

### FPI investment trends – how worried should we be?

Dear Investor,

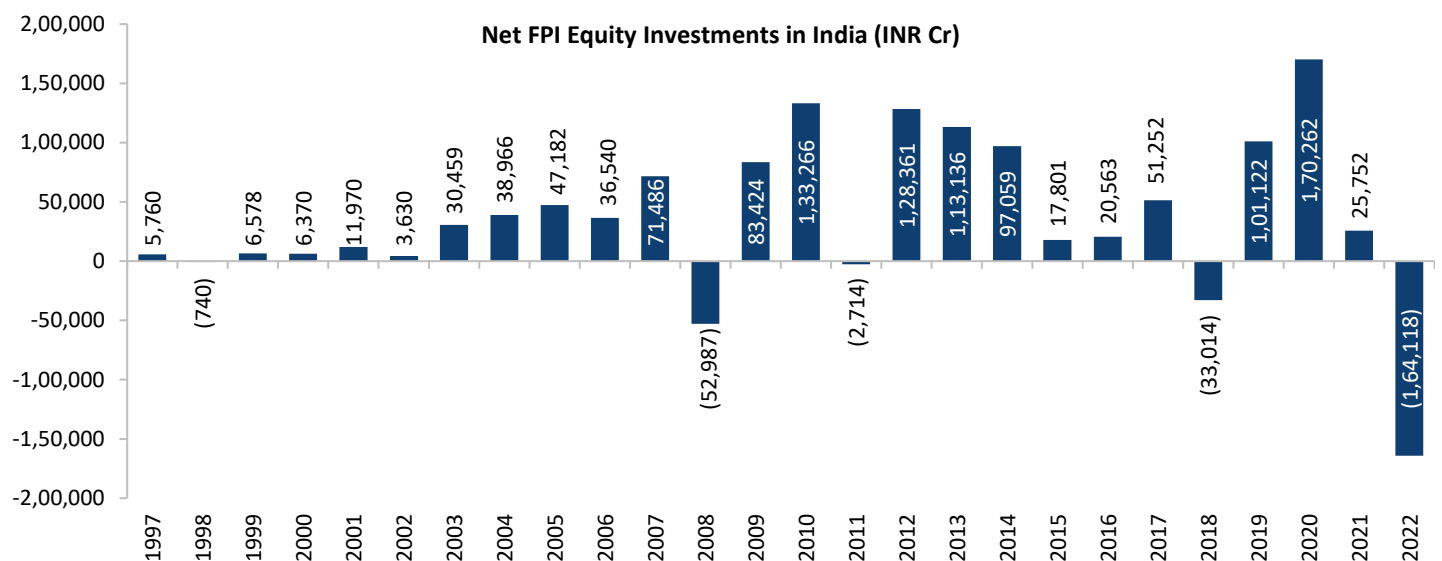
Recently, there has been a spate of reports about the sharp outflows of Foreign Portfolio Investors' (FPI) monies out of India. In some circles, this has sparked a considerable amount of apprehension, especially since FPIs have led the movement of market indexes in India for several years now.

In this connection, we think that it is relevant to discuss the following points:

- What exactly has been the outflow of money because of sales by FPIs?
- What proportion of the FPI monies in India have been redeemed?
- Are there any counterbalancing forces to the FPIs? And if so, to what extent?
- How likely is it that FPIs permanently exit India, and what importance does India have in their scheme of things?
- Isn't currency depreciation a serious negative factor that affects the FPIs? How badly has the Indian rupee fared?

#### FPI net inflows annually

The following chart gives the data about annual FPI net equity inflows into India.



Data Source: (1) SEBI – From 1997 to 2013      Note: figures for 2022 are till 25<sup>th</sup> May 2022  
(2) NSDL – From 2014 to 2022

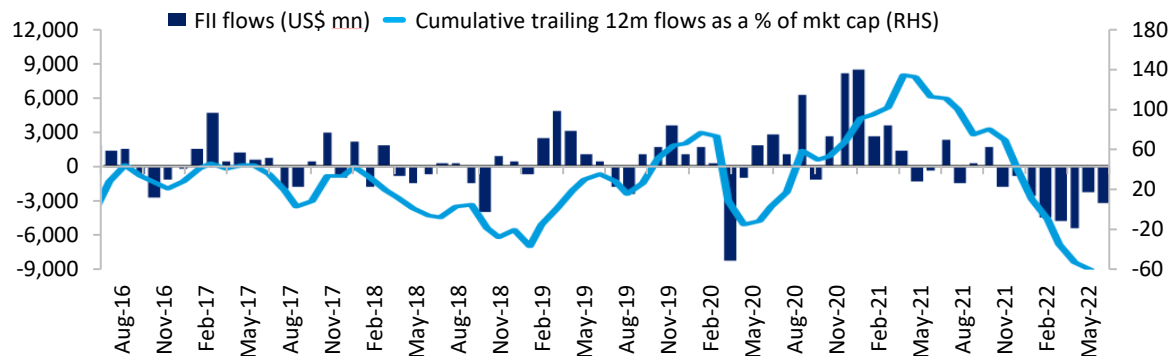
There **has** been a sharp outflow of equity funds from India by the FPIs this year. However, let us put things in perspective:

- The net outflow in calendar 2022 (until May 25<sup>th</sup> 2022) has been to the equivalent of US\$ 22 billion.
- It has been estimated that the cumulative value of FPI investments in India (at their peak in September 2021) was US\$ 667 billion (Source: Business Standard – 30<sup>th</sup> March 2022)
- The value of FPI investments in India is likely to have appreciated in 2021 by at least US\$ 100 billion, considering that the Nifty 50 Index grew by 24% in calendar 2021, and this was followed by a nearly 15% growth in calendar 2020.
- The proportion of net outflows to cumulative value of FPI investments was greater in 2008 compared to 2022.

**Domestic inflows into equity have acted as a counterbalance:**

**FII Inflows into Indian Equities Market**

Apr-22 marked 7<sup>th</sup> consecutive month of FII outflows (-US\$2.2bn, FII outflows flows slow-down in April. However, it is picking up in May-22, YTD CY22 flows stood at -US\$20bn)

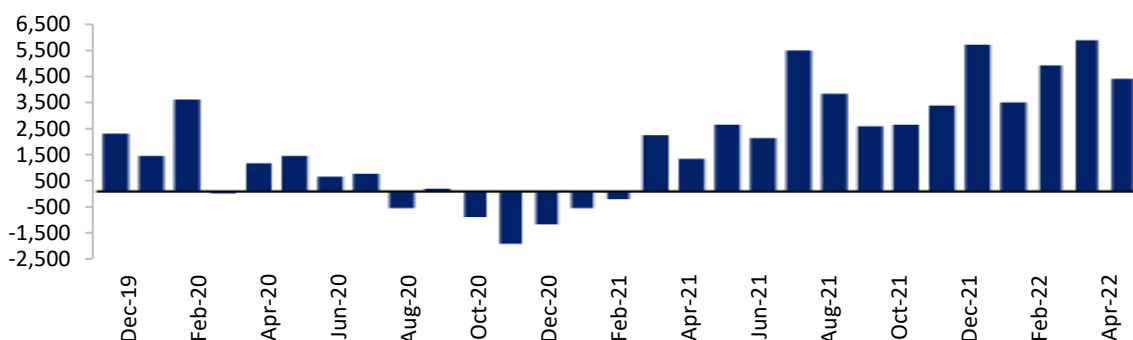


*Although there have been net outflows from FPIs.....*

Source: BofA Global Research, NSDL, Bloomberg

**DII flows into Indian equities market (US\$ mn)**

DII flows continue to remain robust with Apr-22 witnessing inflows at +US\$4.4bn (-25% MoM), YTD CY22 (Apr-22) inflows stood at a robust +US\$19.1bn



*.... they have been compensated, at least so far, by domestic inflows*

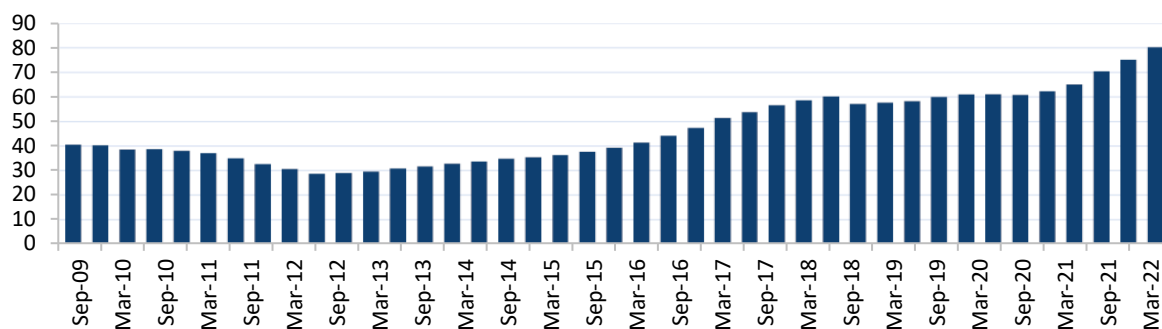
Source: BofA Global Research, AMFI, Bloomberg

Source: Bank of America Securities

According to a recent report from Bank of America Securities, cumulative YTD net inflows by FPIs in Indian equity markets (Jan – Apr 2022) were a negative \$ 20 billion, and cumulative net inflows in Indian equity markets by domestic institutions were a positive \$ 19.1 billion during the same period.

**There are reasons to believe that domestic equity inflows should be robust in the future:**

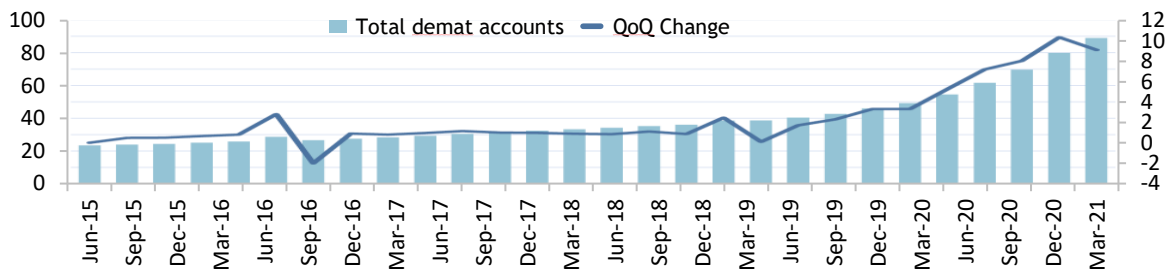
**No. of retail folios (MF accounts) investing in equity funds(m)**



*The number of equity mutual fund folios have doubled over the last 5 years*

Source: AMFI, Jefferies

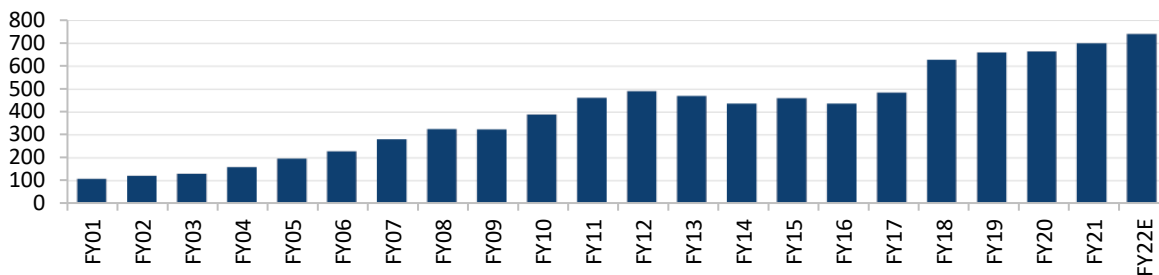
**Demat account trends (m)**



*The number of demat accounts have trebled over the last 5 years*

Source: NSDL, CDSL, Jefferies

**Indian household (HH) savings trend - \*FY22 Jef est. (US\$ bn)**



*The absolute amount of household savings in India has risen by \$275 billion over the last 5 years*

Source: RBI, Jefferies

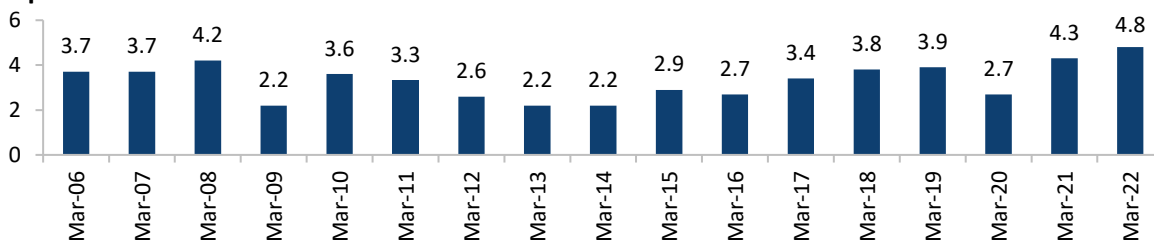
Source: Jefferies

It is interesting to note from the charts that

- a) The number of retail mutual fund folios in India that invest in equity has doubled from 40 million to 80 million in the last 5 years.
- b) The number of demat accounts in India has more than trebled from 27 million to 90 million in the last 5 years
- c) Household savings in India over the last 5 years has increased from \$475 billion to \$ 750 billion.

Also, it is relevant to look at these charts that explain asset ownership patterns in India:

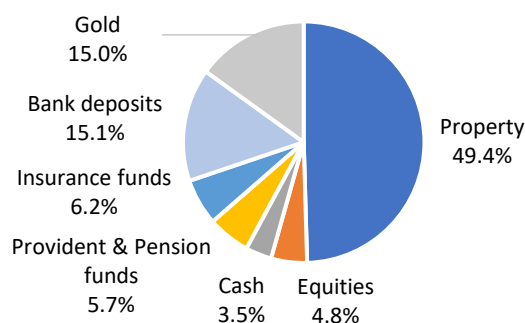
**Equities as a % of Indian household assets**



*While equity holdings as % household assets is at a high...*

Source: RBI, Jefferies

**Indian Household asset ownership - Total Indian Household assets Mar-22: US\$ 10.7 Trn**



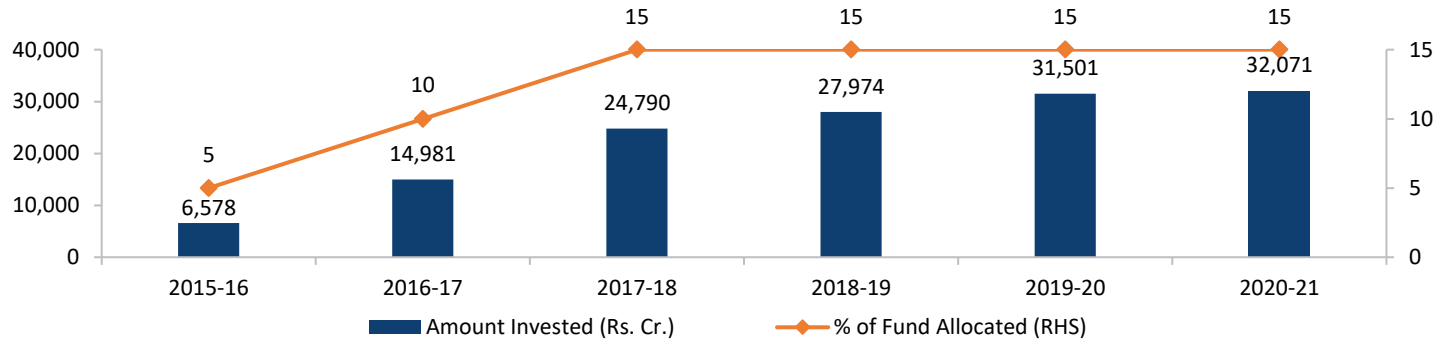
*...equities are still a small share of the overall household asset pie*

Source: RBI, AMFI, Jefferies

In India, equity holdings are only 4.8% of household assets. The campaigns of AMFI have created awareness about the benefits of equity investing and, despite the volatility that comes with equity, the expected returns are much higher than what one can sustainably expect from a bank fixed deposit.

In addition, the investment of organized labour’s provident fund money has received increased allocation towards equity in recent years. This is serious long-term money and will enhance the flow of domestic equity inflows.

**EPFO investment in ETFs**



Source: Financial Express 22<sup>nd</sup> November 2021

Given these factors, we can reasonably conclude that Indian domestic inflows into equity would continue to be robust. Of course, there would be dips and bear markets in between, but we are talking about the decadal trends.

**Is it likely that FPIs will permanently leave India?**

We think this is highly unlikely.

**Fund allocations to India by GEM funds increased to 14.4% in April from 13.9% in March**

Country allocations by GEM funds (%)



Source: EPFR, Kotak Institutional Equities, Kotak Securities.

Allocation of Global Emerging Market Funds (GEM) to India is at 14.4% in April 2022 compared to about 28% allocation to China. It is interesting to note that GEM allocation to India has increased from just over 10% in April 2021 to 14.4% in April 2022. It is also pertinent to point out that the redemptions of FPIs has not been just an India phenomenon, but an emerging markets phenomenon.

FPI ownership of India stocks is presently at less than 19.5%, which is less than what it was during the March 2020 pandemic-induced panic.

Let us not forget that FPIs invest in India because they see an investment opportunity, and for no other reason. India's economy is amongst the fastest growing in the world, with an estimated 13% nominal GDP growth over the next decade.

India also provides a diversified market to choose from, with industries ranging from IT to consumer products to automobiles to chemicals and pharmaceuticals to financial services. Such a diversity is not available in all emerging markets.

Also, India's stock market settlement systems are as efficient as any in the world.

Given these factors, it seems highly unlikely to us that FPI investors have developed a permanent aversion to India.

The pattern of FPI investments is also undergoing a change. This phenomenon of sector rotation is a notable feature in all markets, and we are seeing this in FPI investments in India too:

#### **FPIs offloaded stocks in financials and information technology sectors in April** **Sector-wise net FPI flows, April 2022 (US\$ mn)**

Sectors	FPI Inflows (US\$ mn)									
	1 Month	3 Months	6 Months	CY 2022	CY 2021	CY 2020	CY 2019	CY 2018	CY 2017	CY 2016
Consumer Discretionary	12	(1,625)	615	(2,120)	4,220	1,868	740	(2,591)	(127)	580
Consumer Staples	250	(508)	(1,878)	(818)	(32)	3,091	(679)	(1,347)	(1,298)	(811)
Energy	(121)	(440)	(1,221)	(601)	985	1,218	3,092	(1,531)	624	1,465
Financials	(1,688)	(6,835)	(10,926)	(7,859)	(2,058)	7,197	10,322	(587)	5,089	358
Health Care	686	808	40	364	(493)	1,281	(482)	426	(1,666)	(2,281)
Industrials	(413)	(2,281)	(2,613)	(2,515)	106	951	(982)	(742)	(1,489)	631
Information Technology	(1,123)	(2,754)	(5,416)	(4,876)	(3,233)	274	(2,346)	(353)	(3,041)	(876)
Materials	12	981	695	1,270	(273)	42	(427)	(354)	389	605
Real Estate	(108)	(267)	106	(397)	1,106	(85)	(73)	(201)	100	64
Telecommunication Services	57	155	181	206	1,797	(877)	(262)	3	1,220	(439)
Utilities	74	33	(113)	219	536	(461)	939	284	416	412
Others	117	399	435	357	1,045	8,609	4,539	2,639	7,607	3,498
<b>Total</b>	<b>(2,242)</b>	<b>(12,329)</b>	<b>(20,092)</b>	<b>(16,768)</b>	<b>3,704</b>	<b>23,108</b>	<b>14,381</b>	<b>(4,354)</b>	<b>7,824</b>	<b>3,206</b>

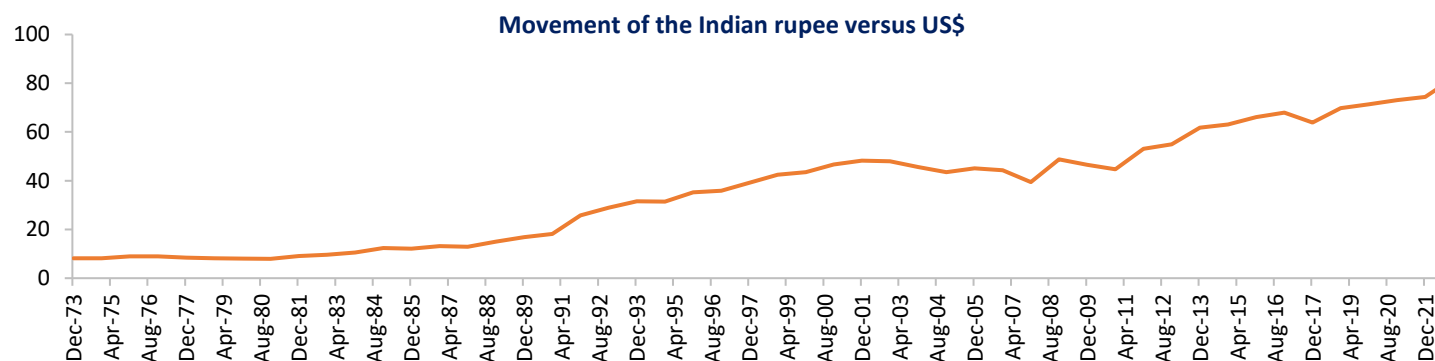
Notes: (a) BSE had classified around 4,800 number of issuers into 22 sectors. Any FPI investment outside those 4,800 issuers, is classified under "Others". We have reclassified those 22 sectors into GICS sectors.

Source: NSDL, Kotak Institutional Equities, Kotak Securities

It is clearly seen from the table above that the rotation is happening from previously popular sectors such as financials and information technology to sectors like healthcare, consumer discretionary and materials.

We have been talking about the inevitability of such sector rotations in our previous newsletters. Indeed, our entire investment style is to buy strong companies when they are not very popular so that they benefit from the inevitable sector rotation.

**How serious is the rupee depreciation risk?**



Source: Bloomberg

Apart from the time when India devalued the Indian rupee (early 1990s), the average depreciation of the rupee against the US dollar has been around 3.0 to 3.5% per annum.

Time period	Average annual depreciation	Comments
1973-1983	2.6%	
1983-1993	11.6%	Devaluation of the rupee
1993-2003	3.8%	
2003-2013	3.1%	
2013-2022 (*)	2.7%	For 8.5 years

We can expect a 3.0 to 3.5 % annual depreciation of the Indian rupee against the dollar. Of course, in some years (like 2022) it would be sharper, but we are talking here about decadal trends.

**What can upset this apple cart?**

A very sharp increase in interest rates in the US and other developed markets can upset this calculation. That would lead to a severe (albeit temporary) constriction of flows into emerging markets, including India. It is our opinion though, articulated in previous paragraphs, that for an FPI, the monetary benefits of investing in India outweighs the risks.

In conclusion, dear Investor, we suggest that we pay more attention to the other important factors in investing that are within our control:

- a) Which businesses we choose to buy.
- b) How much of such companies we buy, and
- c) And what price we buy.

These factors have, we submit, a far greater impact on our portfolio performance.

Happy investing.

With warm regards,

Yours sincerely,

**(E A Sundaram)**

Chief Investment Officer and Portfolio Manager

***“I care not what others think of what I do, but I care very much about what I think of what I do”  
- Theodore Roosevelt***

Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 31 <sup>st</sup> May 2022			Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 31 <sup>st</sup> May 2022	
Name	GICS Sector	Weight		
ITC	Consumer Staples	6.67%	Industrials	17.55%
HDFC Ltd	Financials	5.30%	Consumer Discretionary	6.81%
Bosch Ltd	Consumer Discretionary	4.48%	Health Care	5.78%
Indraprastha Gas Ltd	Utilities	4.41%	Consumer Staples	2.39%
HDFC Bank	Financials	4.39%	Utilities	0.60%
Cummins India	Industrials	4.37%	Real Estate	(0.81%)
Asian Paints Ltd	Materials	4.25%	Communication Services	(2.80%)
Sanofi India	Health Care	4.16%	Information Technology	(5.22%)
Blue Dart Express Ltd	Industrials	4.10%	Materials	(5.93%)
Colgate-Palmolive I Ltd	Consumer Staples	4.01%	Energy	(10.21%)
		<b>46.14%</b>	Financials	(11.16%)

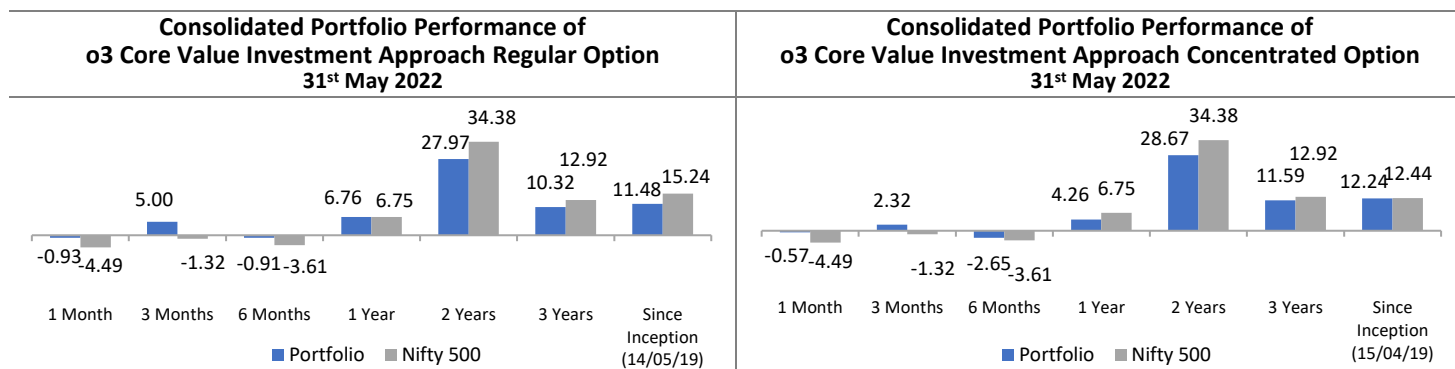
**Investment Objective:** The investment objective is to achieve capital appreciation through investment in a diversified portfolio of strong businesses, purchased at reasonable valuation.

Regular Model Portfolio Details as on 31 <sup>st</sup> May 2022		Regular Model Portfolio Composition as on 31 <sup>st</sup> May 2022	
Weighted Average ROCE	20.74%	Large Cap	41.50%
Portfolio PE (1 year forward PE, based on FY24)	24.04	Midcap	39.50%
Portfolio Dividend Yield	1.67%	Small Cap	16.00%
Average Age of companies	61 Years	Cash	3.00%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order)\*
- Midcap: Market cap below 100<sup>th</sup> company to the market cap of the 250<sup>th</sup> company in the Nifty 500 (sorted by market cap in descending order)\*
- Small Cap: Market cap lower than the 250<sup>th</sup> company in the Nifty 500 (sorted by market cap in descending order)\*

\*As on last working day of the month i.e. 31<sup>st</sup> May 2022

Regular Model Portfolio Composition as on 31 <sup>st</sup> May 2022			
Model Portfolio Overlap with Nifty 500	24.50%	Model Portfolio Overlap with Nifty 50	28.81%



- Benchmark is Nifty 500, the portfolio is spread across different market capitalization, hence Nifty 500 is chosen as benchmark
- Since inception date stated is considered to be the date on which the first client investment was made under the investment approach

**Disclaimer:** Performance depicted is based on all the client portfolios existing as on such date, using Time Weighted Rate of Return (TWRR) of each client and then computing arithmetic average for the overall strategy. Past performance is no guarantee of future returns. The above portfolio performance is after charging of expenses. The performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document.

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