TRADER DAILY

Bombay Rising

It boasts the third-most-active exchange in the world, with $450 billion in stock-market capitalization. But is India the next great trading frontier -- or merely an impenetrable maze of barriers? Duff McDonald travels to the heart of Mumbai in search of the answer.

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The obvious question: Can India funtion as an outsourcing center for trading?

FEATURE

It's late July, it's hotter than hell and I can't seem to find the Bombay Stock Exchange. I'm standing on Dalal Street -- the Wall Street of India -- but the exchange is nowhere to be found. Just looking for a crowd has proved to be an unworkable strategy; the streets of Mumbai are as packed as Times Square on New Year's Eve.

The fact that the BSE's open-outcry pit -- like its Stateside counterparts -- is more an artifact than the actual center of Indian market-based capitalism does at least partly explain my plight. Still, here I am, on day one of my search for the heart of trading in India, and its most venerable institution eludes me. I finally break down and ask someone. He stifles a laugh as he explains that I'm literally standing on the doorstep of the BSE itself.

I step back and look up: Sure enough, tucked behind an overhang rises the gaudy '70s-style architecture of the 28-story Jeejeebhoy Towers, named for a former chairman of the exchange. A short time later, I'm on the nineteenth floor of the BSE, sitting in a blue-and-purple conference room with a mixture of plastic and Formica that lends it a vibe somewhere between a high-school cafeteria and the starship Enterprise. A wraithlike man who is the general manager of "knowledge management" for the BSE is speaking in monotone as he takes me through a series of slides about the BSE's upgrades.

There are slides about the fact that the BSE is the fifth-largest exchange (by number of trades) in the world, slides about the volume of single-stock futures, slides about the lack of any defaults by members of the exchange despite the volatility of the market and slides with a smattering of mumbo-jumbo about cooperation with the Securities and Exchange Board of India -- India's SEC. A short time later, I'm treated to a tour of the exchange's old open-outcry room, which is only about the size of a basketball court. There's nobody here, as trading on the BSE has gone electronic, a transition achieved in a mere 50 days way back in 1995 and a feat the New York Stock Exchange resists to this day.

When I'm told that some 7,000 traders used to pack into this room every morning, it seems impossible -- images of frat kids stuffed into phone booths and clowns crammed into Volkswagen Beetles come to mind. But then the real point hits me: This country's markets are moving so fast, they've leapfrogged America's -- at least in terms of technology -- in less than a decade.

While I've come to the BSE to find real, live Indian traders -- the first step in my quest to discern if India is, indeed, the next great trading frontier -- there's nothing to see here but the old gong they used to bang to open trading. I give it a whack and take a picture to show Mom and Dad back home. My tour here is over, but it's only just begun.

Two days later and 10 minutes to the west, I'm in the offices of Rashesh Shah, the CEO of local investment bank Edelweiss Capital. Shah tells me he'd like his firm to be thought of as the Goldman Sachs of India, and by the looks of his digs, it's well on its way. Indeed, one could easily mistake his offices on Nariman Point for a Goldman Sachs outpost: There are the Lucites celebrating completed deals, the tailored suits on most of his staff, the Montblanc pens I see sticking out of more than a few pockets. Shah carries himself like a Wall Streeter -- he's earnest without being overbearing and smart without being arrogant.

When I ask him, then, to define the state of trading in India, he isn't exactly pessimistic -- his professional career, after all, hinges on the development of India's capital markets -- but he's honest enough to admit there's work to be done: He cites a lack of market making, a relatively small number of proprietary trading desks and a history of undercapitalized brokerage firms.

Trading in India, he says, is still a "cottage industry." This is, after all, a country where speculator is a dirty word, and Indians, he says, have not quite come to terms with cutthroat capitalism: There's no real corporate debt market to speak of. They don't allow naked short selling in what essentially remains an order-driven market. And although India's capital markets are wide, they're not deep. "There may be 6,000 or so listed companies," Shah says, "but only about 700 of them matter."

Just as quickly, though, he turns bullish, proffering a parade of positive figures:
200 percent: the increase in the Sensex since early 2003
6 million: total brokerage accounts in India
250 million: population of India's growing middle class
70,000: estimated number of millionaires in India
803: number of foreign institutional investors, or FIIs, registered in the country
$13.5 billion: amount invested in India by FIIs in fiscal 2004

Indeed, Shah points out that the country's liberalization of its capital markets, crucial to a viable trading environment, continues apace -- from the elimination of long-term capital-gains taxes on securities transactions to the lifting of a prohibition on derivatives trading in 2000. And although a lack of complete convertibility of the rupee and tight regulatory controls over foreign-capital flows have kept the domestic markets from turning into a momentum-based free-for-all, an otherwise welcoming stance toward foreign money has resulted in growing investor interest from across the globe.

On top of that, the market infrastructure is ready and waiting. In 2004, India's all-electronic National Stock Exchange (NSE) ranked third in the world in terms of total transactions, after only the NYSE and Nasdaq -- and just two ahead of the Bombay Stock Exchange. The country's settlement system, at T+2, is actually a day faster than the T+3 of the United States. Better yet, consider the case of New Vernon Advisors, a New Jersey–based fund with an advisory arm in Mumbai that raised $240 million for an India fund last July, began investing in October and has already topped $625 million. But this is just a drop in a monsoon: Total stock-market capitalization in India is now some $450 billion, and it seems as though there are new India-focused funds started each day.

In truth, those looking for something to trade can certainly find it in the more than $50 billion in equity derivatives that changes hands each month, the $25 billion or so in commodity derivatives and the $35 billion in the equity markets themselves. Clearly, Shah and his colleagues aren't hesitating to do so: Before I head back out into the streets of Mumbai, Shah reminds me that Edelweiss alone handles $125 million in derivatives trades daily.

There may be no better evidence that India is developing its own cult of equity than the fact that the country already has its own answer to the Oracle of Omaha. His name is Rakesh Jhunjhunwala, and he's widely referred to as the Warren Buffett of India -- except that Jhunjhunwala's got trading skills as well. That's not the only difference. I doubt Buffett would show up to a meeting with a journalist with curry stains all over his shirt or keep a statue of Ganesh in his conference room.

Still, when I arrive at Jhunjhunwala's Nariman Point office for an afternoon sit-down, I walk past what look to be *Wall Street Journal* etchings of legends of both investing and trading: John Bogle, John Templeton, Buffett, George Soros. In Jhunjhunwala's expansive two-room office, a bull and bear sit on the conference table, CNBC plays on a flat screen on the wall and a doorway to the balcony leads to an outdoor garden with a view of the harbor below.

These are no mere affectations. Indeed, there's no question of Jhunjhunwala's abilities. While it depends on whom you ask, he's worth anywhere from $150 million to $250 million (admittedly un-Buffett levels, but impressive nonetheless for India), having started out with a meager $138 investment 20 years ago. His most recent score was a five-bagger on an investment in CRISIL, India's most respected credit-rating agency, which was purchased by Standard & Poor's last April. Forty-five and married, Jhunjhunwala has his own "Ten Commandments of Investing" and "Ten Commandments for Trading" posted on his office walls, and he reacts with disdain when I ask him about the comparisons to Buffett. "Don't insult that great man," he says over the Indian music playing not so softly in the background. "Plus, I don't want to be anybody's clone anyway."

In some respects, neither does India. Indeed, intriguing differences exist between India's capital markets and those of other countries. Consider that the Indian government supports commodities with minimum prices. Or that single-stock futures are highly liquid and heavily traded. And while you'd expect some indigenous commodities, such as guar seed, to find more traders in India than, say, Chicago, it's worth noting that India has the only steel-futures contracts in the world.

Still, clone or no clone, it's the parallels with other markets that jump out more. The New York Stock Exchange and Nasdaq find their counterparts in the Bombay Stock Exchange -- which just celebrated its 130th anniversary -- and the youthful all-electronic National Stock Exchange, just 11 years old but already eclipsing the BSE's volume by two to one. (Unlike the NYSE or Nasdaq, both the NSE and BSE list stocks, debt and derivative securities.) Bombay's Dalal Street, like Wall Street itself, has become more metonym than specific locale.

In that regard, Exchange Plaza in the Bandra-Kurla complex, which the NSE and National Commodities and Derivatives Exchange call home, has been referred to as Bombay's Canary Wharf, and like the London complex, it's a sparkling development that marks the first true break from the geographical power centers of decades past.

If it's a weekday in Mumbai, I must be sitting in a taxi with no air conditioning, completely lost -- again. I'm looking for Refco India, one of the largest derivatives-trading outfits in the country (now named Man Financial-Sify following Refco's subsequent implosion in the fall), and my driver has already asked 10 people for directions. He's never heard of it or the "compound" it's supposedly part of, something I'd pictured like a Silicon Valley corporate campus. I couldn't have been more wrong. Half an hour later, we pull up to the regal-sounding Belvedere Court in the Modern Mills compound. Regal, though, it's not: It's a drab-looking complex of office buildings no different from much of the rest of the city.

Inside, I'm led past a few banks of traders in front of flat screens -- nothing new there -- and toward the office of managing director Vineet Bhatnagar. When I knock and push open the door, I'm greeted by the thing I came to find in theory but didn't expect to literally see in practice: an American -- one of three in the room -- in the middle of telling Bhatnagar why his quantitative trend-following model is the right one for Refco's clients. His name is Mike Martin, he of the eponymous Martin Capital Management of Los Angeles.

Not to take anything away from Mike Martin -- he's ahead of the pack -- but if he has already found his way into the back rooms at Belvedere Court, India's capital markets are clearly open for business. And it raises a natural question: Who's actually trading in India -- and what are they trading?

To start, local players in Indian securities markets are a mix of derivatives specialists like Edelweiss Capital and financial institutions like ICICI Bank (think of it as the Indian Wells Fargo); joint ventures between local Indian firms and global players (DSP Merrill Lynch, JM Morgan Stanley and Kotak Securities, of which Goldman Sachs owns 50 percent); a few hundred smaller brokerage firms; and a growing number of homegrown investing celebrities like Jhunjhunwala.

Because the debt market is not very developed, the majority of trading has an equity or commodity aspect to it. Aside from the cash market, which is concentrated in just a few stocks -- the top 10 stocks accounting for 80 percent of the volume in Indian stock markets, and trading in the top 100 accounting for 99 percent -- it's local arbitrage opportunities that garner the most attention.

The favorite trades are cash-to-futures spread trades in the equity markets, index and volatility arbitrage, arbitrage among the country's 23 different stock exchanges and -- less frequently -- arbitrage between local and international markets in commodities. (The lack of total currency convertibility has, in all likelihood, hampered growth in the latter.)

As evidenced by the presence in India of the guys from Martin Capital Management, the country also offers the opportunity to take proprietary trading systems and apply them to the Indian market, either on one's own behalf or as a service to others. Over drinks at Geoffrey's Pub in Nariman Point, Martin's Christopher McCauley describes what they're doing as a form of "insourcing" -- providing Indian investors the ability to layer a trend-following function on top of their capitalization- or style-focused investing strategies.

When I ask what drew them to India, he says Refco's reputation preceded it, and at that point, it was only a matter of choosing the right country. (This, of course, was before Refco's collapse, but that hasn't stopped Martin Capital from continuing to make inroads in the country.) The fact that Mike Martin has dated Indian women and become a fan of Bollywood films seems to have tipped the scales in India's favor. A local investor who preferred, for obvious reasons, to remain anonymous put it more bluntly: "For better or worse, Americans and Europeans feel better operating with Indians than they do with Chinese, and that's helping drive all this."

Mike Martin's Bollywood obsession aside, Manish Jain just might be the perfect frontman for Martin Capital's foray into the Indian capital markets. Indian-born and American-raised, Jain's unique mix is unquestionably valuable when trying to sell the message of American financial products to an Indian audience. Jain is young, good-looking and unassuming, and he's also prepared to take clients out on the town if that's what it takes (on the day I met him, he was still recovering from an extremely late night).

In September, Jain agreed to move from the U.S. to India to work full-time on the company's effort to grab new customers. And he doesn't seem to be minding it at all. I ask him in December what's struck him most about his time in India. "Besides getting chai delivered to my desk every day?" he responds. "It's that Indian people are very open to new ideas and financial vehicles -- such as Martin Capital launching India's first managed commodity fund in mid-January. Even though this country has the brainpower and the intensity to compete, they're continually looking for ideas outside the country in addition to their own homegrown offerings."

And what of foreigners looking for opportunities in India? While there's a certain amount of paperwork involved, it's actually not that difficult to get in a position to trade in the Indian equity and derivatives markets. All you have to do is meet a few basic requirements -- falling within a broad category of financial institutions as well as having relationships with local back-office partners -- and then register as an FII or as a sub-account of one. Hedge funds are currently prohibited from becoming FIIs but are permitted to have sub-accounts or to trade in structured products like participatory notes (PNs), which are effectively total return swaps with FIIs that have purchased the actual Indian securities and are estimated to account for some 20 to 25 percent of overall FII investment activity. While a handful of foreign broker-dealers have gone the FII route, including ABN Amro, Citigroup, HSBC and UBS, the majority have chosen to avoid the procedural hassles of such a move and to stick with using an FII as an intermediary.

The more FIIs there are, goes the thinking, the more modern securities-market functionality -- such as high-quality research -- they will demand, thus acting as a catalyst for overall reform. Indeed, the government continues to relax restrictions on FIIs, such as the decision in 2004 to increase the limit on the open-interest position for a single FII in equity-index products from 500 million rupees (about $11 million) to 2.5

billion rupees ($60 million).

There seems to be no shortage of new FII applicants. Recent funds awarded the designation include U.S.-based Matterhorn Group, Monsoon Capital and Voyager Investment Advisors, as well as Swiss fund Naissance Capital and Bermuda-based FMG Inc. And even though hedge funds are prohibited the direct FII route, that hasn't put a damper on their own investments. According to Andrew Schneider of Hedgeco.net, more than 30 hedge funds have investments in India totaling some $18 billion, $6 billion of which was allocated in 2005 alone. That includes funds like Boyer Allen and London's Sloan Robinson. And the locals are taking note: "Traders are just starting to think of launching their own hedge funds," says Trideep Bhattacharya, an equity analyst covering IT services companies for UBS in Asia. "But that culture is just beginning -- give it three or four years, and it will be real."

Although average Indian Arb traders reportedly pull down just $300 to $400 a month -- and most don't even have a corporate e-mail address -- that doesn't mean there's not a good bit more money going around for those who rise above the masses. Hit your numbers, and compensation can begin to approach Western levels (although you won't see as much of it as you would during happy hour at Foxhounds in the World Financial Center).

Indeed, as I fold a piece of naan around a chunk of lamb over lunch at ITC Grand Central Sheraton with Chirag Shah, a vice president at Refco, I barely catch a glimpse of what appears to be a Swiss watch before he pulls his cuff down to conceal it again. He's explaining to me that Indian traders have yet to entirely embrace the culture of flaunting that's easy to find in other trading meccas, and he's so clearly modest about the timepiece that I decide not to ask what make it is.

"Yes, I've got Tumi luggage. And I've got an iPod," he says. So we're all the same in the end, then, I ask? Not entirely, he says. It is true that as in any major city, young traders flush with cash will find their way to the hot spot du jour, reading *Time Out Mumbai* just as their peers use their own local edition as a guide to what's hot. But consider the decision to buy a Porsche. "People in Mumbai won't buy a Boxster, but they will buy a Cayenne," Shah offers. My wordless response suggests I'm not following him. "Ground clearance," he says, laughing. "Have you seen the roads in Bombay?"

After meeting Shah, a young, smart, driven man who seemingly could go toe-to-toe with any American or European trader, an obvious question comes to mind: Can India function as an outsourcing hub for trading the way it has for IT services and call centers -- a place to trade global securities with lower overhead than you'd have putting 20 traders in Jersey City? Despite evidence that it's already happening in a limited sense, that appears unlikely.

First, there's the lack of a meaningful talent pool. Not that there aren't capable traders in India -- there are thousands of them -- but the ineffable quality that makes a good trader a good trader means you don't just replace one the way you would a call-center operator. Thus, for such a wholesale shift to take place, you'd have to move the traders themselves -- relocate the top trading talent to Mumbai. Indeed, many in Mumbai suggest that in the trading world, the trend is in the other direction. "India actually exports its best trading talent," says Edelweiss Capital's Rashesh Shah. "Even in something like equity research, in which we've seen a lot of companies move their operations to India, the best analysts will get taken abroad. The higher up the skill set you go, the less offshorable it is. Let's face it -- most smart traders in India will end up going to the U.S."

And this, perhaps, is a bigger threat to your typical trader's job than the prospect that it will be outsourced to India: the possibility of top Indian talent coming from India to take it away. There's a joke in India about the top business school in the country, the Indian Institute of Management, Ahmedabad: If you don't get in, you can always go to Harvard. Goldman has been recruiting there since 2001. Ultimately, Goldman won't ship its top traders to India, but it will certainly hire the best local talent it can find.

Still, over lunch with Chirag Shah, he feels the need to remind me that it's all just getting started -- that if, for example, you tell someone in India that your client trades $100 million a day, the reply will be, "Why does he trade so much? Can't he make up his mind?"

I laugh at the joke, but he's not really kidding. Then he shrugs. "There was a time when a stockbroker had trouble finding a suitable spouse in this country," Shah says, cocking an eyebrow skyward. "But not anymore." And with that, it all becomes crystal clear. Attractive spousal candidates for traders? Yes, India's capital markets have arrived.

No comments yet:

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