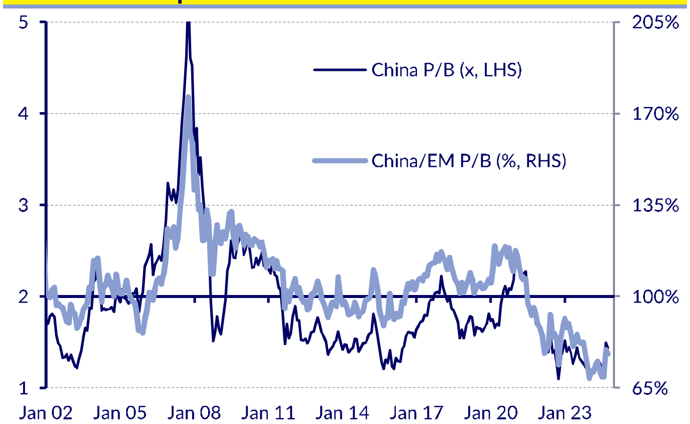
Source: CLSA, Bloomberg, IBES, MSCI

Similarly, on asset based multiples, China has rerated somewhat relative to EM peers, now trading on a 20% price book discount versus the 30% discount on offer going into September, while still offering almost the same profitability as overall EM (ROE of 11.0% for China versus 11.6% for EM).

However, the extreme book discount for China versus US internet names remains largely intact at 70%.

Figure 26

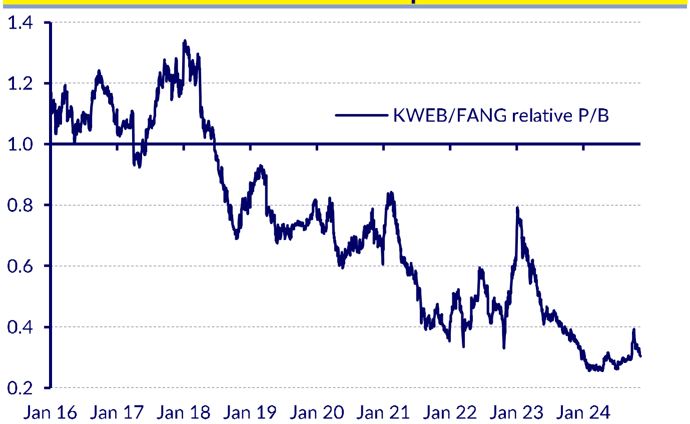
China versus EM price to book



Source: CLSA, MSCI

Figure 27

China versus US internet sector relative price book



Source: CLSA, Refinitiv

Restoring India to a 20% from 10% overweight

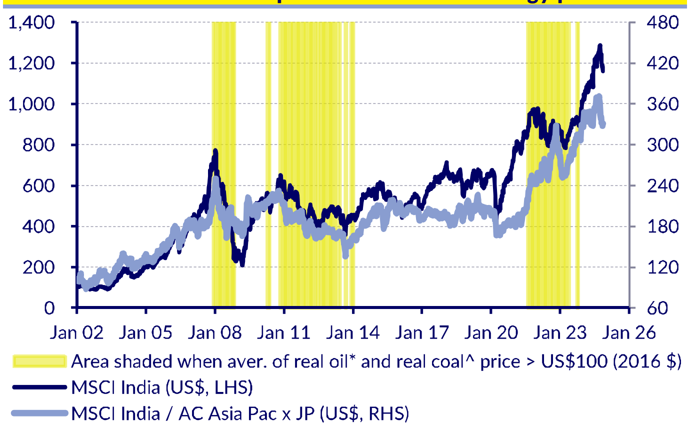
MSCI India has corrected by c.10% in US dollar terms since we top sliced our exposure in early October, or by 12% since the 27 September peak. Paradoxically, India has recorded steady net foreign investor selling of a cumulative US$14.2bn since early October (almost fully unwinding the US$16.6bn of net purchases from June through September), while investors we have met over the year have been waiting specifically for such a buying opportunity to address underexposure to what is arguably the principal scalable growth opportunity in EM.

India has latterly become a relative posterchild of EM FX stability

India remains sensitive to energy prices (86% of the country's oil consumption is imported, 49% of natural gas and 35% of its coal needs) and we remain concerned about the potential for risk premium in the oil price or at worst, a substantive supply interruption from Iran-Israel tensions. Although at least partially mitigating this risk is the c.10% discount applied to c.40% of oil imports which are sourced from Russia.

Figure 28

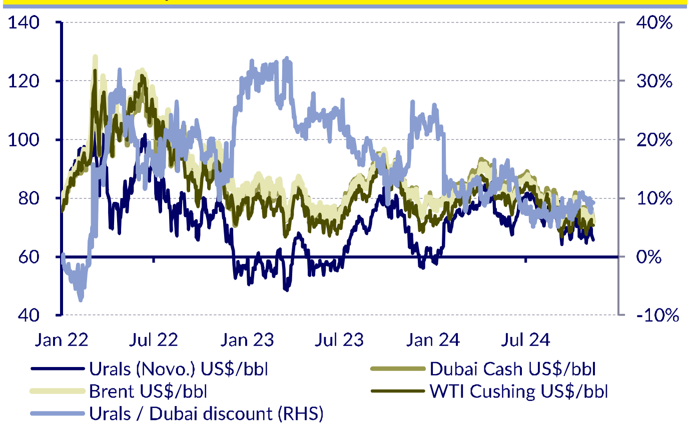
India absolute and relative performance versus energy prices



Note: *Brent crude; ^Newcastle thermal coal FOB. Source: CLSA, MSCI

Figure 29

Crude oil: Urals / Dubai discount

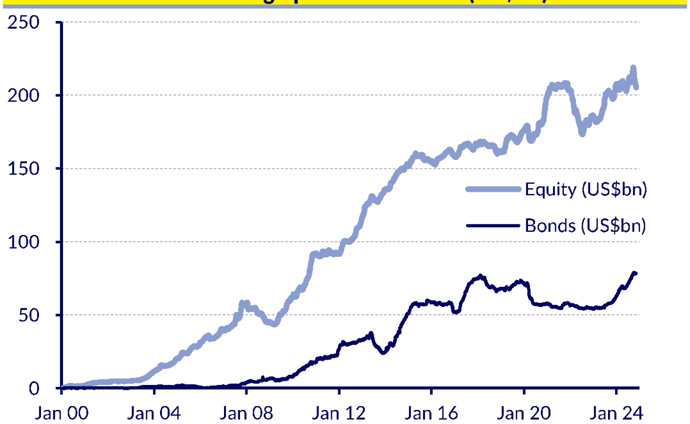


Source: Refinitiv, CLSA

Moreover, an uptick in bond net portfolio inflows post India's inclusion into the JP Morgan GBI-EM fixed income benchmark, together with India's rising global export market share (being relatively unexposed to the US) supports the external position.

Figure 30

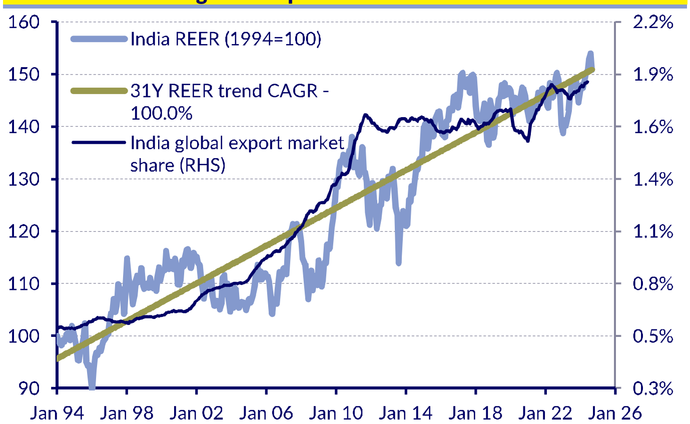
India cumulative net foreign portfolio inflows (US$bn)



Source: CLSA, Central Depository Services (India)

Figure 31

India: REER versus global export market share

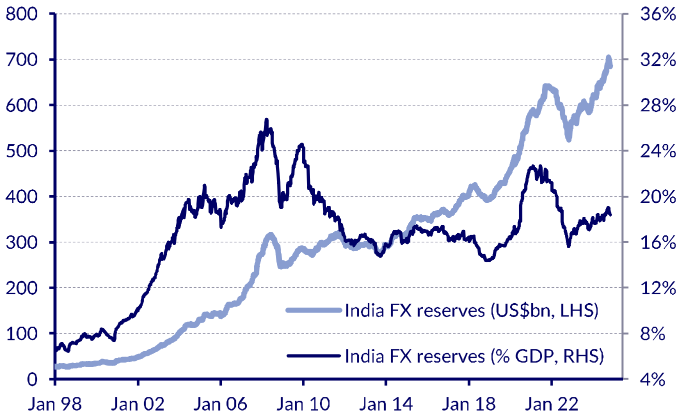


Source: CLSA, Bloomberg, BIS, IMF Direction of Trade Statistics

Importantly, the RBI has managed to accumulate a veritable war chest of FX reserves (some US$700bn worth) which it actively deploys for FX intervention in defence of the rupee. That is a realistic prospect given that India's basic balance of payments funding gap (the unfunded portion of the basic balance after adding net portfolio flows) which has a helpful coincident fit against nominal USDINR momentum, is currently close to 1% of GDP *surplus*—a level which has historically been associated with rupee stability versus the US dollar.

Figure 32

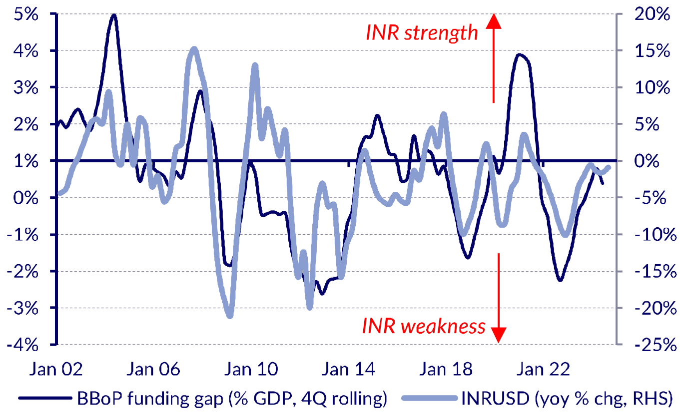
India foreign exchange reserves



Source: CLSA, Reserve Bank of India, Oxford Economics

Figure 33

India BBoP funding gap versus USDINR momentum



Source: CLSA, IMF, Refinitiv

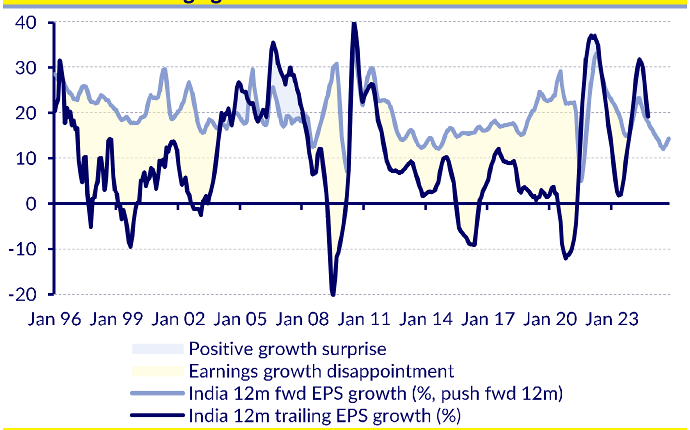
Earnings momentum has softened yet the outlook remains robust

India is exiting a rare episode of earnings surprise (delivered EPS growth superior to consensus expectations of sell-side analysts made 12-months prior) lasting since December 2023. This does not happen often—just 21% of the time since 1996.

Sell-side consensus 2025/26 EPS growth estimates are 18% and 14%, respectively, while revisions to 12-months ahead EPS forecasts are broadly stable.

Figure 34

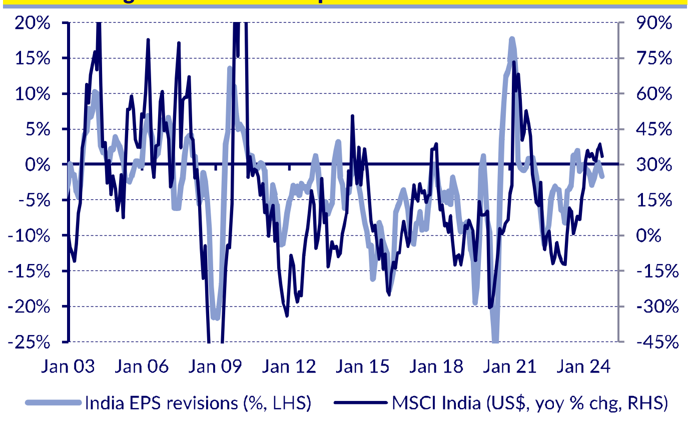
MSCI India earnings growth: forecast versus delivered



Source: CLSA, MSCI, IBES

Figure 35

India earnings revisions versus performance momentum



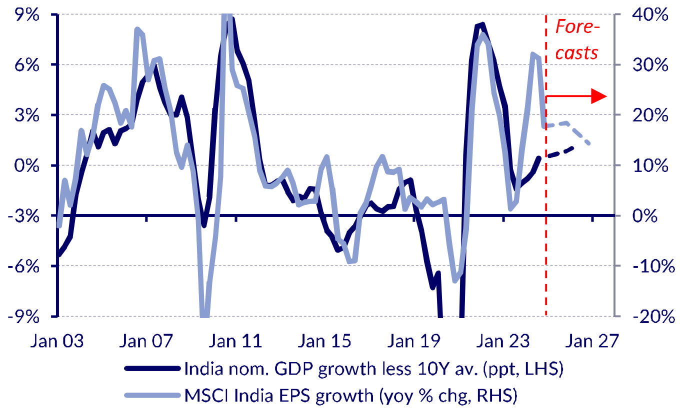
Source: CLSA, IBES, MSCI

India is one of the few emerging markets where a relationship between corporate earnings growth and the changes in the pace of economic output holds true, attributable to the country's more domestically oriented equity market. Indeed the r-squared between nominal EPS growth and nominal GDP growth relative to trend, using two decades of quarterly data, is 59%.

So we find it encouraging that our forecast acceleration of India's nominal GDP growth through 2025/26 (based on our CLSA economics team projections) is sufficiently strong to validate the current consensus EPS growth estimates. Given recent years' rupee stability and the acceleration in local currency earnings, the trend progression in dollarised EPS for India has regained the 30-year trend line having been flat for the decade to 2020.

Figure 36

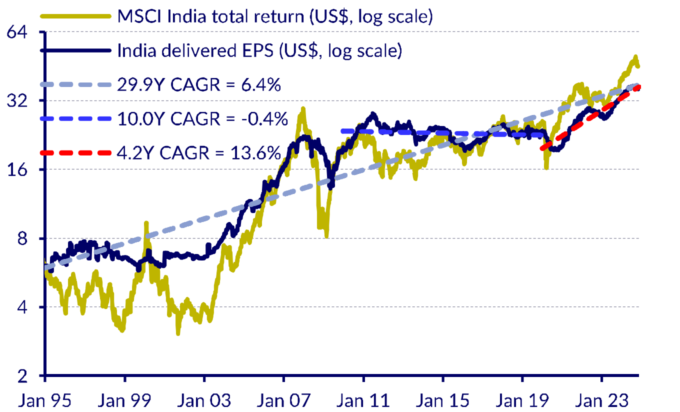
De-trended India nominal GDP growth versus EPS growth



Source: CLSA, IBES forecasts, CLSA forecasts

Figure 37

India US dollar EPS progression



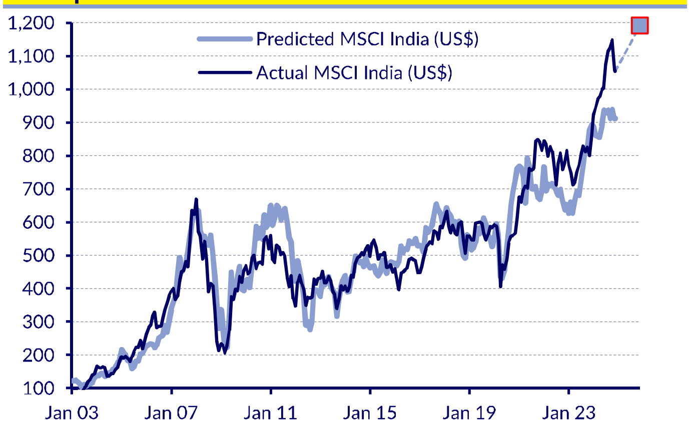
Source: CLSA, IBES, MSCI

Our model implies 13% 12-month potential upside for MSCI India

Our econometric regression model for MSCI India has on average historically explained c.80% of monthly index movements in US dollar terms. While the model indicates that Indian equities remain 13% overbought (although at end-September the peak deviation was as high as 21%), there is 13% US dollar upside potential over the next 12 months based on CLSA economic projections.

Figure 38

Model predicted versus actual MSCI India



Source: CLSA, MSCI, ISM, MOSPI, Reserve Bank of India, Refinitiv

Figure 39

Four factor regression model for MSCI India

Explanatory variable	Coeff.	P value	11 Nov current	+12m forecast	+12m change
India IP growth	0.34	0.02	3.1%	6.5%	+3.4ppt
US ISM headline	0.84	0.00	46.5	52.0	+5.5ppt
India M3 growth	1.49	0.00	11.1%	14.2%	+3.1ppt
USDINR	-2.26	0.00	84.1	85.0	+1.1%
MSCI India index level			**Current**	**Predicted**	**Upside**
Model predicted based on curr. variables			1,053	912	-13%
Model predicted based on f'cast variables			1,053	1,192	13%
Adj. R square 0.78		**Intercept**	0.00	**Observations**	263

Regressing YoY chgs for MSCI India against YoY chgs of independent variables

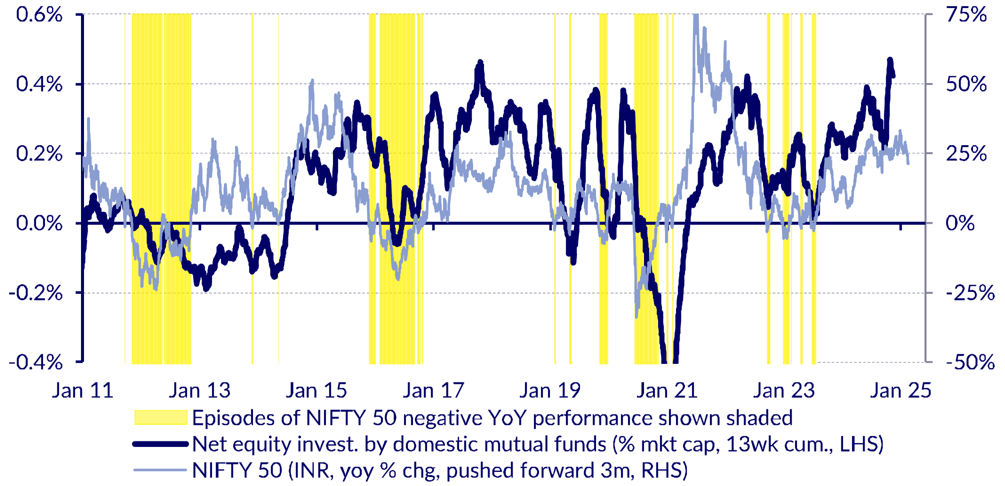
Source: CLSA, MSCI, ISM, MOSPI, Reserve Bank of India, Refinitiv

Domestic retail appetite remains strong, offsetting foreign jitters

Indian equities are 83% domestically owned, the highest such proportion across emerging markets. Rolling three-month cumulative inflows into domestic equity mutual funds have accelerated to 0.42% of market cap, just off a record high. Given the high domestic equity ownership, there is an especially faithful association between Indian mutual fund flows and NIFTY 50 index momentum.

Figure 40

India domestic mutual fund flows versus equity momentum

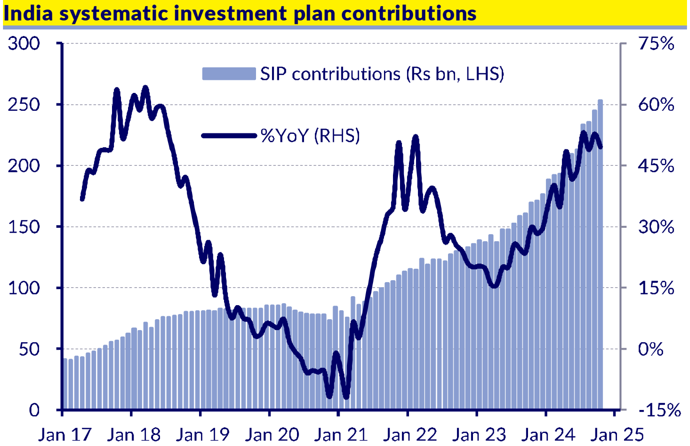


Source: CLSA, Securities & Exchange Board of India, WFE

Monthly contributions to Indian systematic investment plans (SIPs) reached a record Rs253bn (US$3.0bn) in October, which as an integral component of overall domestic mutual fund flows, has compensated for foreign investor net selling since early October.

Figure 41

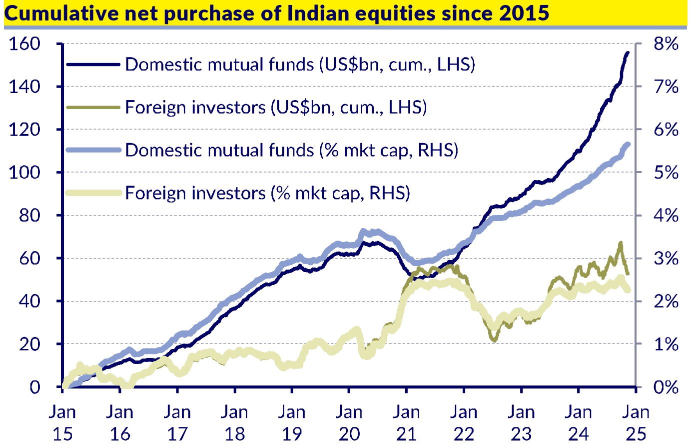
India systematic investment plan contributions



Source: CLSA, Association of Mutual Funds in India

Figure 42

Cumulative net purchase of Indian equities since 2015



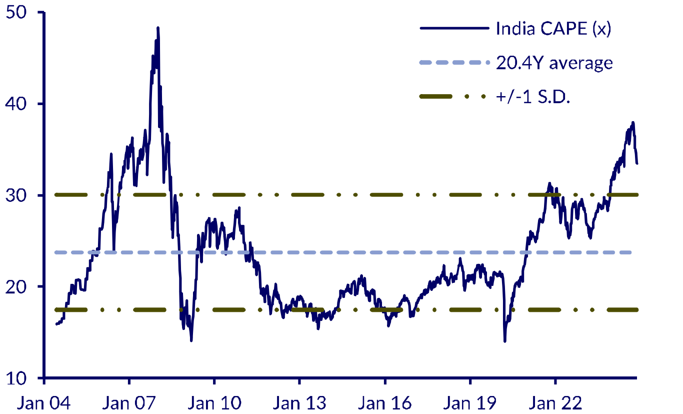
Source: CLSA, Securities & Exchange Board of India, Bloomberg

Valuation, though expensive, is now a little more palatable

India's cyclically adjusted PE multiple has somewhat retraced to 33.5x from a September peak of 37.9x. Yet CAPE is inherently backward looking and grounded on a trend-reverting earnings stream with an implicit assumption of the future imitating the past. For both India and EM this is far from the reality. Indian real EPS (deflated by CPI inflation) has in recent years broken out to 30% above its 10-year rolling average (used to compute CAPE) whereas for EM real EPS remains 11% below its respective 10-year average level.

Figure 43

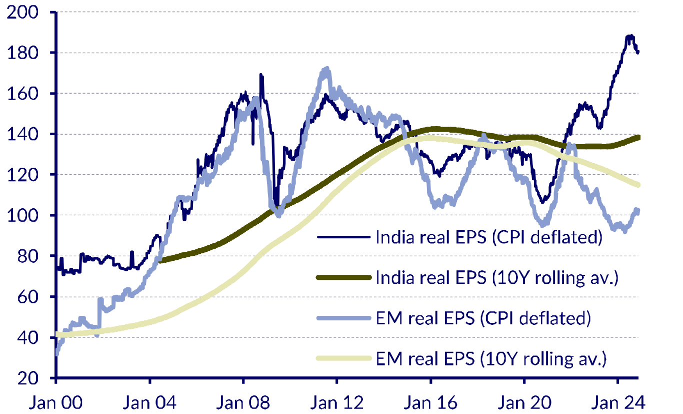
India CAPE



Source: CLSA, IBES, Refinitiv

Figure 44

India versus EM: Real EPS progression versus trend



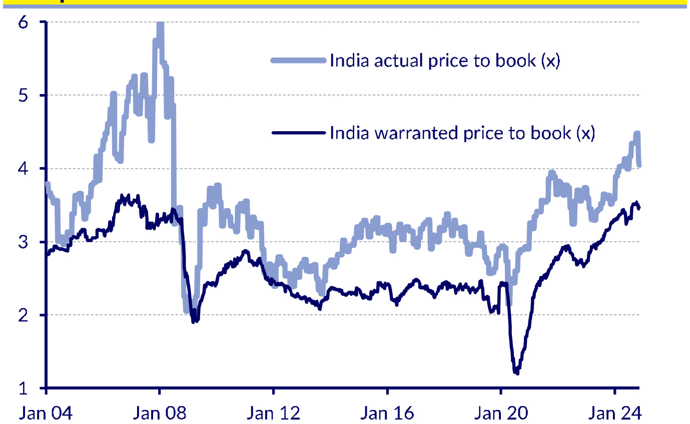
Source: CLSA, IBES, Refinitiv

Similarly, India's asset based valuation has de-rated a little to a book multiple of 4.0x from the recent peak of 4.5x. But employing a Gordon Growth model (P/B = ROE-g/COE-g) yields a warranted price book at a lower 3.5x. Moreover, the ratio of India's actual price book to warranted has fallen back to 17% versus the 20-year average of 29%.

In addition, India's 23% price book premium versus overall EM can be justified by the market's superior ROE (15.8%) and lower COE (10.3%) compared to EM (13.1% and 11.5%, respectively) together with India's structurally superior growth.

Figure 45

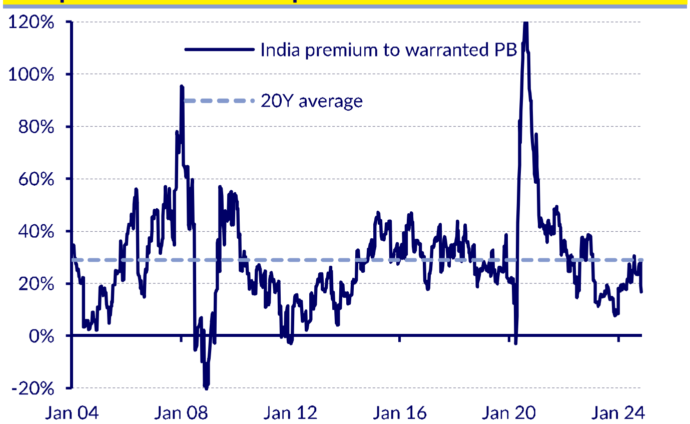
India price to book: Actual versus warranted



Source: CLSA, MSCI, IBES

Figure 46

India premium to warranted price book



Source: CLSA, MSCI, IBES

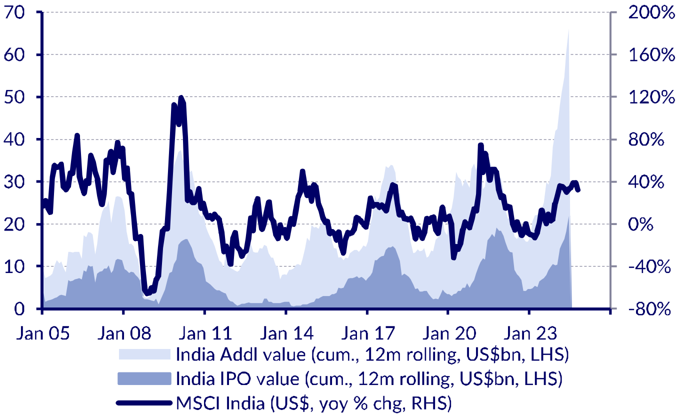
Suffering from success: The risk of suffocation by primary flow

A chief risk for the Indian equity outlook is the acceleration in issuance which ultimately threatens to swamp the secondary market with supply. Cumulative 12-month rolling issuance (IPOs and secondary offerings) reached a record US$66bn in October, although we need to control for the increase in overall market cap when making historical comparisons.

As a proportion of market cap, issuance has reached 1.5%, close to the same level at which it peaked in the last four cycles in Indian issuance which in turn coincided closely with peaks in secondary market momentum.

Figure 47

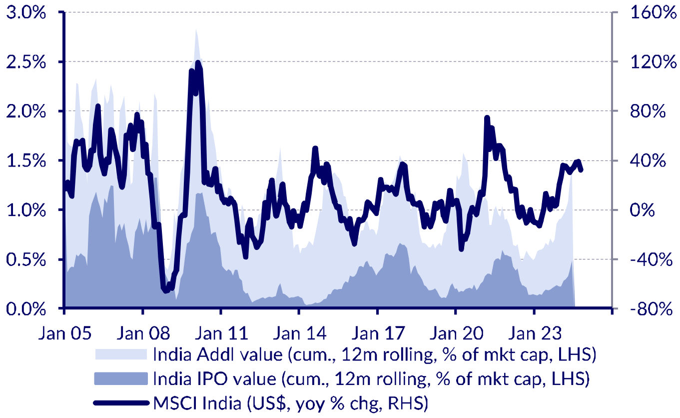
India total issuance* versus equity market momentum



*Note: IPOs + additional
Source: CLSA, Bloomberg, MSCI

Figure 48

India total issuance* (% of market cap) versus equity market momentum



*Note: IPOs + additional
Source: CLSA, Bloomberg, MSCI

Appendix: CLSA country allocation

Figure 49

CLSA market weights versus MSCI All Country Asia Pacific ex Japan

Market	CLSA Recommendation	MSCI AC APAC ex JP weight (%)	CLSA weight (%)	CLSA - MSCI (bps)	CLSA / MSCI (x)
China	**Benchmark**	**26.5%**	**26.5%**	**0**	**1.00**
Taiwan	15% underweight	18.6%	15.8%	(279)	0.85
India	**20% overweight**	**17.8%**	**21.3%**	**356**	**1.20**
Australia	25% underweight	15.4%	11.6%	(386)	0.75
Korea	25% overweight	9.3%	11.7%	233	1.25
Hong Kong	Benchmark	4.1%	4.1%	0	1.00
Singapore	Benchmark	3.1%	3.1%	0	1.00
Indonesia	40% overweight	1.5%	2.1%	59	1.40
Thailand	10% overweight	1.4%	1.5%	14	1.10
Malaysia	60% underweight	1.4%	0.5%	(82)	0.40
Philippines	Benchmark	0.5%	0.5%	0	1.00
New Zealand	Benchmark	0.4%	0.4%	0	1.00
Cash		0.0%	0.9%	85	
		100.0%	**100.0%**	**0**	
Japan	Off-index perform in line				

Source: CLSA, MSCI

Research subscriptions
To change your report distribution requirements, please contact your CLSA sales representative or email us at cib@clsa.com. You can also fine-tune your Research Alert email preferences at https://www.clsa.com/member/tools/email_alert/.

Click to rate this research
Great
Solid
Meh

Companies mentioned

Analyst certification

The analyst(s) of this report hereby certify that the views expressed in this research report accurately reflect my/our own personal views about the securities and/or the issuers and that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

Important disclosures

CLSA ("CLSA") in this report refers to CLSA Limited, CLSA Americas, LLC, CLSA Australia Pty Ltd, CLSA India Private Limited, PT CLSA Sekuritas Indonesia, CLSA Securities Japan Co., Ltd., CLSA Securities Korea Ltd., CLSA Securities Malaysia Sdn. Bhd., CLSA Philippines, Inc, CLSA Singapore Pte Ltd, CLSA Securities (Thailand) Limited, CLSA (UK), CLSA Europe B.V. and/or their respective affiliates. CLST ("CLST") in this report refers to CL Securities Taiwan Co., Ltd.

The policies of CLSA and CLST are to only publish research that is impartial, independent, clear, fair, and not misleading. Regulations or market practice of some jurisdictions/markets prescribe certain disclosures to be made for certain actual, potential or perceived conflicts of interests relating to a research report as below. This research disclosure should be read in conjunction with the research disclaimer as set out hereof and at www.clsa.com/disclaimer.html, the Terms and Conditions of Use as set out at https://www.clsa.com/terms-and-conditions-of-use/ and the applicable regulation of the concerned market where the analyst is stationed and hence subject to. Investors are strongly encouraged to review this disclaimer before investing.

Neither analysts nor their household members or associates may have a financial interest in, or be an officer, director or advisory board member of companies covered by the analyst unless disclosed herein. In circumstances where an analyst has a pre-existing holding in any securities under coverage, those holdings are grandfathered and the analyst is prohibited from trading such securities.

The analysts included herein hereby confirm that they have not been placed under any undue influence, intervention or pressure by any person/s in compiling this research report. In addition, the analysts attest that they were not in possession of any material, non-public information regarding the subject company that has securities listed in the relevant jurisdiction(s) at the time of publication of this report. (For full disclosure of interest for all companies covered by CLSA in this report, please refer to http://www.clsa.com/member/research_disclosures/ for details.)

As analyst(s) of this report, I/we hereby certify that the views expressed in this research report accurately reflect my/our own personal views about the securities and/or the issuers and that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this report or to any investment banking relationship with the subject company covered in this report (for the past one year) or otherwise any other relationship with such company which leads to receipt of fees from the company except in ordinary course of business of the company. The analyst/s also state/s and confirm/s that he/she/they has/have not been placed under any undue influence, intervention or pressure by any person/s in compiling this research report. In addition, the analysts included herein attest that they were not in possession of any material, non-public information regarding the subject company that has securities listed in the relevant jurisdiction(s) at the time of publication of this report. The analysts further confirm that none of the information used in this report was received from CLSA's Corporate Finance department or CLSA's and/or CLST's Sales and Trading business. Save from the disclosure below (if any), the analyst(s) is/are not aware of any material conflict of interest.

Key to CLSA/CLST investment rankings: From 6pm (HK time) on 28 June 2024: Outperform (O-PF): Total stock return (TSR) expected to exceed or be equal to 10%; Hold (HLD): Total stock return expected to be below 10% but more than or equal to negative 10%; Underperform (U-PF): Total stock return expected to be below negative 10%. TSR is up/downside to 12-month target price plus dividend. Up to 6pm (HK time) on 28 June 2024: BUY: Total stock return (including dividends) expected to exceed 20%; O-PF (aka ACCUMULATE): Total expected return below 20% but exceeding market return; U-PF (aka REDUCE): Total expected return positive but below market return; SELL: Total return expected to be negative. For relative performance, we benchmark the 12-month total forecast return (including dividends) for the stock against the 12-month forecast return (including dividends) for the market on which the stock trades.

"High Conviction" Ideas are not necessarily stocks with the most upside/downside, but those where the Research Head/Strategist believes there is the highest likelihood of positive/negative returns. The list for each market is monitored weekly.

According to the key to CLSA/CLST investment rankings effective from 6pm (HK time) on 28 June 2024: Overall rating distribution for CLSA (exclude CLST) only Universe: Outperform - CLSA: 68.28%, Hold - CLSA: 24.35%, Underperform - CLSA: 7.38%, Restricted - CLSA: 0.08%; Data as of 1 Oct 2024. Investment banking clients as a % of rating category: Outperform - CLSA: 14.04%, Hold - CLSA: 1.51%, Underperform - CLSA: 1.03%; Restricted - CLSA: 0.08%. Data for 12-month period ending 1 Oct 2024. Overall rating distribution for CLST only Universe: Outperform - CLST: 73.77%, Hold - CLST: 18.03 %, Underperform - CLST: 8.20%, Restricted - CLST: 0.00%. Data as of 1 Oct 2024. Investment banking clients as a % of rating category: Outperform - CLST: 0.00%, Hold - CLST: 0.00%, Underperform - CLST: 0.00%, Restricted - CLST: 0.00%. Data for 12-month period ending 1 Oct 2024. For purposes of regulatory disclosure only, our Outperform rating falls into a buy rating category; our Hold rating falls into a hold rating category; and our Underperform rating falls into a sell rating category.

According to the key to CLSA/CLST investment rankings effective up to 6pm (HK time) on 28 June 2024: Overall rating distribution for CLSA (exclude CLST) only Universe: BUY / Outperform - CLSA: 72.61%, Underperform / SELL - CLSA: 27.39%, Restricted - CLSA: 0.39%; Data as of 28 June 2024. Investment banking clients as a % of rating category: BUY / Outperform - CLSA: 14.60%, Underperform / SELL - CLSA: 2.05%; Restricted - CLSA: 0.39%. Data for 12-month period ending 28 June 2024. Overall rating distribution for CLST only Universe: BUY / Outperform - CLST: 79.66%, Underperform / SELL - CLST: 20.34%, Restricted - CLST: 0.00%. Data as of 28 June 2024. Investment banking clients as a % of rating category: BUY / Outperform - CLST: 0.00%, Underperform / SELL - CLST: 0.00%, Restricted - CLST: 0.00%. Data for 12-month period ending 28 June 2024. There are no numbers for Hold/Neutral as CLSA/CLST do not have such investment rankings.

For a history of the recommendation, price targets and disclosure information for companies mentioned in this report please write to: CLSA Group Compliance, 18/F, One Pacific Place, 88 Queensway, Hong Kong and/or; CLST Compliance (27/F, 95, Section 2 Dun Hua South Road, Taipei 10682, Taiwan, telephone (886) 2 2326 8188). EVA® is a registered trademark of Stern, Stewart & Co. "CL" in charts and tables stands for CLSA estimates, “CT” stands for CLST estimates, "CRR" stands for CRR Research estimates and “CS” for CITIC Securities estimates unless otherwise noted in the source.

Charts and tables sourced to CLSA in this report may include data extracted from CLSA’s automated databases, which derive their original data from a range of sources. These can include: companies; analyst estimates/calculations; local exchanges and/or third-party data or market pricing providers such as Bloomberg, FactSet or IBES. Additional information on data sources for specific charts or tables can be obtained by contacting the publishing analysts.

This report is subject to and incorporates the terms and conditions of use set out on the www.clsa.com website (https://www.clsa.com/disclaimer.html and https://www.clsa.com/terms -and-conditions-of use/) and the references to “publication/communication” or “Publications” thereof shall include this report. Neither this report nor any portion hereof may be reprinted, sold, resold, copied, reproduced, distributed, redistributed, published, republished, displayed, posted or transmitted in any form or media or by any means without the written consent of CLSA and/or CLST. CLSA and/or CLST has/have produced this report for private circulation to professional, institutional and/or wholesale clients only, and may not be distributed to retail investors. The information, opinions and estimates herein are not directed at, or intended for distribution to or use by, any person or entity in any jurisdiction where doing so would be contrary to law or regulation or which would subject CLSA and/or CLST to any additional registration or licensing requirement within such jurisdiction. The information and statistical data (for private or public companies) herein have been obtained from sources we believe to be reliable. Such information has not been independently verified and CLSA and/or CLST makes no representation or warranty as to its fairness, adequacy, accuracy, completeness or correctness. The replication of any third party views in this report should not be treated necessarily as an indication that CLSA and/or CLST agrees with or concurs with such views. None of CLSA and/or CLST, its affiliates and their respective directors, officers, employees, advisers and representatives makes any representation or warranty, express or implied, as to and no reliance should be placed on, the fairness, accuracy, completeness or correctness of such data or information contained herein or any statement made in this report. Any opinions or estimates herein reflect the judgment of CLSA and/or CLST at the date of this report and are subject to change at any time without notice. Where any part of the information, opinions or estimates contained herein reflects the views and opinions of a sales person or a non-analyst, such views and opinions may not correspond to the published view of CLSA and/or CLST. Any price target given in the report may be projected from one or more valuation models and hence any price target may be subject to the inherent risk of the selected model as well as other external risk factors. Where the publication does not contain ratings, the material should not be construed as research but is offered as factual commentary. It is not intended to, nor should it be used to form an investment opinion about the non-rated companies.

This report is for information purposes only and it does not constitute or contain, and should not be considered as an offer or invitation to sell, or any solicitation or invitation of any offer to subscribe for or purchase any securities in any jurisdiction and recipient of this report must make its own independent decisions regarding any securities or financial instruments mentioned herein. This is not intended to provide professional, investment or any other type of advice or recommendation and does not take into account the particular investment objectives, financial situation or needs of individual recipients. Before acting on any information in this report, you should consider whether it is suitable for your particular circumstances and, if appropriate, seek professional advice, including legal or tax advice. Investments involve risks, and investors should exercise prudence and their own judgment in making their investment decisions. The value of any investment or income may go down as well as up, and investors may not get back the full (or any) amount invested. Investments that are denominated in foreign currencies may fluctuate in value as a result of exposure to movements of exchange rate. Past performance is not necessarily a guide to future performance or liquidity. CLSA and/or CLST do/does not accept any responsibility and cannot be held liable for any person’s use of or reliance on the information and opinions contained herein. To the extent permitted by applicable securities laws and regulations, CLSA and/or CLST accept(s) no liability whatsoever for any direct or consequential loss arising from the use of this report or its contents.

To maintain the independence and integrity of our research, our Corporate Finance, Sales Trading, Asset Management and Research business lines are distinct from one another. This means that CLSA’s Research department is not part of and does not report to CLSA's Corporate Finance department or CLSA’s Sales and Trading business. Accordingly, neither the Corporate Finance department nor the Sales and Trading department supervises or controls the activities of CLSA’s research analysts. CLSA’s research analysts report to the management of the Research department, who in turn report to CLSA’s senior management. CLSA has put in place a number of internal controls designed to manage conflicts of interest that may arise as a result of CLSA engaging in Corporate Finance, Sales and Trading, Asset Management and Research activities. Some examples of these controls include: the use of information barriers and other controls designed to ensure that confidential information is only shared on a “need to know” basis and in compliance with CLSA’s Chinese Wall policies and procedures; measures designed to ensure that interactions that may occur among CLSA’s Research personnel, Corporate Finance, Asset Management, and Sales and Trading personnel, CLSA’s financial product issuers and CLSA’s research analysts do not compromise the integrity and independence of CLSA’s research.

Subject to any applicable laws and regulations at any given time, CLSA, CLST, their respective affiliates, officers, directors or employees may have used the information contained herein before publication and may have positions in, or may from time to time purchase or sell or have a material interest in any of the securities mentioned or related securities, or may currently or in future have or have had a business or financial relationship with, or may provide or have provided corporate finance/capital markets and/or other services to, the entities referred to herein, their advisors and/or any other connected parties. As a result, you should be aware that CLSA and/or CLST and/or their respective affiliates, officers, directors or employees may have one or more conflicts of interest. Regulations or market practice of some jurisdictions/markets prescribe certain disclosures to be made for certain actual, potential or perceived conflicts of interests relating to research reports. Details of the disclosable interest can be found in certain reports as required by the relevant rules and regulation and the full details of conflict of interest with companies under coverage are available at http://www.clsa.com/member/research_disclosures/. Disclosures therein include the position of CLSA and CLST only. Unless specified otherwise, CLSA did not receive any compensation or other benefits from the subject company, covered in this report, or from any third party. For CITICS disclosure about specific companies mentioned herein, please access: https://www.clsa.com/member/research_disclosures_citics/. If investors have any difficulty accessing this website, please contact webadmin@clsa.com. If you require disclosure information on previous dates, please contact compliance_hk@clsa.com.

Any disputes related to this report shall be governed by the laws of Hong Kong and to the non-exclusive jurisdiction of the courts of Hong Kong in connection with any suite, action or proceeding arising out of or in connection with this material. In the event any of the provisions in these Terms of Use shall be held to be unenforceable, that provision shall be enforced to the maximum extent permissible to reflect the intention underlying the unenforceable term, and the remainder of these General Disclaimer shall be unimpaired.

This report is distributed for and on behalf of CLSA (for research compiled by non-US and non-Taiwan analyst(s)), CLSA Americas, LLC (for research compiled by US analyst(s)) and/or CLST (for research compiled by Taiwan analyst(s)) in Australia by CLSA Australia Pty Ltd (ABN 53 139 992 331/AFSL License No: 350159); in Hong Kong by CLSA Limited (Incorporated in Hong Kong with limited liability); in India by CLSA India Private Limited, (Address: 8/F, Dalamal House,