Motilal Oswal Presents

The 2nd Edition of Investor Survey on Passive Funds - 2024

The rise of index investing is transforming India's investment landscape.

Foreword

Dear reader,

The investment habits are rapidly evolving, and passive funds are gaining significant traction as investors seek easy, economic & efficient ways to diversify their portfolios. This report, drawn from the responses of over 3,300 participants to Motilal Oswal AMC's survey, offers a factual analysis of current attitudes, behaviors, and knowledge around passive funds and ETFs.

"Knowledge First" is our motto at Motilal Oswal, which amplifies our belief in the power of understanding. By interpreting these trends, we aim to contribute valuable insights into how investors view and engage with passive investments. This report is not a guide for making investment decisions; rather, it provides an interpretation of participant perspectives, shedding light on how passive funds are influencing financial journeys today.

We hope this report will be a useful resource for industry professionals, investors, and policymakers as they explore the evolving landscape of passive investing.

Pratik Oswal

Chief of Passive Business,

Motilal Oswal Asset Management Company

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The rise of Index Investing
Transforming India's investment landscape

As the Indian financial landscape evolves rapidly, passive funds have emerged as a significant force, reshaping traditional investment approaches and attracting a diverse investor base. This transformation is largely fueled by favourable regulatory support, technological advancements, AMCs contributing with the launch of several index based products and a surge in financial literacy among the populace.

Over recent years, passive funds have witnessed exponential growth, with their combined Assets Under Management (AUM) skyrocketing from **₹7 lakh crore in September 2023 to over ₹11 lakh crore by September 2024.**

This remarkable increase of 1.5 times over the past year reflects a growing interest in this category.

What is a Passive Fund?

A passive fund, such as an Index Fund or ETF, seeks to deliver returns closely aligned with its benchmark, like the Nifty 50 or Nifty 500. It achieves this by mirroring the index's stock composition and weights. Passive funds provide several advantages to investors—they are straightforward, effective for wealth building, and cost-efficient due to lower expenses.

Easy
A basket of stocks representing a particular index.

Economical
Low cost broad market exposure.

Effective
Index funds are effective as they eliminate subjectivity and bias.

About the survey

AUDIENCE	DURATION	RESPONSES
Mutual Fund investors Mutual Fund distributors	1st September 2024 to 31st October 2024	3,300 investors and 110 distributos Online surveys and in-person interactions

This survey aims to provide insights into both investors' and distributors' perspectives on passive funds.

Study of investors:

- Awareness and understanding of passive funds
- Preferences and allocation patterns
- Future perspectives on passive fund investments

Study of distributors:

- Understanding of passive funds and their role in the market
- Current allocation and plans for future allocation
- Key drivers influencing their adoption of passive funds

Age Distribution

Category	Age(yrs)	%
Gen Z	18-27	22%
Millennials	28-43	33%
Gen X	44-59	24%
Boomers	>59	21%

Geographic Distribution

Top 5 Metros	58%
Tier 1 (other than metros)	42%

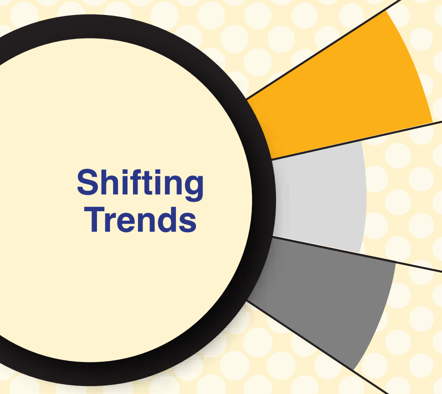
Gender Distribution

Male	79%
Female	21%

2024 vs 2023

Our 2024's survey on passive funds builds on the insights from last year's report, which included responses from **2,000** investors.

This year, we have expanded our reach to include over **3,300 mutual fund investors and 110 distributors,** capturing a broader perspective on the evolving passive funds landscape.



Increased allocation

80% of investors increased their passive fund allocations this year, up from 53% last year, reflecting growing confidence in passive funds.

ETF popularity surges slightly

57% of investors are now invested in ETFs, up from 41% last year.

Shift towards risk-adjusted returns

In the 2024 survey, the top reason for choosing passive funds is **'better risk-adjusted returns'**, compared to 'lower cost' in 2023.

Long-term commitment

81% of investors plan to hold their passive investments for over three years, a slight increase from 80% in 2023, highlighting sustained trust in a long-term investment approach.

Key highlights of the report

High awareness of passive funds

98% of mutual fund investors are aware of passive funds.

58% of investors have only a basic understanding of passive funds, indicating a need for enhanced financial education.

Better returns, diversification, simplicity, and lower cost are the key reasons for investors to prefer passive funds

63% invest in passive funds because they received better risk-adjusted returns.

Increasing allocation towards passive funds

On average, investors plan to increase their allocation to passive funds by **15%** in the next 12 months.

80% investors have increased their allocation towards passive funds in the past 1 year.

Growth of Smart Beta Funds

20% of passive fund investors include factor or Smart Beta Funds in their portfolios, with Quality, Momentum, and Value being the top choices.

Diversification is the main reason distributors recommend passive funds

51% of distributors believe passive funds are an effective way to achieve portfolio diversification.

39% of distributors believe passive funds offer better risk-adjusted returns.

SECTION 1:
Awareness, understanding and preference

Awareness and understanding

98% of mutual fund investors are aware of passive funds.

58% of investors have a basic concept level understanding of passive funds.

Preferences

Key reasons driving investor preferences for passive funds are Better returns, diversification, simplicity, and lower costs.

63% people invest in passive funds mainly because they offer better risk-adjusted returns.

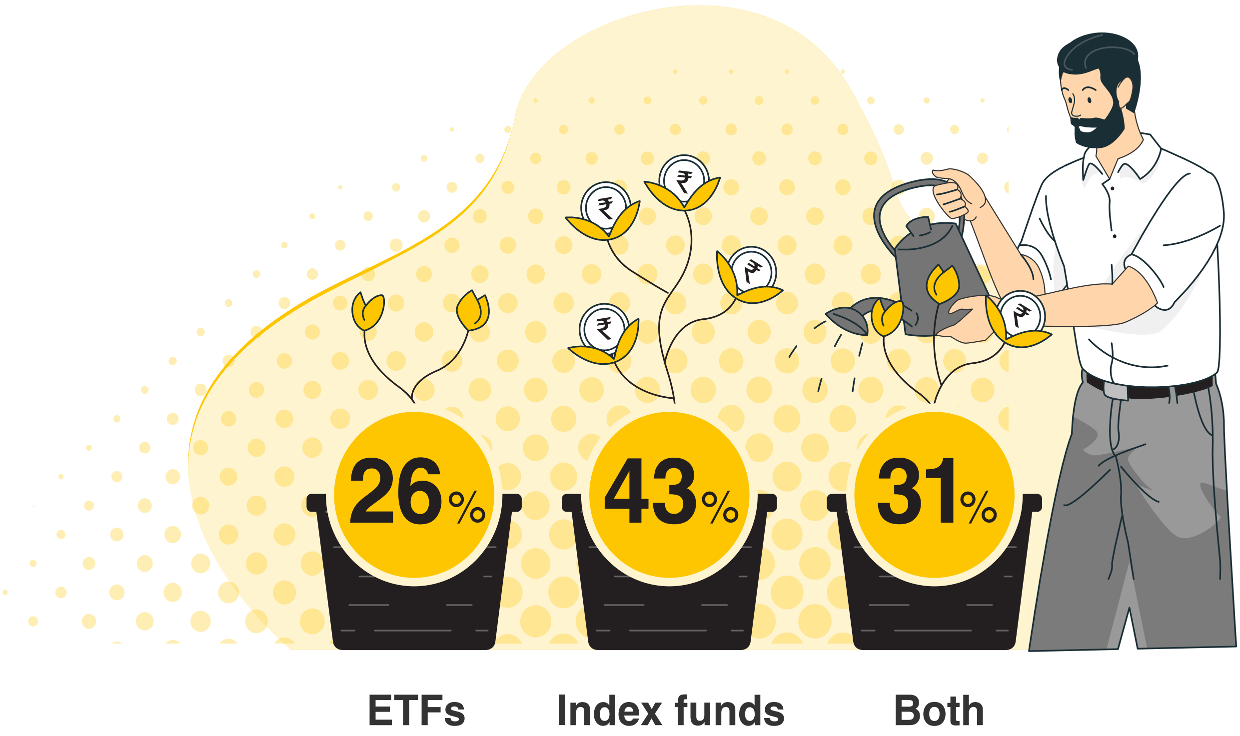
This shows how passive strategies can deliver steady performance and may help investors benefit from market growth over time.

Top 5 reasons to invest in passive funds (ETF/Index).

1. Passive funds offer better risk-adjusted returns
2. Passive funds help in portfolio diversification
3. Passive funds are simple to understand
4. Passive funds charge lower commission
5. Passive funds are easy to invest without help from others

Which categories of passive funds have investors preferred?

74% of investors choose Index Funds
(43% only Index funds, 31% both ETFs and Index Funds.



Investors chose Index Funds for simplicity while ETFs were picked for returns & trading capabilities.

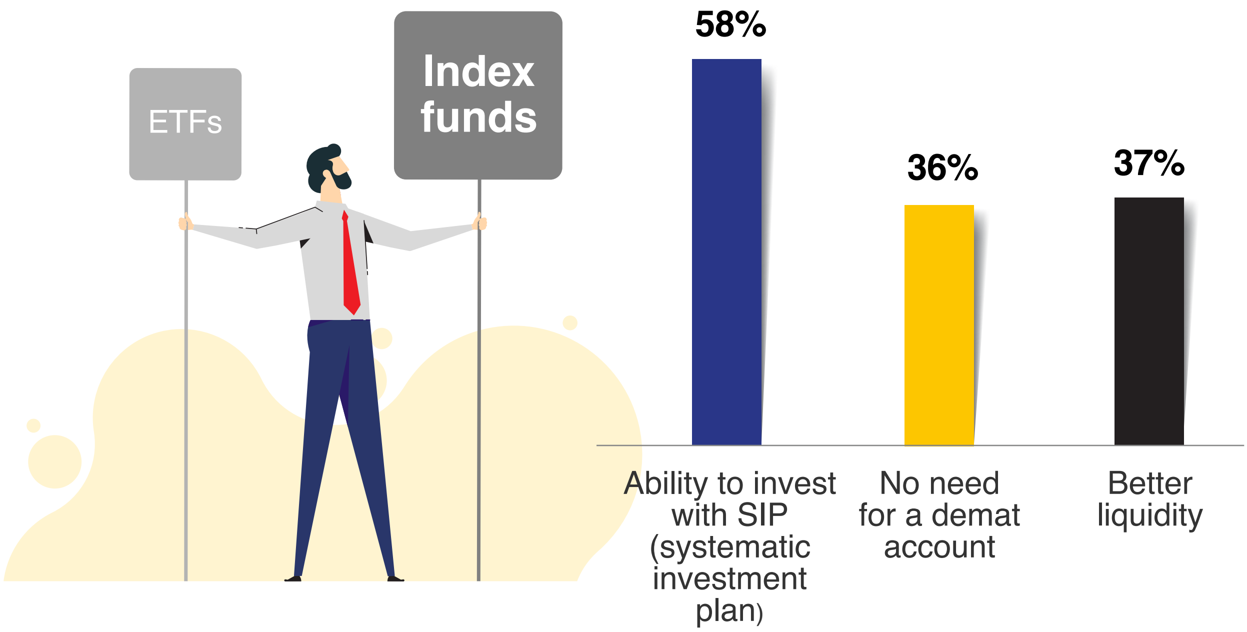
Within various investor age groups, the younger generation (Gen Z and Millennials) shows a stronger preference for index funds, compared to older age groups.

While **~46%** of the GenZ and millennials favour index funds,

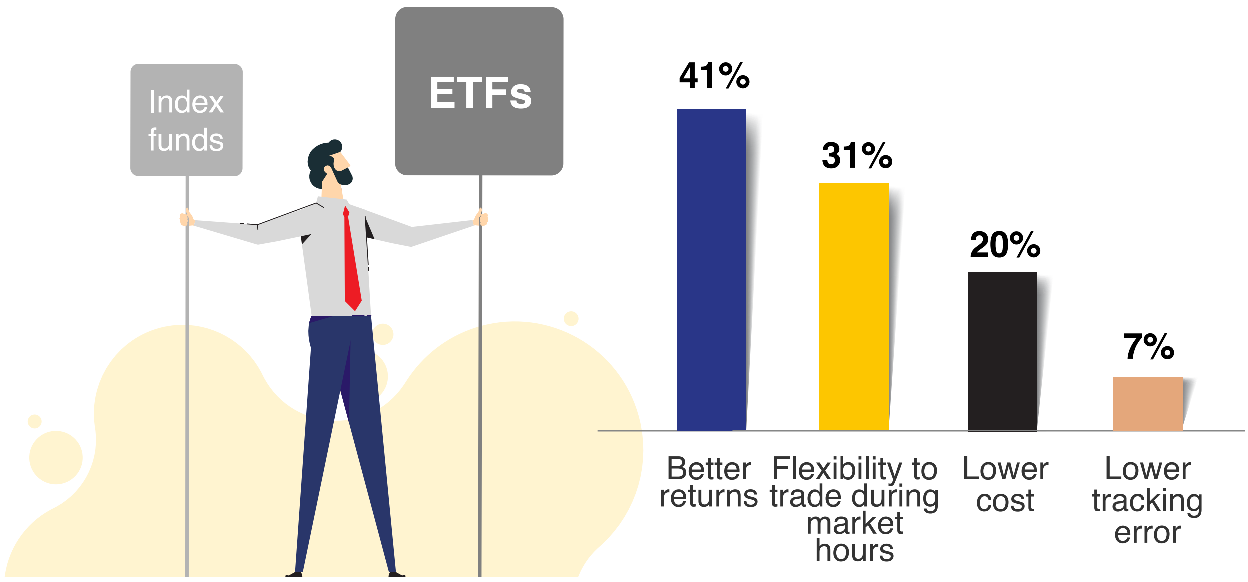
the percentage drops to **~35%** for GenX and Boomers.

*GenZ: Born before 2012; Millennials: Born 1981 – 1996; Gen X: Born 1965 – 1980; Boomers: Born post 1955

Reasons for preferring Index funds over ETFs.



Reasons for preferring ETFs over Index funds.



Investors prefer sectoral indices over benchmark indices.

- **67%** of passive fund investors prefer Indian sectoral indices like Nifty IT and Nifty Bank.
- **61%** of investors prefer Indian benchmark indices.
- Commodities and Smart Beta Funds are gaining traction among passive fund investors.

SECTION 2: **Behavioural indicators**

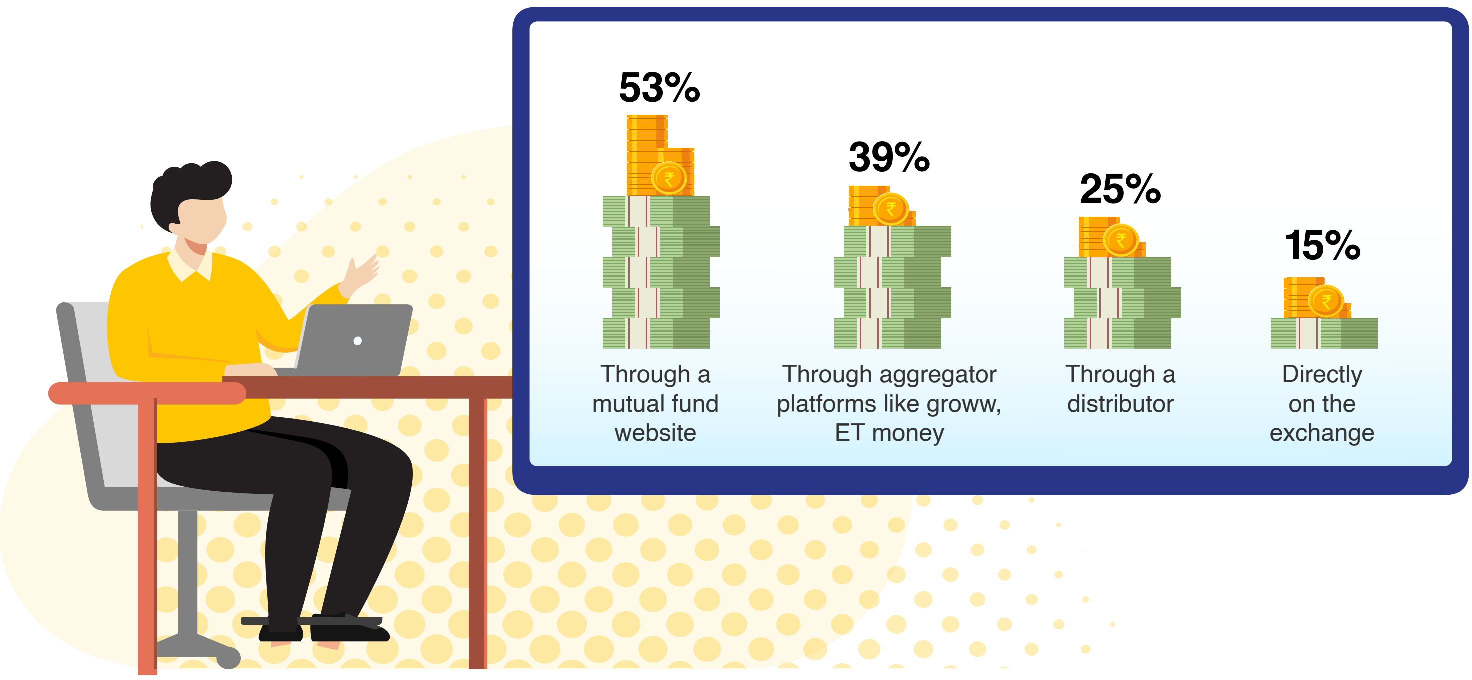
A systematic and disciplined approach to investing appeals to investors, making SIPs a preferred method for investing in passive funds.

58% investors prefer to invest via SIP mode.

Social media & friends have had maximum influence when investing in passive funds.

Passive fund investors want clear and simple information from distributors and mutual fund companies to understand their options better. Many turn to social media, especially YouTube, for easy-to-follow updates and insights on passive fund investing strategies.

How do investors prefer investing in passive funds?



SECTION 3: **Selection and allocation**

Selection

Investors consider factors like **expense ratio, brand reputation, and advisor recommendations** when selecting passive funds. Among these, **56%** prioritise expense ratio as the key deciding factor.

Most investors take a long-term view with passive funds.
81% plan to hold their investments for over three years.

The survey reveals that **42%** investors are planning to hold their investments for 3-5 years, **33%** aim to maintain their positions for 5-10 years and **6%** aim to hold for more than 10 years. This trend shows that passive fund investors are committed to staying invested for the long term.

Allocation

Passive fund investors typically hold an average of **8-9** funds in their portfolios.

80% of investors have increased their allocation towards passive funds over the past year. The younger generation (Gen Z), has contributed the maximum to this significant rise in passive fund allocations.

On average, investors plan to increase their allocation to passive funds by **15%** in the next 12 months. This growth reflects confidence in the performance of passive funds and their role in building diversified portfolios. We expect the influx of new investors to drive competition and innovation within the market.

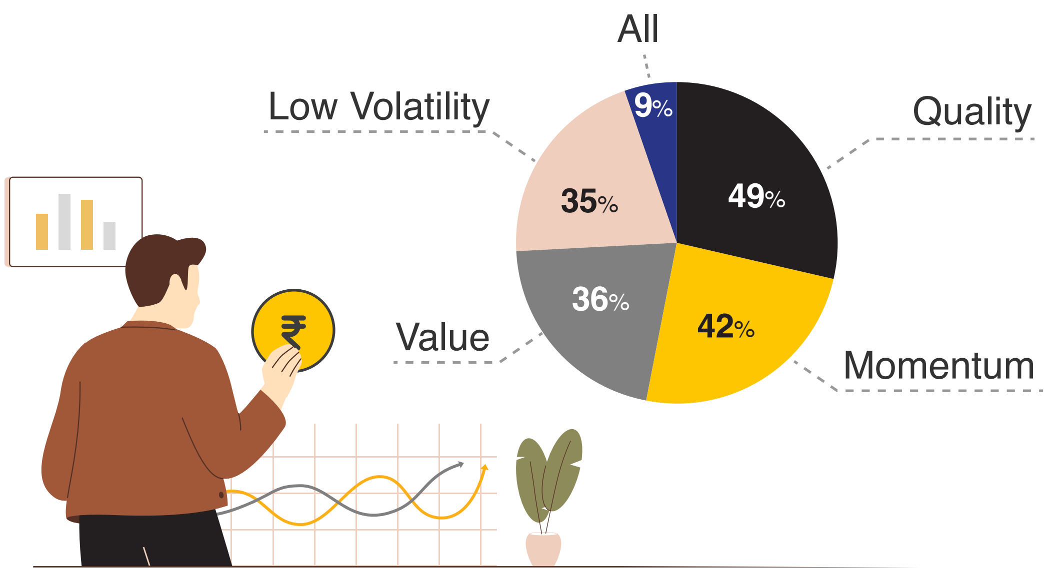
50% of mutual fund investors who are not yet investing in passive funds plan to start doing so next year. This shows growing awareness and acceptance of passive funds among different types of investors.

SECTION 4: **Factor/Smart Beta funds**

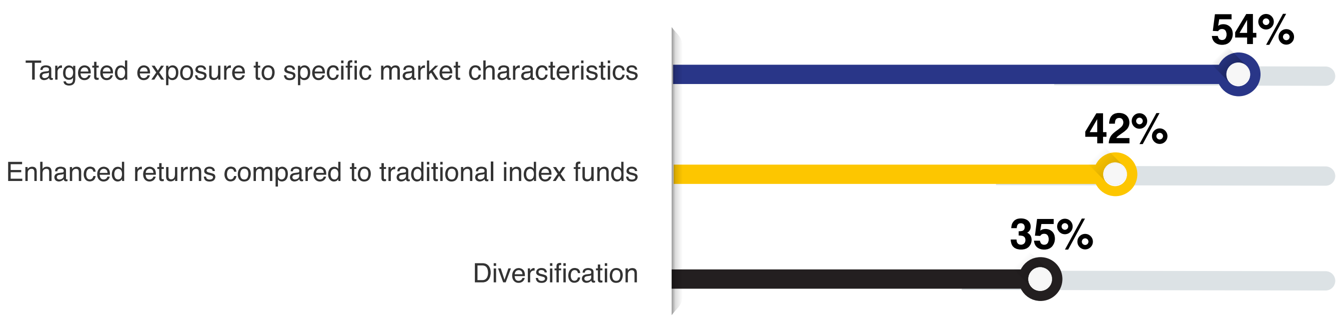
Factor or Smart Beta Funds combine active and passive strategies, using alternative weighting methodologies to potentially outperform traditional index funds.

20% of passive fund investors include factor/Smart Beta Funds in their portfolios, with Quality, Momentum, and Value being the most popular factors.

Which factor/Smart Beta Funds do investors prefer?



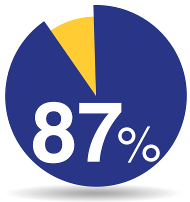
Reason for investing in factor/Smart Beta Funds.



SECTION 5: **Distributor lens**

35% distributors consider themselves experts in understanding passive funds.

58% have a basic understanding, and **7%** are unfamiliar.



of distributors rely on asset management companies for information on passive funds.

Reason for distributors to include passive funds (ETF/Index) in their product basket.

51% Passive funds help in diversification

39% Passive funds offer better risk-adjusted returns

34% Passive funds are simple to understand

32% Passive funds are less risky than active funds

28% No need to continuously monitor the portfolio

Key metrics for distributors while choosing passive funds are Performance, Tracking error, and Liquidity.

Distributors focus on several factors when choosing passive funds, with **performance** being the most important. They also check **tracking error,** which shows how closely a fund follows its index—a lower tracking error means better alignment. For ETFs, liquidity is key to ensure investors can buy or sell easily without affecting prices.

Distributors currently allocate about 10% of their investments to passive funds and plan to increase this by around 5% in the next year.

The rise of passive funds is not just a passing trend

The emergence and growth of passive funds mark a transformative phase in India's investment landscape, driven by increased awareness and changing investor preferences. As more individuals recognise the benefits of low-cost, transparent investment options, passive funds are becoming integral to wealth-building strategies across diverse demographics. The ongoing thrust on education and clarity around these products will further enhance investor confidence and participation. With regulatory support fostering transparency and accessibility, passive fund investing is poised to become a cornerstone of the Indian mutual fund ecosystem, empowering investors to make informed decisions that align with their long-term financial goals.

Further, the shift towards passive funds reflects a broader trend of democratising financial markets in India. As younger generations embrace technology and digital platforms for investment research, they are more likely to engage with passive funds that offer simplicity and efficiency. This trend not only encourages a culture of disciplined investing through methods like Systematic Investment Plans (SIPs) but also positions passive funds as a viable alternative to traditional active management strategies.

Further, distributors are poised to be key players in this transformation, facilitating access to innovative products that meet specific needs. Their role will be crucial in demystifying passive funds for many individuals who may still be hesitant due to misconceptions or lack of knowledge.

As the market matures, the introduction of innovative products such as Smart Beta Funds will likely cater to the evolving preferences of investors seeking tailored strategies.

Ultimately, the rise of passive funds is not just a passing trend; it signifies a fundamental change in how Indians approach investing, prioritising long-term growth over short-term speculation. Our report aims to enhance financial literacy and empower a new generation of investors, paving the way for a more robust and inclusive financial ecosystem in India.

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Source: MOAMC Internal research

Investments in securities market are subject to market risks, read all relevant documents carefully.

The SIP amount, tenure of SIP, expected rate of return are assumed figures for the purpose of explaining the concept of advantages of SIP investments. The actual result may vary from depicted results depending on scheme selected. It should not be construed to be indicative of scheme performance in any manner. Past performance may or may not be sustained in future.

Index schemes follow a passive investment technique and shall only invest in Securities comprising one selected index irrespective of its market conditions. If the Securities market declines, the value of the investment held by the Scheme shall decrease.