

Passive funds' share in total MF AUM declines despite growing popularity

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Even as passive investing continues to grow in popularity, its share in the mutual fund (MF) assets under management (AUM) is on the decline.

After tripling from 5.8 per cent in April 2019 to 17.7 per cent in March 2023, passive funds' share slipped to 16.6 per cent by the end of 2024. This decline has occurred despite record net inflows, investment account additions, and new fund launches last year.

Experts attribute the slowdown in passive growth to a combination of unfavourable market conditions and shifting retail investment trends in the equity space, exacerbated by outflows from passive debt offerings.

In the last two years, small cap and midcap stocks have outperformed large caps by a wide margin.

Given that around 90 per cent of the passive equity AUM tracks large cap indices such as the Nifty 50 and the Sensex, the mark-to-market gains for passive funds was much lower compared to active equity schemes. In the two-year period ended December 2024, the Nifty 50 gained 31 per cent while Nifty Small cap 100 and Nifty Midcap 100 went up 93 per cent and 82 per cent, respectively.

Small cap and midcap funds account for 24 per cent of the active equity AUM. Additionally, schemes like flexi cap and multi cap also deploy a significant portion of their corpus in small cap and midcap stocks. Even active large cap funds invest up to 20 per cent of their AUM in these stocks.

Secondly, the performance differential resulted in investors putting in record sums into active small cap and midcap funds.

"While the outperformance of small cap and midcap funds, and the subsequent surge in investor interest in these schemes has been a key factor, the strong inflows into thematic funds also aided the AUM share gain by active equity funds," said Vishal Dhawan, founder & chief executive officer (CEO) of Plan Ahead Wealth Advisors.

The double advantage resulted in active equity funds' share in the industry AUM surging to 46 per cent in December 2024 from 39 per cent in March 2023, shows data from the Association of Mutual Funds in India (Amfi).

The declining trend in the passive AUM share is also a result of the change in debt fund taxation in April 2023. The removal of indexation advantage dried up inflows into the fast-growing passive debt space, which had amassed over Rs 1.5 trillion within a span of a few years. The passive debt AUM, which stood at Rs 1.7 trillion in March 2023, has gone up only by 19 per cent since then to Rs 2 trillion.

"A major reason for drop in passive AUM share seems to be passive debt funds with target maturity funds showing flat growth. This can be a result of outflows and lack of fresh offerings," said Sriram BKR, senior investment strategist, Geojit Financial Services.

However, passive equity funds have continued to garner higher inflows. Passive funds together raked in a net of Rs 1.3 trillion in 2024 compared to Rs 71,404 crore in 2023 propelled by record number of fund launches. The inflows have largely gone into passive equity funds. The passive equity AUM surged 38 per cent in the first 11 months of 2024 to Rs 8 trillion. In comparison, the active equity AUM went up by 39 per cent.

The inflows into passive funds was supported by a record 130 fund launches. The spree of new offerings more than doubled the index fund investment accounts to 12.5 million.