

RIA Talks India

A Practical Look at Passive Investing



Koel Ghosh
Head of South Asia
S&P Dow Jones Indices

RIA Talks India is an interview series where industry thinkers share their thoughts and perspectives on a variety of market trends and themes impacting indexing and passive investing in India.

Koel Ghosh, Head of South Asia at S&P Dow Jones Indices (S&P DJI), chatted with Ladder7 Financial Advisories' Suresh Sadagopan to get his take on using passive investing as a tool for risk management.

Koel: As an index provider, S&P Dow Jones Indices would like to better understand how financial advisors use products based on indices. Please tell us about passive products like ETFs and index funds that can be used in an advisor toolkit in India.



Suresh Sadagopan
Founder
Ladder7 Financial Advisories

Suresh: As a financial advisor, the choice to include various products in a portfolio is dependent upon the investor's risk appetite, reward expectation, liquidity and tenure needs, taxation, etc. While choosing products, advisors will also have to contend with managed products and passive ones. There are merits on both sides, in some subcategories at least.

In the large-cap space, most funds are not able to beat index returns, after adjusting for fees. In mid- and small-cap spaces, active funds seem to be able to beat passive funds more frequently. Hence, having some ETFs or passive funds may be helpful in the large-cap category. Also, in the smart beta (or factor) investing space, many ETFs (and passive funds) have started sprouting up, and they could be good candidates to consider in certain portfolios.

Koel: What are some of the strategies you use, and what are the potential benefits of including passive products in a portfolio?

Suresh: It is our belief that capturing the wisdom of the markets will eventually shine over stock-picking skills. However, it may take some time to mature in India before we get to a stage similar to what the U.S. is experiencing now.

We use ETFs and passive funds that track broad indices. We also use smart beta funds as a satellite strategy in our overall passive investing strategy. However, what we do differs from client to client.

The benefits of passive investing can be manifold. Fund manager risk is mitigated, and typically lower-cost investing is facilitated. Passive vehicles may also have advantages for long-term investment in that the underlying index reconstitution infuses dynamism for a portfolio of stocks. It can help to create a manageable portfolio that encompasses nearly the entire market.

Koel: How do you position your ETF use to clients?

Suresh: We prefer index funds for their liquidity, ease of trade, lack of impact costs, and buyback. We educate our clients about why passive investing may be a good strategy and why we are choosing that for them. We also explain all the typical benefits of the passive products, including potentially the lower cost, mitigation of fund manager risk, automatic alignment periodically to a well-constructed index, etc.

We have tried using ETFs in the past. However, there are some issues that we are currently facing with regard to ETFs in India. Liquidity can be a problem in ETFs when looking at higher volumes. Impact cost is high in a lot of cases, which negates any lower total expense ratio of ETFs. Unlike passive funds where the asset manager is the counterparty, for ETFs, another person who wants to buy is the counterparty when one wants to sell. So there is no assurance that one will be able to sell off ETFs when one wants at near-market prices. Additionally for ETFs, clients require a dematerialization and trading account, which in some cases, they may not have. Reporting can be a problem, as ETFs in dematerialization accounts and those as mutual fund holdings may be reported separately.

Koel: Have indexing and ETF use changed your investing behavior or your clients' behavior?

Suresh: We are advisors looking forward to using new tools and strategies that are good fits for our clients. Index products are one such tool. Hence, we may look to use them more and more as we get to see more products in this space and as passive investing itself evolves.

Koel: As an active manager who is using passive tools, how do you describe this blend of capabilities, and what is the mix of active and passive you favor?

Suresh: We see our role as financial architects who are using available products to build a financial edifice for our clients. Hence, we are product- and strategy-agnostic to a great extent. We choose products that are suited to our clients and help in achieving their goals and funding their expenses.

At every point, we evaluate what makes sense for our client set and suggest that mix for the client. Currently, we find that we use 10-25% passive investment-oriented products. However, it is an evolving situation and it could be a higher number in the future.

Koel: Finally, do you see more RIAs in India adopting this approach?

Suresh: RIAs are using passive strategies today, and they are the ones who will promote passive products if they mesh well with their advisory approach. The use of passive vehicles may likely increase in the years to come as the choice expands, the offerings mature, if costs go down, and a good track record gets built for passive tools vis a vis their active counterparts.

General Disclaimer

© 2021 S&P Dow Jones Indices. All rights reserved. S&P, S&P 500, S&P 500 LOW VOLATILITY INDEX, S&P 100, S&P COMPOSITE 1500, S&P 400, S&P MIDCAP 400, S&P 600, S&P SMALLCAP 600, S&P GIVI, GLOBAL TITANS, DIVIDEND ARISTOCRATS, S&P TARGET DATE INDICES, S&P PRISM, S&P STRIDE, GICS, SPIVA, SPDR and INDEXOLOGY are registered trademarks of S&P Global, Inc. ("S&P Global") or its affiliates. DOW JONES, DJ, DJIA, THE DOW and DOW JONES INDUSTRIAL AVERAGE are registered trademarks of Dow Jones Trademark Holdings LLC ("Dow Jones"). These trademarks together with others have been licensed to S&P Dow Jones Indices LLC. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC. This document does not constitute an offer of services in jurisdictions where S&P Dow Jones Indices LLC, S&P Global, Dow Jones or their respective affiliates (collectively "S&P Dow Jones Indices") do not have the necessary licenses. Except for certain custom index calculation services, all information provided by S&P Dow Jones Indices is impersonal and not tailored to the needs of any person, entity or group of persons. S&P Dow Jones Indices receives compensation in connection with licensing its indices to third parties and providing custom calculation services. Past performance of an index is not an indication or guarantee of future results.

It is not possible to invest directly in an index. Exposure to an asset class represented by an index may be available through investable instruments based on that index. S&P Dow Jones Indices does not sponsor, endorse, sell, promote or manage any investment fund or other investment vehicle that is offered by third parties and that seeks to provide an investment return based on the performance of any index. S&P Dow Jones Indices makes no assurance that investment products based on the index will accurately track index performance or provide positive investment returns. S&P Dow Jones Indices LLC is not an investment advisor, and S&P Dow Jones Indices makes no representation regarding the advisability of investing in any such investment fund or other investment vehicle. A decision to invest in any such investment fund or other investment vehicle should not be made in reliance on any of the statements set forth in this document. Prospective investors are advised to make an investment in any such fund or other vehicle only after carefully considering the risks associated with investing in such funds, as detailed in an offering memorandum or similar document that is prepared by or on behalf of the issuer of the investment fund or other investment product or vehicle. S&P Dow Jones Indices LLC is not a tax advisor. A tax advisor should be consulted to evaluate the impact of any tax-exempt securities on portfolios and the tax consequences of making any particular investment decision. Inclusion of a security within an index is not a recommendation by S&P Dow Jones Indices to buy, sell, or hold such security, nor is it considered to be investment advice.

These materials have been prepared solely for informational purposes based upon information generally available to the public and from sources believed to be reliable. No content contained in these materials (including index data, ratings, credit-related analyses and data, research, valuations, model, software or other application or output therefrom) or any part thereof ("Content") may be modified, reverse-engineered, reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P Dow Jones Indices. The Content shall not be used for any unlawful or unauthorized purposes. S&P Dow Jones Indices and its third-party data providers and licensors (collectively "S&P Dow Jones Indices Parties") do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Dow Jones Indices Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON AN "AS IS" BASIS. S&P DOW JONES INDICES PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Dow Jones Indices Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

S&P Global keeps certain activities of its various divisions and business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions and business units of S&P Global may have information that is not available to other business units. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

In addition, S&P Dow Jones Indices provides a wide range of services to, or relating to, many organizations, including issuers of securities, investment advisers, broker-dealers, investment banks, other financial institutions and financial intermediaries, and accordingly may receive fees or other economic benefits from those organizations, including organizations whose securities or services they may recommend, rate, include in model portfolios, evaluate or otherwise address.