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Things to consider when choosing a mutual find

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How does one select the best mutual fund to invest in? And how do mutual funds choose the right company to invest in? Should one follow a star fund manager if changes jobs, or stick with the fund? Sunil Singhania, CIO, equity investments at Reliance Mutual Fund; Nilesh Shah, managing director, Kotak Mahindra Asset Management Co. Ltd; Anup Maheshwari, EVP, DSP BlackRock Investment Managers; and Navneet Munot, chief investment officer, SBI Mutual Fund discuss various issues around mutual fund investing at the Reliance Mutual Fund Day event. Edited excerpts:

How to choose a right mutual fund because ultimately, it boils down to that. We are talking about a lot of mutual funds beating index, we are talking about a lot of mutual funds giving 25-30% compounded annual growth rate (CAGR), but truth be told, there are laggards as well. So how do we choose the right mutual funds?

Singhania: I will give you a different perspective to it. Unfortunately, an equity investor in India invests two% of his net-worth in equity and wants to make 100% on it and wants to churn every week, every month or so. The better thing to do is to allocate properly and whether then a mutual fund scheme gives you 28% or 32%, it is not going to matter too much. However, we get fixated a lot by these numbers. And our view is that, I gave that example in the interview that the way a Kohli or a Tendulkar is not going to hit a century every day, the same way, each of us would not be the best fund manager or the best scheme every single day.

So, you have to look at the longevity of the fund manager. You have to look at their experience, you have to look at the track record and then just zero down on four or five fund houses. You are set.

That does not entirely answer the problem of an investor when he is looking at at least about 50-60 funds, all of them who are equity mutual funds or you have 50-60 debt funds. So, you have of course, a lot of websites, Crisil, Value Investor, which give you 10-year average returns, 10-year best performing first 10 funds, 5-year best performing top-10 funds, 3-year best performing, 7-day best performing, 7-month best performing. It is damned confusing. There are some common elements, but which one should you look at?

Munot: Somebody earlier in my career and a gentleman sitting here told me that you guys are like pharmaceutical manufacturers. You have the antibiotics, you have the painkillers, you have the syrups, everything. Then I am the doctor for the investor, I am saying that I am the doctor and based on what he exactly needs then I choose that what is that I need to buy from each one of these manufacturers.

And how he does it, basically, what you need to do is like two major things—the risk profiling and then your overall goal setting. So, let us say, your kid is a four-year-old and you will know that he will need certain money if you want to send him to university at the age of 20, in 16 years. You have that much of money and you need that much of money. This is what you can save, this is what you need for that specific goal.

And then, risk profiling is important because it is easy to say that equity does great, but you have a 2008 and it can go down by 60% also. If you are investing money for two years, not a great idea to put all the Rs 00 in equity alone. So, then you look at, all of us have certain emotional biases, cognitive biases. Understand yourself and then look at your goals and then decide which asset you need to put how much money. And within that, maybe then you choose the right fund which basically matches the asset allocation that you need and then the right profile according to your profile, the right kind of funds are chosen.

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(From left) Reliance Mutual Fund equity investments CIO Sunil Singhania, Kotak Mahindra Asset Management MD Nilesh Shah, DSP BlackRock Investment Managers EVP Anup Maheshwari, and SBI Mutual Fund chief investment officer Navneet Munot.

Mutual fund industry is also facing some challenges. One of the best funds of your house, DSP BlackRock Micro Cap has actually stopped fresh investments. So, there is a bit of a challenge now. With so much investments, how are you going to manage so much money?

Maheshwari: It is a nice problem to have actually. But, the challenge in that particular product is the space that it invests into, by its very nature has very less liquidity. The level of risk that you are taking is a lot higher, obviously and clearly, what you do not want is to set wrong expectations for investors coming in because a lot of investors look at your past, recent performance and then come into the product.

So we just wanted to set expectations right, also the fact that liquidity is a bit of a challenge in this environment, so we would like to not have a situation where because of the money flow coming in, you are influencing prices in a non-fundamental fashion. So the thought was, let us just take a pause, it is a fairly decent size for the space that it is investing in and at the appropriate time, hopefully, we will open it again.

Let me go back to the question which still needs a little more fleshing out in terms of how do you choose. How do you choose or should you choose the fund manager rather than the fund which means have a portable system where you have to go with the fund manager if he were to change jobs.

Shah: Out of all these three, I have probably worked in more mutual funds and despite my leaving, all those companies have continued to do well.

So, by not chasing fund managers, you have made money and if you had chased me, you would have also made money. So the limited point here is that if you have to go from Mumbai to Delhi, there are multiple modes of transport available, you can take as many trains, as many buses, as many cars, as many flights, point is that you should begin the journey.

Now, maybe in the plane you will reach faster, but you will not enjoy the fun of eating batata poha or vada pav on the street.

But if you pick up a train, you will probably take a little longer to reach, but you will enjoy the journey. So, just begin the journey. It does not matter in which mode you are. If you have a balanced, some amount of mode then anyway you will be able to reach there.

And as Madhu mentioned and Navneet mentioned, if you do not have that capability, please go to the distributor, please go to the advisor, they will know which funds to choose. They will know which allocation to make and that will hopefully create reasonably good journey for you.

Is there, for equity mutual funds as well as for debt, a more reasonable period? Should I look at a 10-year return? What is a good way to judge a fund?

Maheshwari: A good way is probably the way we look for companies to invest into. It is possibly a good way to invest in the fund itself, which is you normally look for very stable managements who have a track record of creating value through time, who have a very defined vision of where they want to—in this case, an investment philosophy perhaps—and obviously, the right integrity, ethics, etc. So, our mutual fund has been very fortunate that we are blessed with a number of players which meet that criteria.

So, there is a good amount of selection available. But, I always feel, given all those factors, if you identify a fund house or a few fund houses that you like, you are probably better off selecting the worst performing fund in that fund house at a point in time rather than always chasing the best performing fund because it is the same team, it is the same philosophy, it is the same style, it is just that maybe that product or that group of stocks has not performed for a while and that actually creates potential for them for the future.

So, most people tend to look at the last 1-year and 3-year performance and it works through time sometimes, but a way to increase those returns or actually to look at the underperforming parts of the same fund house and actually investigate more into those funds than just buying what has already performed.

And if I can just add to that, we did one analysis, if every year for a certain period of time, you chose the two best performing funds of the previous year and you kept changing your portfolio every year versus choosing the two worst performing funds of the previous year, you would always have a better outcome of the worst performing funds through time than the better performing funds.

So the law of averages may be playing out.

Maheshwari: It works.

One thing which I always wanted to know. Reliance's mid and small cap fund has done extremely well. SBI Magnum of course, we all know, the fund has done well. Your both, micro fund and the small and midcap fund have done well and Kotak also has the opportunities fund which has done well. I was just looking at some of the returns over the last three years or five years, all of them have given almost similar returns or 27-28% kind of CAGR. Do you guys look at each other's portfolio or do you guys have a bit of a friendly competition among yourselves?

Munot: No, of course, we look at everybody's portfolio. As Ridham was rightly saying a few minutes back that in India, there is so much of opportunity to generate alpha and beat the benchmark which most of us in the industry have been able to do over the last 30 years, this is our 30th anniversary, and the whole industry has grown and over a period of time, consistently, across market cycles.

And the reason is there are a lot of arbitrages. So you have a research arbitrage where let us say the large foreign investors who own 23% of the market, their universe is maybe 100 stocks and there is a large part of the universe which is not there. Or you put more resources, there is so much of inefficiency in the market, you can make more money. There is a time arbitrage. There will be UP election result on March 11, market will go up or go down. Donald Trump victory, Brexit, some or the other news flow, market goes up or goes down.

If you have a longer term orientation, you can look at companies very differently. So there are those arbitrages still available and for a long period of time, all of us who have invested in research resources, who have invested in processes, who have invested in the right kind of people, would be able to generate that alpha for a long period to come.

Let me come to how you guys handle your business because that is always interesting for those of us who watch you. What do you look for in companies?

Singhania: I do not know whether I will be able to answer that in such a short period of time. But very clearly, the basics are the same. You have to look at the business, you have to look at the potential, you have to look at the management, but somewhere down the line, you also have to look at what is already discounted in the price and that is what equity investing is all about.

So, we are here to not buy the best company, we are here to buy the best stock and there is a difference between buying the best company and buying the best stock.