PGIM India Mutual Fund

Can you predict the top performing asset class of 2024?

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Dear Investors and Partners,

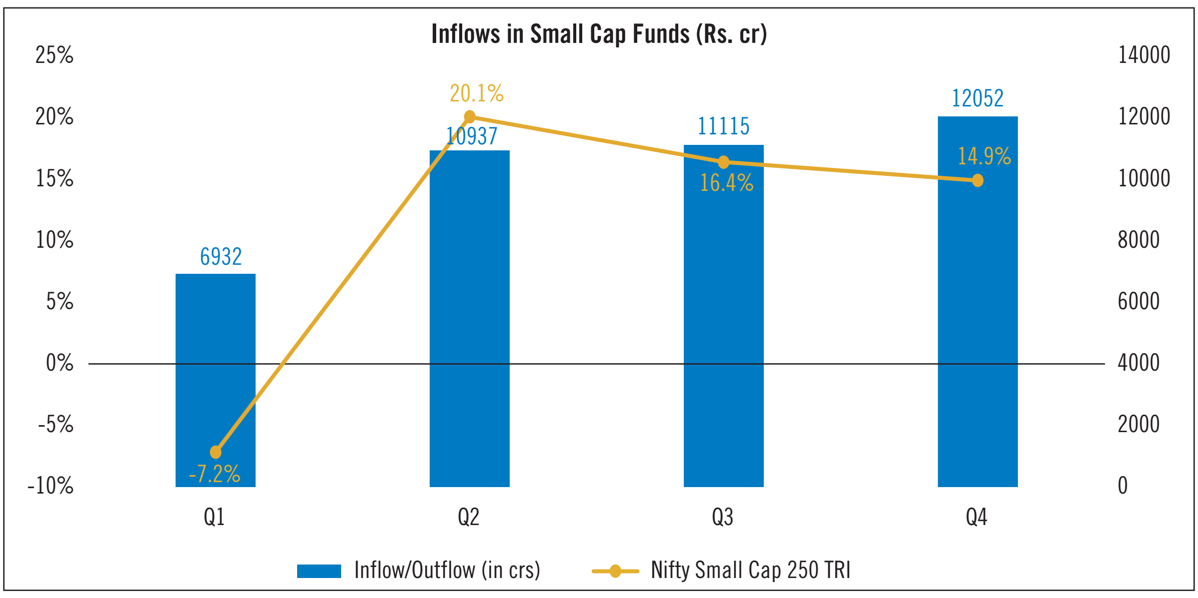
The year 2023 was momentous for the mutual fund industry as it crossed 50 lakh crore assets under management mark in December 2023, which is a proud moment for all the industry stakeholders. It is worth noting that the growth has been particularly sharp in the last decade as the awareness and acceptance of mutual funds grew manifold. The AUM of the Indian MF industry has grown from Rs 8.90 lakh crore in November 2013 to Rs 50 lakh crore at the end of December 2023, showing more than 5 fold increase in a span of 10 years.

Before moving to talking about future. Let's look back at some of the trends witnessed in 2023:

In CY23, the industry received cumulative net inflows to the tune of 1.58 lakh crore in open-end equity funds category (excluding Hybrid and ELSS). And, one category that stood out was Small Caps, which received cumulative net inflows of Rs 41,035 crore in CY23, which accounted for nearly 26% of the overall share of total inflows in equity fund categories in 2023. (Source: ACE MF, AMFI)

The large inflows into Small Caps came on the back of a superlative performance. The Nifty Small Cap 250 TRI delivered 49.09% in CY23. (Source: Bloomberg). However, whether that consistency will endure in the coming year is something only time will reveal. However, history suggests that top performers rotate; no single asset class performs well each consecutive year. For instance, Small Caps performed best in CY 23. In contrast, in CY22, gold was at the top among all asset classes, delivering 11.7%, while Small Cap Index delivered negative -1.8% in the same year. Small Caps performed well back in CY 2021 with 63.3% return. Investors who would have invested in small caps seeing superlative performance of CY 2021 i.e. 63.3% would not have been happy with small caps in CY 2022, which delivered negative return.

Another point to note is the sharp jump in inflows and market performance for small caps funds category in Q2 from Q1 2023 (Source ACE MF, AMFI). This is a classic case of performance chasing by investors, comorbid with herding and recency bias. Investors influenced with recent impressive fund performance tend to follow the crowd, fearing missed opportunities. This behavior disregards long terms strategy in favor of recent trends.



All the data above throws light on one fact that it is hard to predict which asset class will perform well each year. Thus, instead of over allocating to a specific asset class which performed well in the recent past, one should keep a diversified portfolio aligned with their risk profile and goals in asset classes like equities – domestic and international, debt, real estate – physical or REITs, alternatives and so on, this is also evidenced by Gary P. Brinson, Randolph Hood, and Gilbert L. Beebower (BHB) in their popular study in 1986, stating that asset allocation is the key determinant (over 90%) of your portfolio return.

Instead of waiting and trying to find which asset class would perform well, the best strategy is to spread your investments across various fund management styles e.g. growth, value and momentum styles and investment philosophies. This could minimise risk by spreading investments, capturing different market opportunities and reducing the effect of singular market movements.

Instead of getting swayed by news headlines or market noise, let the asset allocation formula decide the quantum of allocation you would have within each asset class. Once you get your asset allocation right, keep invested till you achieve your goals.

In my opinion, adhere to a few and simple hacks to generate long term wealth:

- Draw up a budget tracking your income and allocate your expenses towards needs and wants. While it becomes necessary to take a loan for big ticket purchases like house, foreign education, etc., taking on too much debt for discretionary goals can put your finances off track.
- One can enjoy the income in the early phase of their career, but let me tell you – Retirement is the only financial goal for which you don't get a conventional loan, so start saving and investment for retirement as early as possible.
- It is advisable to allocate your resources to insurance – health and life, saving – emergency fund with at least one year's of expense is must.
- Invest in yourself, learn new and multiple skills that can help you generate a secondary source of income to get an edge over others even during your retirement.

In the increasing complexity of financial markets marked by constant change and uncertainty, coupled with human tendencies to be emotional, have a short term focus etc., investors might not consistently make an unbiased decision to reach their financial goals. Thus, it becomes paramount to take the guidance of a trusted personal financial adviser or mutual fund distributor, who can design a bespoke solution for your unique goals.

Stay safe & happy investing.