GAINING POPULARITY

ETF outlook brightens amid slowdown as foreign investors flock to safety

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MUMBAI

Amid the global economic uncertainty that has made investment more of a gamble than ever, exchange-traded funds (ETFs) have held their own, while offering an avenue of entry for foreign investors to India that the regulator regards with approval.

An ETF is a listed security that tracks an index, a commodity or a basket of assets such as an index fund, but trades like a stock on an exchange. ETF prices change through the day as they are bought and sold. They are regarded as providing the diversification of an index fund with the flexibility of a stock.

India's capital markets regulator, the Securities and Exchange Board of India (Sebi), clears ETFs faster than it does other funds. ETF assets in India continue to increase while foreign investors are offloading stakes in all other asset classes. This is persuading both foreign and domestic fund houses to start ETFs in India.

This year the regulator has cleared at least 21 ETFs run by foreign fund managers, compared with five in 2010, four in 2009, five in 2008, and six in 2007.

"In fact, the regulator has clearly indicated that it's more comfortable with broad-based foreign money (coming in through ETFs) as the identities of the investors are clearly indicated," said Naveen Kumar, managing director, **INDXX Capital Management Services Pvt. Ltd**, which has started four ETFs with allocations in India.

Broad-based funds are those with a large number of clearly identifiable investors, unlike other foreign funds over which Sebi has occasionally expressed concern.

"ETFs mostly bring in retail money to invest in stocks or indices listed on the exchanges. So, the money coming through ETFs is more transparent in nature," Kumar said.

While the segment is relatively new in India, global ETF assets are worth at least $21.05 trillion (₹1,040 trillion). There are 34 global ETFs with an exposure to the country, including eight India-dedicated funds, with overall assets of at least $72 billion.

"We see growth and plan to launch three more ETFs with India exposure in the next one year," Kumar said.

Domestic fund houses, including Birla Sun Life Mutual Fund and Kotak Mutual Fund, are also keen on starting ETFs.

"As one of the asset classes, we will look at ETFs," said A. Balasubramanian, chief executive of **Birla Sun Life Asset Management Co. Ltd**, which managed assets worth ₹67,475.15 crore as of 30 June.

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Most ETFs started by Indian fund houses are based on gold and the National Stock Exchange of India's 50-share index Nifty. That is likely to change as the market matures.

Kotak Mahindra Asset Management Co. Ltd, which manages ₹33,993.54 crore of assets, has three ETFs excluding gold, according to chief executive Sandesh Kirkire.

"We have some more of the sort on our drawing board," Kirkire said. "As markets deepen you will find more ETFs coming in."

Global ETFs with exposure in India invested $2.57 billion locally in the July-September period, according to INDXX Capital. During the period, equities witnessed a net outflow of $13.92 million, and debt assets saw inflows of $1.41 billion by foreign institutional investors (FIIs).

As investors globally migrate to safer asset classes, FIIs are offloading their direct stock investments in emerging economies, including India. In contrast, money continues to flow into ETFs in the country.

India-dedicated ETFs mostly invest in the Nifty. INDXX Capital calculated that, given a base of 1,000, an ETF based on the Nifty would have grown at 12.5% since February 2010 against an advance of 3.3% by the index.

While India's benchmark equity indices are trading at least 20% down from their year-opening levels, assets under the eight India-dedicated foreign ETFs remain almost constant at around $3 billion for the year, indicating incremental investments into these funds. Assets under India-dedicated ETFs have grown exponentially from $172 million in January 2007 to $3 billion by July end.

Since January 2010, there have been no net ETF outflows from India, unlike domestic equities. INDXX Capital estimates the total assets under ETFs with India exposure at close to $5 billion and this is expected to grow in the coming years.

"ETFs constitute nearly 7% of the total FII assets in India and by next year this should go up to 9-10%, considering other factors (are) constant," said Kumar.

There are 29 ETFs currently traded on the National Stock Exchange (NSE).

"As financial literacy improves, you will find higher allocation to such asset classes," said Kirkire.

While global ETF managers want to enhance their India exposure, the country currently does not have too many underlying assets on which they can be based.

"In countries like India, where the index fund category is not comprehensive enough, investors might not be able to take specific sector or market segment exposure, a choice that is available on the actively managed side," said Harshendu Bindal, president, **Franklin Templeton Investments India Pvt. Ltd**, which manages ₹34,729.35 crore in mutual funds. That should change.

Asia's oldest bourse, BSE Ltd, has a number of indices that ETFs could be based on.

Sebi is to keen to approve BSE's application to get the indices approved for global ETFs to encourage competition among the exchanges, said a person with direct knowledge of the discussions between BSE and Sebi.

Apart from the six broad BSE indices based on market cap, there are 13 sectoral ones based on different industries.

"There has been a growing interest in launching ETFs on the BSE platform, r the relaunch of Sen said a BSE official want to be named. eign and domestic houses have appro launch index-base we are in talks with

The regulator di to queries.

ETFs also have lo ratios than those o mutual fund.

The expense r from 0.35% to 1 1.5% in the case of while actively ma charge up to 2.5% o "as they are not ne quiring the servi managers and anal Securities said in report.

India Infoline debuted in the r business with the of an S&P CNX Nift in which all fees a were capped at 0.2

The average exp ETFs, including g on 30 April, was 0. port said. That co 2.5% for most o fund schemes. For stalment plans, the tio is typically 1.7%

"The advantage the cost structure informed retail in institutional inve Jaideep Bhattach marketing officer, **Management Co.** manages asse ₹69,105.09 crore. many investors wh to invest in ETFs n demat accounts a major hindrance."

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