Why Indian advisers have failed to generate alpha

The focus for market practitioners should not be about whether or not the Sensex can reach 35,000. Regardless of how the markets perform, wealth managers need to start giving the right advice to their clients, says Siddhartha Rastogi of Ambit Capital.

The past year has been a turbulent time for Indian stock markets. This was due to various cues such as Brexit, US presidential elections and demonetization. In response, both the Nifty and Sensex indexes declined approximately 6% post-September 2016 and gained only 4% 5% in the past year.

Despite the underperformance of financial markets, wealth allocation data, according to Karvy's 2016 wealth report, reflects a skew towards financial assets which were around 57% of portfolios as compared with physical assets which stood at around 43%. Yet returns from physical assets such as gold and real estate for this period were much higher – at roughly 8% and 40%, respectively.

"Are successive wealth managers inclined towards following industry trends?" asks Siddhartha Rastogi, director, investments advisory, private wealth and fund raising at Ambit Capital. "Why do they struggle to change their investment pattern in spite of low performance by their preferred asset class, and therefore fail to generate alpha?"

He believes that having the precise mix of skills to deliver great wealth management service requires years of experience and specialised knowledge. "Every client requires a financial portfolio which matches their risk appetite and financial needs," he adds.

In Rastogi's view, the Indian markets have reached a stage where an investor should be practicing 'caveat emptor' – responsible on their own for checking the quality and suitability of the financial instrument before the purchase is made.

SIDDHARTHA RASTOGI
Ambit Capital

HIGH CHURN AND TIMING THE MARKET

One big dilemma that the investment industry faces, says Rastogi, is the timing of its investments. "Most wealth managers put out 'buy' recommendations when a bull run is already underway, claiming that the future is bright," he explains. "It may really be so, but do they also issue advice that cautions

investors about rampant profit-booking at these higher levels?"

More than a bull-run, he says the role of wealth managers becomes critical during bear phases. "During downturns, when there is panic in the markets, many wealth managers tend to shy away from looking at the brighter side of the economy," he adds. "The brave ones also do not fare particularly well. Their new investment proposals invariably get turned down by clients due to a fear of potential losses."

In such a scenario, many advisers recommend clients to pull out as quickly as they can under the belief that markets can crack further. Their missive to the clients usually ends with the sentence: 'Let us enter when markets bottom out.'

Truth be told, no wealth manager can always accurately predict the market's future, says Rastogi, adding that, in the meantime, heavy churning in the stocks and wrong timings of entry/exit ensure that the client loses precious time and money.

LOW EMOTIONAL QUOTIENT OF WEALTH MANAGERS

With the rise in savings and digitisation, more money is finding its way into the financial markets. As a result, there is a need for more financial wizards. Inline with this, more IIT-ians, engineers, chartered accountants and MBAs are getting attracted to the wealth management industry.

"These folks spend approximately USD50,000 to USD60,000 in top business schools and other similar educational institutions to complete their studies,' says Rastogi. "To pay back the loans or recover the money spent, they get carried away to sell (or, is it mis-sell?) products without understanding the suitability of the product for the customers."

Their zeal to 'make big' in life forces them to thrive on customers' greed, he adds, completely ignoring the risk appetite of the customers. "And, yes, this is how complex and high-cost instruments find way into the portfolios of clients."

CONFLICT OF INTEREST

The other predicament that he believes wealth managers face is how they can avoid recommending a product that is ultimately paying for their salary.

For example, until recently, asset managers were paying upfront commissions of as high as 6% to 8% to their biggest distributors on close-ended equity funds that were locked in for 3 to 5 years. Similar incentive structures were offered by fund houses on their capital protected products, until SEBI cracked down on upfront revenues.

"There are enough statistics to prove that close-ended funds have paid lumpy fees to wealth advisers with the singular objective to induce retail customers to lock in equity money," explains Rastogi. "It is embarrassing to note how many of these funds have delivered absolutely horrendous returns."

NEXUS OF MANUFACTURER, ADVISER AND INTERMEDIARY

At the same time, there are many clients who chase high yields and have no understanding about the concept of default or junk bonds and risks associated with it.

"Such highly-resourceful wealth managers use various intermediaries to move the money and pay off the money so that all parties are satiated," says Rastogi. "At the time of default, the client is the only one who loses money with no accountability on the manufacturer or wealth manager."

TOO MUCH PRESSURE TO DELIVER QUARTERLY NUMBERS

In wealth management, both adviser and client need to have an immense amount of patience. Without it, Rastogi says money can evaporate like it never existed. "Unfortunately, listed entities – that need to deliver quarterly numbers to the street – come under the pressure to deliver quick returns on their investment."

For these entities, the investment is really the wealth manager's salary, he explains. "Trying to get quick returns puts undue pressure on the manager. This, in turn, leads to the manager earning more and more revenues by mis-selling high-cost insurance and close-ended products."

REDUCED ECONOMIC CYCLES

At the same time, economic cycles have become more severe – and even shorter.

During good times, therefore, both wealth managers and fund managers juice up undue risk and chase returns over consistency as they are aware – during downturns – that not only their fund, but also their jobs, will be in danger.

"They tend to move up the risk curve, chase momentum, form cartels and deliver returns," explains Rastogi. "There are examples galore when during a particular economic cycle, wealth managers have issued similar advice to their clients."

But, ultimately, neither the fund manager nor the wealth manager is able to time and exit the market, he adds. And the poor client becomes even poorer. ■