AS OIL FALLS, INDIAN EQUITIES MAY RISE

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As we approach the end of 2014, one of the year's biggest stories has been the declining price of oil. On June 20, 2014, Brent was at nearly $115. On November 13, 2014, it fell below $78, a cumulative decline of over 32%.[1] Through November 13, 2014, India's equities, measured by the BSE Sensex, had appreciated more than 30%.[2] That is in an environment where broad emerging market equities[3] have been basically flat. **India: World's Fourth-Largest Oil Consumer** [4] The bottom line: India uses a lot of oil, but it has very limited oil resources. The country depends on oil imports for more than 70% of its oil needs.[5] We believe that, as the price of oil falls, India's economic growth prospects—and by extension, equity market performance—may improve. **Historical Study: 3-Month 20% Brent Oil Price Declines and SENSEX Performance** The table shows price declines of at least 20% over a three-month period in the price of Brent , since the liberalization of India's equity markets, and the corresponding three-month performance of the BSE SENSEX.

Oil				SENSEX	
Start Date	Starting Crude Price	Ending Crude Price	% Change in Crude Price	Start Date	3-Month Performance[1]
10/8/1991	$21.7	$16.9	-22.2%	1/8/1992	122.3%
9/29/1993	$17.4	$13.5	-22.2%	12/29/1993	9.9%
12/5/1996	$24.6	$19.4	-21.2%	3/5/1997	-1.7%
10/3/1997	$21.6	$16.4	-24.0%	1/3/1998	9.6%
9/3/1998	$13.4	$10.2	-24.3%	12/3/1998	29.8%
9/7/2000	$34.6	$27.5	-20.5%	12/7/2000	-1.9%
8/1/2001	$25.0	$19.6	-21.4%	11/1/2001	9.3%
1/24/2003	$30.5	$24.3	-20.2%	4/24/2003	24.9%
7/11/2006	$73.7	$58.7	-20.4%	10/11/2006	10.3%
6/6/2008	$137.7	$104.1	-24.4%	9/6/2008	-38.1%
3/1/2012	$126.2	$98.4	-22.0%	6/1/2012	9.2%
8/13/2014	$104.3	$77.9	-25.3%	11/13/2014	N/A
Average			**-22.1%**		**16.7%**

[1]Three-month performance: Refers to the change in level of the BSE SENSEX Index over the three-month period following a 20% or greater decline in the price of Brent Oil. Source: Bloomberg, as of 11/13/14. Concept for chart from Jyotivardhan Jaipuria, et al., "Falling Crude Prices = Good Days Ahead," Bank of America Merrill Lynch, 10/20/14. Past performance is not indicative of future results. You cannot invest directly in an index.

- **Eleven Declines of 20% of More:** Since India's equity markets liberalized in 1991,[6] there have been 11 three-month periods where the price of Brent oil has dropped by 20% or more. On eight of these occasions, the following three-month period for the BSE SENSEX delivered a positive return. The average return of all 11 periods was nearly 17%.
- **Since August 13, 2014, Brent Oil Has Dropped More Than 25%:** While we can never know what the future will bring, we can indicate the historical relationship that India's equity markets have had with the price of Brent oil. India's equities could therefore warrant a closer look. **Quantifying the Connections between India & Oil Prices** • **Oil Prices to India's Gross Domestic Product (GDP):** A variety of studies

have attempted to identify a predictive relationship between the price of oil and the rate of India's GDP growth. One recent study indicates that, for every $10 drop in the price of a barrel of oil, India's GDP increases by 0.1%[7]. While it's difficult to determine a cause with that degree of precision for the GDP growth rate of an emerging market economy, given that India imports an average of about 2.6 million barrels of oil per day[8], the savings can certainly be substantial when oil prices drop.

- **Oil Prices to India's Inflation Rate:** Among emerging markets, India is known for stubbornly high inflation. At the beginning of 2014, the year-over-year change in India's consumer price index was about 10%.[9] As of the end of September, this measure was below 6.5%[10] —a significant decrease. India imports more than 70% of the oil that it needs, and oil has a 9.5% weight in India's CPI.[11]

Conclusion: A Lower Oil Price Helps India Manage Its Twin Deficits While all of the relationships we've outlined between India and the price of Brent oil are certainly important, the most important could very well have to do with India's "twin deficits." India is known for having a significant current account deficit, which stems largely from its need to import oil. India also is known for having a particularly stubborn fiscal deficit, which stems largely from its need to subsidize fuel prices for its citizens. A lower price of oil can mitigate both of these issues, thereby allowing Prime Minister Modi's government greater flexibility to pursue other important reforms.

[1]Source for intro paragraph: Bloomberg, with data through 11/13/14. [2]Source: Bloomberg; period measured is 12/31/13 to 11/13/14. [3]Refers to MSCI Emerging Markets Index; performance measured from 12/31/13 to 11/13/14. [4]Source: "India Analysis Report," U.S. Energy Information Administration, 7/26/14. [5]Source: Nidhi Verma, "India Ends Diesel Controls, Raises Gas Prices," Reuters, 10/18/14. [6]Source: Jyotivardhan Jaipuria, et al., "Falling Crude Prices = Good Days Ahead," Bank of America Merrill Lynch, 10/20/14. [7]Source: N. Madhavan, "Are Low Crude Oil Prices Here to Stay?" Forbes India, 11/3/14. [8]Source: "The Future of the Indian Rupee Is Tied to Oil Imports," Knowledge @ Wharton, 11/15/14. [9]Source: Bloomberg, as of 12/31/13. [10]Source: Bloomberg, as of 9/30/14. [11]Source: "The Emerging Markets Weekly: Summer Smog," Barclays, 7/17/14.

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DEFINITIONS

Generic 1st Brent Crude Oil Contract : An index created from continuously rolling generic or the immediate 1st month oil contract. It is supposed to closely reflect historical prices of crude oil in the market.

BSE Sensex 30 Index : A market capitalization-weighted index designed to measure the performance of 30 large, established firms listed on the Bombay Stock Exchange that represent the industries of India's economy.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Inflation : Characterized by rising price levels.

Consumer Price Index (CPI) : 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.

Current account deficit : Situation where a country has a greater level of imports than exports.

Fiscal deficit : Situation where government spending exceeds government revenue.