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'Having funds on NSE and BSE platforms is fantastic'

A road can be used by a lunatic driver speeding at 140 km/hour for the thrill or by a sensible driver. The stock market offers the opportunity to make wonderful long-term returns — but also the temptation of reckless driving.

AJIT DAYAL, PRESIDENT, QUANTUM MF

Aarati Krishnan

The easy money part is over, but 2010 will continue to offer opportunities for sensible investing, says Mr.Ajit Dayal, President of Quantum Mutual Fund, rounding off the year with an interview to Business Line on issues ranging from no-entry loads, to the prognosis on India Inc for 2010.

There has been a sharp decline in mutual fund inflows since August, when entry loads were waived. What is your sense of how this issue will evolve?

My view is that quite a few distributors were mis-selling mutual funds to their client base. The focus of the distributors was on the commissions that they would earn, rather than what was best for the investor over the long term. Unfortunately, most of the mutual fund houses in India were part of this system because it allowed the fund houses to show a growth in Assets Under Management on which the AMCs (asset management companies) earn their fee.

So, there was an artificial demand for mutual funds based on the ability to sell, rather than the need to buy. After SEBI's new rule, the distributors have no incentives to sell mutual funds so this artificial demand has disappeared. The distributors are now playing the regulatory arbitrage – selling those financial products like ULIPs which allow higher commissions.

Now, with these forced lower commissions and expenses, the mutual fund industry should be advertising about the advantage of lower cost products like mutual funds versus the higher expense products like ULIPs! But, there is silence. The mutual fund industry may be paralysed by the fact that many mutual fund houses are in the insurance business themselves.

Quantum Mutual Fund does not face these issues. We were the 29 {+t} {+h} mutual fund house when we launched our first product in February 2006 – but we were the first to refuse to play along with an opaque and loaded distribution system.

Would the availability of MFs on trading platforms like NSE, BSE encourage churning, as investors are used to trading too much on stocks?

Cars are designed to run at speeds of 140 km per hour and more. That does not mean we should drive the car at 140 km per hour! Credit card companies give us spending limits on our credit cards. That does not mean we need to go on a shopping spree. We need to balance what technology or accessibility allows us to do, with what is sensible.

Having mutual funds available on the NSE and BSE platforms is fantastic. It increases the reach of mutual funds by 30,000 per cent and there is a move to bring transparency in the process. The contract note from the broker will show the amount of commission brokers will earn from investors on each mutual fund transaction.

Of course, there is scope for misuse. Investors must read and understand why they are buying mutual funds – they cannot expect the regulator to tell them what to do every day.

Only six of ten equity funds have managed to outperform the market indices in 2009, a far fewer number than in earlier bull markets. Is this a trend likely to stay? Are active managers in India likely to find the going tougher from here on?

The year 2009 was challenging for many momentum managers. The BSE-30 Index was stuck in an 8,000 to 10,000 trading range till March 2009 and many fund managers felt that the market would fall to the 6,000 levels. So, they stayed on the sidelines. Then, when the first sign of green shoots and a global economic recovery appeared, the index galloped to the 12,000 levels by mid-May catching many fund managers by surprise as they were still in cash, waiting for the markets to head down. The 17 per cent surge in the index the day after the election results put many fund managers in a difficult spot.

Quantum Long Tern Equity Fund outperformed the index by 14 percent. We are boring, value investors and like to buy stocks when they look cheap. We did not have much cash – we were fully invested. The debate of active fund management (where stocks are chosen by the fund manager) versus passive fund management (where the index is blindly replicated) is, in my opinion, misguided. Our indices change too often. The indices contain so many companies that I would never trust with the savings of our investors. The focus should be on risk.

The market is factoring in fairly high earnings growth estimates for FY11. Are these achievable for India Inc?

I have no doubt that, over the long term, many Indian companies are capable of showing a 15- 20 per cent growth in earnings every year and investors should focus on that. There will be short periods when there is no growth as happened to be the case for the year-ended March 31, 2009. Recent quarters have shown raw material costs and operating leverage aiding profit growth. Toplines seem to be still sluggish. Do you see scope for sustainable profit growth through 2010, in this light?

The first stage of the profit recovery was definitely aided by lower raw material costs but, in my opinion, there will be a pick up in sales volumes and pricing power in the next few months and this operational leverage will aid the profit growth for the next few quarters. There will be sectors where there is pricing pressure (mobile phone tariffs and cement) and there will be sectors where selling prices, if left to free market forces, should collapse by 20-30 per cent (say, real estate) but in most other sectors there will be the impact of higher volume demand and less capacity additions. How long this will continue is a function of when businessmen are ready to jump on the growth bandwagon again.

We can see first signs of exuberance again today, with statements like 'the Indian economy could grow by 9 per cent' and so on. This may be followed by the irrational capacity additions. These capacity additions will eventually hurt the earnings cycle and share prices. Don't get me wrong – the 9 per cent growth in GDP can happen. But it must happen in a sustainable manner - not as a result of some global events that are not under our control.

After a year of stunning gains, will 2010 be a more challenging year for fund managers? Where do you see the opportunities and pitfalls?

The stock market is a place where companies that need capital for growth come to find those investors who have the savings to meet these needs.

But now it is all about the gambling and the liquidity and the excitement of making money every second.

A road can be used by a lunatic driver speeding at 140 km/hour for the thrill or by a sensible driver who understands the benefits of using a vehicle versus walking.

The stock markets always offer the opportunity to make wonderful long term returns – but they also offer the temptation to be a victim of reckless driving. Momentum investors are challenged on a daily basis and their final risk-return result is a function of how good and successful their last trade was.

In 2010 and beyond, our job at Quantum will be to stay focused on the managements of companies that we can buy into for a sensible price. Very boring when compared to the fast-paced world of high-frequency trading but we recognise the risks we take and sleep well every night.