With 24 percent of this MF's assets in ETFs, its CEO feels ETFs and index schemes are the future of MF industry

The CEO of LIC Mutual Fund believes that retail investors will follow institutions in passive investing soon

DINESH PANGTEY

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Index funds and ETFs are two passive avenues of investments. ETFs have been showing exponential growth over the past few years, thanks to big-ticket mandates from PF Trusts (EPFO). This is in line with the fact that a trend seen in the west, tends to get adopted in India with corporates aligned to it at the start and retail following thereafter. Corporates have already started pouring investments into passive funds. I believe soon we will see similar interest building up in retail space as well.

Both foreign and Indian investors like passive funds
My stance on passive funds stems from two key reasons – its attractiveness for foreign and domestic investors.

Growth in world GDP is going to come from Asia. Economic growth in several nations of Asia will result in an increase in the share of Asia in global GDP. India is expected to grow the fastest among the lot. As on date, India fares relatively well on various economic indicators among its peers. FIIs have been bullish on India for quite some time now. India outperformed EM peers in the first six months of 2021 despite the uncertainties amid the second wave of covid infections. In dollar terms, the Sensex and Nifty jumped 8.26 percent and 10.81 percent, respectively, compared to 6.94 percent gains made by the MSCI Emerging Markets index during the period (Source: BSE/NSE). The increasing pace of vaccination, the government's stimulus packages, and the Reserve Bank of India's liquidity support mechanisms kept investors glued to Indian equities during the January-June period.

If history were to give us any indication, it is understood that the benchmark Index of any economy grows the fastest during the economy's road to $5 trillion club (GDP). The US took 11 years to go from $2 Trillion to $5 Trillion (1977-1988). The Dow Jones rose from 700 levels to 12000 between 1977 and 2000, a 17x gain. Japan took 8.5 years to go from $2 Trillion to $5 Trillion (1978-1986). The Japanese stock market zoomed from 2000 to 37000 (1978-1991) – an 18.5x gain. China took five years to go from $2 Trillion to $5 Trillion (2004-2009). During this time, the Hang Seng went from 8500 to 32000 (Source: CEIC).

India entered the $2 trillion club in 2015. We have a long way to go before we reach $5 trillion. Since 2015, the Nifty hasn't even doubled from ~8000 to 15000 today. This makes a pretty good case for foreign as well as domestic investors to invest in passive funds at least for the next 5-8 years, till India becomes a $5 trillion economy.

Low FD rates will push investors more towards equity

India has already set itself on the path of transforming itself into a developed economy. One of the key characteristics of a developed economy is that it has a low inflation rate and therefore the interest rates are also relatively lower. Inflation rate in the US never crossed 4 percent since 1990 (Source: CEIC). As a result, interest rates since then has hovered around 3 percent before falling to near-zero level presently. In my view, as India progress to become a developed economy, we should see our inflation coming down and therefore our interest rates falling over a longer period time (8-12 years). A simple analogy that could be drawn here is that our interest rates in the 1990s were upwards of 15 percent. During the same period, FD rates were around 18-20 percent (Source: RBI). This has come down as our economy kept on getting bigger and bigger. Today a five-year FD offers less than 7 percent return (Source: RBI). Thus, in my view, FD rates are only going to see a downward trend in the long run.

All this indicates that domestic investors will most probably shift to the equity market. And passive funds could be the preferred route for such investors. We have already started seeing the shift at least in the corporate segment where Government of India has directed public sector enterprise and PF trusts such as EPFO to shift to passive funds to ensure reasonable returns to investors in order to compensate for falling FD rates. Slowly we may see even the retail segment getting active in this space.

DINESH PANGTEY *is CEO of LIC Mutual Fund*

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