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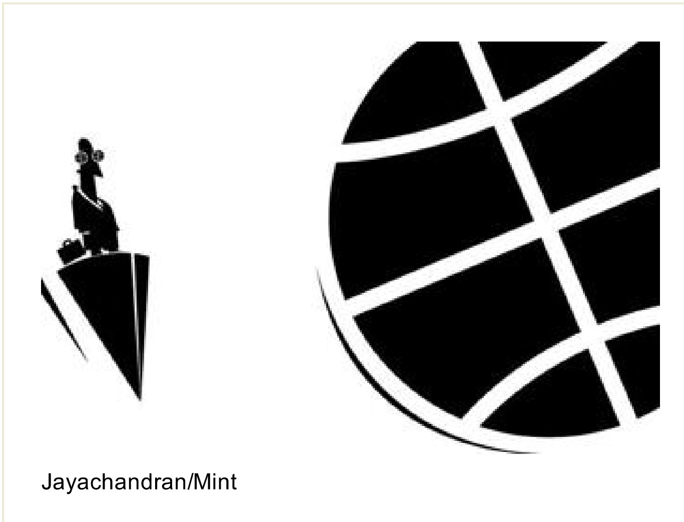
Why Indian investors should look at global markets

With inflation being much higher here than what it is globally, exposure from Indian stocks is divergent compared to global markets

Vikas Gupta



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Most investors have a huge home bias. What this means is that most investors prefer to invest in their home markets. Sample this: investors in the US invest about 73% in their home market when the US stock market accounts for 50% of global equities. Those in the UK invest around 50% at home, when the UK stock market makes up only 10% of global stocks. Indians invest nearly 98-100% of their equity portfolios in the Indian stock market, which is only 2-3% of the global stock markets. In that sense, the home bias is more severe in the case of Indian investors.

This is even more alarming when we consider that at least 40% of the expenses of an Indian high net worth individual (HNI) are dollar-dependent. Given that the Indian rupee faces a 4-6% annual depreciation in the long run vis-à-vis the dollar, this is a precarious situation for Indian investors' purchasing power.

We should remind ourselves that the purpose of investing is to maintain and grow post-tax, post-inflation purchasing power of the invested capital at an adequate rate. An exposure to only Indian equities is highly risky. This is because while our expenses are linked to global currencies like the dollar and corresponding exchange rates, our investment corpus is linked only to domestic equities and currency. And since the Indian economy constitutes only a small portion (3-4%) of the global economy, an exposure to only Indian companies is risky.

Furthermore, with inflation being much higher here than what it is globally, exposure from Indian stocks is divergent compared to global markets.

Therefore, an ideal investment portfolio would have exposure to global markets in proportion to the exposure of future liabilities in those currencies and on those markets. Given that 40% of liabilities are in dollar or other global hard currencies (such as British pound and euro), the investment corpus should also have 40% exposure to global stock markets. However, there are numerous controls on foreign investments, and for most HNIs, it will be difficult to get the required exposure to global markets through direct equities.

However, for most HNIs, at least a 10% exposure to global stock markets is possible at the initial stage. This can gradually be raised.

Since the US market makes up 40-50% of global stocks, Indian investors should look at gaining exposure to it as an initial step. The advantage of the US stock market is that the companies listed on it have nearly 50% revenue exposure to global economies, including developing and emerging economies. This provides a convenient exposure to the world economy through US-listed equities.

How to invest

You can invest via international brokers that offer this facility. The money has to be transferred via your bank through the Liberalised Remittance Scheme of the Reserve Bank of India.

The easiest way of gaining exposure is to buy direct equities with advise from a portfolio manager or investment adviser who has an understanding of global stock markets. It is not advisable to buy just one or two stocks. A typical Indian investor is most likely to buy an Apple Inc., or Google Inc., or Coca-Cola Enterprises Inc., as their first global stock. That is a very risky step. You should buy a basket of not less than 20 stocks in approximately equal proportion. These should ideally be from several different industries and sectors, should be of high quality and available below their intrinsic value.

Remember that the global stock portfolio is still an equity portfolio. Same rules of prudence while investing in Indian stocks apply while picking global scrips. Avoid highly leveraged companies, small- and micro-cap companies, loss-making companies and overvalued companies. At least, stay away from them in the beginning.

What about returns from the global portfolio? A US portfolio should provide an approximate return of 8-11% in the long run in dollar terms. With a 4-6% rupee depreciation, that is a 12-17% rupee return. This compares well with the domestic stock market, albeit few percentage points short.

The next step, after gaining exposure in the US exposure, would be to look at European stock markets. This probably has to be done via buying companies listed across European markets. A further addition of Japanese companies will nearly complete the exposure to developed markets. Emerging markets could follow once the portfolio is fully exposed to developed markets. The required emerging market exposure would be small since the primary exposure to one of the major markets, i.e., India, is already there.

This portfolio would be much more diversified and would reduce your exposure to the Indian economy. It provides exposure to the global economy, hard currencies, developed market central banks, and capital markets. Certain sectors are under-represented in the Indian stock markets and this helps gain exposure to those as well.

Dividends and capital gains from global markets will be taxed in India and you should consult your tax adviser on this matter. Though withholding taxes can be accounted for while filing returns.

It might take some time to get comfortable with the idea of a global equities exposure. So start with getting familiar with the markets and reading about them. After this, you can go on to see which markets, sectors, and companies look overvalued and which are undervalued. Once you have gained familiarity, and are tracking these markets regularly, you can then take the step of finding out about brokers and advisers who can help set up global broking accounts, and provide proven strategies for investing globally.

And remember: start with a small corpus and exposure, and then grow it as you gain more confidence.

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