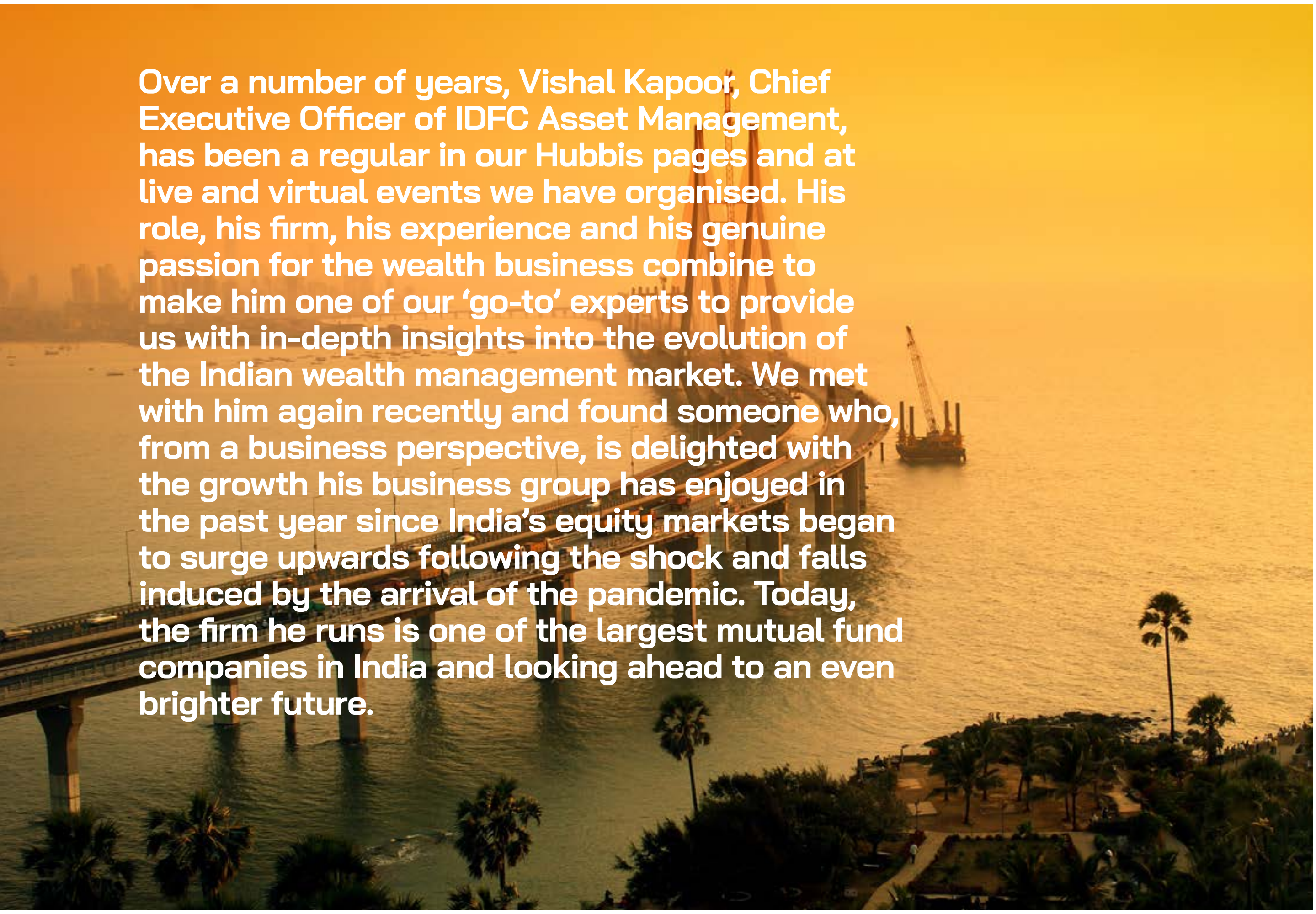
IDFC Asset Management's Head on India's Asset Management Market and its Fast-Track to Growth and Diversification



Over a number of years, Vishal Kapoor, Chief Executive Officer of IDFC Asset Management, has been a regular in our Hubbis pages and at live and virtual events we have organised. His role, his firm, his experience and his genuine passion for the wealth business combine to make him one of our 'go-to' experts to provide us with in-depth insights into the evolution of the Indian wealth management market. We met with him again recently and found someone who, from a business perspective, is delighted with the growth his business group has enjoyed in the past year since India's equity markets began to surge upwards following the shock and falls induced by the arrival of the pandemic. Today, the firm he runs is one of the largest mutual fund companies in India and looking ahead to an even brighter future.

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We last met with Vishal for an in-depth conversation in mid-2019. That was like a different era, when markets were rather more mixed in India when investor confidence was far less robust than today, and yet it was a time without the continual shadow of the pandemic hanging over each and every one of us.

Whatever the pandemic has thrown at him, at the firm and at clients, Vishal has continued to chart a course for IDFC Asset Management (IDFC AM) to keep enlarging the product range, to keep diversifying the opportunities to present to clients, especially as equities have proven so appealing in an era of declining interest rates, and rising economic prospects for India.

Aside from the growth and diversification of mutual funds, along with the enhanced dissemination of information and education on financial investments and specifically funds, the firm has also been investing in two other key areas. One area is what he calls 'a true blue' hedge fund, and the second involves the application of artificial intelligence (AI) and machine learning (ML) in portfolio construction within fund management.

Dynamic growth and market maturation

As to broader market trends in fund management, Vishal explains that there are as yet no very clear winners and losers as largely because the growth is across the board and across a country that is still in its infancy in terms of the financialisation of household savings and the penetration of the asset management industry. "In every market penetration metric you can imagine, India is well behind the developed world," he reports, "and that means across all segments of wealth, from high to modest, there is huge growth potential."

Accordingly, with so much growth in India, there is still room for plenty of banks and firms to expand, and perhaps only later will more modest growth and the maturation of the market see the true longer-term winners and losers emerge more clearly.

The true winners will emerge

"From the private banks serving the upper segments, through the mid-market where there are numerous IFAs and others, everyone is still talking about dramatic growth," Vishal observes. "And then you have the new entrants, the FinTech disruptors, the robo-advisors, appealing to some client segments, especially Gen Y or Gen Z, first-timers coming into the market, people who are comfortable with just getting on the platform and doing it themselves. And in fact, that is the fastest growth area currently."

He says that at the risk of oversimplifying the distribution landscape, there are those three broad buckets of distribution available today, all with huge headroom for growth. "And that means this is not the time really when any of them will emerge as the winning model, and each has their advantages and disadvantages, and a clearer competitive landscape of winners and losers will likely emerge considerably later," he says.

Retail investors lag the market rally

As to the product manufacturing end of the market, where IDFC AM still sits, he observes that the fundamental question is around the products that truly add value, and then how to communicate that to the distributors and partners, and then to the end investors. "Actually," he notes, "equity mutual fund inflows were down for most of 2020 despite the incredible surge in the market after the fall in March. The industry actually suffered net equity redemptions for most of the year. And a lot of the AUM growth in wealth management in 2020 was due to mark to market gains, not because of net inflows from retail investors."

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Rising risk appetite

He adds that this somewhat odd situation has finally changed since March this year, and equity flows are now very much positive, with lots of retail participation, resulting in further rises for the market.

"Before the money came back into equity funds, where did it all go?" he ponders. "Well, much went into fixed income as investors were clearly fearful for a long time about losing money, so became conservative, and that has only changed in recent months as local investors have joined in the huge rally."

Alternatives and pure hedge funds

Vishal shifts his attention to the alternatives space, remarking that

VISHAL KAPOOR
IDFC

there are increasing numbers of alternate investments funds (AIFs) spanning the private and public arenas. "AIFs are allowed to take long and short positions, not just long," he reports, "whereas short positions are not allowed for mutual funds and more traditional investments. AIFs can short the market and leverage can further propel those returns."

He also points to what he calls Category 3 AIFs, which have become much more popular and while many of them are largely long-only, a smaller portion of them offer a hedged strategy, thereby some sort of insurance. "Actually, most long only AIFs are still highly correlated to the underlying assets, largely equities and some to commodities as well," he comments. "What we have been doing is building what I earlier called a 'true blue' hedge fund offering, which is uncommon here in India; this is a pure absolute return strategy."

A new 'true blue' hedge fund strategy

Vishal explains that in many absolute return funds, the level of maximum risk or net exposure to the market is quite broadly defined, which can therefore change the nature of the product quite dramatically, for example, it could become highly correlated to the market.

"However," he elucidates, "what we are doing is keeping the net exposures tightly defined and much closer to neutral. We've defined exposure ranges from plus 30% of the neutral position, to minus 20%. So the manager can take up to a 30% long position in a bullish market, or a minus 20% if it is a bearish market he is anticipating. On average, we are targeting to be relatively closer to a net neutral position which reduces risk for the investor."

Applying technology to portfolio curation

Vishal also returns to focus in more detail on his earlier reference to the application of AI and ML to portfolio management and allocation. He explains that AI and ML is already being applied extensively to enhance customer service, for instance, through chatbots, and AI is also now being used in the marketing area to help predict customer activity by analysing what they have actually been doing.

He elaborates on the technology aspects in portfolio management, noting that quant models in the past used to be static algorithm-driven formulae driving a portfolio, but the application of ML is achieving new and fascinating results. "The outcomes are partly dependent on the quality of data, of course," he reports, "and we have been working hard to filter and structure our data for a few years already, and we are delighted to see the steady improvement in the results we are achieving."

"Portfolios managed by a seasoned fund manager deploying AI/ML techniques to process high quality, objective data are likely to be very distinct from the traditional, largely similar processes currently deployed, which often rely on an individual manager's stock-picking expertise. Over time, risk and return characteristics for these alternative approaches could be markedly different, offering investors a much wider choice."

The mission of this approach is to run a true absolute return product, which is essentially a new asset class in India. "With low or minimal correlation, volatility is under control in a very active manner," he explains. "We think that it can be an attractive product, which may have an absolute gross return outcome in the early-teens, but with volatility levels which may be less than a half of the market, and with a correlation which is actually extremely low versus the market."

Building the optimal portfolio

"What we have been working on in recent years is using AI to build a portfolio of stocks," he reports.

Key priorities

His first mission remains adding value through the product range. "That is still an imperative," he says, "so we are continually discussing new investment ideas, identifying areas of core value, looking at which ideas will sustain over time, and then how we can efficiently manufacture the right strategies."

The second key mission is to further develop the distribution network. "We estimate that the actual number of distributors who are really relevant in a country as large as India could be just about 35,000-40,000. This is too narrow for India, so we are working hard with industry bodies to see how we can expand the number of distributors, how we can help train them better, and so forth. And we have been working on how we can help those businesses transition ownership to keep them going, as many do not have such plans in place."

The third core priority is investor education and awareness. "As you know, I am very passionate about this, as is our firm as a whole, so we have really expanded and improved our capabilities for delivering investor education to the market, making it much more appealing and interactive. We have about 25 million individual fund investors in the country, but we should easily see that rise to over 250 million. There's a lot of headroom for incredible growth here."

"And this gets a lot more interesting and it is relatively new in Asia. If the IBM Deep Blue computer can beat Kasparov at a game of chess, then AI and ML can also process big data to potentially create a very efficient portfolio, perhaps even almost theoretically perfect. Because if we feed in the right data, it could give you the best result out of the various combinations possible. We are trying to focus on the best returns per unit of risk; so we are not just chasing absolute returns, we also factor in downside risk and volatility."

He offers more detail, noting that the mission at the outset involved sticking to the larger cap stocks, the top 200 companies as represented by the BSE 200 Index, and then applying certain criteria to narrow down the selection and weight them into a portfolio. "The results are really fascinating," he says. "If you look at the last few years where the argument globally has been that it's very difficult to generate alpha, especially in large caps, our model - which we have run for over two years, has indeed been able to deliver alpha. And most importantly, it is a model which has really managed risk very well."

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The internationalisation of investments

He turns his attention to another interesting trend in India, namely the globalisation of investments. "This is not new, but it is accelerating now," he observes. "The concept of global diversification, the ability to buy into feeder funds and access international assets conveniently, but in local currency, is well established. But over the past year or more, we have seen more investors taking direct international exposures, perhaps willing to buy directly in the NASDAQ index or even directly into active funds, or stock picking themselves."

And greater global diversification

At the same time, there is geographical diversification within this internationalisation, for example with China playing a more prominent role, as well as Europe.

"This has all become more diverse and more sustained," he says, "so that, month on month, flows into international funds are considerably larger. We have just started in this space by offering our first US equity growth fund offering. We felt that a classic US actively managed diversified fund may be a good place for any average Indian investor to start. It is a feeder strategy into the JP Morgan US Growth Fund. Since it is not hedged for currency exposure, any Rupee loss or gain is to the investor, and longer-term, the dollar has outperformed the rupee."

An eye on the drive towards passives

Another trend he identifies is the expansion of the market for passive strategies such as ETFs. "There are more and more investors attracted by both the performance and fees of passive strategies," Vishal reports. "Those numbers are relatively small, but I think that's an area of growth and we are closely tracking the trends."

And another trend is towards more investment into thematic funds, many of which have been gaining increasing traction since earlier in 2020. "Investors are open to new ideas and are prepared to take a bit more risk and broaden their core portfolios," he explains.

In the fixed income arena, Vishal reports that his firm has created unique Target Maturity Gilt Index Funds that invest into Indian government securities. "The idea here is that rather than buying Indian government securities directly, which can be difficult to do for an average retail investor, they can buy into a low-cost passive fund with a defined target maturity, which is when the fund ends. In the interim, they can exit the fund at any point in time. And if you plan to hold it to maturity, you should be able to reasonably predict the total return you are likely to receive. This area of passives in fixed income is certainly another growth area."

Staying ahead and staying the course

Vishal rounds off the conversation by remarking that the dynamism of India's capital markets and the financialisation of India's vast and growing pools of savings is creating a virtuous circle of growth and potential. "True winners will emerge when the mists clear in coming years, and we certainly believe that our approach will see us right up there amongst the leaders in the asset management industry here. We are already in the Top 10, and we are working hard to keep ahead of the game by focusing on delivering the right ideas and solutions to our customers." ■

Getting Personal with Vishal Kapoor

Born in the east of India in a suburb of Kolkata, which was once known as the Detroit of India, he studied there through to graduating in accounts and economics, before attaining his post-graduate qualifications from the Indian Institute of Management in Ahmedabad.

Kapoor has around 25 years of rich experience in financial services across functions and businesses including asset management, banking and consumer marketing, and has built a successful track record of building strong teams and sustainable businesses.

Before taking up his current role at IDFC AMC, Kapoor's last assignment was with Standard Chartered Bank as the Managing Director, Head of Wealth Management, India, where he served on several leadership committees including the regional and country management group of the bank as well as the Global Wealth Management leadership team.

He was also a Director on the Board of Standard Chartered Securities India Limited. In his earlier career, Kapoor worked with American Express as the Senior Director and Head of Financial Advisory Services in India. In this role, he was instrumental in setting-up and rapidly transforming the onshore consumer banking business to becoming a high growth, highly profitable business unit.

Before that he worked at ITC Threadneedle AMC, which was then part of the giant British tobacco group, BAT, which had diversified into financial services and asset management. "That was my first formal job, in the very early days of the mutual fund industry," he recalls, "and being able to participate at that stage was a very enriching experience. The 1990s were the early days in the development of the broader, modern financial services here, following the 1991 deregulation and liberalisation reforms in India."

Married, with one daughter approaching 21 years old who is studying in the US, Vishal says his first trip whenever possible will be to the US to see her. And then perhaps enjoy another outward-bound trip to the great landscapes and invigorating air of Scotland.

His final word is on the pandemic and its impact. "I am surprised by how resilient and adaptable we have all been" he says. "There are plenty of negatives of living through lockdowns of course, but in a city like Mumbai, cutting down commute can actually release a lot of time and energy to do other things. Family time, more leisure time and greater productivity has been amongst the several positives. But I do hope for a full return to some of our former normalcy and travel soon."