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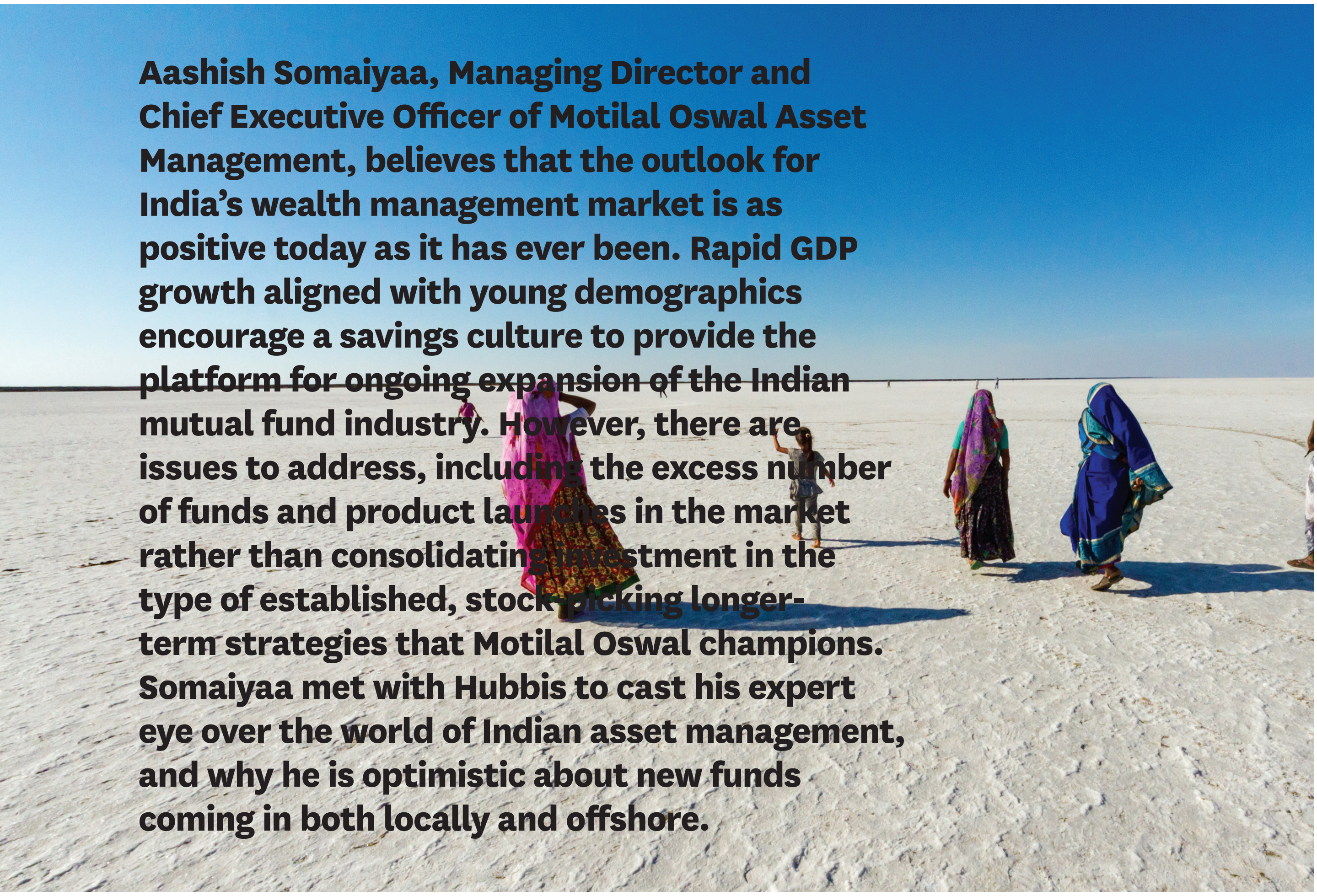
Motilal Oswal: Building and Diversifying India's Asset Management Industry



Aashish Somaiyaa, Managing Director and Chief Executive Officer of Motilal Oswal Asset Management, believes that the outlook for India's wealth management market is as positive today as it has ever been. Rapid GDP growth aligned with young demographics encourage a savings culture to provide the platform for ongoing expansion of the Indian mutual fund industry. However, there are issues to address, including the excess number of funds and product launches in the market rather than consolidating investment in the type of established, stock-picking longer-term strategies that Motilal Oswal champions. Somaiyaa met with Hubbis to cast his expert eye over the world of Indian asset management, and why he is optimistic about new funds coming in both locally and offshore.

"MANY PEOPLE IN OUR BUSINESS," he began, "seem to believe that the only way to get new money is by showing new products to potential customers every month, or every quarter. This means that there is too much of buying which happens on the basis of novelty, and perhaps on too short a time horizon perspective. This means too much focus on tactics, and not enough focus on risk-return expectations based around client goals. Product selling and even worse, 'feature' selling can be counter-productive, after all the most essential is the return."

Following the US model?

Looking from a wide-angle perspective, Somaiyaa sees India moving towards the US model. "In the US, for every hundred dollars of assets managed in mutual funds about half of that is managed by way of alternatives, such as hedge funds, concentrated portfolios and other strategies," he reports. "India is actually just beginning to go that way, with mutual funds becoming more and more retail and standardised, while at the same time there is a nascent trend for some of the more successful asset managers to open their own shops focusing on alternate assets. In the West today, the mutual fund managers are no longer the big names, it is all the alternative and hedge fund managers."

Moving towards alternative strategies

He extrapolates on this, noting that long-term buy and hold is a great strategy, proven over time, but it needs patience and maturity at investors' level. Alternative platforms enable right investor segmentation with focus and conviction as opposed to mutual funds. That apart, specialist and alternative funds have been rising in prominence because the average individual's inability to stomach the continuing intermittent volatility offers them a fertile ground to seed their funds with strategies of varying risk return combinations.

Regulation, he elucidates, is one of the factors that is somewhat commoditising the mutual fund industry, both in equities and increasingly in fixed income. "Creativity and innovation," he observes, "will therefore come only outside the mutual fund sector, while many of the wealth managers, private bankers, high net worth and ultra-wealthy investors gravitate towards the specialists. This trend will become increasingly prominent."

Diversity

Somaiyaa does not make any judgement on whether this is a positive or a negative development. "It is a trend towards diversity and greater choice," he explains, "so we will see new strategies such as long-short and other ideas that might offer a better return per unit of risk. Second, pushing risk aside, returns might be higher for those willing to push for maximum returns. Meanwhile, the mutual funds increasingly become the retail asset allocation, for financial planning, savings and somewhat of a commodity."

He also observes that at the same time, the understanding of risk in India is rising. "We are at the early stages of this portion of the market's evolution, as everyone has been so focused on growth, but there is the beginning of a greater sensitivity to risk."

Matching assets to investors

He also maintains that there needs to be some improvement in distribution, to more accurately match products to expectations. "The product makers and products are tightly regulated, but the distribution practice is not yet regulated, so standards are lagging," he reports. "For example, we need to be wary of what we call 'incidental advice'."

Incidental advice, he elucidates, is advice as applicable or relevant to just what role the product may play in a context or a particular investment for the client. This may be more "here and now" when a client approaches a distributor or vice versa while they are trying to promote a particular product, without sufficient sensitivity or regard to how that product might fit the client's asset allocation, or long-range financial plan.

"We need a better definition of advice and better regulation in that sense," Somaiyaa comments. "There

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is some consultation going on regarding advisers and distributors, but much more needs to be done."

He also observes that the wealth management industry is under some pressure on pricing. "There is some pressure to offer more passive products or at least cheaper products because of the move towards advisory practices and the need to move to a fee-based pricing model rather than depending on embedded commissions," he reports. Since this is happening at a time when recent performance of active funds is below par there is a sort of fillip to passives and they are getting increased attention. While we believe that active funds have huge potential to outperform in Indian markets, the interest in passives is not just related to alpha or lack of it, it is also fuelled by regulatory drive to advisory practices, cost consciousness and also the rise of digital and DIY cult.

He analyses equity products as having four component parts. The base is beta and beta-plus (what the western world names closet indexers or funds with low tracking ranges), the third level is alpha chasers, and the fourth level is the alternate strategies. "The more basic strategies are seeing greatest fee pressure, naturally," he comments, "as they are not so differentiated. But pressure in India is only at the early stages, this is not the Western world. And we learn a lot from developments in the Western markets, so you already see a lot of private bankers making early moves to get into the advisory and the fee-based space. This is actually happening quite rapidly, due to the pace of development here and in India today, the wealth managers and private bankers that I speak to are already reinventing their business models." ■

Getting Personal

Although his family hails from the state of Gujarat, Somaiyaa was born and raised in Mumbai, although he completed his undergraduate engineering studies in a nearby city named Pune. "I returned here four years later and then completed my postgraduate in finance."

"My career was built more of opportunity than planning," he reports. "Many people look back and cast it all in a structured light, but very often careers develop in other ways. The standard script might have been that as an engineer and a Finance postgrad I become a consultant or investment banker, but I went into the sales of investment products, where competition was less as the industry was in its early stages."

His first role was with what was then Prudential ICICI and ICICI Prudential Mutual Fund, before becoming a project manager with AXA when they launched in India. "That was only about 15 months, before Prudential ICICI hired me back and I stayed there until 2012 when I joined Motilal Oswal."

Somaiyaa is married but with no children as yet. He enjoys spare time reading at home, where he has assembled an extensive library. "Every time I go to a bookshop or every time I pass through an airport I always buy a few books, or I might peruse the Amazon site and buy there. I read avidly, but my buying means there are many books at home which I still have yet to get to."

A recent favourite read was "A Piece of the Action", which tracks the development of the US financial system and the evolution of today's financial landscape there. "In particular it was fascinating to learn about the arrival of the credit card, it really was one man's vision and determination that has created what we have worldwide today."

Watching movies at home is another passion, especially Bollywood movies. The Bollywood movie Sholay is one of his favourites. "It is kind of a take-off of some old Western classics that might have starred Clint Eastwood, it is somewhat of a cult movie from the 1970s."

And his favourite movie of all time is actually a Hollywood release in the form of Bruce Almighty, starring Jim Carrey and Morgan Freeman. "A fascinating and engaging vision of how a divinity might conduct himself," Somaiyaa comments. "People are often a bit surprised when I cite this as my favourite movie."

He is also a bit of a news junkie, and loves travel, for business or for pleasure. "Montreux in Switzerland is a favoured place," he notes, "and a walk along the promenade there is always a pleasure, what a beautiful setting."

Key Priorities

"We have been working on developing our offshore presence," Somaiyaa reports. "Our focus areas are the Middle East and the Swiss UK part of Europe, and the US. What we want to achieve is to reach out to family offices and the UHNW space. We already have a fund which is domiciled in Mauritius and next quarter we are creating a fund which will be domiciled in Dublin, an Irish fund to reach out to the European markets."

Somaiyaa's view is that much of the money that comes into India via funds is through a BRICS fund, or a GEMs fund or Asia ex-Japan or some such grouping.

"I think that is suboptimal and there is really little or no connection, for example, between India and Brazil," he comments. "Local managers like us have portfolios full of domestic inward-looking midcaps, we are stock pickers and we see a greater shift towards bottom-up single country investment focusing on India, which is where we have a greater role to play. That is why we are focusing on the offshore market, seeking money to come directly into India."

Somaiyaa says that when he meets institutional investors, family offices, and private bankers outside the country, he finds them to be a bit more appreciative of the Motilal Oswal s understanding of process and philosophy.

"I do find the international audience a bit more appreciative of what we do," he says. "So that's a strategic priority, to widen the sources of inflows for us. If you're outside the country and investing into India, someone like us who's a bottom-up, select sector kind of stock picker, we can add a lot as far as the country's domestic growth is concerned."

The second priority is to deepen domestic distribution. "Historically, we were known more as an alternative fund manager, but we now have a five-year domestic mutual funds track record, so our retail distribution and prominence are improving, and we plan to push this expansion further."

India is enjoying remarkable growth in disposable income, which results in a boost for both the consumption sector and for financial services. Somaiyaa sees the combination of population growth, increasing education levels and urbanisation, the growing importance of savings and planning for the future all as supporting factors for the asset management industry.

And Somaiyaa's third priority is to expand and enhance the investment team.

Somaiyaa closes the conversation by conceding that the past two or so years had been difficult, as Motilal is somewhat of style-biased manager. "We buy high-quality high-growth and these are low churn strategies, holding stocks for an average of about five years plus. But in the last year and a half the market in India has been high beta, it has been favouring sectors which are more cyclical or contrarian in that sense, for example state-owned enterprises like the banks and others. This has resulted in underperformance of our holdings, but we stick to our strategy because we believe eventually the market comes back, so we avoid chasing what's working in the markets. We are now seeing a wider recovery for our style, so we are getting back on track."