

# JPMorgan Indian Investment Trust

## Indian specialist backs cyclical recovery

**JPMorgan Indian Investment Trust (JII) has performed strongly over the past six months, as a landslide election victory for pro-reform Narendra Modi of the BJP sparked a major reappraisal of the stock market. The trust seeks capital growth from a portfolio of companies chosen for their quality, value and growth characteristics. The managers take a long-term view and made an early move into cyclical stocks, which hurt performance during the ‘taper tantrum’ in mid-2013, but has helped drive returns since the turn of the year. A move down the capitalisation spectrum has seen turnover tick up, but it remains within a long-term range below 40%. The discount – although above 10% – is around average levels, perhaps reflecting greater caution towards single-country funds.**

12 months ending	Share price (%)	NAV (%)	MSCI India (%)	MSCI Emerging Markets (%)	MSCI World (%)
30/09/11	(23.0)	(20.9)	(24.2)	(14.9)	(2.7)
30/09/12	4.4	5.1	3.7	13.2	18.0
30/09/13	(17.6)	(13.7)	(12.7)	1.0	20.6
30/09/14	44.4	38.9	37.5	4.5	12.7

Source: Thomson Datastream. Note: Total return basis.

### Investment strategy: Quality, discipline and valuation

JII's managers, Rukhshad Shroff and Rajendra Nair, seek to construct a fairly concentrated (c 40-50 stock) portfolio of Indian companies chosen for their potential to achieve profitable, sustainable growth. Investment opportunities are assessed for quality characteristics, capital discipline and valuation on a range of measures. While bottom-up factors are most important, the managers build the portfolio with an eye towards diversification by sector and theme. With the economy in India beginning to recover and the new government focused on balancing the books and freeing up businesses and infrastructure projects from red tape, the managers have tilted the portfolio towards cyclical stocks in areas like private-sector financials and consumer discretionary businesses such as automotive suppliers.

### Indian market outlook: Time for a reappraisal?

Following the BJP's landslide election win in May, Indian stocks surged ahead (in some cases it seemed indiscriminately), reversing a valuation discount versus the world and potentially calling into question the sustainability of the rally. However, with the beginning of a shift from foreign investment (vulnerable to changes in sentiment as the UK and US begin to move to higher interest rates) towards more domestic investor participation (domestic mutual fund flows have turned positive in 2014 after five years of net outflows), there may be continued support for the market, although a near-term correction is not out of the question.

### Valuation: Discount remains above 10%

In spite of strong recent absolute performance, JII was trading at a 14.7% discount to cum-income NAV at 15 October, above its one, three- and five-year average levels and wider than the 10.3% one-year low point reached in June after the election result. This is broadly in line with the peer group averages for both India specialists and single-country Asia ex Japan investment trusts as a whole.

## Investment trusts

20 October 2014

**Price** 438p  
**Market cap** £463.0m  
**AUM** £541.9m

NAV\* 512.7p  
Discount to NAV 14.6%  
NAV\*\* 513.4p  
Discount to NAV 14.7%  
Yield Nil

\*Excluding income. \*\*Including income. Data to 15 October 2014.

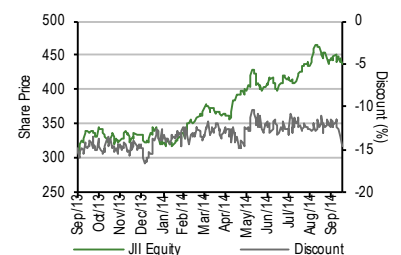
Ordinary shares in issue 105.7m

Code JII

Primary exchange LSE

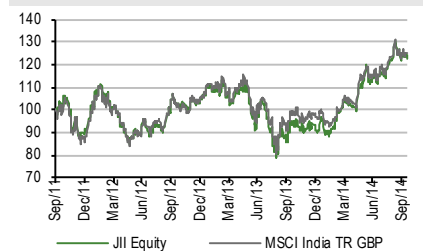
AIC sector Country specialists: Asia-Pacific

### Share price/discount performance\*



\*Including income. Positive values indicate a premium; negative values indicate a discount.

### Three-year cumulative perf. graph



52-week high/low 466.0p 317.0p

NAV\* high/low 534.1p 367.2p

\*Including income.

### Gearing

Gross 4.7%  
Net 4.7%

### Analysts

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[Edison profile page](#)

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

JPMorgan Indian Investment Trust (JII) seeks long-term capital appreciation through investments in India or in companies that earn a material part of their revenues in India. The company will not invest in other countries of the Indian sub-continent or Sri Lanka. The trust aims to outperform its benchmark, the MSCI India Index expressed in sterling. The company does not pay dividends, reflecting its focus on capital appreciation and the low average yield available in the Indian equity market.

#### Recent developments

28 July 2014: Interim management statement for three months ended 30 June. NAV TR +7.7% vs 9.9% for MSCI India Index. Share price TR +9.7%. (All figures in sterling terms.)

30 June 2014: JPMorgan Funds Ltd appointed as Alternative Investment Fund Manager (AIFM), with investment management delegated to JPMAM.

#### Forthcoming

AGM	30 January 2015
Preliminary results	December 2014
Year end	30 September
Dividend paid	N/A
Launch date	1994
Continuation vote	Five-yearly, next 2019

#### Capital structure

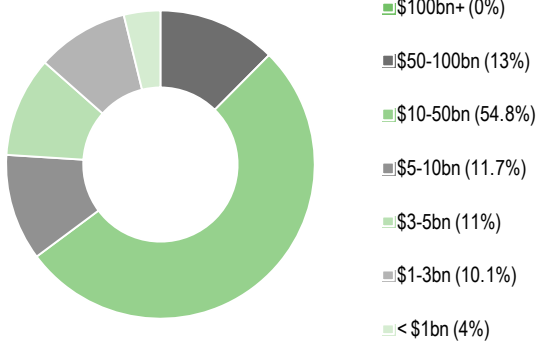
Ongoing charges	1.5%
Net gearing	4.7%
Annual mgmt fee	1.0% of gross assets
Performance fee	None
Trust life	Indefinite
Loan facilities	\$40m one year

#### Fund details

Group	JPMorgan Asset Management
Managers	Rukhshad Shroff, Rajendra Nair
Address	60 Victoria Embankment, London, EC4Y 0JP, UK
Phone	+44 (0)20 7742 6000
Website	<a href="http://www.jpmindian.co.uk">www.jpmindian.co.uk</a>

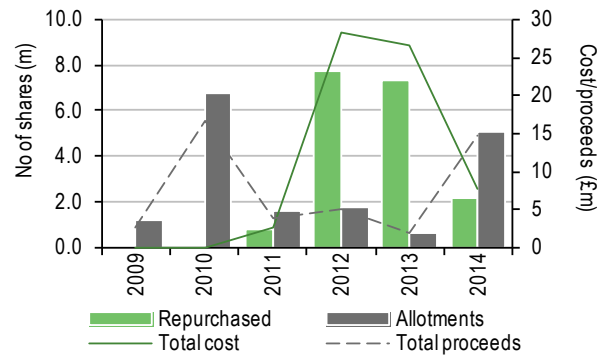
#### Distribution of holdings by market capital (31 August 2014)

Over 65% of portfolio assets were accounted for by companies with market caps over of £10bn.

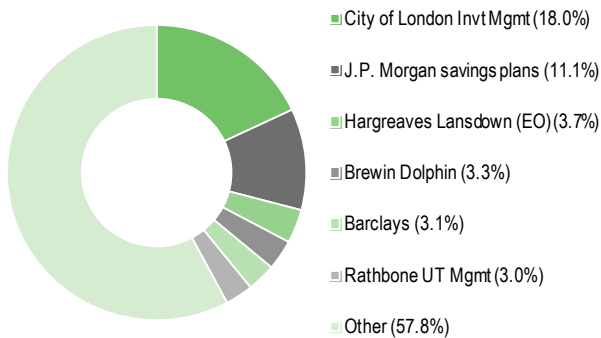


#### Share buyback policy and history

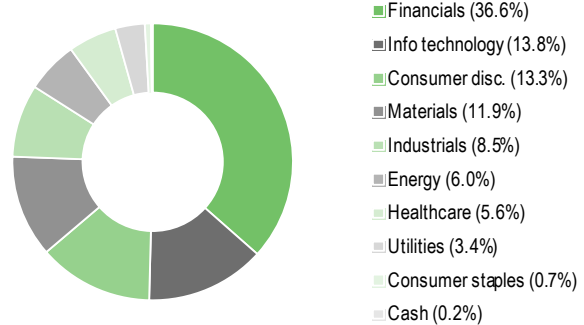
JII is authorised both to repurchase up to 14.99% of its ordinary shares and to issue shares from treasury. Allotments below are exercise of subscription shares.



#### Shareholder base (as at 1 June 2014)



#### Sector exposures of portfolio (as at 31 August 2014)



#### Top 10 holdings (as at 30 September 2014)

Company	Sector	Portfolio weight %	
		30 September 2014	31 March 2014*
Infosys Technologies	Information technology	7.0	9.1
Tata Consultancy Services	Information technology	6.9	6.8
HDFC Bank	Financials	6.8	9.8
Housing Development Finance	Financials	6.6	6.6
Reliance Industries	Energy	5.3	7.1
Sun Pharmaceutical Industries	Healthcare	4.4	3.6
Tata Motors	Consumer discretionary	4.3	4.3
Kotak Mahindra Bank	Financials	3.3	3.0
Mahindra & Mahindra	Consumer discretionary	3.2	N/A
IndusInd Bank	Financials	3.1	N/A
<b>Top 10 (% of portfolio)</b>		<b>50.9</b>	<b>59.6</b>

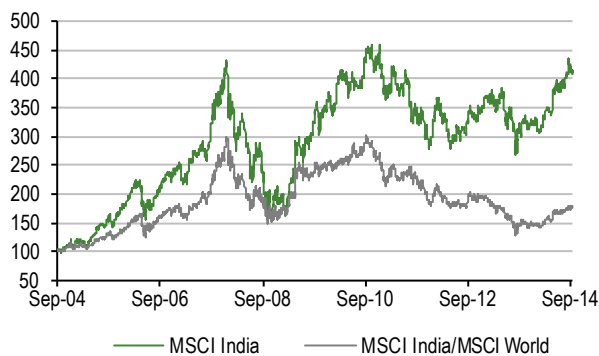
Source: JPMorgan Indian Investment Trust, Bloomberg, Edison Investment Research. Note: \*Where no figure is shown for March 2014 portfolio weight, the stock was not in the top 10.

## Indian market outlook: Scope to rise further after rally?

India has provided a bumpy ride for investors in recent years. Exhibit 2 shows notable outperformance for the MSCI India Index versus the MSCI World Index during both 2007 and 2009, but also periods of underperformance, particularly in the 2008 financial crisis and the 'taper tantrum' of mid-2013. Such volatility can be typical of single-country emerging markets funds, but for investors who can take a long-term view, these funds may provide a useful way of accessing individual country fundamentals. India, for instance, has a population only slightly behind that of China, yet its demographic factors favour more sustainable future growth: its median age is 27, compared with China's 36.7, and its population is growing at three times the rate of China's.

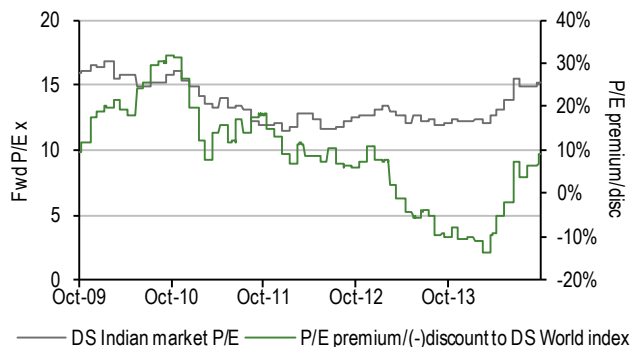
The Indian equity market is broad, with over 7,000 listed companies on the two main exchanges, the BSE and NSE. Many are illiquid and the main index used by foreign investors – the MSCI India – has just 67 constituents, although a wide range of sectors are represented, including IT services, financials, industrials and consumer stocks, geared to the country's economic development.

**Exhibit 2: Indian market and world market**



Source: Thomson Datastream. Note: Total return, £ terms.

**Exhibit 3: Indian market forward P/E and relative**



Source: Thomson Datastream. Uses Datastream indices.

The landslide victory by Narendra Modi and the Bharatiya Janata Party (BJP) in this year's election sparked a major rally: while the MSCI India index had risen by 5% between 1 January and 1 May, from 1 May to 1 October it has advanced 22%. Such performance throws a spotlight on valuations (Exhibit 3): the Indian market 12-month forward P/E ratio has moved from a c 10% discount to the world market in early 2014, to a c 10% premium (Datastream indices). The 12-month forward P/E for India is 11% above its five-year average (as is the World Index forward P/E, incidentally). However, JII's managers point out that India has historically traded at a premium to other emerging markets, largely justified by better returns on capital and the lack of reliance on any particular area (Brazil and Russia, for instance, are very resource heavy). They add that the nascent economic recovery may provide support to current valuations, which for the headline Sensex index are modestly above five- and 10-year averages on a forward P/E basis, and modestly below average on a price/book basis.

## Fund profile: Largest and oldest UK-listed India trust

Launched in 1994 as the Fleming Indian Investment Trust, JPMorgan Indian IT is the oldest and largest of the three UK-listed closed-end funds investing in India, with a market capitalisation of c £475m. It invests solely in companies listed in India (not elsewhere in the subcontinent), or those that earn a material part of their revenues in India. Managed by Rukhshad Shroff and Rajendra Nair of J.P. Morgan Asset Management's Pacific Regional Group, its aim is to achieve long-term capital growth by investing in quality companies that can benefit from India's development as a major economy. The trust is benchmarked against the MSCI India Index, although its portfolio includes c 30% in stocks outside the index. It may use gearing to enhance returns.

## The fund managers: Rukhshad Shroff and Rajendra Nair

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### The managers' view: Election landslide vindicates cyclical bias

The 2014 Indian election has dominated the recent discourse for investors, and JII managers Rukhshad Shroff and Rajendra Nair are no exception. As Nair points out, a generation of India fund managers has never operated under a majority government, and the convincing win by Narendra Modi's BJP should herald an era of deregulation, fiscal rectitude and infrastructure investment. However, the manager cautions against expectations of a 'big bang', as the government seems to be treating the path of reform and a return to faster growth "more as a test match than a Twenty20".

Much of what the new government has achieved so far is "unexciting but significant", focusing on tackling administrative bureaucracy and kick-starting stalled infrastructure projects. As long-term investors, the managers are unconcerned by the summer spell of consolidation in Indian equities following the euphoric post-election rally. "Our base case is that the recovery will continue to gain momentum, towards GDP growth of 6.5-7% in two years, so we are positive on a medium- to long-term horizon, although in the short term the market could be vulnerable to a correction," says Nair.

The managers' positive outlook for the economy predates the BJP landslide and hit performance in Q313, when an imminent reduction in US quantitative easing sparked an emerging markets sell-off, particularly in those – such as India – with weak currencies and budget deficits. The trust began to move towards quality domestic cyclical in mid-2013 – "about three months too soon" – but kept on this repositioning as more economic green shoots became apparent, accelerating after the election. While an upturn in corporate capex is yet to materialise, Nair says sentiment at both corporate and retail investor level is better and the economic picture looks more resilient, with India benefiting from lower commodity prices, and a decline in imports (caused by the weaker currency and a curb on importing gold) helping to address the deficit. Monetary policy remains somewhat hawkish to contain inflation, and Nair says interest rates are likely to remain relatively high until mid-2015.

A significant support for the Indian market could come from domestic investors. Nair points out that Indians are prolific savers, with \$1tn of savings, yet since 2009, while foreign investors ploughed \$100bn into Indian stocks, domestic investors – who were already underexposed to equities – have pulled out \$25bn. With improved fundamentals, better political news and less attractive returns on offer from assets such as cash, bonds and gold, the managers expect to see more domestic buying of Indian equities, providing further liquidity support for their bullish outlook.

## Asset allocation

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### Investment process: Long-term focus on quality and growth

The managers of JII are part of J.P. Morgan Asset Management's 77-strong Pacific Regional Group and are based in Hong Kong, although four of the India team work out of local offices.<sup>1</sup> Stocks are chosen for their ability to achieve profitable, sustainable long-term growth, through sustainable corporate advantage, capital discipline and a focus on profitability. The managers have a strong bias to quality stocks. Potential investments are assessed using an appropriate valuation framework, forecasting growth, profitability and sustainability over a long-term horizon, and not simply looking at price/book ratios or short-term forecasts such as 12-month forward price/earnings.

Emphasis is placed on understanding the sources of expected return, and positions are sized according to conviction, although with smaller stocks the stakes are likely to be smaller (at 31

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<sup>1</sup> Indian tax rules mean it is more tax-efficient for foreign funds to be managed from outside India, although the local regulator, SEBI, is pressing for more equal treatment to boost the country's asset management industry.

August there were 25 sub-1% positions, 19 holdings representing between 1% and 3% of the portfolio, and nine positions greater than 3%). Valuation is an important consideration, although this is balanced with a focus on quality. The investment process is largely bottom-up, and company-specific factors will outweigh top-down considerations in constructing the portfolio.

The managers monitor risk in terms of active positions, unintended exposures and diversification. Stocks may be sold once they have achieved their objective, if the investment case changes or the managers believe they have made a mistake, or where more compelling opportunities are evident.

## Current portfolio positioning

At 30 September JII held 53 stocks, up from 42 at the start of 2014. The longer list mainly reflects a move into small and mid-caps, and the market cap profile now differs markedly from the benchmark, with 25% of the portfolio in sub-\$5bn stocks c/f 10% of the MSCI India index.

**Exhibit 4: Sector allocation**

	End September 2014 (%)	End March 2014 (%)	Change (% pts)	MSCI India end September 2014 (%)	Trust active weight (% pts)	Trust weight/benchmark weight
Financials	36.8	33.9	2.9	18.2	18.6	2.0
Consumer discretionary	13.5	10.0	3.5	6.7	6.8	2.0
Materials	11.1	9.8	1.3	7.3	3.8	1.5
Industrials	8.7	3.7	5.0	5.4	3.3	1.6
Utilities	3.1	2.3	0.8	3.9	-0.8	0.8
Telecom services	0.0	1.4	-1.4	2.9	-2.9	N/A
Healthcare	5.7	6.5	-0.8	9.5	-3.8	0.6
Energy	5.3	7.1	-1.8	11.8	-6.5	0.4
Info technology	14.4	18.7	-4.3	22.9	-8.5	0.6
Consumer staples	0.8	6.9	-6.1	11.4	-10.6	0.1
Cash	0.6	-0.3	0.9	0.0	0.6	N/A
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>	<b>0.0</b>	

Source: JPMorgan Indian Investment Trust, Edison Investment Research. Note: Ranked by active weight (excluding cash).

At a sector level there are also significant divergences from the benchmark (see Exhibit 4), with the trust holding twice the benchmark levels of financial and consumer discretionary stocks, but significant underweights in consumer staples, energy and technology stocks (although the latter is still the second-largest absolute weighting). In the past six months the managers have raised the exposure to cyclical stocks, with higher weightings in financials (mainly private-sector banks but also some state-owned financials) and consumer-discretionary stocks, as well as materials (specifically cement, which is geared to domestic construction and corporate spending). These new positions have been funded by reducing weightings in more classically defensive sectors such as healthcare, telecoms and consumer staples, as well as technology, which is more geared to a recovery in developed markets than on a domestic upturn. Benchmark-relative weightings were also affected by moves in the MSCI India Index itself, for instance a reduction in the representation of financials as MSCI removed or reduced companies that reached limits on foreign ownership.

The managers retain their bias to quality companies, which may have cost them some relative performance in the immediate aftermath of the election. Many of the stocks that rallied the most were the poorly managed, over-leveraged names and state-owned financials, which re-rated as they were perceived to be most geared to a policy-led recovery, although many of these stocks have corrected more recently. The focus on quality cyclicals has been in place for at least a year, but the managers have increased their conviction in this area post-election, reflecting greater optimism on the scope for a domestic recovery.

The recent moves in the portfolio have meant an increase in turnover relative to recent history – c 38% in the current financial year compared with c 25% a year for the previous two years – but Nair notes that over the life of the trust, annual turnover has been between 10% and 40% and remains within this range.

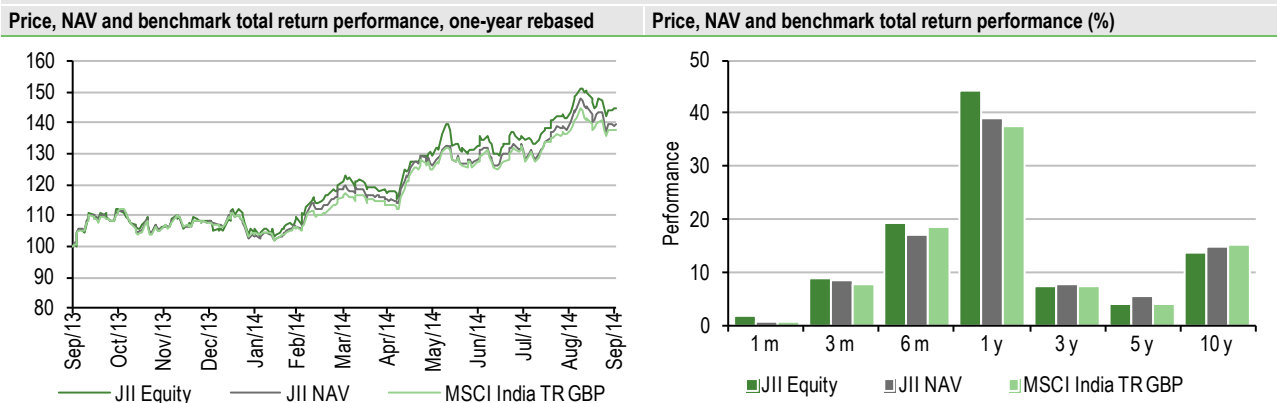
## Performance: Market euphoria sparks one-year surge

JII's NAV total return performance has been broadly similar to that of the benchmark MSCI India Index over most periods, although this is not an indication of a 'closet tracker' portfolio (see Current portfolio positioning section): nearly a third of the portfolio value is in stocks outside the benchmark, and there are significant divergences in terms of sector weightings. Share price total returns have lagged slightly over longer periods and outperformed slightly in more recent times, reflecting more positive sentiment towards Indian equities. Absolute returns were particularly strong over six months and a year (c 20% and c 40% respectively) and are still solid over 10 years, at c 10-15% a year, but more subdued (c 5% a year) over five years (Exhibit 5).

It is important to note the impact of strong recent performance on cumulative return figures; on a rolling 12-month basis, two of the past four years to 30 September have seen double-digit declines in both JII's share price and NAV, as well as the MSCI India Index. However, on a relative basis, Exhibit 6 shows JII outperforming broader emerging markets and the world over many periods.

JII's managers do not hedge currency exposure (the performance figures below are all in sterling terms), so returns will be affected by movements in the £/INR exchange rate. The managers note that hedging is relatively expensive (more so at times of greater dislocation) and would incur a cost drag on performance that would potentially outweigh any benefit.

**Exhibit 5: Investment trust performance**



Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

**Exhibit 6: Share price and NAV total return performance, relative to benchmarks (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI India	1.0	0.9	0.7	5.1	(0.3)	0.2	(11.9)
NAV relative to MSCI India	(0.2)	0.6	(1.3)	1.0	1.2	8.1	(2.6)
Price relative to MSCI Emerging Markets	7.5	6.8	12.6	38.1	3.8	(1.8)	14.5
NAV relative to MSCI Emerging Markets	6.3	6.5	10.3	32.9	5.4	6.0	26.6
Price relative to MSCI World	2.3	5.4	12.8	28.2	(22.6)	(28.1)	55.1
NAV relative to MSCI World	1.1	5.1	10.6	23.3	(21.4)	(22.3)	71.5

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-September 2014, £ adjusted. Geometric calculation.

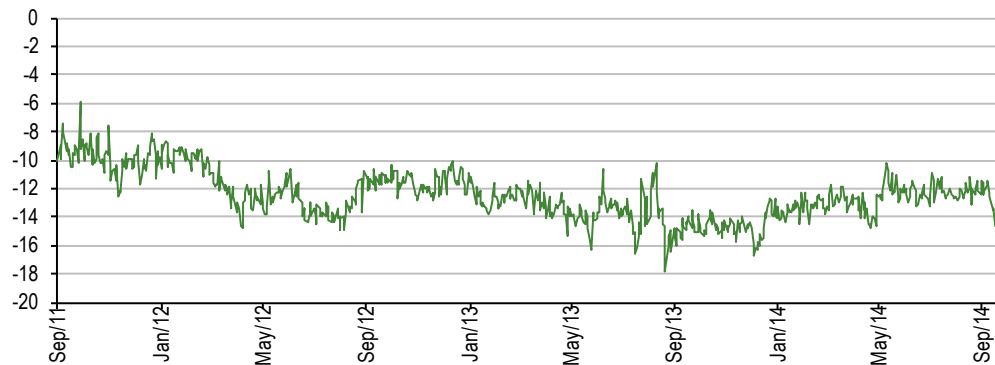
## Discount: Narrower since Indian election

At 15 October JII shares traded on a 14.7% discount to cum-income net asset value. This is wider than the average levels over one, three and five years (13.3%, 12.5% and 10.3% respectively). Having hit a 10-year high of 17.8% in September 2013 as the 'taper tantrum' battered sentiment towards emerging markets with weak currencies and budget deficits, the discount has trended narrower during 2014 and had broadly been in the 10-13% range since the Indian election in May, before widening as jitters hit global markets in mid-October.



JII will buy back shares to manage the discount, although there is no hard target as to the level of discount at which this will occur. Repurchased shares are held in treasury and may be reissued later. So far in 2014 2.2m shares have been bought back at a cost of £7.6m, although the last buyback took place on 15 May, the day before the BJP election victory was announced.

**Exhibit 7: Discount over three years**



Source: Morningstar, Edison Investment Research

## Capital structure and fees

JII has one class of share and 105.7m ordinary shares in issue (excluding treasury shares), following the final exercise and conversion of subscription shares in January 2014 (c 5m new ordinary shares were issued as a result). It may buy back up to 15% of its shares and allot up to 10% per year, and 19.9m shares are held in treasury as a result of buybacks. The trust has an indefinite life subject to five-yearly continuation votes, the most recent of which was at the January 2014 AGM.

At the 2014 AGM, it was agreed to cut the management fee payable to J.P. Morgan Asset Management from 1.2% to 1.0% of total assets. The notice period was reduced to six months for performance-related reasons (12 months for any other reason) and a resolution was passed requiring a 25% tender offer at NAV minus costs should JII underperform the benchmark MSCI India Index over its next three financial years (ending 30 September 2016).

JII is permitted to gear and is currently c 5% geared via a \$40m loan facility. The managers indicate that they would be willing to increase the amount of gearing modestly to take advantage of any short-term corrections in the market, as long as their fundamental view remains optimistic.

## Dividend policy

India is not a high-yield market and investment income is insignificant (c 0.1p per share for the half-year ended 31 March 2014). With fees being charged to income, JII actually made a revenue loss in H114. The trust is focused on achieving capital growth and has not paid a dividend since 1994.

## Peer group comparison

There are only three investment trusts with an Indian equity focus; these are shown in Exhibit 8, along with a selection of Indian mutual funds drawn from the IMA Specialist sector. JII is the biggest of the three closed-ended funds. NAV total returns have been broadly average over one year and have lagged slightly over three and five years. Charges are the lowest in the group and are also lower than all but one of the open-ended funds. Average returns for the open-ended funds have been close to those of the investment trusts over all three periods. However, JII has outperformed the open-ended fund managed by the same team. Nair says that while the two portfolios are

broadly the same, there are three factors that have enabled the investment trust to outperform: the use of a modest amount of gearing; a greater bias to less liquid small- and mid-cap stocks, which are harder to hold in the open-ended fund because of the effect of capital flows in and out of the portfolio; and finally, outflows themselves, which have accelerated in the mutual fund in recent months as investors have taken profits after the strong run in Indian equities.

#### Exhibit 8: Funds investing in general Indian equities

% unless stated	Market cap/fund size (£m)	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount (-)/ premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
<b>JPMorgan Indian</b>	<b>465.9</b>	<b>30.0</b>	<b>25.4</b>	<b>31.4</b>	<b>1.5</b>	<b>No</b>	<b>-13.8</b>	<b>105.0</b>	<b>0.0</b>	<b>2.0</b>	<b>0.4</b>
India Capital Growth	37.3	53.9	30.1	10.9	3.0	No	-23.3	95.0	0.0	3.1	0.4
New India	163.7	31.1	34.9	60.6	1.6	Yes	-13.6	99.0	0.0	2.0	0.5
<b>Sector weighted average</b>		<b>31.6</b>	<b>28.0</b>	<b>37.4</b>	<b>1.6</b>		<b>-14.3</b>	<b>103.0</b>	<b>0.0</b>	<b>2.0</b>	<b>0.4</b>
<b>JII rank in sector</b>	<b>1</b>	<b>3</b>	<b>3</b>	<b>2</b>	<b>3</b>		<b>2</b>	<b>1</b>		<b>3</b>	<b>3</b>
<b>Mutual funds</b>											
Aberdeen Global Indian Equity	3224.2	30.0	35.6	60.9	2.2						
Baring India Fund	13.6	37.2	--	--	3.1						
BlackRock Global Funds - India	315.1	39.3	24.8	23.7	2.0						
Fidelity Funds - India Focus Fund	1064.1	34.9	26.6	35.4	2.1						
Franklin India	1496.3	40.2	26.6	39.3	1.9						
HSBC GIF - Indian Equity	1475.6	38.1	19.5	-3.5	1.9						
Invesco India Equity Fund	85.6	33.6	25.2	32.3	2.2						
JPMorgan Funds - JPMorgan India	868.4	23.5	16.6	21.1	2.1						
Jupiter India	263.8	44.5	18.7	26.6	1.8						
Matthews Asia Funds India	3.8	54.1	41.5	0.0	2.0						
Neptune India	75.7	39.7	23.5	12.4	2.4						
Pictet-Indian Equities	145.3	32.5	22.7	6.0	2.2						
Schroder ISF Indian Equity	138.2	29.0	37.8	30.3	1.4						
<b>Weighted average</b>		<b>33.8</b>	<b>27.4</b>	<b>36.0</b>	<b>2.0</b>						

Source: Morningstar 15 October 2014. Note: TR = total returns of NAV for investment trusts, TER = total expense ratio. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 36-month period by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as percentage of shareholders' funds. Mutual funds are retail investor share classes.

## The board

JII has five directors. Hugh Bolland joined the board in 2004 and became chairman in 2008. Richard Burns became a director in 2006. Hugh Sandeman was appointed in 2010, while Nimi Patel joined the board in 2011. The newest director, Rosemary Morgan, was appointed in December 2013 and replaces Peter Sullivan, who stood down at the January 2014 AGM. The directors have backgrounds in fund management, investment banking and the law.

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