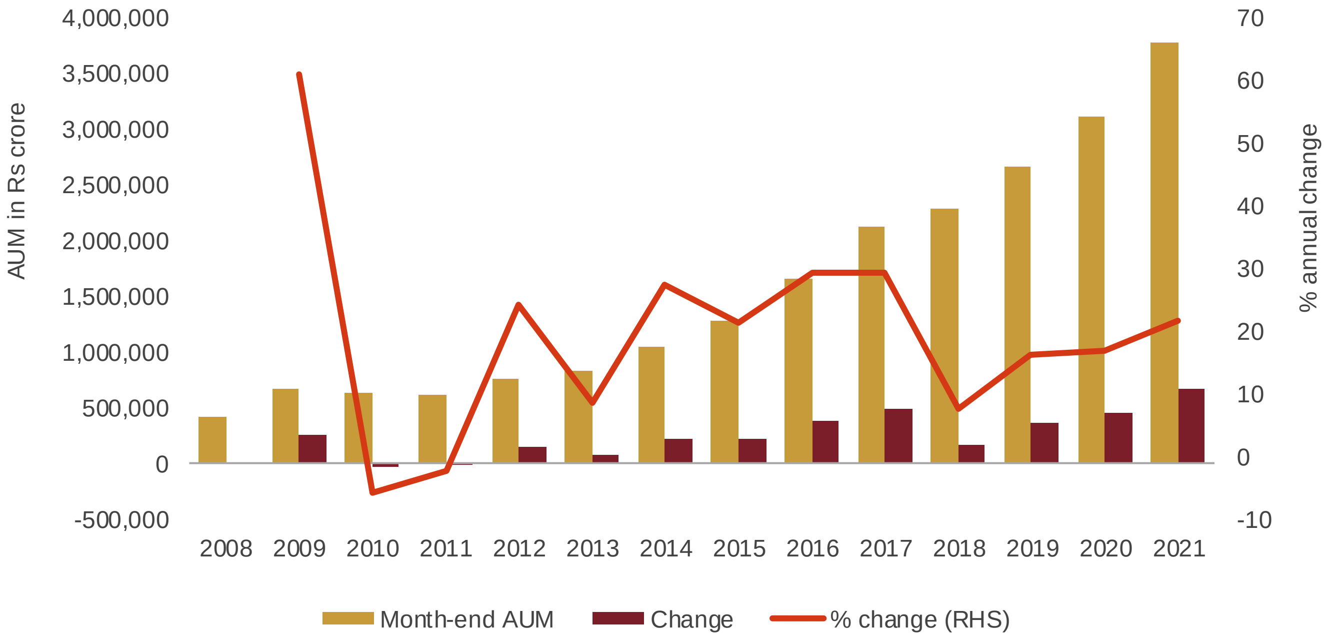
MF assets see record gains to close at new high in 2021

In a break from 2020, equity oriented funds hog the lion's share

Assets under management (AUM) of the domestic mutual fund industry, excluding domestic fund of funds (FoF), surged further in 2021 to close at a record Rs 37.73 lakh crore.

The industry added Rs 6.70 lakh crore — a record absolute asset gain for any calendar year on record, with the previous peak being Rs 4.80 lakh crore in 2017, followed by ~Rs 4.5 lakh crore in 2020. In percentage terms, the industry gained ~22% compared with ~17% in 2020.

Industry asset gains vs annual flows and percentage change



Note: Excludes domestic FoFs
Source: AMFI, CRISIL Research

2020 and 2021 asset flows see divergent plot lines

Net flows in the two years were similar at around Rs 1.81 lakh crore, but the plot lines were starkly different. While 2020 had seen sharp inflows into debt-oriented mutual funds, 2021 saw equity-oriented mutual funds cornering the bulk.

To be sure, the net inflows into debt-oriented funds in 2020 had come despite the liquidity crisis, with as much as Rs 1.94 lakh crore of outflows in March — the most since September 2018, which had seen Rs 2.10 lakh crore of outflows following the IL&FS credit crisis — as the pandemic and the ensuing economic lockdown left investors chary.

Open-ended debt-oriented mutual funds saw inflows of Rs 2.01 lakh crore during 2020 even as equity-oriented funds saw net inflows of just Rs 9,100 crore. Hybrid funds also took a beating with an outflow of over Rs 53,000 crore. However, passive funds continued to garner money, amounting Rs 62,000 crore, led by flows from institutional investors such as the Employees' Provident Fund of India (EPFO).

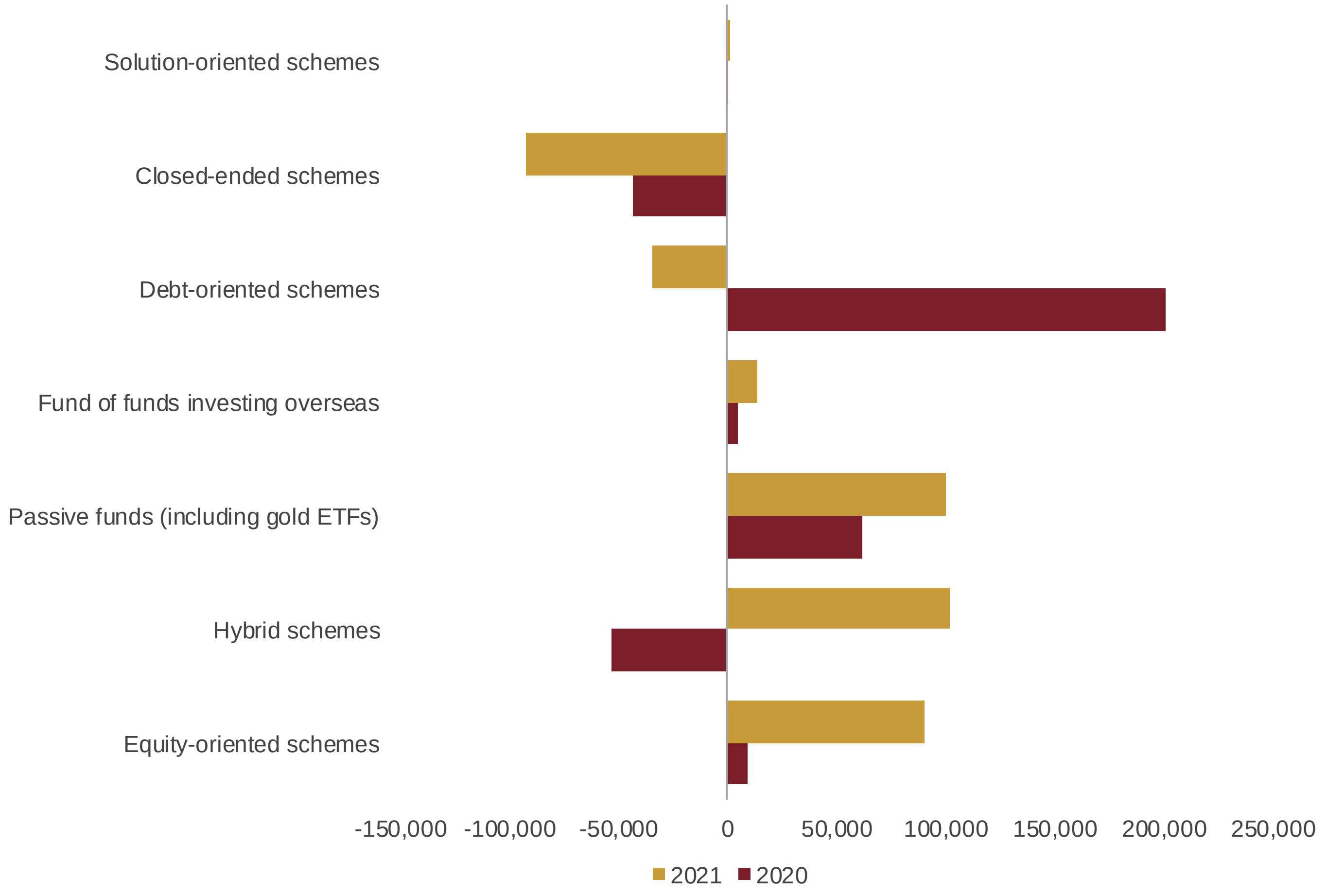
In contrast, 2021 saw investors put a larger amount of their money in equity-oriented mutual funds, drawn by the strong gains in the underlying equity market. Equity mutual funds saw net inflows of Rs 91,000 crore, while passive funds got Rs 1.14 lakh crore and hybrid funds Rs 1.02 lakh crore. Passive funds and hybrid funds benefitted from a spate of new fund offers, at 41 and 8 funds, respectively.

Underperformance of actively managed funds, especially in the large-cap space (read our detailed report on this phenomenon in our white paper titled 'Shrinking Alpha' at https://www.crisil.com/en/home/our-analysis/reports/2021/07/shrinking-alpha.html) whetted investor interest in the passives.

Debt mutual funds, at the other end, saw net outflow of Rs 35,000 crore in 2021 as investors shied away from the category amid a fall in returns and as investors waited on the side lines, monitoring probable interest hikes by the Reserve Bank of India. The central bank, however, refrained from hiking interest rate during the year, staying more supportive of growth. The RBI stayed tolerant of high inflation given that most of it was due to supply-side factors (oil and commodity prices).

CRISIL expects the central bank to continue to withdraw liquidity in the banking system in a calibrated manner as more certain signs of economic recovery become visible. The Monetary Policy Committee of the Reserve Bank of India will likely hike the reverse repo rate during its February review, to narrow the corridor with the repo rate to 25 basis points (bps), and follow this up with a 25 bps hike in repo rate in March as demand-side pressures on inflation start to rise. The upward movement in yields is expected to reduce the sheen of long-maturity debt funds, making short-maturity debt funds such as floating rate funds and roll-down strategy funds such as target maturity debt funds better bets for investors.

Category-wise flows, 2020 vs 2021 (Rs crore)



Note: Excludes domestic FoFs
Source: AMFI, CRISIL Research

Other notable developments

SIP inflows make new calendar year, monthly records

The industry logged net inflows of Rs 1.14 lakh crore in 2021 through systematic investment plans (SIPs), crossing the Rs 1 lakh crore mark for the first time in any calendar year since AMFI started declaring this data.

The last month of 2021 also saw SIP flows come in at their record monthly high of Rs 11,300 crore, after crossing the Rs 11,000-crore mark for the first time in November 2021.

Furthermore, the number of SIP accounts rose to 4.91 crore, accounting for Rs 5.65 lakh crore of the industry's assets as of December.

ETFs become the largest MF category while liquid funds lose sheen

Benefitting from the strong inflows from the EPFO and other pension trusts, together with new launches and individual investor interest, assets of exchange-traded funds (ETFs) surged to overtake liquid funds as the largest MF category in 2021. The category closed 2021 with assets of Rs 3.84 lakh crore compared with Rs 3.61 lakh crore for liquid funds.

Liquid funds lost sheen as their returns dipped in line with low interest rates, making other money market MF categories more attractive for investors with higher risk appetite. The category's assets are also now treated on a par with those of other debt MF categories as mark to market, rather than the amortisation rule that it benefitted from previously.

Floating-rate, target maturity and ESG funds gain traction

2021 saw categories such as floating-rate debt funds and passively managed debt funds in the form of target maturity funds gain traction within the industry. While floating-rate debt funds benefitted from their ability to latch on to the interest rate movement, investor focus on credit quality amid views of rising interest rates brought in traction for target maturity debt funds.

On the equity front, we also saw increasing traction in the environmental, social and governance (ESG) space, as the theme of 'conscious investing' became popular among investors.

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