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Strategic Asset Allocation in the Indian Economy

Khushi Gupta

I. Introduction

"The difference between success and failure is not which stock you buy or which piece of real estate you buy; it's asset allocation." ~ Tony Robbins.

Asset allocation diversifies one's portfolio by dividing your money into different asset classes. It helps to eliminate systematic risk, thereby maximising returns.

According to the Asian Development Bank, the Indian economy is expected to grow by approximately 8% in the next 5–6 years, endorsed by increasing public investment in infrastructure and a pickup in private sector investment. Numerous experts speculate that the Indian Stock Market will also have progressed and expanded to the fifth largest in the world, accounting for the highest market capitalisation.

This paper discusses different industries' performance and potential. Industries like Renewable energy and FMCG. These Industries have high potential, are value-based, and are bound to see rapid growth and capital inflow in the future because of the increase in consumer demand, rising income, growing urbanisation, government policies and supportive regulations, rising demand for clean energy, rising demand for digital technology, and many more factors.

The data is collected from various sources available on the internet and analyzed. This paper aims to provide information to individuals about future growing industries and make them aware of the potential risks and returns from the industry.

Anyone looking for long-term investment and who is risk-neutral can benefit from this paper, irrespective of investment size, i.e., lump sum or systematic or strategic investment plans.

Asset allocation and asset classes

What is asset allocation?

Asset allocation is an investment strategy in which one's portfolio consists of investments divided into different asset classes in different proportions according to an individual's goals or requirements. Asset allocation balances risk and returns as it helps to make a negative correlation portfolio by investing in different asset classes and reducing the impact of systematic risk on the portfolio.

The asset allocation approach takes emotions out of investing. As human beings, out of greed and fear, we tend to invest when the market is bullish and sell when the market is bearish. Therefore, asset allocation helps us to be disciplined investors by investing money every month or according to one’s strategy, irrespective of market movements.

Trying to time the market becomes gambling rather than an investment; hence, asset allocation gives you protection and helps you stay longer in the market.

Asset Classes

Asset classes are a group of investments that exhibit similar characteristics, often behave similarly to one another in the marketplace, and are subject to the same law and regulation. There is usually little to sometimes a negative correlation among different asset classes. Each asset class has its own set of risks and returns.

Asset classes are divided mostly into two categories: traditional and Alternative assets.

Traditional assets consist of Equity, Fixed income, and Cash.

Equity, or stocks, are shares of ownership publicly traded in the market. For companies to expand and meet their financial objectives, they often sell part of the company’s shares in exchange for cash to the general public. Buying these shares represents a great way to profit from the success of a company. They are the most popular category of asset class. Equity is highly volatile and has the highest risk and return among the traditional asset classes. It is a high-risk investment for the short term. Stocks are of two types: value-added (dividend-paying) and growth-based (capital appreciation). One can invest in stocks by directly investing in markets or through various mutual funds.

Fixed Income: A Fixed income is a financial instrument that generates a fixed amount of income. It is a kind of loan where the investor buys a bond and acts as a lender, and the company borrows the money for an agreed-upon period, and the investors receive the interest as per the compounding frequency of the invested capital at the end of the period. It is less volatile compared to equity, resulting in lower returns than equity, with some exceptions. The most common forms of fixed-income investments are corporate and government bonds.

Cash: It is the most simple form of all asset classes, and it is also known as money market instruments. It is liquid, as it is the cash you have in hand. It has very low risk, hence the lowest return. Cash investments are savings accounts, certificates of deposit, Treasury bills, foreign currency, etc.

Alternative asset classes consist of Real Estate, commodities like gold and silver, Infrastructure, Hedge Funds, Venture Capital, Private equity, Private Debt, Real assets, and digital currencies.

Alternative investment options are highly volatile, i.e., they are highly risky, illiquid, and capital-intensive. Alternative asset classes are used for diversifying portfolios and minimising their risk.

Conservative and aggressive portfolio

A portfolio is constructed based on many factors, like time horizon, capital available to invest, and many other factors, but the most important of them all is risk tolerance, which differentiates a portfolio from whether it is conservative or aggressive.

Conservative portfolio: In a conservative model portfolio, generally, a large percentage of investors' money is allocated to low-risk securities such as fixed income and money market instruments. The goal of a conservative portfolio is to prevent capital erosion over maximum returns; hence, it is even referred to as a capital preservation portfolio. Risk-averse investors, have a low-risk appetite or are investing for a short time horizon (to safeguard themselves from huge losses) opt for conservative portfolios.

Moderately conservative portfolio: A moderately conservative portfolio is suitable for investors who wish to preserve most of the capital invested but are also willing to take on a little risk exposure for inflation protection. In this strategy, high-discount or coupon-paying securities are selected.

Moderately Aggressive Portfolios: These are also referred to as balanced portfolios as the composition of assets is divided almost equally between fixed-income securities and equity. This strategy is for risk-neutral and long-term investors.

Aggressive portfolio: The main aim of this strategy is long-term capital appreciation, hence it is also referred to as a capital growth strategy. In this strategy, capital mostly consists of equities and some fixed-income securities for diversification. This strategy is for risk-neutral or high-risk tolerance and long-term investors.

Diversification and Rebalancing

The main motto of diversification is not putting all eggs in one basket,i.e., dividing your investment among various asset classes. As the correlation between different asset classes is little to sometimes negative, it can never move up or down together. For example, if the price of gold is high at the same time, the market can be bearish, and if an investor’s only investment is in equity, it can cause him huge losses and be subjected to high risk, but if the same investor invests in both gold and stocks, he is safeguarded from losses. Not just different asset classes, but diversifying among different negatively correlated industries in the stock market can give your portfolio diversification benefits. Investing in highly risky assets is also not a problem for diversification, as it balances out the portfolio and generates high returns by minimising risks. Hence, diversification is very important for asset allocation.

Rebalancing is readjusting the value of a portfolio's asset allocation back to its original investment plan or asset mix. This is important because, over time, certain investments may deviate from your investment goals. Rebalancing ensures that your portfolio is not focused on only one or more asset classes, and it reorients your portfolio back to the desired level of risk. One can rebalance their portfolio annually or when the relative weight of an asset class surpasses or falls short of the decided percentage of the investment plan.

Asset Allocation Strategies

When considering asset allocation strategies, there isn't a one-size-fits-all rule or an ideal approach to investing. Each financial advisor adopts distinct methods, and every investor is unique, with different goals, risk tolerance levels, and time horizons. Apart from investor-related factors, external factors such as market fluctuations and shifts in interest rates also influence allocation strategies. Some asset allocation strategies are:

Strategic asset allocation

Strategic asset allocation involves determining and maintaining a suitable balance of different asset classes within an investor's portfolio. This approach requires regularly rebalancing the portfolio to uphold the predetermined proportions of individual assets.

Tactical asset allocation

A tactical asset allocation strategy entails tactically adjusting the proportion of different asset classes in an investor’s portfolio to capitalise on changing market conditions. It aims to optimise short-term investment strategies, offering greater flexibility in navigating market dynamics, thereby enabling investors to allocate more resources to higher-yielding assets.

Dynamic asset allocation

Dynamic asset allocation stands out as a widely favoured investment approach, allowing investors to adapt their investment ratios in response to market and economic fluctuations. In contrast to the manual buying and selling involved in tactical asset allocation, dynamic asset allocation utilises automated systems driven by financial models.

Factors affecting asset allocation

Every individual is unique; so are their goals, risk tolerance, and investment horizon, which influence their investment plan.

Investment Objective: An individual's goal drives their desire to attain a certain level of return or savings for a particular purpose or aspiration. Consequently, varied objectives influence an individual's investment decisions and risk tolerance.

Risk tolerance: Risk tolerance indicates the extent to which an individual is willing and capable of enduring potential losses on their capital invested with the expectation of achieving a higher return in the future. Every individual has a different level of risk tolerance. There are three kinds of investors: risk-averse, who prefer low to negligible risk; risk-neutral, who prefer normal or moderate risks; and risk-seeking, who look forward to taking high risks. Risk tolerance becomes an important factor for asset allocation, and it differs for all three kinds of investors.

Time horizon: The time horizon is the duration for which an investor is going to invest, mostly depending on the goal of the investor. Different time horizons involve different risk tolerance levels.

Age: An investor’s age plays a crucial role in determining how long an investor can stay invested. Younger investors can stay invested for a longer period, so they are least impacted by the short-term volatility of the markets, which allows them to invest in high-risk investments like equity and focus on long-term wealth creation. On the other hand, investors nearing their retirement have financial responsibilities and are sensitive to short-term market volatility, so large proportions of their investments are invested in less volatile options.

Current Market Analysis

2023 has been a significant year both globally and domestically because of events like the default of major US banks SVB and Signature Bank, which caused an impact on IT and start ups in India; the rise in US inflation, which caused the depreciation of Indian currency; and FIIs pulling capital out of India because of high-yielding bonds in the US, followed by rumours of an increase in crude oil prices; and the war between Israel and Palestine, which caused the down movements in Indian markets.

Anyhow, Indian markets remained stable and showcased growth, reaching all-time high milestones in equity as Sensex touched the milestone mark of 70,000 in December and Nifty touched the important mark of 20,000 in September with $4 trillion in market capitalization. The Indian stock market is ranked fourth in the world in terms of market capitalization, following the United States, China, and Japan.

The mutual fund industry also did exceptionally well, as AUM crossed the 50 lakh crore mark in December 2023 with high inflows in the small cap category, and debt mutual funds showcased a dip because of the removal of indexation benefits. Gold outperformed fixed income assets and provided a return of 13% because of the depreciation in Indian currency against the dollar, but with the change in indexation law, a sovereign gold bond is a preferred option as it provides an additional 2.5% return in the long term with tax benefits.

Fixed income assets like fixed income and PPF didn't perform well, as the government bond benchmark yield started at 7.3% and ended at around 7.2% . The real estate sector saw 5% growth in overall sales, pointing towards a promising future.

With the current markets, asset allocation becomes even more important as the markets are very volatile and unpredictable, with some asset classes performing exceptionally well and others not performing so well. Therefore, segregating your investment helps to minimise your risk and maximise your returns, with bonds being the safest option with minimum risk and return and equity providing a return of 12–13% with high risk. The safest and my preferred option is Mutual Funds which provide various options like investing completely in equity or in a mixture of equity and debt, among others, which helps diversify the investment. And I believe Gold should be a part of every investor’s portfolio since it has a negative correlation with other asset classes, and experts advise that gold should constitute 10–15 percent of the total portfolio at most. Gold always benefits from global crises. One should aim to create a portfolio with negatively correlated asset classes.

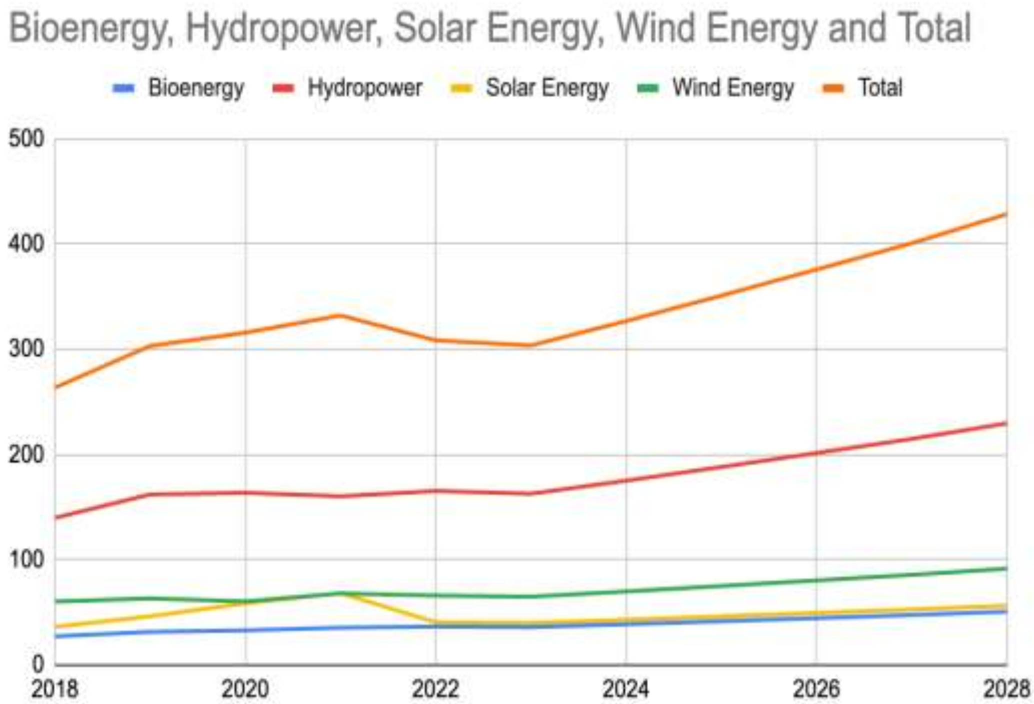
Among the movements in Indian markets, industries with promising growth potential are Renewable sector, FMCG sector, healthcare and insurance sector, IT sector, Real estate sector, and automobile sector. In this paper, we will discuss the Renewable and FMCG sectors.

Renewable Sector

Over the previous seven years, over $79 billion has been spent on renewable energy in India, while the Union Budget 2024 allotted Rs. 600 crore to fulfil the future target of Renewable sector in India and By 2030, India wants to have 450 GW of renewable energy capacity, comprising 5 GW of small hydropower, 10 GW of biofuels, 280 GW of solar power, and 140 GW of wind power.

With this increasing need, the nation has made tremendous progress towards meeting this objective. Various initiatives are being taken by the Indian government, like the Pradhan Mantri Suryodaya Yojana (PSY) campaign, where the government is promoting solar energy by constructing mega solar parks and deploying solar rooftops. Not just solar and wind energy The Indian government is also supporting the use of additional renewable energy sources, such as bioenergy and small hydropower. India has considerable potential for bioenergy, with an estimated 25 GW potential from only agricultural waste.

The graph below showcases the expected growth of different energies in the renewable energy sector by 2028.



The renewable energy sector is an attractive investment sector because global energy demand is on a steady upward trajectory and is expected to increase by 50% by 2050 because of emerging economies. The Ministry of Power founded REIPFB to provide one-stop help to industry and investors for project development and new investment, creating a niche for investors wanting to invest in green energy opportunities. India is also exploring alternatives to fossil fuels by pleading to ban diesel cars, which are expected to be replaced by EV vehicles.

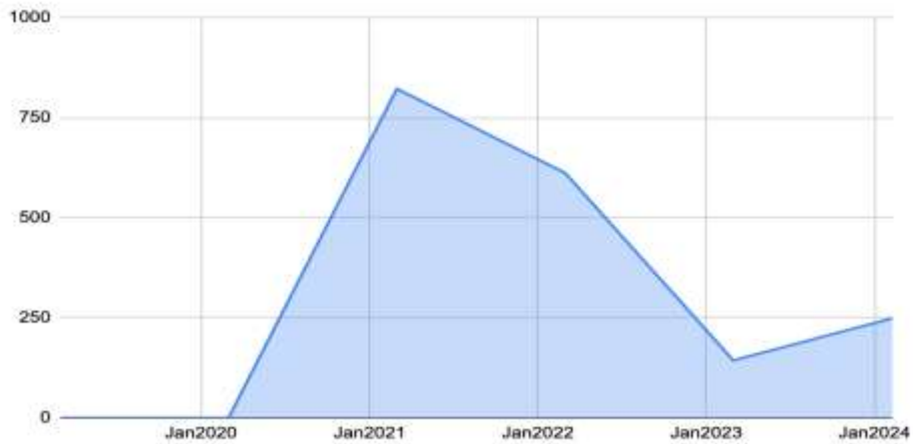
One can benefit from the growth in the renewable energy sector by seizing on various investment options, like investing in equity by investing in companies investing in green energy like Adani Green Energy Ltd.., Tata Power Solar Systems Ltd.., NTPC Ltd.., Borosil Renewables Ltd.., etc., or buying stocks of battery storage companies or companies that are suppliers to green energy companies. Other options than equity are Mutual Funds some of the funds are the Nippon India Power & Infra Fund, Tata Resources and Energy Fund, ESG Funds, etc., or one can buy international stocks and funds.

Company Analysis

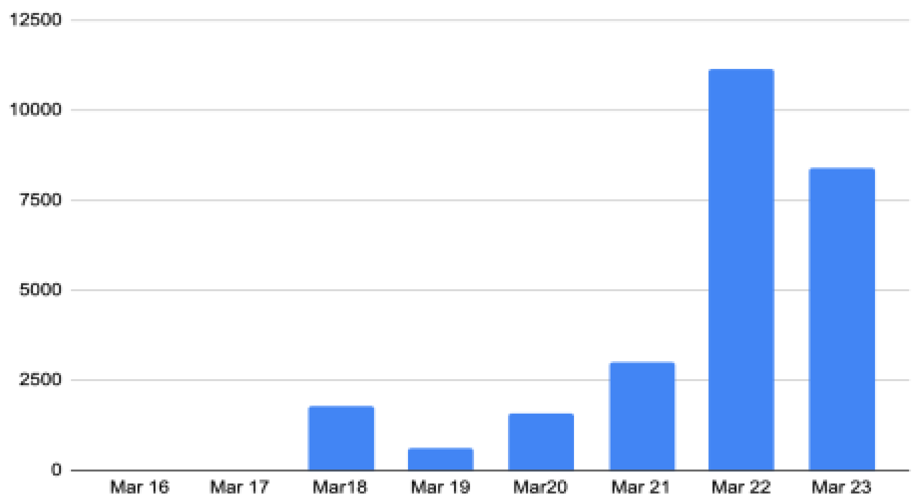
Adani Green Energy Ltd.

Adani Green Energy Limited (AGEL) is one of the largest renewable companies in India, with a current project portfolio of 20,434 MW. AGEL is an Adani group's initiative towards a better, cleaner, and greener future for India. Driven by the Group's philosophy of 'Growth with Goodness', the Company develops, builds, owns, operates, and maintains utility-scale grid-connected solar and wind farm projects. The electricity generated is supplied to central and state government entities and government-backed corporations. On the back of long-term Power Purchase Agreements (PPAs) of 25 years with central and state government entities, AGEL has leveraged its capabilities and expanded its presence across 12 Indian states. The Company deploys the latest technologies in its projects. With a portfolio of 54 operational projects and 12 projects under construction, AGEL is driving India on its renewable energy journey.

Adani Green Energy is forecast to grow earnings and revenue by 19.9% and 20.4% per annum, respectively, while EPS is expected to grow by 13.8% per annum.



The above graph shows Price to Earning ratio for 5 years. The P/E ratio indicates that a company is generating high earnings compared to its current valuation. It helps to understand the growth potential of a company. AGEL's PE ratio was at an all-time low in 2020 and was at its peak in 2021. It is now following a steady upward direction. AGEL has positive growth potential.



The above graph shows total revenue generation for AGEL with an all-time high in 2022 and a drop in 2023 because of a block deal involving over 40 million equity shares of the company changing hands, and many foreign companies also have shareholdings in AGEL, which might cause fluctuations.

There is a high potential for growth for AGEL in the upcoming years. According to me, one should definitely invest in AGEL. It does not have high risk, with a Beta of 0.83 and a return of 16.92% in three years.

FMCG Sector

FMCG is the fastest-growing sector in Indian markets, as it is fast-moving and highly in demand because of its high usability and low price. Products like toothpaste, soap, pre-prepared meals, notepads, chocolates, and cookies are piled high on the shelves of supermarkets, with the majority of sales coming from personal care and household items.

An increase in the FMCG sector is due to increasing income, improvements in people's lifestyles, and urbanization. A significant rise in the Indian FMCG industry is due to rising demand for healthy and organic products due to rising awareness about health, so consumers are shifting to natural, organic, and chemical-free alternatives. In response, many companies are launching new products and investing in research and development in this area. It has even become easier for companies to reach consumers directly with the help of e-commerce and digital marketing; hence, more focus and capital expenditure are given to them.

The other factors contributing to the growth of the FMCG sector are the new government-made India programme aiming to promote domestic manufacturing and the National Food Processing Policy, which aims to boost food processing and reduce food waste.

The FMCG industry in India is expected to continue growing rapidly in the coming years, driven by factors like an increase in consumer demand, an upward shift in income,and supportive government policies. However, the industry may face challenges such as high competition, higher raw material costs, and changes in consumer preferences. One can seize and benefit from the growth in the FMCG sector by investing in equity. Some of the highly growing companies in this sector are Nestle India, ITC Ltd., Hindustan Unilever, Britannia Industries Ltd., Dabur India Ltd., and many more. Other than equity, one can invest in Mutual Funds like Tata India Consumer Fund Growth,ICICI Prudential FMCG Fund Growth, and Mirae Asset Great Consumer Fund Growth.

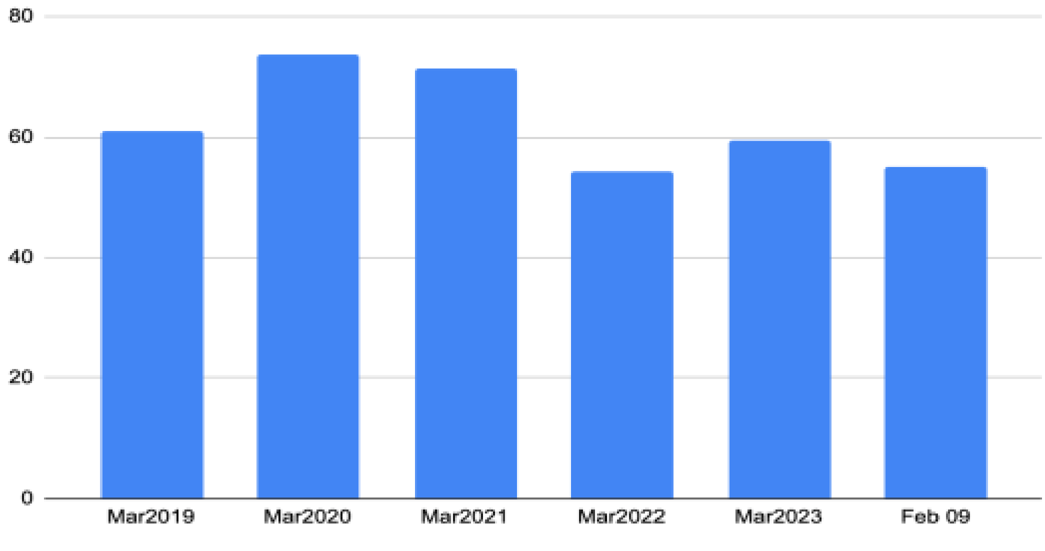
Or one can invest directly in an ETF like the ICICI Prudential Nifty FMCG ETF.

Company Analysis

Hindustan Unilever

Unilever India is the biggest among other Unilever companies in business due to its high volume of sales. The strategy followed by HUL is “winning over many of India's,” that is, the same product, campaign, and logistics that worked wonders in one part of the country will work on other parts of the country as well. Nine in ten households use HUL products. A major reason for the growth of HUL in India is its mass population and the fast evolution of Indian consumers, with many people in the middle class bracket experiencing a growth in the working population. Consumers are moving towards products with proven superiority. The most popular brand of HUL is Lifebuoy. It is India's no. 1 soap brand; Horlicks, Surf, Red Label, Lakme Cosmetics, and Kissan are some of the others on the list.

In January 2023, HUL was marked as India’s most valuable company. There was a significant growth of 11% for FY 21–22, followed by a growth of 15.53% for FY 22–23 in net sales of the company, with the highest year-on-year market share gain ever witnessed by HUL. It is forecasted to grow earnings and revenue by 9.2% and 7.1% per annum, respectively, and EPS is expected to grow by 9.2% per annum, whereas ROI is predicted to grow by 25.9% in 3 years.



The graph above demonstrates the price per earnings ratio of HUL over the course of 5 years, with the highest P/E ratio in the year 2020, followed by a dip in the P/E ratio because of the price cuts taken to pass on the benefit of commodity deflation and due to a decrease in premium products in light of inflation. The price-earnings ratio to growth of HUL is 4.08, with a sustainable growth rate of 3.3%.

HUL is a blue-chip company and a part of the Nifty 50, making it a good choice for investment with an avg beta of 0.56, making it a low-risk company with a 9.38% return in three years.

II. Conclusion

In a nutshell, Asset allocation is the way in which investors diversify their investments among different asset classes like equity, fixed income, commodities like gold, silver, real estate, etc. One cannot just diversify their investments by investing in various asset classes, but they can diversify even by investing among different industries in the same asset class that are negatively correlated to each other, e.g., when crude oil prices go up, airline prices go down.

There are different asset allocation strategies, like strategic, tactical, and dynamic, for long- or short-term time horizons, depending on the investor. There are also other factors affecting an investor’s investing decision, like age, investment goals, and the main factor being risk tolerance, according to which a portfolio is created, i.e., aggressive or conservative.

One does not need to be an expert or have a huge amount of capital to invest; instead, anybody who knows the basics can start investing with a principal of Rs. 500 in SIPs and learn to be a disciplined investor, as it is not easy to time the market. Trying to time the market is more like gambling than an investment.

In this paper, we also discuss the Renewable energy and FMCG sectors among the other high-growth potential industries, mention some companies related to these fields, make a detailed analysis to get an understanding of the true picture and help readers form an informative investing decision.

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