RAJ SAM/MINT

(From left) Rohan Gupta, Vasanth Kamath and Anugrah Shrivastava founded smallcase Technologies in 2015 to offer investors an alternative to mutual funds.

A curated basket of stocks now just a click away

This online investment platform helps people put money into a basket of stocks curated on a particular theme

Malavika Velayanikal
BENGALURU

A little over five years ago, Vasanth Kamath and his friends from IIT-Kharagpur, Anugrah Shrivastava and Rohan Gupta, began looking for an answer to a logical question that nagged at them: Why can't you take portfolio exposure to stocks through your broker? Why does it only have to be through the mutual fund route?

The idea behind a mutual fund is to enable a retail investor to have a portfolio of stocks managed by an expert—but the drawback is that the investor subsequently has no control over the portfolio. Wealth managers also provide portfolio management services, but the minimum investment is ₹50 lakh, which excludes most retail investors like you and me.

The three friends wanted to find a way for regular investors to put money into a portfolio of stocks instead of having to go stock by stock. "So we created smallcase as an instrument for taking exposure in a basket of stocks," says Kamath, co-founder and CEO of smallcase Technologies.

This makes smallcase an alternative to both mutual funds and portfolio management services. A Silicon Valley startup, Motif, founded by Hardeep Walia, has also created this kind of alternative financial tool in the US. Its 'motifs' are based on a variety of themes from cleantech and fighting cancer to changing interest rates.

NEW INFRA FOR CAPITAL MARKETS

In India, to enable such portfolio-as-a-unit thematic investing required building a platform to plug in multiple entities, including stock exchanges, trading sites, brokers, investors and financial advisors. "It's new infrastructure for the capital markets," says Kamath, 28, whose family has always traded in the stock market. He recollects spending summer vacations in Mangaluru as an eight-year-old taking calls from clients and punching in orders for his uncle who was a broker. Another family member built Omnesys, whose trading software most brokers use in India. Thomson Reuters acquired the firm in 2013.

Kamath went on to study economics at IIT Kharagpur, and met Shrivastava, 30, his senior who did the Chartered Financial Analyst (CFA) programme while they were in college. After IIT, Kamath joined Tracxn, a Bengaluru-based deal discovery platform for venture capital, while Shrivastava worked for Nomura in Mumbai, where he built portfolios for institutional investors. Around 2014, they began talking about how to enable one-click investment in a portfolio of stocks treated as a unit.

They got together with Gupta, 29, who was working for Goldman Sachs in New York, building low latency trading platforms. The three of them quit their jobs and founded smallcase Technologies in 2015. Initially, it was part of a fintech startup accelerator run by discount trading brokerage Zerodha. They built the back end for investing in a portfolio where the allocation for each stock is automatically calculated based on its weightage. multiple trades for the stocks in the portfolio had to be executed on the stock exchange at one go through a trading site like Zerodha.

> It took time to convince brokers that smallcase was not going after their clients but wanted to collaborate and build an ecosystem

Unlike a mutual fund, the smallcase is in the investor's trading account, so she has full control. One can add or remove a stock from the smallcase or alter allocations, although most people don't have the bandwidth track the stocks as closely as is required to do this.

Most investors prefer to pick portfolios made by experts instead of creating their own, although the platform enables an investor to create her own smallcase and invest in it as a unit. To help the majority of investors, the platform, which is a Sebi-registered financial adviser, has an expert team putting up thematic smallcases, such as one that guards against volatility by investing in both equity and gold.

Apart from the initial investment into the smallcase, the platform enables periodic rebalancing, again with one click. The smallcase creator tweaks the holding from time to time and notifies investors, who then hit the rebalance button to trigger 'buys' and 'sells' on their trading account. All this happens in real time where stock prices are changing.

TIME TO EXPAND

Last February, Sequoia Capital India led an $8 million series A round of funding for the startup. There are 50 Sebi-registered financial advisors creating smallcases for investors on the platform. Some are free, others may require a monthly or annual subscription fee and set minimum investment limits. These are typically created by wealth managers who will then track the performance of stocks in the smallcase and rebalance it periodically.

Trading sites other than Zerodha have been enabled on the platform as well, allowing more investors to execute smallcases in their preferred accounts. Apart from Zerodha, Axis Direct, Kotak Securities, HDFC Securities, IIFL Securities, 5paisa, Edelweiss, and Alice Blue are on the platform. This has helped build credibility for the platform, which also earns a fee each time an investor executes a smallcase.

"We had the thesis that this instrument could play out in the Indian market. The idea seemed interesting. But you can never get a sense of how users will react until you put the product in front of them and ask them to commit money to it," says Kamath. "We're asking people to invest through us. It's a reputation and trust-driven business."

Zerodha gave smallcase a start, but it was hard to pull in other institutional brokers, who said they would rather build their own smallcases for their investors. "The biggest hurdle was to convince brokers that we were not going after their client base. We wanted to collaborate and build an ecosystem for smallcases," recalls Kamath.

Finally, he was able to show brokers the value of being on a platform where a diverse set of independent financial advisors would be creating smallcases that investors would execute on the broking sites. This essentially expands business for brokers as well as financial advisors, who gain from network effects.

"We think of it as a marketplace to put our offerings up," says Anoop Vijaykumar, fund manager at Capitalmind, whose smallcase has a basket of 25 stocks based on their four-year momentum factor.

The 'creators' page lists all the available smallcases. An investor can read about the creator, the thesis behind each smallcase, and see its past performance relative to a benchmark index. This helps a prospective investor, but there's a downside.

"People are picking investment advisors like they pick mutual funds, where they look at the recent history of returns and decide. That may not be the best way to pick advisors. You may want to pay more attention to their investment philosophy and how they've performed over a longer term," explains Vijaykumar.

"It's a nascent platform, still evolving. The number of advisors is small. A lot more needs to happen in terms of the advisor ecosystem as well as the execution platform. I'm expecting more innovation in this space in the next two years."

Malavika Velayanikal is a consulting editor with Mint. *She tweets* @vmalu

PROBLEM, CHALLENGE & SOLUTION

The idea of a mutual fund is for a retail investor to have a portfolio of stocks managed by an expert. The drawback is the investor has no control over it.

smallcase created an instrument for investors to take exposure in a basket of stocks based on a theme, without having to track individual stocks.

Unlike a mutual fund, smallcase is in the investor's own trading account. He or she has full control and can add or remove a stock or alter allocations.

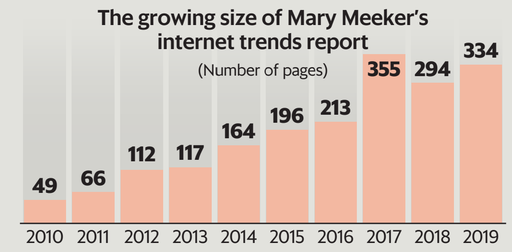
IN SEARCH OF THE NEXT BIG THEME

Thematic investors look for big trends that will impact companies, and build a portfolio. The theme-based view is considered superior to the sector-based one as technological, demographic and environmental trends cut across industries.

howindialives.com

MAKING SENSE OF WHAT'S TO COME

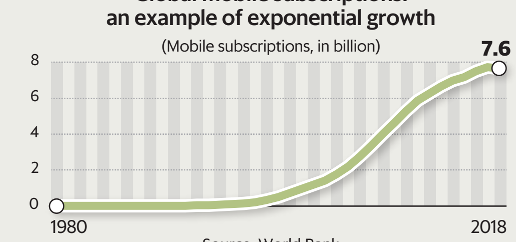
Understanding big themes is crucial to venture capitalists and secondary markets. The growing size—as well as following—of Mary Meeker's annual internet trends report is an indicator of this.



Source: Bondcap.com

WHY TREND-SPOTTING IS CRUCIAL

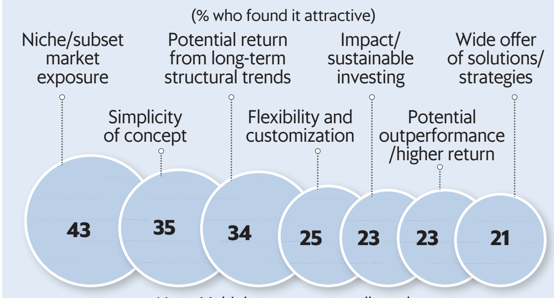
One of the reasons behind the rush to spot trends is the speed with which platforms scale. They go from zero to a billion users, and upend industries. For example: mobile phone usage and social media.



Source: World Bank

WHY INVESTORS LIKE THEMATIC ETFs

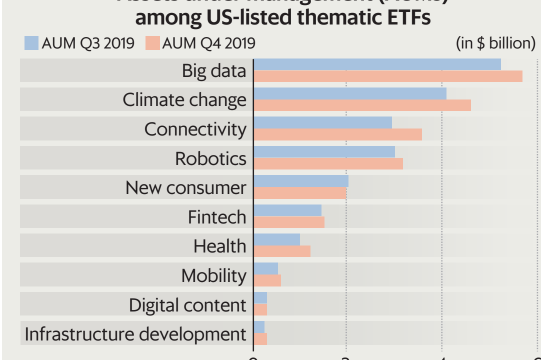
There are many reasons why investors find thematic exchange-traded funds (ETFs) attractive, including subset market exposure, simplicity of concepts and the potential return from long-term structural trends.



Note: Multiple answers were allowed
Source: Global ETF Study 2019, JP Morgan

WHAT STRIKES A CHORD WITH INVESTORS

Venture capitalists as well as retail customers go for theme-based investing. The US has more than 120 listed thematic ETFs with more than $27 billion in assets under management, with big data and climate change leading.

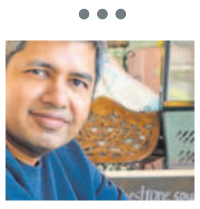


Source: Thematic ETF Report, Q4 2019
howindialives.com is a database and search engine for public data

GRAPHIC BY NAVEEN KUMAR SAINI /MINT

I'm expecting a lot more innovation in this space over the next two years.

ANOOP VIJAYKUMAR
FUND MANAGER, CAPITALMIND



Without tech, it would have been hard for brokerages like ours to stay in business.

ALOK JAIN
FOUNDER, WEEKENDINVESTING

We're asking people to invest through us. It's a reputation and trust-driven business.

VASANTH KAMATH
CO-FOUNDER AND CEO, SMALLCASE

How stock brokers are trying to impress and attract millennials

Sumit Chakraberty
BENGALURU

The Bombay Stock Exchange (BSE), dating back to 1875, started as a broker's forum under a tree on Dalal Street, and is Asia's oldest stock exchange. For over a century, registered brokers exchanged shouts, gestures and signals on the floor to make trades happen.

The National Stock Exchange (NSE) came up in 1994 to provide screen-based electronic trading. It gave fibre-optic access to brokers in other cities who could join the trading in the centralized exchange located in Mumbai. That ended the era of disjointed stock exchanges.

Dematerialization of shares started in the late 1990s and online trading began at the turn of the millennium where investors could buy and sell shares through electronic brokers such as ICICI Direct and Sharekhan. More brokers went online but another disruption was to come in the next decade.

Online financial services company Zerodha brought "discount broking" to India in 2010, applying a flat fee of ₹20 on a trade whatever its size. It removed even that in December 2015, charging only for futures, options, and day trading. This attracted newcomers and young investors who could do small commission-free trades to get a feel of the market. Within a decade, Zerodha overtook legacy players to become the country's largest brokerage in terms of number of trades, according to NSE data.

SIMPLE ADVICE

Alok Jain, who was one of the first brokers to become an NSE member from New Delhi in 1996, saw the writing on the wall when Zerodha started its flat fee model. The brokerage fee others were charging for investment advice and facilitating trades were suddenly antediluvian. "I could see that it would be difficult for brokerages such as ours to stay in business," says Jain, an engineer from IIT with an MBA in finance from the University of Maryland.

He started his Weekend Investing blog in 2016 where he put up his entire portfolio of stocks, and posted details of his weekly trades. He soon built up a following of investors who liked his portfolio and thesis of momentum investing. The "MI50" product he built for his own use gave returns of 54% when it completed a year on March 31, 2017, says Jain.

The popularity of his blog prompted him to register with Sebi as a financial adviser to provide portfolio management services to high net-worth individuals (HNIs). But his transition from broker to adviser wasn't complete.

Abhishek Banerjee, founder of Hyderabad-based investment advisory firm LotusDew, uses AI-based analytics to create specialized portfolios for retail investors.

Even as exchanges and brokerages evolved, new investment instruments came up. The country's first mutual fund, Unit Trust of India came up in 1963 and remained a monopoly until 1987 when other institutions were allowed to offer mutual funds. This became a mode for investors to take exposure in a basket of stocks managed by an expert instead of investing in individual stocks on their own.

Its appeal was limited by hidden fees, lack of transparency, and no control for the investor beyond entering and exiting the fund. Last year, a new portfolio investing instrument called 'smallcase' became available in India, which resides in the investor's trading account, thus providing control and transparency.

This has enabled advisers like Jain to offer their portfolios as smallcases for retail investors to buy with a subscription fee. Millennial professionals typically have an appetite to invest but not the time to track and manage their portfolios. Such an instrument gives them that option.

It also ties in with another stock market trend, which is the growing share of algorithmic investing and emerging influence of AI. It's getting harder for an ordinary investor to keep up with new age investment experts who no longer need armies of analysts when an AI engine can do all the crunching.

NEW INVESTORS

One of these new investment advisers is Abhishek Banerjee, a computer science engineer who was a senior research analyst with Franklin Templeton. Last year, he founded an investment advisory firm in Hyderabad, LotusDew, which uses AI-based analytics and data points to create portfolios.

Banerjee, who offers a couple of his portfolios to retail investors as smallcases, likes the fact that the value proposition of these is upfront unlike a mutual fund. "There are 1,277 financial advisers registered with Sebi. Most of them are not active, but of the ones that are active, very few have their track record independently calculated and publicly available," says Banerjee.

As more and more elements of the stock market get digitized, it increases its potential to attract a new generation of investors who're no longer drawn to real estate to park their disposable income.

Sumit Chakraberty is a consulting editor with Mint. *Write to him at* chakraberty@gmail.com