Aditya Birla Sun Life AMC Ltd.

ARE INDIANS MAKING THEIR **MONEY WORK?**

Authors

Harish Krishnan

Co-CIO & Head - Equity

Vinod Bhat

Senior VP, Portfolio Manager &
Head – Knowledge Management

Introduction

Today, India stands at the cusp of transformative growth - a host of factors ranging from political stability, enabling regulations coupled with pro-growth policies, increased consumption, focus on manufacturing, and a fecund environment for innovation and entrepreneurship are blending to help India not just leapfrog, but possibly pole vault its growth curve. Inarguably, this will also create opportunities for both the private sector as well as households to expand and grow their wealth.

With the India growth story shaping up well, its resilience and ability to grow in an environment where many major economies are struggling has got global investors to take note.

But the key question here is whether the larger Indian population is going to stand by as mere spectators or will partake in this growth story. Choosing to do the latter would then bring us to the most pertinent question, "How do you make your money work for you by capitalising on the prevailing and future growth opportunities?"

In this paper, we seek to underscore the India opportunity and identify the right vehicle for riding this growth story. In this context, an extensive analysis of the change in household asset allocation in India has been done to highlight a growing shift towards the financialisation of savings.

Further, we have examined the potential of equities as an asset class to capture growth opportunities most optimally while presenting ways to mitigate the risk that has historically been associated with equity investing.

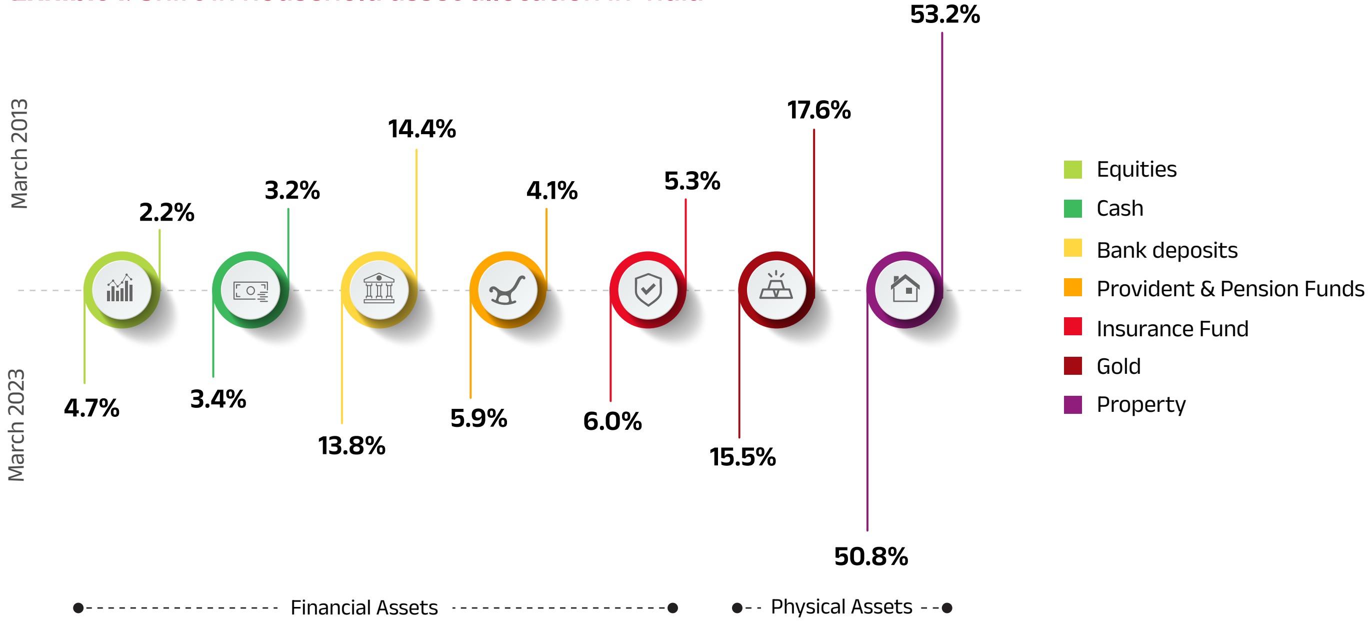
The overarching aim of this paper is to help investors ensure that their money is working for them and that they are well-positioned to harness the benefits of a growing economy.

Changing investment contours of the Indian household asset allocation

Traditionally, Indians have gravitated towards perceived safe investments with predominant exposure to fixed-income generating investments coupled with cash in hand.

However, India's investment landscape has evolved significantly in recent years as the financialisation of savings, product-side innovation, and financial services disintermediation has brought larger swathes of the population into the fold of savings and investments. More specifically, there has been a small but distinctive shift away from physical assets and towards financial assets even though physical assets still constitute two-thirds of the household asset allocation while financial assets only constitute one-third.

Exhibit 1: Shift in household asset allocation in India



Source: Jefferies, Morgan Stanley, ABSLAMC Research

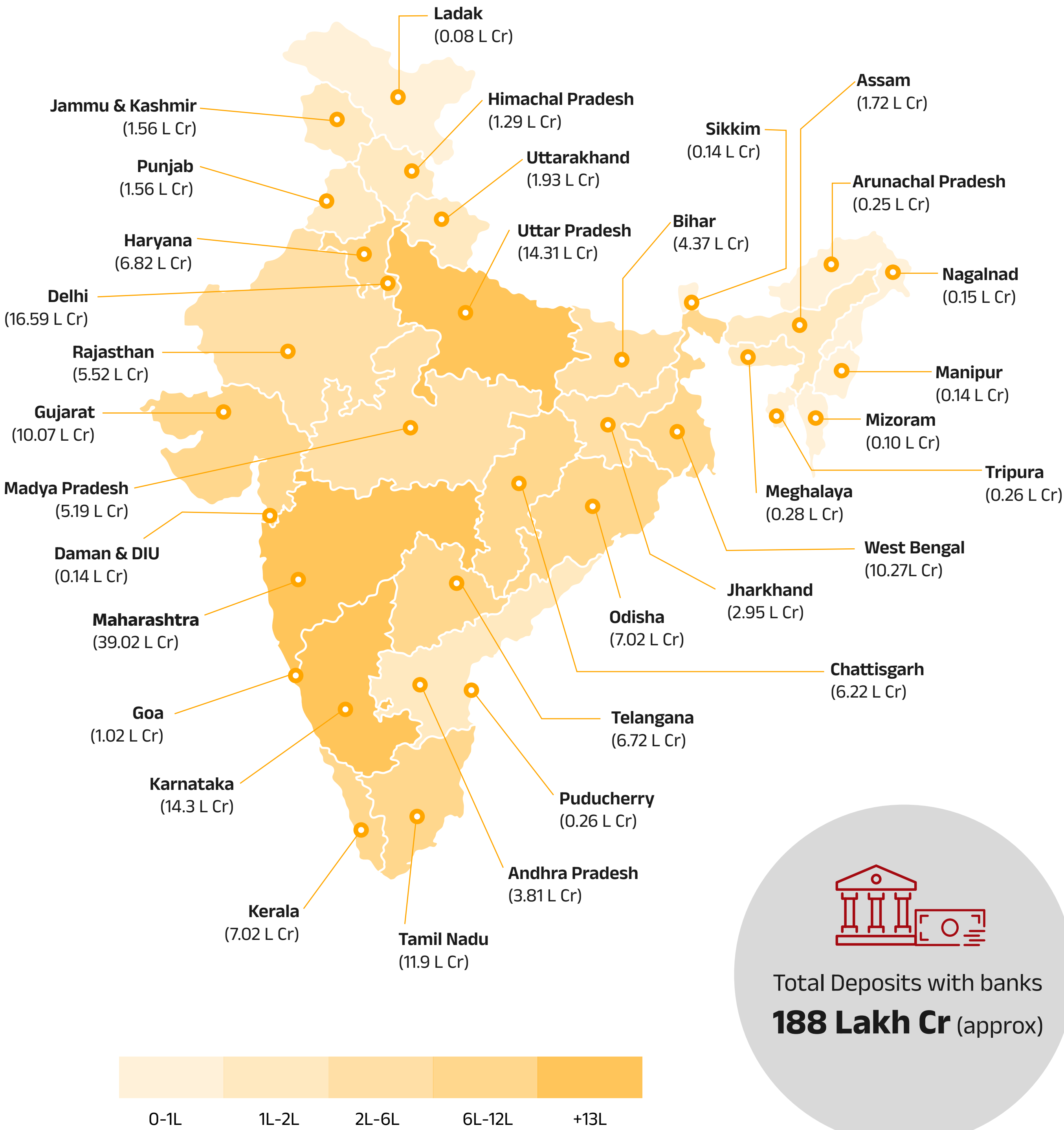
Key points to note are:

In the time period 2013-2023, total household assets have increased from Rs. 336 Trillion to Rs. 914 Trillion, witnessing an almost 3x growth. In this time period, exposure to real estate has reduced slightly while exposure to equities has doubled from 2.2% to 4.7%. Equities is still less than 5% of household asset allocation against 35% in the USA.

However, Indian financial assets are still dominated by traditional fixed-income bearing instruments, with market-linked securities being a small portion of the total assets.

Bank Deposits and Cash still constitute half of the Financial Assets. In fact, allocation to Cash is ~75% of the allocation to Equities.

Exhibit 2: State wise traditional assets



Total Deposits with banks
188 Lakh Cr (approx)

Source: ABSLAMC Research; RBI report

Traditional assets are considered the preferred investment option in India due to their safety and reliability.

Analysis of historical returns of asset classes

A deep-dive into the research paper - **'Asset Returns in India: A Historical Survey, 2023; Inflation's Shadow'** published by Rajan Raju and Mallika Raju in November 2023 (SSRN-id4641106) showcases the strong performance of equities in 5-and-10 year rolling periods with nominal returns being in the range of 12.5 – 13.5%.

Further, on a 10-yr horizon, real returns are negative for equities only 12% of the time, indicating their resilience.

In 5-and-10-year rolling period, bank deposits show returns of 7.8%. On a 10-yr horizon, real returns are negative 28% of the time.

And cash gives negative returns on a real basis 100% of the time.

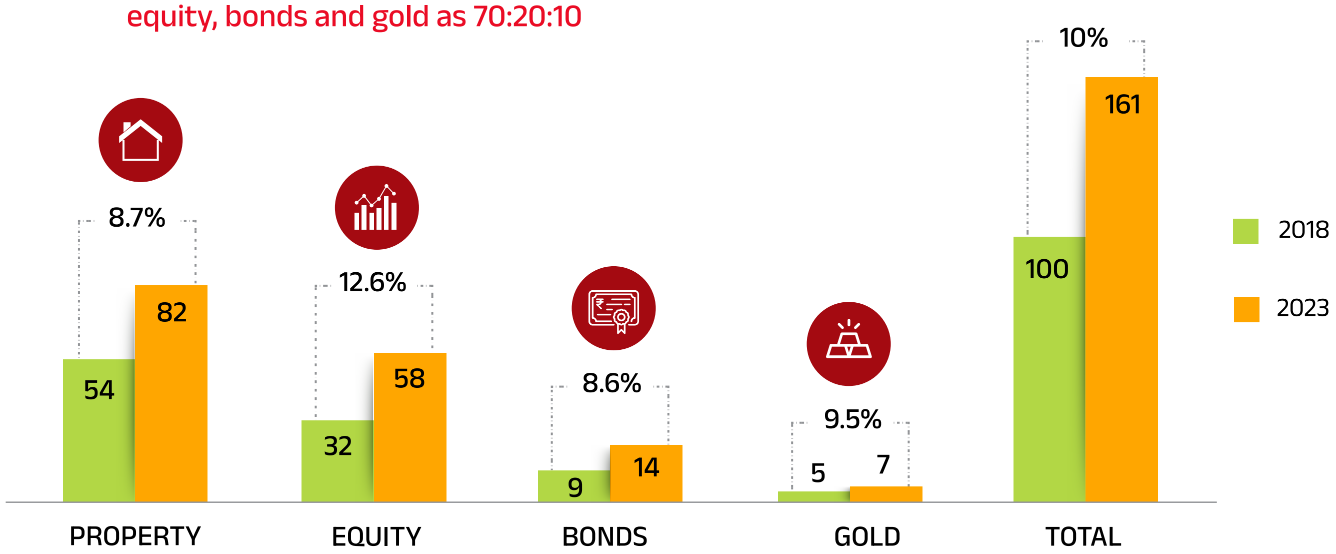
Exhibit 3: Nominal and Real Returns for Asset Classes on 10 year rolling period

Period 10 Years	Nominal Return		Real Return
Asset Class	Mean	Std Dev	% of time Negative
Equity	**13.3**	4.7	**11.7**
Gold	10.5	**5.2**	22.1
Real Estate	8.8	1.8	
Bonds	8.7	0.4	
FD	**7.8**	**0.4**	**27.8**

Source: Asset Returns in India: A Historical Survey, 2023; Inflation's Shadow - research paper by Rajan Raju and Mallika Raju.
Unlike traditional saving instruments, investments in Mutual Funds are subject to market risks. Hence, the performances are not strictly comparable.

To further highlight the disparity and depict the opportunity cost for Indian investors, let us consider the scenario if the household allocation ex-property would have been split as 70:30 between equity and debt or 70:20:10 among equity, debt and gold. In such a scenario, the overall portfolio would have delivered a CAGR of 10% over past 5 years versus 8.5% for the historical allocation. Traditional household asset allocation has led to a drag of 1.5% in the 5-yr portfolio CAGR or a loss of ~INR 55 trillion in investor wealth over the past 5 years.

Exhibit 4: Illustrative returns in scenario when portfolio ex-property split between equity, bonds and gold as 70:20:10



Source: ABSLAMC Research
Disclaimer: All numbers are rounded up to the nearest whole number.

The ongoing inflationary trend also holds implications for wealth creation. While 2022 probably marked the peak of inflation, projections for future inflation levels globally have undergone a series of upward adjustments. Inflation gradually cripples the value of our money. A case in point is that Rs. 100 in 1979 would have been worth just Rs. 3 in 2022.

Wealth creation potential for Indian households

Inarguably, there is a perceptible shift in the mindset of Indian investors as they become more aware of the benefits of market-linked financial instruments. This shift is evident from the ongoing financialisation of savings. The next level of change will be precipitated by a larger shift towards equity investments as Indians gear up to harness the long-term benefits of equity investing while becoming more proactive about risk mitigation.

Our analysis suggests that equity as a percentage of total household assets could potentially double to 10% over next 10 years.

Exhibit 5: Shift in household allocation towards equities over the next 10 years

Equity % of Total Household Assets could potentially double to 10% over next 10 years

	Nominal GDP (INR Trillion)	Assets /GDP (x)	Total Household Assets	Equity %	Equity (INR Trillion)
Mar'08	49	3	149	4.2	6
Mar'13	99	3.4	336	2.2	7
Mar'18	171	3.1	532	3.8	20
Mar'23	272	3.4	914	4.7	43
Mar'28P	469	3.6	1,688	7.5	127
Mar'33P	809	3.8	3,074	10.0	307

Source: ABSLAMC Research

Key assumptions

The nominal growth in INR terms has been 10.6% for the last 10 years and 12.8% in the previous 20 years. With a supportive macro backdrop, a positive cycle emerging over the next 10 years could see sustained double-digit growth in nominal GDP. We have assumed an 11.5% CAGR over the next 10 years.

Assets/GDP is assumed to increase gradually from the current 3.4x to 3.8x over the next decade.

Equity % of Total Household Assets can be expected to double over the next 10 years to 10%. This implies an increase of 0.5% per year, similar to what was seen in the US over the past 30 years.

This would take equity assets to ~Rs 300 trillion. While half of these assets could be accounted for by growth in the existing stock of Equity, the other half could be driven by the shift from FDs to Equity gradually over the next decade along with the associated growth over the next decade.

This shift towards equity allocation is likely to lead to wealth creation over the long term and help investors optimally leverage the opportunities presented by the India growth story.

India - A story well begun but not even half done

One of the key drivers for the shift to Equity investments would be increased confidence in the India growth story. India's ascent to dominance on the global stage is now becoming a reality as the country's thought leadership is transforming into economic leadership. The three megatrends that are catalysing the India growth story include global offshoring, leadership in digitalisation, and energy transition. Within these megatrends, a host of enablers, ranging from sector-specific pro-growth policies, ease of doing business and low associated costs, and increasing financialisation of savings to rapid privatisation and asset sales are acting as tailwinds for the country's growth ambitions. Its rising dominance is evidenced by its ascent across relevant global rankings.

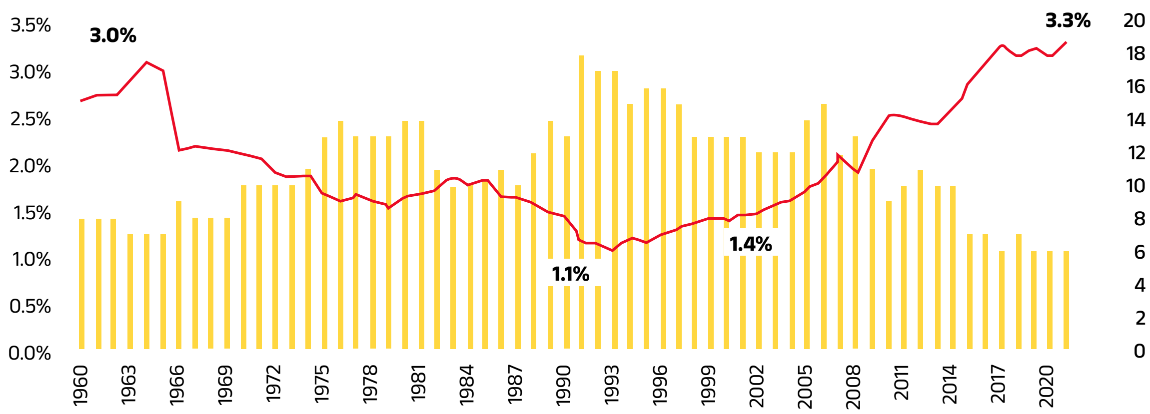
Exhibit 6: Rankings across parameters

Factor	2014	2022	Countries Displaced
Economy Size (GDP)	10	**5**	UK
Auto Market	7	**3**	Japan
Electricity Generation	4	**3**	Russia
Mobile Phone Production	12	**2**	Vietnam, Korea, USA
Steel Production	4	**2**	Japan, USA
Climate Change Performance	31	**8**	Estonia, Norway
Global Innovation Index	83	**46**	Thailand, Mauritius
World Govenrnance Index	103	**68**	Malaysia, South Africa
East of Doing Business	142	**63**	Ukraine, Oman

Source: MSCI, Morgan Stanley, Blackrock

India's contribution to global GDP has increased significantly since the turn of the century. Since 1993, there has been a consistent improvement in India's contribution to global GDP which has been increasing at an accelerated rate 2002 onwards.

Exhibit 7: India's share in global GDP



Source: ABSLAMC Research

According to the International Monetary Fund (IMF), India's contribution to global economic growth is expected to increase by 2 percentage points over the next five years as it is expected to grow faster in the coming years[1]. Currently, China and India together contribute 50% to global growth, with India's share at 16%. This figure is set to rise to 18% by 2027. Despite global challenges, the Asia Pacific region remains a bright spot, projected to contribute about two-thirds to global growth, with India's economy expected to grow by 6.3% in fiscal year 2023-24.

Even as India essays a preeminent role on a global scale, the country is also performing robustly when considering domestic parameters. For instance, over the last two decades and more, many states' expenditures and nominal GDP have grown to the size of the erstwhile Indian GDP, as indicated below.

[1] https://www.imf.org/en/Publications

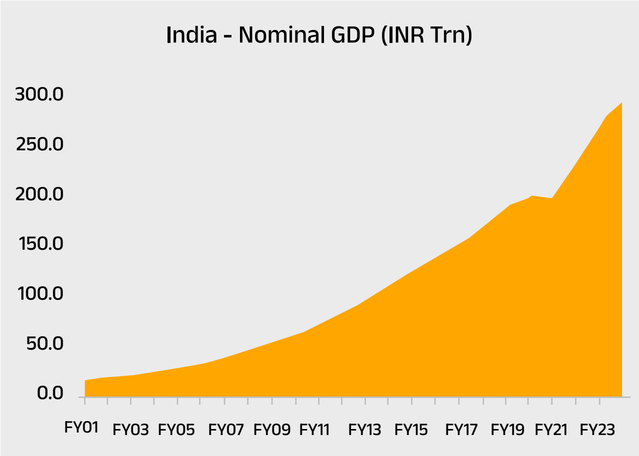
Exhibit 8: Indian States' expenditure and GDP size compared to India

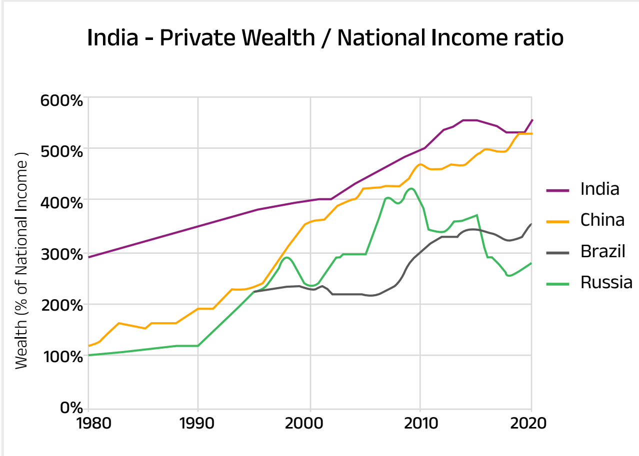
Factor	Total State Expenditure (Rs lakh crore)	Year Closest to Central Govt Total Expenditure	State Nominal GDP	Year Closest to India GDP
Old Uttar Pradesh	5.64	2007	21.17	2001
Maharastra	4.38	2004	31.9	2005
Old Andhra Pradesh	4.36	2003	23.5	2002
Tamil Nadu	3.09	2000	20.7	2000
West Bengal	2.91	2000	17.1	1999
Rajasthan	2.33	1998	12	1996
Karnataka	2.32	1998	20.5	2000
Madhya Pradesh	2.17	1998	11.7	1996
Gujarat	1.99	1997	19.4	2000

Source: ABSLAMC Research

Further, as the Indian economy has grown, the private wealth to national income ratio has risen consistently from 3-4x earlier to 5.5x.

Exhibit 9: Private wealth to national income ratio in India

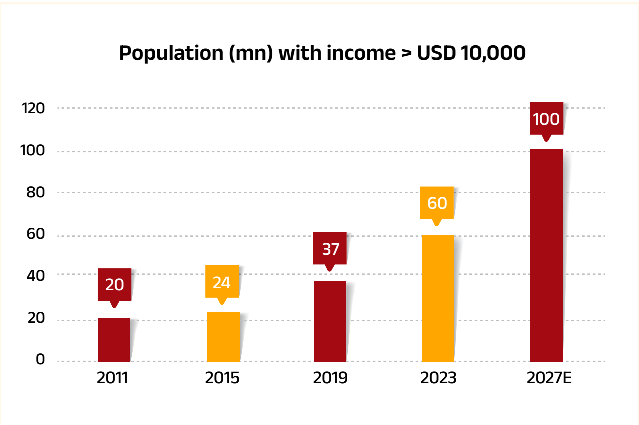


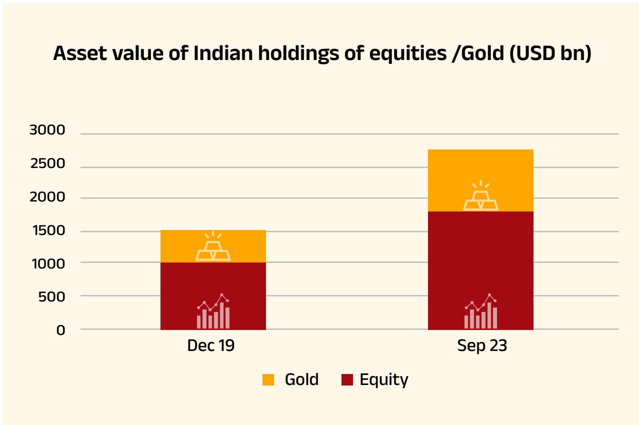


Source: MOSL, World Inequality Report 2022;
Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

Goldman Sachs in its report 'Rise of Affluent India' estimates that that the consumer cohort of affluent Indians (with per capita income of over US$10,000) has grown between 2019-2023 at a CAGR of over 12%, compared to ~1% CAGR of India's population. If the current trajectory continues, they expect 'Affluent India' will grow to ~100 million consumers by 2027, growing at a 13% CAGR. A big part of this trend they assess is the strong wealth effect. Equities and gold have driven a strong increase in wealth in India over the past 4 years. India's market cap has increased over 80% over the past 3 years with rising retail participation. Gold price also rose 65% over 2020-23.

Exhibit 10: Trends of the rising affluent India

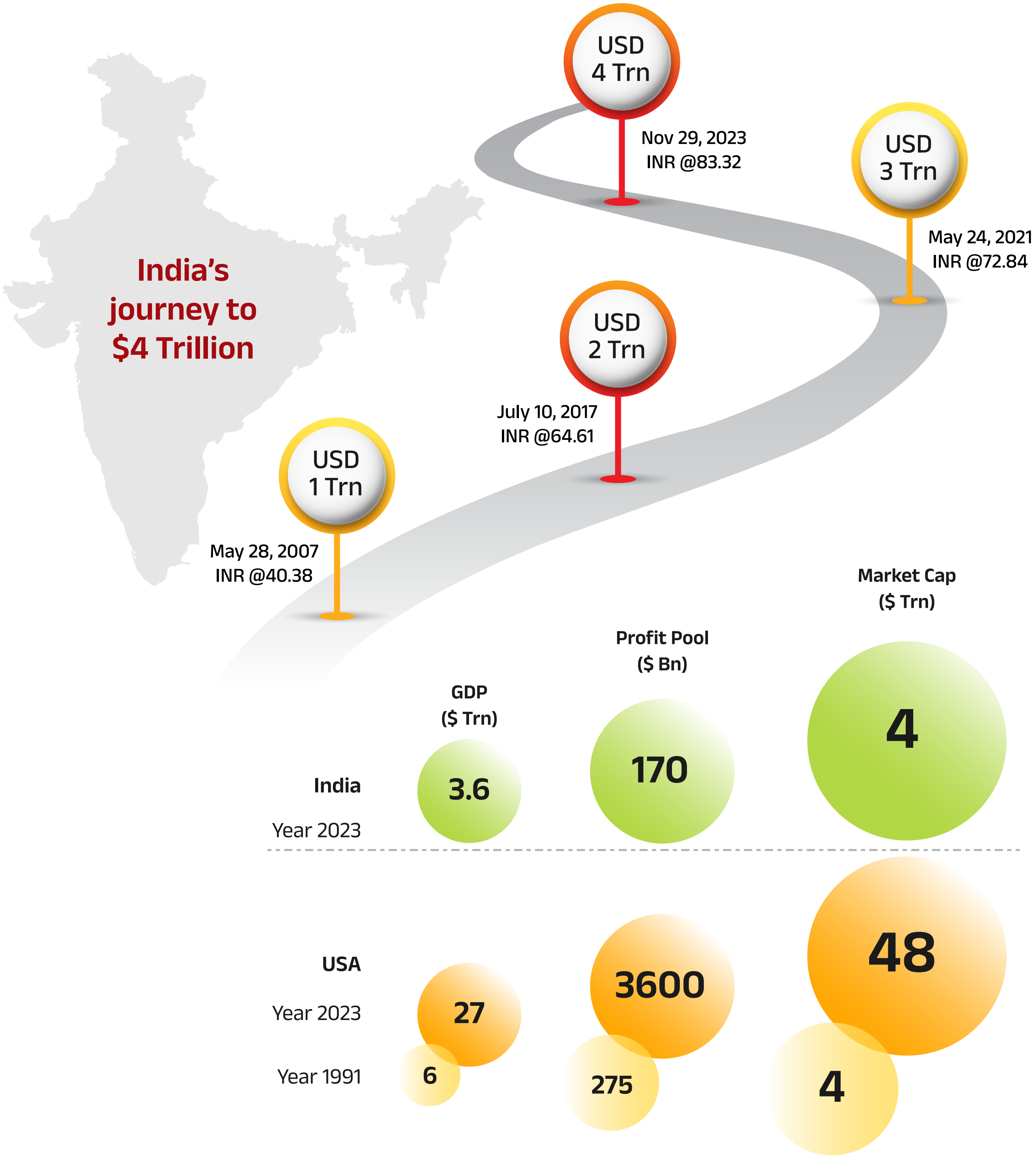




Source: Goldman Sachs, Euro Monitor

In terms of market cap, the Indian equity market has just overtaken Hong Kong and ranks 4th, led by US, China, and Japan and has a long runway of growth ahead.

Exhibit 11: Scaling the charts steadily



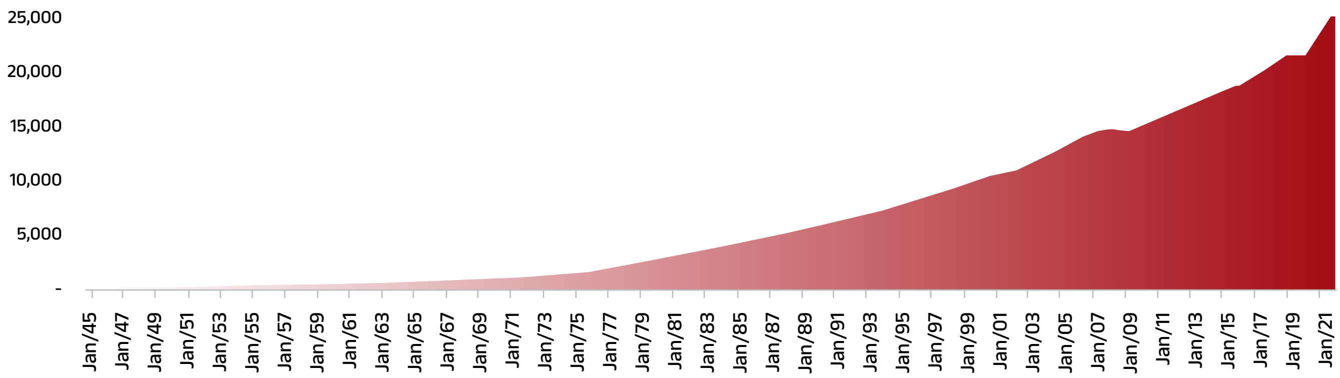
Source: Hindu Business Line, ABSLAMC Research

Wealth creation in The US – A Case Study

Inarguably, India is well on its path to achieving robust growth and solidifying its position in the global order. However, what does this really mean for the Indian population at large?

At this juncture, a look at how the US economy, and correspondingly individual wealth has evolved, could be instructive.

Exhibit 12: USA - Nominal GDP (USD Bn)



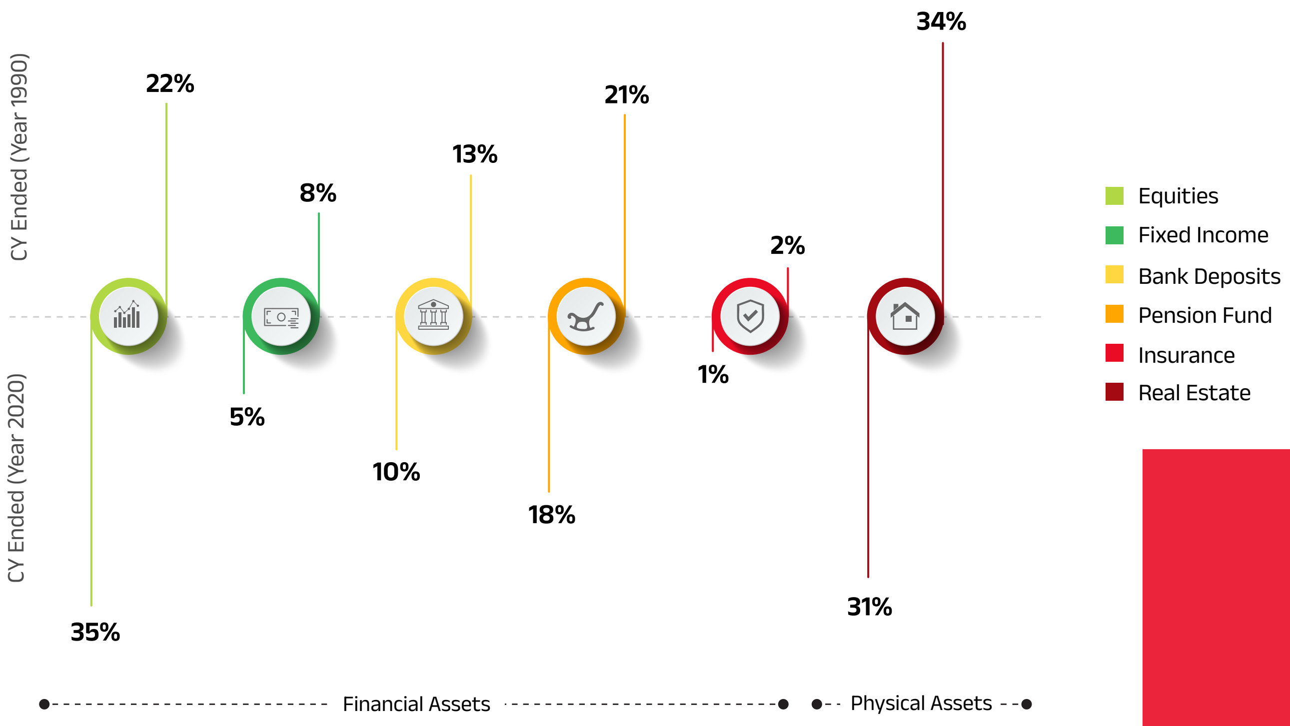
Source: Morgan Stanley, World Inequality Report 2022;
Private wealth =non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

As the US economy has grown since 1950, the private wealth to national income ratio has risen consistently from 2-3X to 6X, thereby highlighting the enormous benefits of economic growth that can accrue to the citizens.

How did the transfer of wealth happen from the economy into the hands of the wider population?

Till 1990, the allocation to financial assets in the US was on a declining trend. However, after 1990, there has been a reversal with an increasing allocation to financial assets. The US has, since then, witnessed a robust uptick in equity investment culture, enabled by regulatory changes which were undertaken to allow retirement funds to invest in listed equities. Accordingly, financial assets now constitute 70-75% of household assets while physical assets constitute 25-30%.

Exhibit 13: Shift in household asset allocation in the US



Source: Jefferies, Morgan Stanley, ABSLAMC Research

Within financial assets, allocation to equities has consistently been over 30% in the 2016-2022 period and was nearly 40% in 2022.

Wealth Creation – Equity Mutual Funds the ideal medium to make that money work?

Based on the trend seen in the US, we can expect that even in India, as the economy sees sustained growth over the next 25-30 years, allocation to equities in the household asset allocation could rise to levels seen in the US.

While investing directly in stocks is an option, consistently selecting the right companies and then maintaining the conviction to stay invested in these companies for the long-term is no easy task. This is especially true for individual investors who might not have the relevant skills or resources to make the right investments choices. In this scenario, wherein the equity landscape may appear confusing and worrisome to investors who have not spent sufficient time in the market, equity mutual funds appear as the most optimal medium for participating in the growth of the asset class.

Over the last several decades, mutual funds have provided retail investors with the opportunity to restructure their financial landscape. It serves as a vehicle for investment that has played a crucial role in the mobilisation of savings from individuals and channelling them into different financial instruments, thereby fostering the creation of wealth and rapid growth in the economy of the country.

There are a multitude of benefits to consider when investing in equity mutual funds.

Access to professional fund management:

Asset Management Companies (AMCs) have a comprehensive industry perspective and continuously monitor various developments to identify potential opportunities.

Optimal mitigation of risk:

Fund managers establish, monitor, and adhere to defined rules to mitigate risks such as concentration risk and stock liquidity.

Focus on diversification:

Equity mutual funds ensure diversification across stocks and sectors, reducing the impact of market shocks on individual investments.

Feasible ticket size:

Investors can start with small amounts, as low as INR 100 through Systematic Investment Plans (SIPs), enabling broader participation in the market.

Ease and convenience:

Investors can easily start this journey with a single transaction and without the need for a demat account or broker account.

Taxation:

Capital gains are taxed based on the investment period.

Effective regulation:

Mutual funds in India are regulated by SEBI, ensuring transparency in disclosures and adherence to regulatory standards.

These benefits make equity mutual funds one of the excellent avenues for investing in the fast-growing equity segment in India.

To further amplify these benefits, investors can consider investing in equity mutual funds via the SIP route. SIP is an investment vehicle that enables individuals to periodically invest a fixed amount of money in an equity mutual fund scheme of their choice. This route helps investors address many of the challenges associated with equity investing and amplify the benefits stemming from the same.

Inculcates a **high degree of discipline** and ensures that the investment process continues in a seamless manner.

Helps investors **benefit from rupee cost averaging** – as the amount of money invested is fixed, regardless of market ups and downs. Over the long-term, it averages the cost of acquisition and aims to reduce the impact of market volatility.

Both these factors together also ensure that the ebbs and flows of the market do not have a disproportionate impact on investment decision making and that investors stay invested for the long-term.

Compounding is perhaps the most important factor in wealth creation and truly exemplifies the concept of making your money work for you. The beauty of compounding lies in the fact that not only does your initial investment generate returns, but **the returns accrued are reinvested to generate higher returns**. Over a period of time, the compounding effect can lead to significant wealth creation.

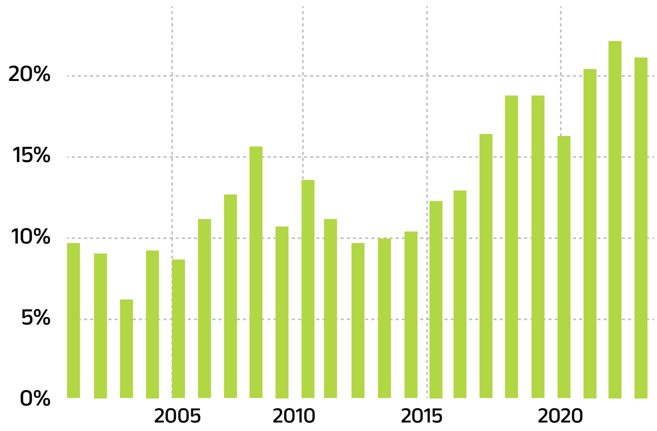
As Indian households mature in their investment choices and create long-term portfolios for partaking in the India growth story and creating wealth, they must consider taking adequate exposure to equity as an asset class via the equity mutual fund route. Further, SIPs act as an ideal vehicle for mitigating some of the risks stemming from equity exposure and optimising the corresponding return potential.

While we have seen consistent growth in the Mutual Fund AUM over the past decade, it is still only around 21% of Bank deposits and Mutual Fund folios are just ~6% of Bank deposit accounts. There's still a long way to go.

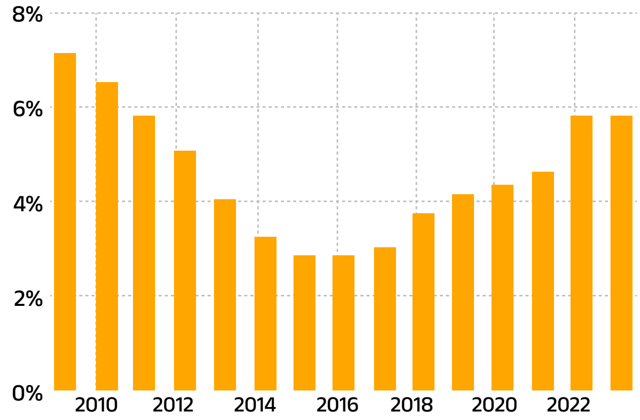
Exhibit 14: Mutual Fund Catching up with Bank Deposits: Long Way to Go

Mutual Fund Folios Relative to Bank Deposits

Mutual Fund AUM Relative to Bank Deposits



MF folios relative to Bank Deposit accounts



Source: Macquarie, ABSLAMC Research

Conclusion

In conclusion, as is evident from this report, India's growth is intricately linked to the growth of its financial savings. Correspondingly, the growth of household wealth is directly linked to household exposure to equity investments.

In this context, the contours of investment portfolios across the country are changing.

There has been a significant rise in mutual fund investments alongside traditional fixed income-bearing instruments. This trend is attributable to factors such as a young workforce, expanding income, enhanced financial inclusion, digitalisation, and heightened awareness about mutual funds.

Moreover, the resilience of domestic investors amidst global volatility has underscored the critical role of mutual funds in stabilising the Indian equity markets during periods of volatility of money flow from Foreign Portfolio Investors (FPIs).

Despite these positive developments, there is a need for significant growth in mutual fund investors, given the vast potential within India's financial landscape and the significant opportunity cost in not taking part in India’s growth story.

The important message here is to make a start.

“The best time to plant a tree was 20 years ago.
The second best time is now.”

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ASSET MANAGEMENT

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