

## POST-ELECTION THOUGHTS

### **Narendra Modi will change the way that India is governed**

1. What the win means politically?
  - The BJP won a majority with 282 seats in the Lower House. The NDA alliance won 336 seats out of 542
  - This is the first time in 30 years that India will not have a coalition Government and the first time in its history that a Government with a non-socialist, pro-market philosophy will be in power with a majority
  - After 12 years as Chief Minister of Gujarat, Narendra Modi has a proven track record of being a decisive leader, who empowers his bureaucrats and facilitates economic growth
2. What is the BJP's vision?
  - Inclusive growth that people from all minorities and income levels will participate in
  - Showing that India is open for business both overseas and domestically
  - Political transparency and accountability - "Less government, more governance"
3. First steps
  - Tackling inflation
    - Fiscally prudent budget expected by July, targeting the subsidy burden
    - Irrigation – a short term focus that will improve agricultural output
  - Rebuilding local and foreign business confidence – addressing high profile tax disputes with MNCs such as Vodafone, Nokia, IBM
  - Slimming the number of Ministries from 35 to approximately 20
    - Speeding up the decision making process and increasing accountability
    - Streamlining overlapping portfolios (e.g. creating a Ministry of Energy by merging separate coal, petroleum and natural gas ministries)
  - Restoring the trust deficit between the bureaucracy and the Government helping to
    - Clear existing stalled infrastructure projects
    - Coordinate an accountable framework for the approval of future projects
  - Addressing resource allocation issues – power, coal, gas
  - Tax simplification – implementing the GST Code
4. Longer term action
  - Agricultural productivity – alleviate poverty and high food inflation
    - Increase crop yields: allow corporate sector investment, thereby reducing fragmented landholdings and promoting mechanisation
    - Shrink subsidies and cutting out middlemen to allow a market pricing mechanism
  - Simplify land acquisition
  - Reform labour union laws
  - Reduce state ownership of public sector assets
  - Rebalance away from a consumer dominated economy (driven by subsidies) towards a focus on the supply side through development of infrastructure and manufacturing
5. Macro outlook
  - Inflation will remain sticky until food prices come down, hence the Government's focus on agricultural productivity

- If the RBI sees evidence in the Budget of targets to bring down the fiscal deficit, it will consider monetary easing
- A short term consideration for inflation is a bad monsoon
- Since Governor Rajan's tenure commenced, the Rupee has stabilised and it is the RBI's current strategy to reduce excessive currency volatility whilst continuing to accumulate FX reserves for the future

## 6. Key risks

- Currently no political opposition in Parliament to act as a check and balance
- Delays in delivering on expectations
- The NDA is currently a minority in the Upper House (62 of 250)
  - The BJP's representation will increase over the course of the Parliament
  - The Upper House's discretion only extends to non-finance related legislation and can be overcome by joint sittings if necessary
- The perception of Narendra Modi as a sectarian, anti-Islam, ultra-conservative Hindu nationalist. Initial steps have been taken to assuage these fears
  - Political rhetoric has emphasised inclusion of minorities in the economic revival
  - Modi has made an unprecedented gesture by inviting Pakistan's PM Nawaz Sharif to his inauguration

## 7. Portfolio construction

- The intention is to exploit the new opportunity whilst maintaining Ocean Dial's investment process
- The bottom up investment philosophy does not change - emphasis on strong balance sheets, high cashflow generation and management quality will remain paramount – we will not bandwagon the election rally by investing in low quality cyclicals
- Areas of focus are businesses that are exposed to a revival in the capex cycle - light engineering, industrials (e.g. cement), financial services and auto-ancillaries. In agriculture, opportunities to play are in mechanisation (tillers and tractors) as well as producers of hybrid seeds, fertilisers, and pesticides
- Less emphasis on the consumer sectors due to excessive valuations, and a re-evaluation of IT and pharmaceuticals due to export related currency concerns

## 8. Equity market outlook

- At 15.6x forward earnings the market trades in line with its long term average, further re-rating is possible of up to one standard deviation above the mean (17.4x)
- An earnings recovery is expected within 12 months, a political and economic framework is being put in place for gains that will accrue over time
- The cost of capital is already coming down and corporates are starting to tap equity markets for fresh capital, which will help deleverage balance sheets, encouraging a capex recovery
- India's current deep rooted perception of poor governance and macroeconomic mismanagement is going to be challenged

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