India: Is there hope beyond the hype?

As India-focused hedge funds face losses or muted returns last year after their 2014 high, HFMWeek takes a closer look at the market

While 2014 was a stellar year for India-focused hedge funds – portfolios gained an average of 46.1% according to HFR – in 2015 the highs and the hype ground to an abrupt halt.

Indian equities ended 2015 in the red for the first time in four years and hedge funds finished their 12-month winning streak in March, losing -0.5% that month, Eurekahedge research indicated.

Hedge funds remained positive at year-end, with the HFRX India index returning 3.2% – ahead of the broader global index which saw the average fund post a -3.6% loss. But such returns fall well-below expectations, managers tell *HFMWeek*.

"You don't come to India to make 15% per year – if you want that sort of return then there are a hundred other markets you should look at," says Anuj Didwania, founder of Mumbai-based Redart Capital Advisors.

He asserts that India is a market where you can make between 20% and 40% on the upside, although he adds that this is caveated by heavy drawdowns like those characterising the current market.

The BSE Sensex, which saw its first decline since 2011 last year when it dropped just over -5%, has endured a choppy start to 2016, with the large-cap index down nearly -5% year-to-date.

Vikas Gupta, head of traded markets at Arthveda Fund Management, describes 2014 as "crazy". "You went from ultra-pessimism to ultra-optimism because of the new government and markets were on the overvalued side," he says, referring to the landslide election of President Narendra Modi in May that year, when the HFRX India index gained just under 9% – its biggest monthly gain since October 2013.

Market participants stress anyone looking at India needs a long-term view and that positive changes in the economy may not happen this year. A number of initiatives mooted by Modi's Bharatiya Janata party have yet to pass through the country's legislature.

"Investors are adopting a wait-and-watch policy before committing substantial long-term capital," says Sandiip Bhammer, ex-Balyasny pro and managing director at investment adviser group Tarragon Capital Advisors.

Global market impact

Managers say global events also impact India. "We're part of a global economy; we hurt if China hurts, there's no two ways about it," says Didwania. And although India has been a net beneficiary of declining commodity prices, especially oil, many hedge funds remain cautious on this, Bhammer adds.

"The country has gone from a position of having a balance of payments deficit to having a surplus for the first time in years, but hedge funds are actually taking that with a grain of salt because while the decline is great it's a double-edged sword," he says.

Slowing exports and a capital flight linked to an upswing in prices could damage any gains the economy makes, one UK-based manager with India exposure writes in their investor update.

The short of it

Making money on the short side is difficult, managers tell *HFMWeek*. "Volatility can kill you very quickly," explains Didwania, adding that stop losses and capital buffers need to be much tighter than in other markets.

For the strategy they plan to roll out in a Mauritian vehicle over the next quarter, Arthveda's Gupta says they will use long-dated puts to hedge market risk where they can be bought cheaply, but adds they will have a long-bias.

Consumer opportunities

Automotive, jewellery and batteries were the sectors dominating hedge fund interest in 2014, with cars and bikes attracting much attention, says Emmanuel Tahar, co-founder and CEO of Third Bridge, an independent investment research company.

Jaguar Land Rover and its Indian-listed parent company Tata Motors was a common name, he says, but early signs of dwindling demand in China eventually filtered through to hurt sales prospects, with the share price subsequently tumbling over 50% between February and September of 2015.

"We also saw growing interest in two-wheelers in India, with Bajaj, TVS, Hero, and Honda registering on the radar for many," Tahar adds.

The consumer growth story will continue, experts tell HFMWeek, with the auto sector, as well as retail banks, internet and insurance companies potential beneficiaries of initiatives aimed at the working segments of the country's near-1.3billion population.

Future outlook

Bhammer notes that the crucial next milestone for continuing positive sentiment is the upcoming parliamentary budget session in February.

If there is optimism following the budget that positive policy initiatives will fructify under Modi, a number of hedge funds may return to trade "opportunistically", he says, adding that eventually investors will start coming back for longer periods.

India-focused hedge funds

No of Active Funds: 100

Total AuM: $2.8bn

HQ:

Asia-Pacific: 68%

Europe: 8%

North America: 15%

Rest of World: 9%

Top 4 performers 2015:

Malabar Capital Trust – Class A Units: 10.0%

Malabar India Fund: 6.0%

ArthVeda AlphaPlus Extreme 25: 5.5%

Redart Focus Fund: 2.8%

Source: Preqin