EQUITY MONTHLY

India's Path to Growth

Perspectives from the Janus equity investment team

At Janus, our goal is to deliver alpha by taking an in-depth approach to fundamental research. We extend this commitment to our clients and partners by providing access to the insights and opinions of our equity research analysts. In this edition of *Janus Equity Monthly*, we offer perspective on gold prices, industrial stocks and long-term opportunities in the Indian market.

MONTH IN REVIEW: EUROPEAN INDUSTRIALS; U.S. HOUSING

Investors seeking a safe haven have piled into gold. But the precious metal may still have room to run. Europe's debt crisis and slow growth in the U.S. will require loose monetary policy for the foreseeable future, in our view, providing support for gold as an enduring store of value. We think prices could hit $2,000 an ounce, based on historical asset allocation and theoretical monetary backing metrics. Most of the gold miners are not attractive to us, however, as they historically tended to make acquisitions that destroy value. We prefer closed-end trusts that provide exposure to potential price increases and generate income.

Industrials are struggling in this market. Several companies have beaten forecasts yet their stocks have not moved higher. Macro sentiment is clearly negative. And investors worry that order growth is slowing while costs rise, pressuring margins. This makes it more important to focus on competitive advantages and incremental margins, in our view. For example, rail companies look attractive to us due to their volume growth, pricing power and operating leverage from growth across a fixed cost base.

Housing remains a tale of two markets. While we are seeing strong dynamics and pricing in the rental market, a lack of confidence and inability to qualify for loans are holding back purchasers in the ownership market. We think these trends will persist for some time, despite the increasingly attractive economics of ownership. Apartment REITs (Real Estate Investment Trusts) look expensive to us, as they already seem to be discounting future rental growth. We believe builders could outperform as they return to better levels of profitability.

INSIDE

Introduced in Europe by Janus Capital International Limited and in Asia by Janus Capital Asia Limited

A JANUS CAPITAL Group Company

India's Path to Growth

India's market is never short on drama. Not a week goes by without news of a cabinet reshuffle, regulatory reform or scandal involving the political or business elite. Bombay recently suffered another terrorist attack. And the Indian stock market has fallen sharply in the current "risk off" climate. Yet the sell-off has created attractive entry points for some India-based companies. Long-term, we think Indian companies can benefit from powerful structural growth drivers in the country, including strong demographics, a resilient consumer market and under-penetration of products and services.

Inflationary pressures and higher oil prices have clearly challenged India's economy. Food and fuel are large components of consumer inflation and the country is battling higher prices. Inflation hit 9.4% in June, up from 9.1% in May, and the central bank recently raised its key interest rate from 7.5% to 8%—the 11th hike in under 18 months. Yet while inflation may not be tamed, the government appears to be making headway. We're optimistic that non-core inflation, primarily in agriculture and energy, has peaked. Stimulus programs have wound down and we think the economy can grow 7-8% through March 2012. That still makes India one of the world's fastest growing regions. While there may be further tightening, we would expect inflation to moderate over the coming months, barring another move higher in oil prices.

> India's new Universal ID program could bring millions of Indians into the financial system.

Foreign direct investment (FDI), meanwhile, appears to be accelerating. FDI came in at $8.7 billion during the April-May period, up 77% year-over-year (off depressed levels). Infrastructure projects are driving investment and we expect government reforms and a speedier approval process to accelerate development. With domestic interest rates high, companies are accessing external financing, which the government is facilitating by easing restrictions on foreign debt deals.

Infrastructure remains a pressing need. Despite remarkable progress over the last 20 years, the electricity supply chain is still a bottleneck to growth. Roads, ports, bridges and rail will require hundreds of billions in investment if India is to realize its potential. While reforms may not be rapid, we think they will continue as the government recognises that improving infrastructure is critical to long-term growth.

Another powerful growth driver is India's new Universal ID program, which aims to give 600 million Indians biometric IDs over a period of five years. The card is important because most of India's poorest citizens (including 440 million below the poverty line) lack an ID card, bank account or even an address. The program is likely to result in much broader financial inclusion by the population as many social services will require an ID and bank account to receive payment. This may also eliminate some of the black market trade in subsidised goods (such as the practice of turning kerosene into adulterated fuel).

In terms of investment, we see several energy-related themes. Domestic supply constraints will likely result in higher energy imports. We think there will be a big opportunity for global exports of coal and liquefied natural gas (LNG). Several companies are looking to build infrastructure to off-load LNG and companies are developing facilities for higher coal imports.

In the long term, financial companies also offer attractive opportunities, in our opinion. Near-term, banks will likely struggle due to higher provisioning requirements, lower net interest margins and slowing economic growth. Yet per capita consumption of financial services is low and firms that offer life insurance, commercial finance and other services are likely to see demand growth as the new ID cards bring millions of Indians into the system. These firms provide potential long-term exposure to the growth of the consumer sector and indirect exposure to India's rapid rural development, which is difficult to invest in directly.

> Despite near-term challenges, India has many companies that we think are well-run and focused on returning capital to shareholders.

India faces acute near-term challenges. There's upside risk to oil prices and inflation, and geopolitical risk as India's relations with Pakistan remain tense. Corruption and tax evasion are serious concerns, and we would like to see stronger corporate governance. Nonetheless, we continue to take a constructive long-term view on the country. India has many companies that we think are well-run and focused on returning capital to shareholders. Compared to China, there is less competition from state-sponsored companies and per capita consumption of goods and services is low on a relative and absolute basis. We think these underlying dynamics offer exciting investment opportunities and runways to growth for select India-based