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The disruptive power of technology

The fund industry may have embraced machines and robots, but managing money still needs the human touch

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PHOTO: iSTOCK

There is a new wave of automated technology sweeping the world. Artificial Intelligence (AI) in the form of intelligent agents, chat bots, digital assistants and AI-based services and apps are set to disrupt industries and eliminate jobs in the coming years. Intelligent or driver-less cars are also already being tested.

It's not just the developed nations; the winds of change are blowing in India as well. Private lender ICICI Bank, for instance, is employing robots to perform tasks like generating customer IDs, updat-

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ing addresses and mobile numbers and resolving ATM-related queries.

Will artificial intelligence and technology change the way the mutual fund industry manages it assets as well?

Navneet Munot, CIO of SBI Mutual Fund, sees artificial intelligence making big strides in the asset management industry in the next few years. “Going forward, artificial intelligence may play a big role in the selection of stocks and identification of market trends. The future of our business is what I call quantamental – fundamental analysis with a quantitative overlay,” he says.

“Technology can undoubtedly create disruption, taking over jobs of fund managers and distributors and the way we do business,” adds Nilesh Shah, CEO, Kotak Mutual Fund.

One thing is clear. Industry experts acknowledge that change is coming. But, how fast and what will change in the domestic mutual fund industry due to AI or other technological advancements is still being debated.

Impact of tech

Technology has already impacted the asset management business significantly in the last decade. For example, attribution analysis, a performance-evaluation tool used to analyse the ability of portfolio and fund managers, was not prevalent 10 years ago but is commonly used now. Attribution analysis involves dissecting factors such as stock selection, market timing and style of investment on fund performance, among other things. It helps determine whether a fund manager is skilled or just lucky.

Technology changes in the core function of fund management have been driven by third party providers such as Bloomberg. “In the last decade, fund managers have become a lot more agile, moving from periodic weekly or monthly reviews to doing real-time analysis of their portfolios,” said Manoj Nagpal, CEO, Outlook Asia Capital, a company engaged in investment management, data analytics and consulting for both individuals and enterprises.

Technology now also facilitates detailed tracking of money flows, which includes the quantum of money going into different schemes as well as the category of investors putting in that money. On the operations side, the turnaround times have become better. For example, online calculation of net asset value is now done almost instantaneously.

Customers have a choice to do transactions online as opposed to going physically to mutual fund offices. Fund houses have started tapping social media platforms like WhatsApp and other applications to facilitate ease of transactions. For example, Axis Mutual Fund’s Easy Services gives customers the option to invest in schemes through an SMS, a phone number or an app.

“While 90 per cent of the business is still conducted offline, 30-40 per cent of transactions are now being routed through the digital mode,” says Himanshu Vyapak, deputy CEO, Reliance Mutual Fund.

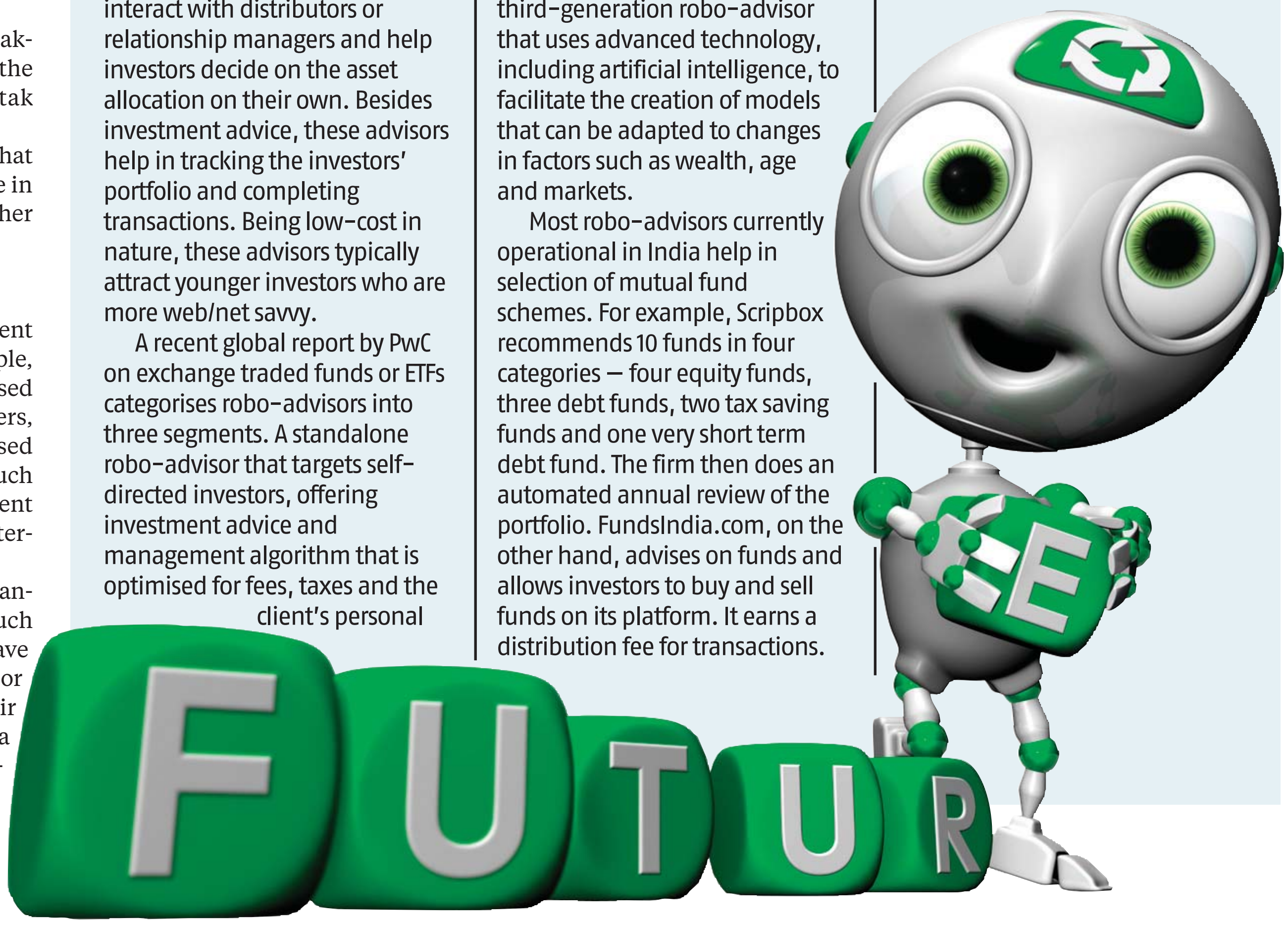
Who are robo-advisors?

A robo-advisor is an an online financial advisory firm that provides automated, algorithm-based investment advice to its customers. These advisors essentially eliminate the need to interact with distributors or relationship managers and help investors decide on the asset allocation on their own. Besides investment advice, these advisors help in tracking the investors’ portfolio and completing transactions. Being low-cost in nature, these advisors typically attract younger investors who are more web/net savvy.

A recent global report by PwC on exchange traded funds or ETFs categorises robo-advisors into three segments. A standalone robo-advisor that targets self-directed investors, offering investment advice and management algorithm that is optimised for fees, taxes and the client’s personal situation. Second, an integrated robo-advisor that targets both self-directed investors as well as advisors (to reach their clients), with focus on mass-market and mass affluent investors. Lastly, a third-generation robo-advisor that uses advanced technology, including artificial intelligence, to facilitate the creation of models that can be adapted to changes in factors such as wealth, age and markets.

Most robo-advisors currently operational in India help in selection of mutual fund schemes. For example, Scripbox recommends 10 funds in four categories — four equity funds, three debt funds, two tax saving funds and one very short term debt fund. The firm then does an automated annual review of the portfolio. FundsIndia.com, on the other hand, advises on funds and allows investors to buy and sell funds on its platform. It earns a distribution fee for transactions.

Then there are full-service robo-advisory firms like ArthaYantra, which deal with other products such as insurance besides mutual funds. These firms provide personal finance advice after assessing the financial goals, risk appetite and spending patterns of the investors.



Will Artificial Intelligence replace fund managers?

According to a recent survey of financial advisors in the US by financial web portal Investopedia, 46 per cent of traditional advisors already use or are in the process of implementing a robo-advisory into their practice and 78 per cent feel technology will greatly impact their practice in the next five years.

Back home, robo-advisory is still at a nascent stage, and market participants expect its impact to be limited, at least in the foreseeable future. “I don’t see technology usurping the role of a fund manager, at least not in the next few years. Even in developed countries where automated quant models are prevalent, fund managers are still in demand because of their ability to interpret data,” says Nagpal.

According to him, Indian investors still rely on distributors for financial advice and will not automatically make the transition to robo advisors. “They need to move from the distributor-led to the advisory model first. Only then will they turn to robo advisory,” points out Nagpal. Adds Vyapak: “In our business, advisory is personal. No doubt, robo advisory will grow but we do not expect it to change the dynamics of personal advisory.”

However, there are some experts who believe there is a real threat to the role of fund managers from machines.

At the *Business Standard Fund Cafe* event held in August, Leo Puri, managing director of UTI Asset Management conceded that the ability of fund managers to beat machines will diminish over time. “Behavioural science is different from computational science. But as information asymmetry reduces, you will not find any difference in the quality of outcome between the two,” said Puri.

Most experts though believe that the change will be

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seen first in developed markets with a visible lag in India. They add that fund managers in India will continue to hold sway over machines for a longer period as India is a market with deeper information asymmetry compared to developed markets such as the US. “In the US, the average fund manager finds it hard to beat the market. In India, 90-95 per cent of fund managers beat the benchmark. Mutual fund assets here contribute just 4-4.5 per cent to the market capitalisation of the Indian market, much smaller than the contribution of 30-35 per cent in the US. Only when our asset base starts contributing 20-30 per cent to the market capitalisation, will the role of the fund managers start shrinking,” says Kaustubh Belapurkar, director (fund research) at Morningstar India.

On a similar note, Nagpal points out that artificial intelligence will start gaining an upper hand only if India makes the transition from active to passive fund management. As of August 2016, passive funds (including index funds and ETFs) contributed to 1.8 per cent of the assets under management (AUM), as per data from Value Research, a fund tracking firm.

Striking a balance

Technology may prove to be a double-edged sword. Munot says that going forward there is going to be a lot more information overload and one of the challenges is to separate the signal from the noise. At the same time, he says, the higher computing power and automated applications can be used by fund managers to better identify trends and analyse data points.

While technology may bring in more efficiencies it can also lead to major upheavals in the market. A case in point is the flash crash of 2010 where the Dow Jones Industrial Average plunged by almost 1,000 points in half an hour due an automated trade execution system that went awry. “These instances can, in fact, create opportunities for fund managers who have the courage to go against the market,” says Munot.

“While technology can play a big role, investment management is very much to do with skill of an individual and artificial intelligence cannot take over that role,” said Milind Barve, managing director, HDFC Mutual Fund at the mutual fund round table.

Despite the conviction of sector experts that flesh-and-blood fund managers will continue to outperform, experts worldwide have already sounded the alarm bells. Renowned scientist Stephen Hawking, who has in the past warned of computers overtaking humans in the next 100 years, has specifically also warned of AIs outsmarting humans in the financial markets.

And while AI will ring in more efficient markets, automation may well throttle opportunities to make money in the market. As Munot puts it: “If there are only machines there won’t be any market.”