Offshore Fund Schemes – Hit or Miss!

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Dear Investors and Advisors,

One of the charts that always amazes me is a map our partners at JP Morgan put together, which shows different country performance year by year, across time. In all the colors and years, there is a simple takeaway that always hits home – no one country is a constant winner. This is even more relevant in today's volatile world, where every country's economic and political conditions are fluctuating, and India is no different. When I lived overseas, I hardly saw investors investing 100% of their portfolio in a single country, even if it was the US, their home country. Geographical diversification – holding multiple countries in the portfolio – was a must, just like asset class diversification. 10 years ago, this was something Indian investors perhaps did not recognize, especially with strong local markets. Today, however, geographical diversification is something more and more investors are open to.

So how do you start investing abroad?

Well, offshore mutual funds are a convenient option. In simple words, offshore funds are mutual funds that invest in international markets. These could be funds that buy international stocks directly or buy an international fund often run by an international asset manager. They could be active or passive in nature. Either way, as investors, you enjoy direct access and exposure to international brands and businesses, with the benefit of professional management.

For years, I have had investor conversations challenging the reasons for investing abroad given the performance of local markets. I think there are three compelling reasons to invest abroad, and recent returns (especially the last 1 year), are not the answer!

For one, here's an interesting statistic. If you look at the annualized risk and returns for global markets from 2009 to 2019, and see how countries rank, India equities actually stood out less on the charts than US equities, and even markets like Taiwan and China. The US stacks the best on risk return metrics, in fact. Moreover, US markets actually have a very low correlation to Indian equities – about 0.15, over the last few decades. This is because the stocks representing the US economy tend to have very different themes from India. Two examples are technology – where many themes like digital payments, streaming and cloud are not even listed in India which is largely an IT services market, and healthcare – where the US has a significant presence in terms of biotech and healthcare research compared to India which is a generics market. Adding even 20% exposure of a US fund to an India portfolio, not only takes up expected return, but pulls down the risk.

The second advantage of offshore funds is currency diversification. Any rupee depreciation enhances the returns from investments made in a foreign currency. This makes international funds an asset that gives dollar and Euro exposure and hedges against INR depreciation risk, very relevant especially for those planning expenses abroad. With this rupee depreciation historically being 4-5%, this is a reasonable benefit.

Finally, offshore funds are convenient to buy and taxed like local debt funds. There is no headache of setting up accounts abroad and global taxes. Offshore funds can be used like domestic funds with low minimum ticket sizes and also offer indexation after 3 years. At 20% with indexation, the blended tax rate ends up being between 10-15%, not much higher than local equities.

With all these three benefits, offshore investing is not without risks. Do remember not to use recent returns as a guide to performance and approach offshore funds as a part of your asset allocation. Because they have done well in the last year does not make them less risky – some categories are riskier than Indian equities. The same principles of good equity investing apply here – not timing the markets, holding for the long term, and taking the right amount of risk. An SIP approach works very well in this category. Finally, in the plethora of options, work with a financial advisor to find the funds right for you and the allocation that suits you.

International investing is an important part of your asset allocation, and I have been using this personally for the last 10 years. After you've completed your basic asset allocation, this is a good building block to add and at Edelweiss we run one of the widest offshore baskets, covering 80% of the world across 6 funds, and an additional Indo-Global offering in our new healthcare fund. Do get in touch with your advisor or us for any questions.

Happy Investing!

Regards,
Radhika