In our meetings with clients, two questions come up almost every time. The first is how we incorporate macro data in India into our portfolio construction framework considering the recent confusion and contradictions surrounding the new GDP data series. The second question is, do we not need to hire an army of analysts to track more than 5,000 listed stocks on the Indian stock exchanges. In this essay, we seek to address these two questions.

The scepticism surrounding the accuracy of the GDP data under the new series has been discussed ad nauseam since it was introduced in January 2015. Some critics have compared the Ministry of Corporate Affairs database used by the CSO (Central Statistical Office) with the aggregate reported numbers of a wide universe of listed stocks to highlight the stark divergence. While others have attempted to fine tune the GDP deflator, a tough task with the gap between CPI and WPI still quite wide. Some have sought to develop their own Indian variant of the popular LKQ index of China to prove that underlying growth in the economy is much lower than the official reported numbers. For those unfamiliar with the LKQ index, apparently the premier of China, Li Keqiang had in 2007 remarked that China’s GDP figures are “man-made” and he himself used indicators such as railway cargo volume, electricity consumption and bank loans data to overcome the unreliability of the GDP numbers. However, this essay is not

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1 Source: BSE, NSE.
another critique on the new GDP data series. As investment professionals, we need to work around the macro numbers that the CSO churns out, with more granular, timely and accurate data points.

In 2009, a report commissioned by French President Sarkozy and chaired by Joseph Stiglitz highlighted the shortcomings of GDP as an indicator of economic performance and social progress and recommended, among other things, to use dashboards or sets of indicators to track sustainable development. Over the years, we too have created our own dashboard of high frequency indicators, sourced from various industry associations and agencies, to track the health of the economy. We believe data on variables such as diesel consumption, power generation, cement dispatches, road tendering and automobile sales is more reliable and can be converted into actionable ideas to invest.

After all, our long held view since 2014 has been that the recovery in the economy will be gradual and more importantly uneven. So, in short, not all segments of the economy will turnaround at the same time. Hence, these high frequency indicators are far more useful in picking pockets of turnaround or acceleration than the headline numbers of GDP growth, fiscal deficit or inflation. So while the debate on the accuracy of the macro data will continue, it does not cause any major impediments to our stock selection process. In short, if the monthly cement despatch numbers confirm a trend we would be happy to buy into that sector, but conversely, a 7% real growth in the manufacturing sector of GDP released by the CSO will in all likelihood not trigger any investment action. The fact that most of these macro numbers come with a lag and are often subject to revisions makes it even less reliable.

The second question is how to pick stocks, after identifying trends from the macro dashboard, particularly when the universe of listed stocks on the Indian exchanges is more than 5,000. Over the years, we have created a whitelist of stocks that we feel best transmit a sector view. These are stocks that meet our hygiene factors on management quality, size, corporate governance and good operating metrics. So once the high frequency dashboard throws up a sector that is at an inflection point, or confirms a trend, we waste little time in making up our mind on which stocks will benefit from the sector tailwind. Our long institutional memory serves us well here. This is not to say that the whitelist is not constantly reviewed and revised. Nor are we saying that there is no merit in pure bottom up investing where there is a management change or a new strategy being pursued. So, while it may appear that in a country which has more than 5,000 listed stocks the buy-side should hire an army of analysts, we think there is a long tail that institutional investors can safely filter out of the investment radar on parameters of quality, governance, size, liquidity and track record.

A related point is management meetings. Often, investors place disproportionate emphasis on management meetings in the hope that it will help them spot inflection points earlier than the street. Brokerage houses organize elaborate conferences to provide a platform for investors to interact with senior managers of companies. Our opinion has been that the management of companies, quite naturally, suffer from an optimism bias, and usually cannot be relied upon to pick up inflection points arising from macro factors. So while meeting with the CEO

DISPLAY 1

A Dashboard Approach

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<th>Dashboard</th>
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<tr>
<td>• Electricity Generation</td>
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<td>• New/Completed Projects</td>
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<td>• Port/Road/Airport Traffic</td>
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<td>• Railway Freight</td>
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Indicative list. Source: Morgan Stanley Investment Management.


of a company may help understand the broad strategy being pursued, it is likely to be a poor guide to time when the macro tide will turn in favor of or against the company.

Nate Silver says in his book *The Signal and the Noise*:

> “The signal is the truth. The noise is what distracts us from the truth.”

In the same vein, our mantra, in the current environment, is to invest based on evidence rather than hope. We meticulously update and analyze our dashboard of high frequency indicators and cut out the surrounding noise of confusing macro data. And most importantly, we keep our whitelist of stocks ready.

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**DEFINITIONS**

**Gross Domestic Product (GDP)** is the monetary value of all the finished goods and services produced within a country’s borders in a specific time period. It includes all private and public consumption, government outlays, investments and net exports. The **Consumer Price Index (CPI)** is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

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