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# What to do with Indian equities

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**We downgraded India to neutral in our Asia portfolios, following a rally of over 20% in the past nine months. We think the next leg up in Indian equities may happen at a slower pace, but we continue to like sectors with high exposure to domestic growth. Investors with excessive allocation to the country can consider other alpha opportunities in the region.**

Despite some pullback this month, the MSCI India index has risen over 20% since mid-June last year, when we upgraded Indian equities to most preferred in our Asia portfolios. In addition to the bounce in global equities, the rally has also been built on a rapidly expanding economy.

However, relative to its peers in the region, Indian equities' performance is unlikely to stand out as much as it did before, in our view, with forecasts showing similar upside to other markets in Asia from here. As a result, we downgraded India to neutral, shifting our relative least preferred stance on Singapore to neutral as well.

A downgrade does not signal an outright sell, rather we think the market's next leg up may happen at a slower pace than over the past nine months. We recommend around 1% benchmark-aligned allocations to India for global investors in a balanced multi-asset portfolio, and around 3.5% for Asia-focused investors. Those investors holding broad Indian equities should contend with a slower, albeit still upward, movement from here due to three main reasons:

**India's economic expansion is likely to slow from current levels.** Following several quarters of strong growth, we think the country's economy may have reached its ceiling rate of growth. A likely widening external deficit, high interest rates, and a pause in foreign direct investment inflows would make it hard for India to sustain growth far above the 7–8% range, in our view. We estimate 7.6% real GDP growth for the fiscal year ending this March and 7% for FY25.

**Well-expected election results mean performance may be front-loaded.** India is set to hold general elections over six weeks from 19 April, with preliminary results expected on 4 June. Prime Minister Narendra Modi is widely expected

to win a third term in office, and his Bharatiya Janata Party (BJP) should also secure a majority in the government. While markets generally welcome policy continuity, a look back at history suggests the pre-election performance could end up stronger versus the post-election one as the expected outcomes were already priced in.

**Earnings growth may decelerate, while regulatory concerns and option speculation may lead to some profit-taking in the near term.** Following 16% earnings growth for FY24 ending this month, we think it's likely to moderate to about 14% in FY25. That's because the last 12 months were marked by many industries experiencing the benefits of price hikes and falling input costs, but this is now priced into the base for the next year. Separately, India's market regulator is making efforts to curb excessive speculation in small- and mid-cap stocks as retail investors piled into mutual funds and option trading. While large-cap stocks should stay resilient due to benign fundamentals, regulatory concerns may lead to some profit-taking in the overall market.

So, we now look for high-single-digit upside toward year-end, a moderation of the rally since we upgraded India. Investors who have excess exposure to India can consider alpha opportunities in Asia, such as beneficiaries of generative artificial intelligence (Asia's Super 8), or those that hold solid market share positions and resilient growth outlooks (Asian titans).

Longer term, we continue to believe that India offers one of the best structural growth stories. According to our and IMF projections, India is likely to become the world's third-largest economy by 2028, and the government has continued to support corporate investment without excessive leverage. The ongoing supply chain diversification should also benefit the country. Within India, we like autos, industrials, utilities, real estate, consumer durables, and healthcare sectors due to their high exposure to domestic growth. For offshore investors, we favor financials and internet names.

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