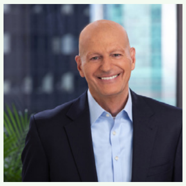
INDIA'S CHALLENGES AND OPPORTUNITIES



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We have recently returned from a research trip to India where we met with government officials and more than 25 company management teams, and toured logistics facilities. The mood in India is clearly buoyant and one CEO put it simply: "Even we locals are surprised!"

A year ago, on our first research trip to India post-Covid, we got a clear sense that business and consumer sentiment were improving, but activity levels were still below pre-Covid levels. This trip, we saw clearly that activity has surpassed pre-Covid levels and confidence is very high. Many corporates are accelerating investment plans, and even rural consumers, who were hit the hardest from the rise in inflation, have turned the corner now that inflation is dropping in a meaningful way. Importantly, monsoon season, which brings essential rain for the more than 50% of the population impacted by the farming industry, is about to start.

DEMOGRAPHIC DIVIDEND

India, with a young population of 1.4 billion people, is experiencing a strong rebound in consumption post-Covid. Consumer confidence is high, and another CEO we met with put it bluntly: "They can take (Covid) on the chin, and just move on!" Such is the extent of the optimism of the Indian consumer, who is borrowing at increasing levels to travel, spend on their children's education, and purchase homes, cars, and two wheelers. We met with management teams from the quick-service restaurant industry and learned that plans to increase the number of stores are accelerating. Our meetings with real estate companies showed strong demand for high-end properties. There is some softness in the mass market segment due to rising interest rates, although there are signs that interest rates have peaked as the inflation outlook moderates.

GROWING THE FORMAL SECTOR OF THE ECONOMY

There is a lot of low hanging fruit to be picked in the Indian economy when it comes to inefficiencies. The Indian government has made, and continues to make, important strides in developing programs to support increases in productivity and higher levels of economic activity. With only 6% of the country's transactions being done digitally, there is a lot of scope for growth. Below are some of the important programs the government has implemented:

1. Aadhaar Biometric Database

This is the largest biometric identity system in the world, and includes more than 1.3 billion people. The system was implemented more than 10 years ago and has allowed more than 81% of adults in India to have bank accounts. Additionally, it has allowed the Indian government to save up to US$27 billion in yearly transfers in social programs that in the past were lost due to corruption at the local level.

2. Uniformed Payments Interface (UPI) System for Real-Time Government Payments

This system has allowed for more than 50% of digital payment transactions in India — both peer-to-peer and person-to-merchant — to be done in the free government network. It is the backbone to support digital transactions between Indian citizens who do not have debit or credit cards and businesses.

3. Goods and Services Tax (GST) Reform

The Modi government has successfully converted 34 different tax systems into a single GST tax system for the country, reducing the levels of bureaucracy for businesses and consumers. This single tax system has brought down logistics costs in India by 2% of GDP.

4. Open Network for Digital Commerce (ONDC)

This most recent initiative is focused on unbundling ecommerce and offers interoperability across ecommerce platforms. ONDC aims to become the gateway between consumers and businesses, breaking the barriers of otherwise walled ecommerce networks and thus lowering transaction costs.

EFFORTS TO REAP THE BENEFITS OF THE CHINA+1 STRATEGY

The "China Plus One" strategy is an initiative by multinational corporations to reduce dependence on China for manufacturing. India is a natural market to compete for the manufacturing jobs that will be leaving China for new manufacturing hubs in the next 10 – 15 years as China achieves rich-nation status. India has a very large educated young population. The Indian government has created a multi-pronged strategy to promote India's manufacturing sector and attract multinational companies:

1. Invest India

The Indian government created this group in 2014, and it now encompasses a team of close to 500 professionals supporting Indian states in competing for foreign direct investment from countries like Vietnam and Mexico. They have created a list of 320 key performance indicators for this purpose and have identified US$194 billion of investments in the next decade spread across 34 distinct sectors.

2. Production-Linked Incentives (PLI) Scheme

India's logistics industry is far behind that of competing manufacturing hubs such as Mexico, Thailand, Vietnam, and others. Although the government has announced an ambitious US$1.4 trillion 5-year investment plan, it has also created a PLI investment scheme where corporations will receive material tax benefits for 5 – 10 years to make up for additional logistics costs while the infrastructure investments take place. Many multinationals are looking into this investment scheme and teaming up with local manufacturing companies in joint-venture structures. Sectors of focus include pharmaceuticals, electronics, solar-powered energy, toys, semiconductors, batteries, cell phones, and more.

3. Railway Freight Corridors

To reduce transportation costs, the Indian government has created close to 2,000 km of new rail tracks that will reduce freight costs by as much as 60% between Delhi and coastal ports near Mumbai. Although this project has been delayed, it is now in its later stages and when completed, a total of 3,958 km of fast tracks (> 100 kmh) will be commissioned.

WHERE ARE THE CHALLENGES?

India is a large, complex, and mostly rural economy with a great potential for modernization and wealth creation in the next 20 years. As a democracy, it is still threatened with high levels of corruption, overall poor infrastructure, and an increasing dependency on imports of oil and gas for its energy needs. The Indian government has made significant efforts in bringing more and more parts of the economy into the formal sector, but there is still a lot more to be done. India's logistics costs are estimated to be between 12% – 13% versus China's 8% – 10%.

The dependency on imports of oil and gas brings a geopolitical risk to investing in India. In addition to this, India finds itself competing for energy with its historical archrival China, which is also increasingly dependent on imports of oil and gas. The complexity is aggravated by the increasing tensions between the US and China. Still, India is more likely to remain inwardly focused and thus avoid the limelight of geopolitics.

Finally, corruption remains a serious problem in India, as evidenced by the surprising loss of the Bharatiya Janata Party (BJP) ruling party in the most recent elections in Karnataka. Despite Prime Minister Narendra Modi's national popularity, his local BJP party was engulfed in corruption scandals that cost them the election. Although Modi has since replaced the leadership of the local BJP, the episode is a reminder of the risks of doing business in India.

INDIA IS MAKING PROGRESS TOWARDS CAPITALIZING ON A MULTI-DECADE OPPORTUNITY

In previous market comments we have designated India as the fastest growing economy in the world. Our recent visit confirms our view that India is capitalizing on this opportunity. The country has a population base that is now the largest in the world. Demographics are favorable with a young, educated population base and a relatively low per capita income.

Over the past 10 years, the government has taken steps to transform the economy. We are convinced India will emerge as one of the most important manufacturing centers in the world over the next 30 years, as China has done over the past 30 years. China's manufacturing output is $4 trillion, or about 10 times India's at $412 billion. India has a long runway for growth and the gap will narrow meaningfully over the next 10 years.

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INDEX PERFORMANCE

June 30, 2023	RETURNS		
Index	**MTD**	**QTD**	**YTD**
MSCI Emerging Markets	3.80%	0.90%	4.89%
MSCI World Index	6.05%	6.83%	15.09%
MSCI EM EMEA	5.03%	2.74%	1.64%
MSCI EM Latin America	12.01%	14.04%	18.52%
MSCI EM Asia	2.71%	-0.77%	4.00%
MSCI Emerging Markets Growth	3.54%	-0.65%	3.32%
MSCI Emerging Markets Value	4.07%	2.53%	6.53%

Source: FactSet

June 30, 2023	RETURNS BY SECTOR		
MSCI Emerging Markets Index	**MTD**	**QTD**	**YTD**
Financials	3.59%	5.68%	4.79%
Information Technology	2.70%	5.05%	20.50%
Consumer Discretionary	6.61%	-6.33%	-4.92%
Communication Services	4.64%	-6.76%	5.01%
Consumer Staples	3.75%	0.28%	2.71%
Industrials	3.26%	1.81%	4.04%
Health Care	-1.24%	-2.50%	-7.27%
Materials	1.70%	-4.17%	-1.91%

Source: FactSet

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