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Growth of the Mutual funds industry

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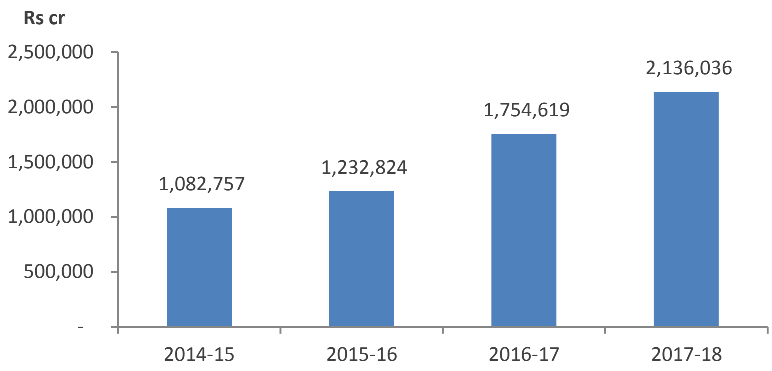
The mutual funds industry is mature today with the overall corpus of funds held by them crossing Rs 20 lkh crore. The AUM is now around 18% of outstanding deposits in the system and the fact that it is growing rapidly is indicative of the discerning saver/investor. The significant part of this growth is that it is well dispersed across both debt and equity. Mutual funds give access to retail investors to draw on the success of equity market through selective investing by the fund managers.

The fact that households are accessing these funds is significant as it competes directly with bank deposits which hitherto were the most preferred vehicle for parking savings. The relatively higher returns on bonds with certain accompanying tax benefits if held for a period of over 3 years makes them more attractive than bank deposits.

In FY18 it has been observed that there was conscious migration from bank deposits to mutual funds as deposit rates had come down sharply making them less remunerative. In incremental terms mutual funds were able to garner a proportionately higher share of household savings.

Chart 1: Size of AUM of Mutual funds



Source: SEBI

The Chart above shows that the AUM had almost doubled in three years which is very impressive given that bank deposits have moved by around 34%. The growth has been hence quite phenomenal and has also helped to provide a boost to both the equity and debt markets. In fact, of late mutual funds activity in the equity market has been more significant in driving sentiment than that of FPIs.

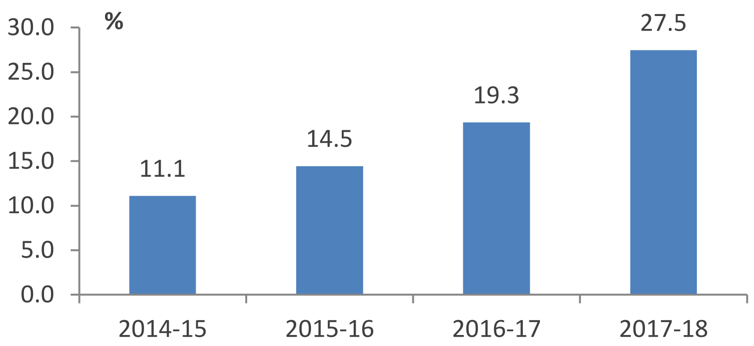
Table 1: Share of mutual funds in Bank deposits plus AUM

Rs crore	2014-15	2015-16	2016-17	2017-18
MF outstanding	1,082,757	1,232,824	1,754,619	2,136,036
Bank deposits	8,533,290	9,327,290	10,757,660	11,474,990
Share (%)	11.3	11.7	14.0	15.7

Source: SEBI

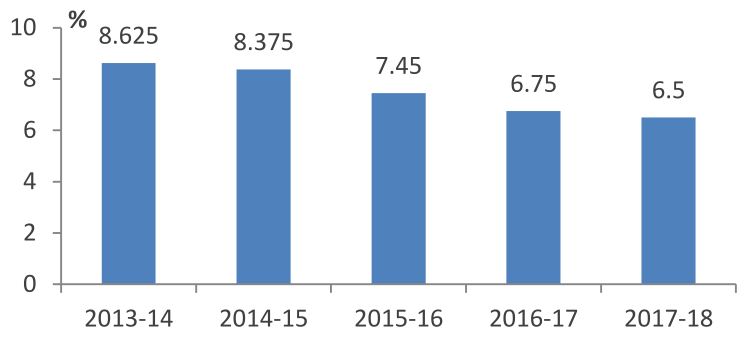
Table 1 reveals that the share of mutual funds in savings deployed in both deposits and mutual funds was stable between 11-12% which increased in FY17 and further to 15.7% in FY17. This is definitely a sharp increase witnessed which is even more distinct when looked at in incremental terms in Chart 2 below.

Chart 2: Share of MFs in incremental deposits plus MFs



Source: SEBI

Chart 3: Average deposit rate (one year)

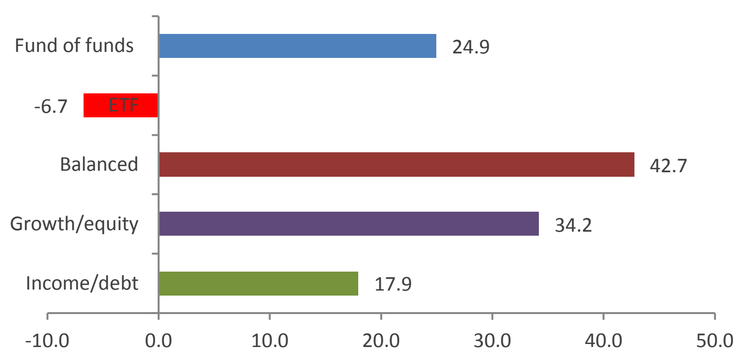


Source: SEBI

The steady increase in the share of mutual funds in total incremental savings deployed in deposits and mutual funds increased from 11.1% in 2014-15 to 27.5% in 2017-18. The continuous upward trend is indicative of the investors becoming savvier with the markets. Mutual funds have been the most effective way of getting retail participation in both the equity and debt markets. This has also been used by corporates to earn better yields on their investments compared with bank deposits, which was a traditional channel for deployment of surplus funds. The declining interest rate trend of deposits has been a deterrent for savers as debt mutual funds have been offering returns of 100-200 bps higher depending on the risk profile of the portfolio.

Which avenues have found favour of investors?

Chart 4: Growth in AUM (%): FY13-FY18



Source: SEBI

Growth in AUM in the last 5 years has been at a CAGR of 25% p.a. The highest growth was witnessed in case of balanced funds at 43% followed by growth/equity funds with 34.2%.

Income and debt funds which compete directly with bank deposits witnessed growth of 18% per annum. The higher growth rate witnessed in case of equity also reflects the changing risk profile of investors including household and corporates where there is an attempt to maximize returns by taking on a certain modicum of risk.

Shares of various schemes in total AUM (%)

Schemes	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Income/debt	70.9	72.8	64.1	63.5	61.2	53.1
Growth/equity	24.6	23.2	31.9	31.3	31.0	35.1
Balanced	2.3	2.0	2.4	3.2	4.8	8.1
ETF	1.9	1.6	1.4	1.8	2.8	3.6
Fund of funds	0.3	0.4	0.2	0.2	0.1	0.1

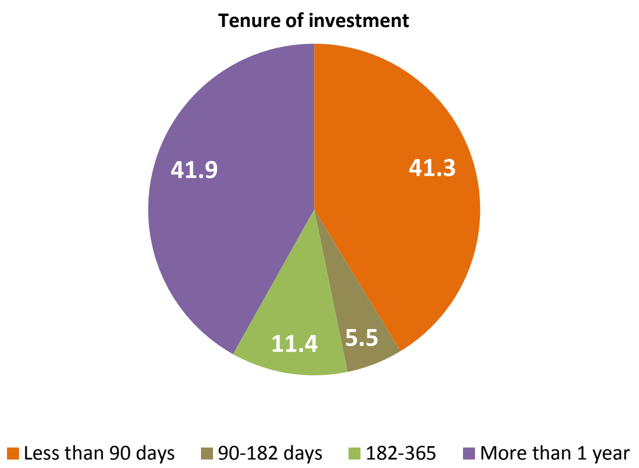
Source: SEBI

The AUM patterns of all mutual funds put together has shown varying trends during the period 2012-1018. With FMPs being largely popular, the share of income/debt funds was high at 72.8% in 2013-14. Subsequently on account of the change in tax laws relating to investment in debt funds with regards to capital gains in the Budget, there was a migration away from debt funds and the share has come down to 43.1% in 2017-18. Simultaneously there has been an increase in the share of growth/equity schemes with the share moving up from 24.6% to 35.1% during this period.

The investor appetite for equity has increased over time and it will be interesting to see whether this trend will be sustained considering that the Union Budget of 2018-19 has introduced long terms capital gains tax on equity as well as equity funds. In fact, with deposits becoming less popular in 2017-18, households preferred to move to mutual funds and also took on higher risk through equity funds investment besides balanced funds (where typically 65% investment is in equity).

How do mutual funds invest?

Chart 5: AUM of mutual funds as of March 2018



Source: SEBI

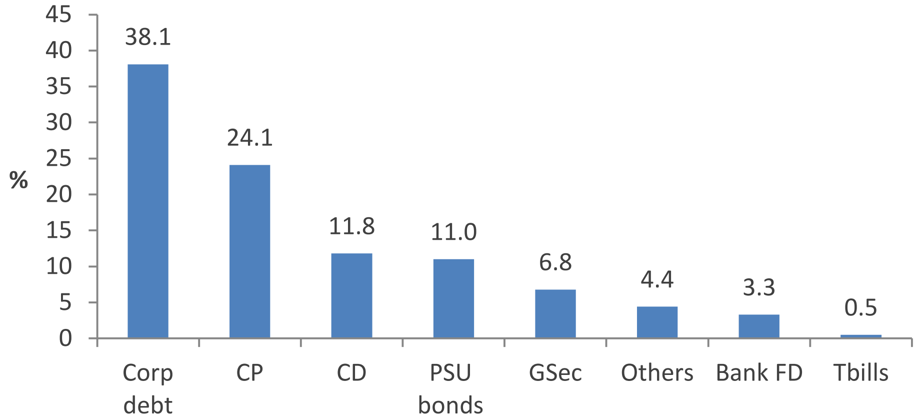
The maturity pattern of the AUM in debt related funds gives an idea of the investment horizons of the respective funds. The classification of the same is in 4 buckets of less than 90 days, 90-182 days, 182-365 days and more than 1 year.

Chart 5 alongside provides the distribution part of the AUM of mutual funds across investments under various tenures as of March 2018.

- The two buckets which dominate the picture are less than 90 days and more than 1 year. Therefore, there is a preference of the relatively shorter and longer tenures of investment.
- The tenure bucket which has the lowest share in the total investment portfolio is 90-182 days.

Further, the deployment of these funds in various instruments is also important as they vary in terms of risk profile, tenure and issuer. Chart 6 below provides a view of how the debt funds have invested across different instruments

Chart 6: AUM of Mutual funds in different instruments: March 2018

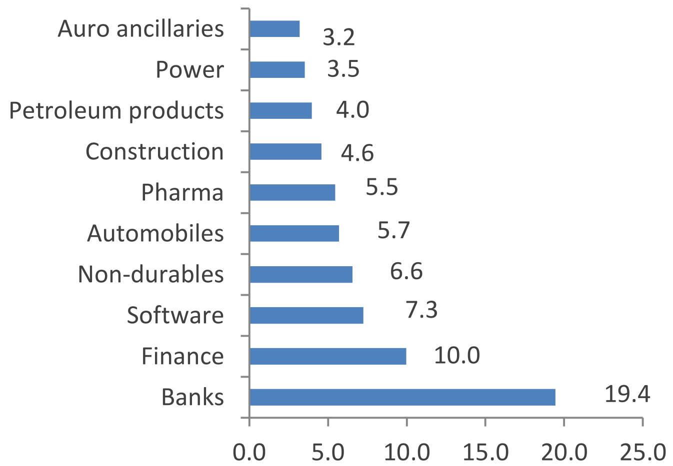


Source: SEBI

As can be seen in Chart 6, over half of the investments are in corporate debt and CP with these two accounting for 52% of total. This is followed by CDs with almost 12% and PSU Bonds with 11%. GSecs come much lower with around 7%. The investment pattern is hence also reflective of the returns that are earned on the portfolio as corporate debt and CPs earn higher returns relative to CDs and PSU bonds. The latter are perceived as being less risky relative to the former two instruments.

How about equity funds?

Chart 7: Sector share of equity funds in FY18: Top 10



Source: SEBI

Chart 7 provides information on the sectoral distribution of the AUM of equity funds as of March 2018. The top 10 sectors account for around 70% of the total funds deployed.

Interestingly the top two sectors are in the financial segment accounting for around 30% of total funds. If software, which is part of the services sector, is added, then 40% of allocation is in the service area. The next two important sectors are in the consumer segment – automobiles and non-durable goods (FMCG) which would be the ones which have steady demand and more importantly are free of any regulation. Pharma comes next which has global influences too and is regulated to a certain extent but has steady state demand usually.

The relatively riskier sectors are construction, petroleum products and power, which are not just subject to policy changes and reforms at various points of time but also counter volatile prices which affect the concerned companies. Cement, capital goods and durable goods come in with shares of 2-3%, while the rest are less than 2% and includes metals, chemicals, transport, telecom, textiles, oils, hotels etc.

Concluding remarks

1. Mutual funds have matured to a very large extent to effectively offer competition to bank deposits.
2. The choice between debt and equity will vary depending on the expected returns as well as tax benefits offered. The present tax on long term gains on equity based income would have a bearing on the flow of investments which needs to be monitored closely in FY19.
3. Their investment pattern in corporate bonds and CPs is a very strong signal that they play a very important role in developing the corporate bond market. Around 60% are in investments with tenure of less than a year making them a dominant player in this segment. Also their participation will have a bearing on the yields in the respective tenures.
4. Investment of equity funds in various sectors can give an indication of the sectors that could be tracked by individual investors as having better prospects.

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