

2007

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## [INDIA: CHALLENGING THE DRAGON]

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October 05, 2007]

## India: Challenging the Dragon

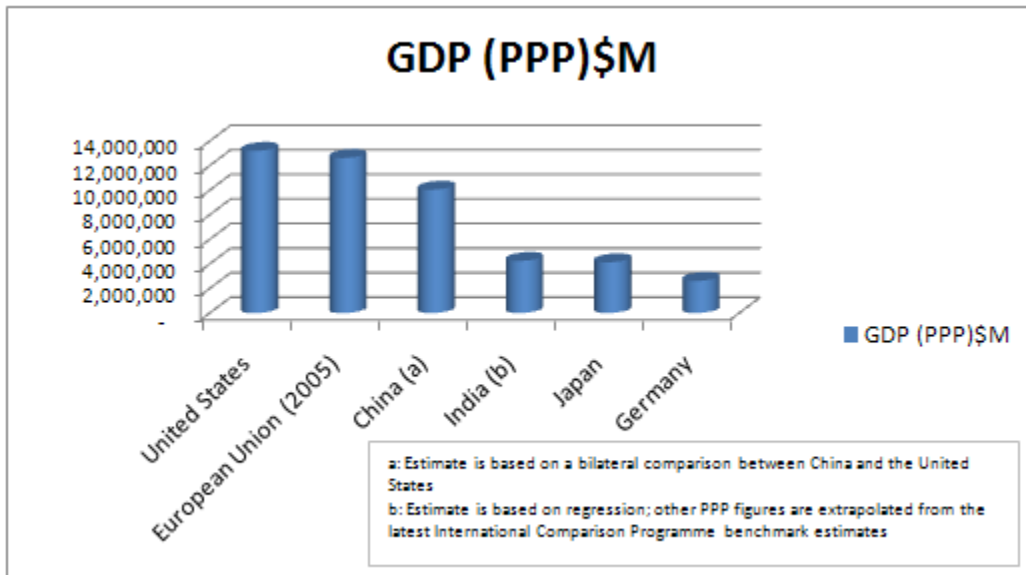
### Why India could be a bigger growth story than China

India is one of the most exciting markets in the world today. A consumer centric, capitalist, democratic society with an economy growing at 9.3%<sup>1</sup> India may well be the greatest economic growth story since the emergence of post war America and could potentially provide investors with a combination of excellent returns coupled with low correlations to the U.S. markets. Despite all this, India's growth potential is largely underappreciated despite the fact that in the long run India may be a bigger growth story than China.

#### 7 Reasons to Invest in India

##### 1. One of the fastest growing economies in the world

India is one of the largest and fastest growing economies in the world. India is the third largest economy in the world, about \$4.2 trillion as measured by Purchasing Power Parity (PPP)<sup>2</sup> and the twelfth largest in the world in dollar terms about \$900 billion<sup>3</sup>.



Source: World Bank, September 2007

Based on projections <sup>4</sup>:

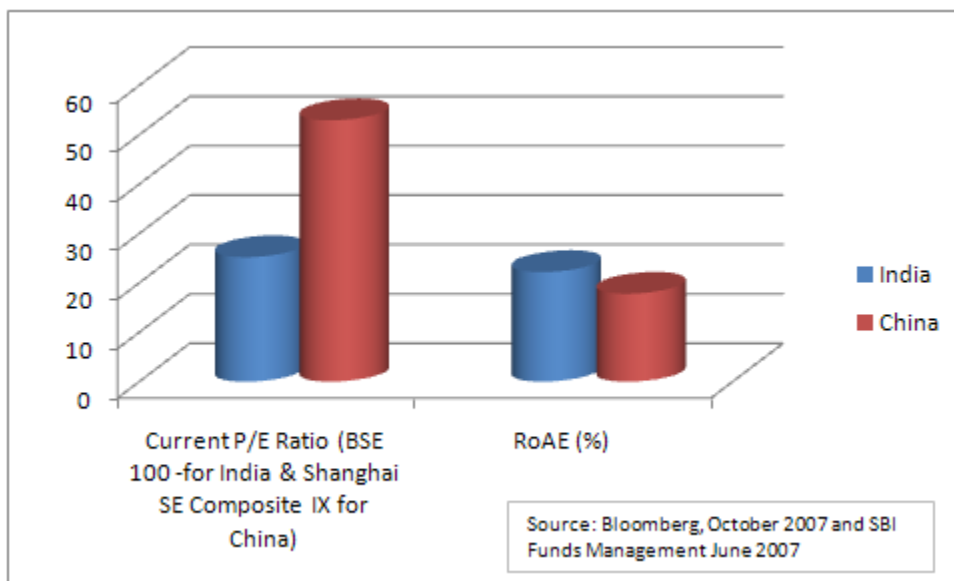
- India will become one of the world's three largest economies in the world in less than 30 years (along with the U.S. and China) and is projected to overtake the U.S. by 2045
- It is the only country among the BRICs (Brazil, Russia, India and China) to maintain a growth rate above 5% throughout the next 45 years
- Income per capita is projected to be 35 times current levels in 2050 India's growth had been projected to be in the 6% range through 2010.

However it grew at an average of over 8% in the last three years accelerating to over 9% in 2006 <sup>5</sup>, with the finance minister believing that a 10% growth rate is achievable <sup>6</sup>. If this impetus is sustained India may exceed current projections and will likely be the success story of the 21st century.

## 2. High return on Invested Capital

Growth is highly prized by investors but if you are an investor with an eye for value, Return on Equity or Return on Invested Capital is a better indicator of success. On this barometer India's performance has been very good. India's ROAE (Return on Average Equity) stands at 22.2% compared to 17.8% for China<sup>7</sup>.

The difference looks even more striking when the P/E ratios are compared India's stocks trade at just 20 times this year's earnings and 18 times next year's earnings while the A-shares in Mainland China are trading at 60 times earnings <sup>8</sup>.

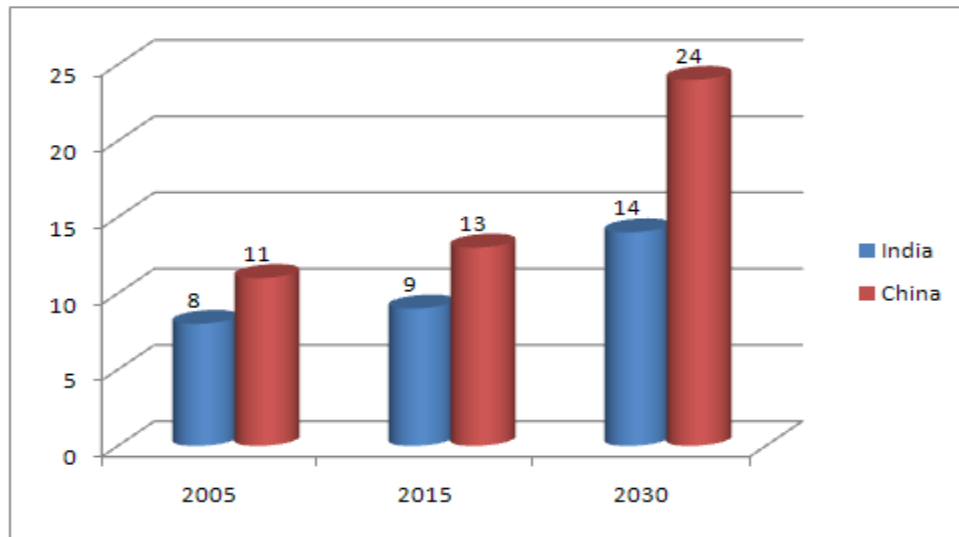


Unlike China, Indian markets are subject to market pressures and closely resemble their free market brethren in the U.S. forcing them to use capital more efficiently.

It is also interesting to note that China's growth is driven by large FDI (Foreign Direct Investments) inflows, in 2005 China received over \$70 billion in FDI compared to India's FDI inflow of less than \$7 billion in 2005. In other words, India has almost matched China's growth with 1/10 the foreign investment<sup>9</sup>.

### 3. India's Demographic Dividend

An aging population combined with low birth rates has caused the savings rate in the U.S. to drop dramatically into negative territory (-0.5%) in early 2007<sup>10</sup>. Western Europe, Russia and even China driven by its one child policy are aging rapidly causing the dependency ratio (the ratio of those outside the workforce to those in it) to increase. India however, is in a unique position where it will see its dependency ratio remain low over the next decade causing its savings rate and GDP growth to increase dramatically.



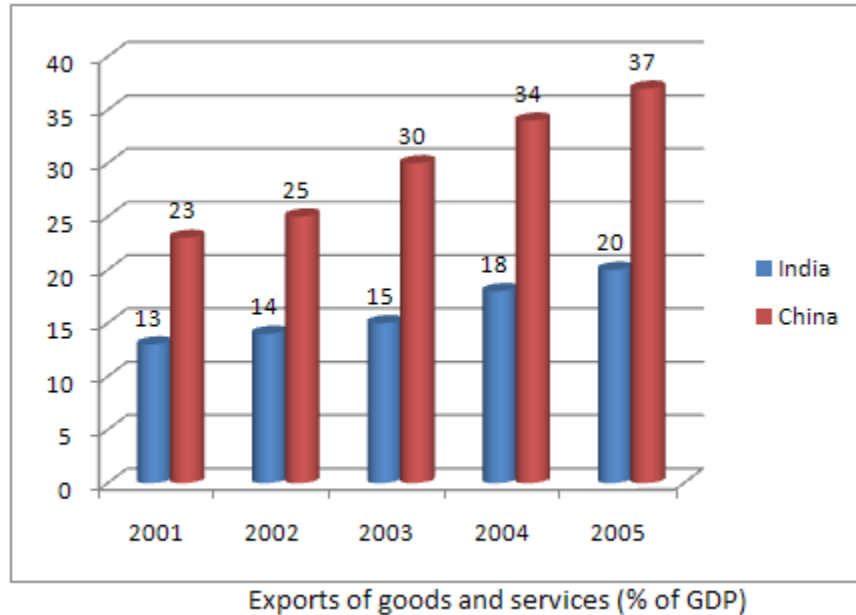
Dependency Ratio India versus China

Source: Societe Generale Asset Management Market Notes - April 2007

India's domestic savings rate has jumped from 20% range in the 1990's to 32%<sup>11</sup>. As India's savings rate continues to increase it will be able to invest more in infrastructure and other core sectors potentially enabling its economy to grow faster.

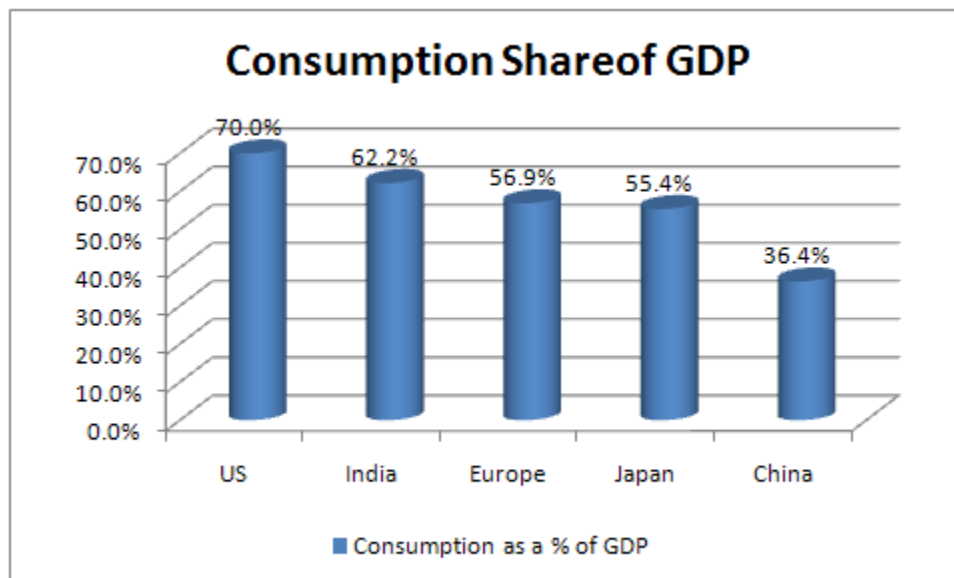
#### 4. Low impact of U.S. Economic Cycles

Unlike China, exports account for a relatively small percentage of GDP making India less susceptible to U.S. and world business cycles.



Source: World Bank Oct 2007

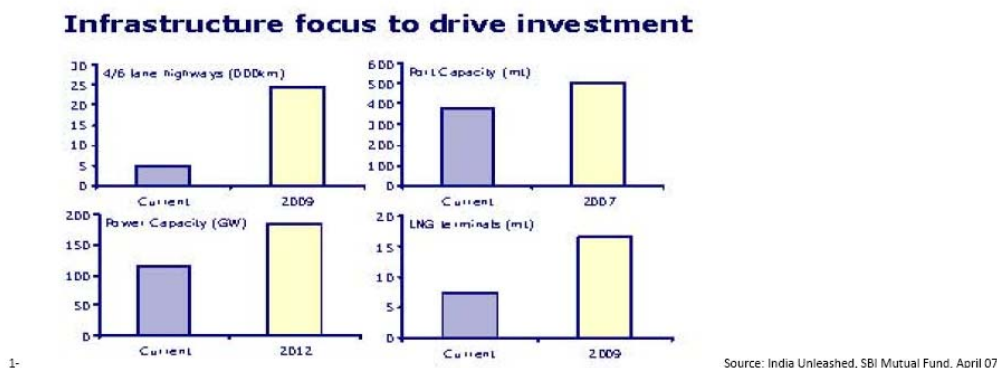
Further, consumption accounts for over 62% of GDP second only to the U.S. making its growth more stable in the long run and less dependent on other economies.



Source: Morgan Stanley Research, June 2007

## 5. Infrastructure multiplier

India currently lags China and other developing countries in the quality of infrastructure. It has achieved exceedingly high growth rates despite rather than due to infrastructural availability. Lack of world quality infrastructure hurts growth by hindering efficient transport of goods and services. This is, however, now set to change. India has implemented some ambitious infrastructure projects on the scale similar to the highway initiatives that changed the U.S. landscape in the 1950's. Indian initiatives include<sup>12</sup>:



**Roads-** the Golden Quadrilateral, 5,846 kilometers of road connecting the four largest cities in India and North-South, East-West Corridor connecting the four geographic edges of the country

**Maritime-** Creation of additional port capacity with USD 25Billion “National Maritime Development Project” to improve India’s port handling capacity.

**Airports-** Multiple new international airports being built including ones in Bangalore and Hyderabad and private investments are allowed in Mumbai and Delhi airports.

With India planning to rapidly increase investments in its infrastructure, growth rates may receive a significant boost that could possibly make India one of the world’s fastest growing economy.

## 6. Investments and Credit multiplier

Only 3.7% of India’s bankable population own credit cards compared to 40-80% penetration in the developed markets<sup>12</sup>. The Mortgage to GDP ratio in India stands at 2.5% compared to 7% in China, 54% in the U.S. and 40% in the European Union<sup>12</sup>. As access to credit in India increases dramatically over the next decade demand for assets be it consumer goods or property will increase correspondingly creating a multiplier effect on India’s growth.

Further, mutual fund assets under management in India is only 9% of GDP compared to the standard 20-70% of GDP seen internationally<sup>12</sup> and the size of India’s retirement market as a ratio of GDP is only a 10th as big as in Singapore, Japan and Malaysia, and a quarter as large as in Hong Kong<sup>13</sup>. As this changes over the next decade and a large percentage of the Indian population invests in the equity markets the market capitalization of India’s equity markets could increase to over \$5 trillion dollars from

the current \$1 trillion making investing in India's equity markets a potentially a very enticing opportunity<sup>13</sup>.

## 7. Better Corporate Governance and cultural proximity

India's economy is built on its entrepreneurs like the U.S. With very little state support for new businesses, the average Indian business is more capital efficient and actually has better corporate governance standards than comparable BRIC countries. India has better control of corruption, Rule of law, regulatory effectiveness, and voice and accountability than China according to a recent Deutsche Bank report.

In addition India has a host of other soft advantages which include-

- A large pool of technologically trained workforce
- An independent judiciary combined with a secular democratic constitution
- A large population of English speakers. India is the largest English speaking country in the world with more English speakers than U.S. and U.K. combined.

In addition to this, most Americans would probably be surprised to learn that India is the most pro-American country in the world. The Pew Global Survey released in June 2005, asked people in 16 countries whether they had a favorable impression of the U.S. A stunning 71% of Indians said yes. Only American's themselves had a more favorable view of America (83%). India is a lot like the U.S in the mid 1900's, a country waking up to momentous changes, which will create one of the largest economies in the world. As an investment destination the Indian Elephant is most definitely catching up with the Chinese Dragon, it is one market that no investor can afford to ignore.

### Footnotes:

1-Bloomberg, October 2007

2- World Development Indicators database, World Bank, 14 September 2007, [http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP\\_PPP.pdf](http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf)

3-World Development Indicators database, World Bank, 1 July 2007, <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>

4- India: Realizing BRICs Potential, Roopa Purushotaman, Global Economics Paper No:109 Goldman Sachs

5- Bloomberg, October 2007

6- Chidambaram confident of 10% GDP growth, June 2007, <http://www.thehindubusinessline.com/2007/06/17/stories/2007061702840300.htm>

7-SBI Funds Management Research, June 2007

8- Barron's Foreign Investment - Asian Trader: Mumbai Sensitive Index Soars on IPO Fever, October 2007

9-Le Monde Jan 2007, India's boundless ambitions <http://mondediplo.com/2007/01/02india>

10- U.S. Bureau of Economic Analysis, <http://www.bea.gov/briefrm/saving.htm>, Thursday, March 29, 2007

11- Phenomenal rise of India's savings, By Kaushik Basu, Professor of economics, Cornell University, BBC News 17 April 2007

12- India Unleashed", SBI Mutual Fund, April 2007

13-\$5 Trillion Equity Market Is in India's Reach: Andy Mukherjee, Bloomberg April 17, 2007

*An investment in the Fund entails the special risks of international investing, including currency exchange fluctuation, government regulations, and the potential for political and economic instability. Emerging markets are typically subject to additional risks not associated with more developed countries. The Fund's share price is expected to be more volatile than that of a US only fund.*

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**The securities markets in the India region are substantially smaller, less liquid and more volatile than the major securities markets in the United States. The value of Fund shares will be affected by political, economic, fiscal, regulatory or other developments in the Indian subcontinent and particularly India, as well as fluctuations in currency exchange rates. The value of Fund shares also is sensitive to stock market volatility.**

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