'This longer-than-expected drag on limits enhancement is definitely not a great situation to be in'

International investing has gained tremendous popularity of late, so much so that the mutual fund industry is about to breach the permissible foreign investment limit of $7 billion, which led many fund houses to put gates on their schemes and suspend fresh inflows. We speak with **Rajeev Thakkar, CIO and fund manager at PPFAS Mutual Fund,** to understand the rationale behind the temporary suspension of the AMC's flagship scheme Parag Parikh Flexi Cap Fund and the factors that led to the reopening of the fund after a hiatus of about one and a half months. Also, he shares his perspective on the US tech stocks in the context of their recent sell-off.

Parag Parikh Flexi Cap Fund, your flagship scheme, will complete 10 years next year. The fund's AUM has ballooned from about ₹6,400 crore in January 2021 to a staggering ₹21,000 crore by December 2021. What, according to you, acted as an inflection point where the fund started gaining prominence and popularity?

As an organisation, PPFAS is more than 40 years old. Our founder, Mr Parag Parikh, started as a stockbroker on the BSE somewhere in the late 70s or early 80s. Even in the context of investment management, we were among the initial people to get the PMS licence in 1996-97. Although the organisation has had a long track record, in the mutual fund space, we were a newcomer in 2013. So, in the initial years, most of the mutual fund clients were people who were the legacy clients of our PMS service.

Now, despite the widely known facts that past performance is no guarantee of the future and that one should focus on the process or the product design, people typically look at the performance track record before trusting someone with their money. So, for Parag Parikh Flexi Cap Fund, the trust really kicked in when people saw our performance in one full market cycle and how the fund sailed through the market drawdown. Also, our scheme's design to invest one-third of assets in international markets was unique when we launched our fund, because of which people took time to understand how it works. Today, India plus overseas investing in a single package is widely recognised and appreciated.

In the context of growing monthly net inflows for this fund, how difficult was it for you to deploy massive funds at a time when the market was making sustained new highs? Given that Parag Parikh as an AMC is a staunch believer in value investing, did the incremental inflows during the rising markets make you anxious?

Firstly, let's look at the flows that we have witnessed. Over a period of time, we've built a sizeable book of SIPs and STPs, wherein my estimate is somewhere in the range of ₹500–600 crore per month. I would like to highlight here that this might not be completely accurate because the SIPs that we see are only the ones that are registered with our registrar, CAMS. A lot of SIPs happen at the backend of the investment platforms while we see them as a series of lump-sum investments. So, in a typical high-inflow month, the flows range about ₹1,000 crore. Now, in the earlier scheme of things, we had the flexibility to invest 30 per cent, i.e., ₹300 crore in overseas stocks. So, that leaves us with ₹700 crore to deploy in India in a month. We have roughly 20 working days. So, ₹35 crore a day is not really that big an amount to deploy.

Further, while valuations have not been very cheap, at the same time, there have been pockets where we find undervalued companies. So, we were able to selectively deploy funds. As per the February 2022 factsheet, we have only about 5 per cent of the net assets in cash, so we are not sitting on excess cash. Moreover, a lot of growth in the fund came in the post-COVID period when the recovery has not been even in terms of stock prices. For example, a lot of private-sector banks did not really participate in the subsequent rally.

You recently reopened this fund for fresh inflows after a hiatus of around one and a half months, as the industry was near the SEBI-prescribed limit of US $7 billion for international investing. Given that there has not been an increase in the overseas investment limit yet, what factors contributed to withdrawing this temporary suspension?

When the announcement came that the incremental investments in overseas securities could not be done from February 2, 2022, it came as a surprise to us and other people in the industry. The trade body AMFI and the market regulator SEBI were in regular touch with regard to these limits and it was known to the regulators that the $7 billion limit is close to exhaustion. So, the expectation widely held was that these ceiling limits would be increased, as and when required. We still had around $300 million available to us if one goes as per fund-house-wise limit but nonetheless, we were impacted.

When the announcement came that the incremental investments in overseas securities could not be done from February 2, 2022, it came as a surprise to us and other people in the industry

Our first stance was to maintain the status quo as far as possible. So, we decided not to disturb the existing SIPs and STPs for clients' convenience. At the same time, we put gates on fresh lump-sum and SIP registrations till the time we got more clarity as to how things would pan out in the future. There were two key events after that, the Union Budget and the RBI monetary policy meeting. Unfortunately, neither of them had anything to say on the overseas limit, suggesting that nothing seemed to be on the cards immediately. We felt that no decision was also a decision, so we had to plan as to how to go ahead.

We had three options: asking people to invest in our tax-saver fund for their equity allocation or launch a completely new scheme that would invest only in the domestic market or reopen the flexi-cap fund. We discarded the first option because of the three-year lock-in period. The second alternative was dropped because we didn't want to clutter our offerings and have too many schemes running. Also, the new scheme would not have any purpose once the international investing limits are enhanced. So, we decided to keep the flexi-cap fund running. As of now, all the incremental investments would be put in the domestic equity only. If the limit increase comes down the road, we can again go back to the previous scheme strategy by rebalancing to take up the foreign allocation.

The idea of international investing is increasingly becoming more mainstream. Though mutual funds are currently barred from investing overseas, we have traditional brokerage houses that facilitate direct buying and selling of foreign stocks. Then we have GIFT city, where NSE's platform has come up, and now even BSE's IGX is about to start. What's your view on this overall opportunity loss for the mutual fund ecosystem?

The option of going through the broker route has been there for more than a decade now. However, this, including the GIFT city facility and the like, is not that convenient or preferable because of several reasons. One is that to exercise them, individual investors need to convert rupees into dollars and for that, they should have either a dollar account with a bank or a running account with a broker who keeps their balances in dollars. The challenge, especially for small investors, is that the currency-remittance rate that they get is not very user-friendly. So, there might be a difference of as much as 2–4 per cent between the interbank rate and the retail rate on the currency transfer that is done.

Also, in the Union Budget a few years back, tax collection at source or withholding tax provisions were introduced on such transactions. This implied that if one remits ₹100, one might have to pay, let's say, ₹5 as a tax to the government, which can be offset against one's tax liability in the income-tax return. All of this adds some friction and costs. In fact, when you invest abroad directly, you should not only be conversant with the Indian laws but with the laws of the investee country too. For example, the US has an inheritance tax. So, in the case of an investor's demise, the investment value is subject to the inheritance tax of about 40 per cent (on the full amount and not just on the gains) as per my understanding and the residual is then paid to the heirs.

So, the most convenient option for retail investors is domestically domiciled mutual funds. Hence, this longer-than-expected drag on limits enhancement is definitely not a great situation to be in. These days, people can even buy foreign mutual funds under the Liberalised Remittance Scheme (LRS). So, in a way, we are exporting our mutual fund activity to overseas providers instead of our own people operating in India. I hope that the limit revision happens soon.

These days, people can even buy foreign mutual funds under the LRS. So, in a way, we are exporting our mutual fund activity to overseas providers instead of our own people operating in India.

When it comes to FANG+ stocks, we've seen the winds flowing on one side so far, where they've had tremendous network effects and things have all gone in their favour. But with some of the recent developments, the kind of free fall in a few international stocks, like Facebook, do you think the moats that some of these tech titans carry are much more fragile than what is perceived? Has it compelled you to revisit your investment thesis about some of these behemoths?

There are two aspects to it. On the one hand, there is a very big network effect and the winner-takes-all kinds of business models that many of these companies have and at the same time, there are certain things that one needs to be continuously mindful of and keep a watch. These are privacy aspects, antitrust issues and potential restrictions on the M&A activities. Given that these are large companies, so they may not be able to carry out very large-scale acquisitions.

Further, many times, there's a change in the environment and some other promising business areas crop up, leading to some new competitors. But it has been seen that in their original areas of dominance, these behemoths continue to do well. Let's take the example of Microsoft. It probably missed out on the mobile phone operating system, where iOS and Android control the market. Still, its dominance on the desktop-operating system and the corporate IT infrastructure remains and it continues to benefit significantly from that.

If we talk about Facebook, it continues to be strong in the social-media space with its platforms such as Instagram, WhatsApp and Messenger, though in a new space like the short-form video content, TikTok has undoubtedly taken a meaningful market share globally. And despite all the controversy over privacy and the new terms and conditions, I don't see people having moved significantly to other apps like Telegram or Signal; people still exchange WhatsApp messages.

So, I am not that worried. In fact, if it is seen that if there is a possibility for competitors to operate in some different niche areas at least, it reduces the antitrust challenges to that extent. We have not made any significant changes in the portfolio composition and we continue to own the companies that we had in the portfolio. ☑