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MUTUAL FUNDS

Good returns

Equity schemes have created wealth for investors

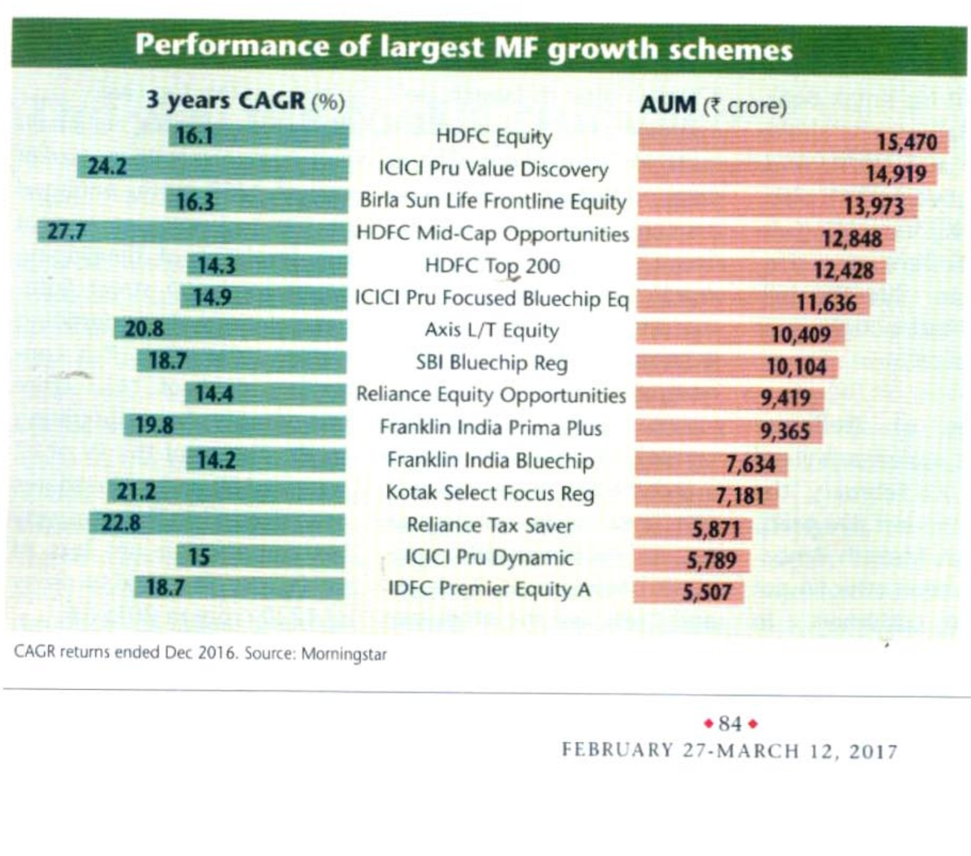
When there are more than one crore active SIP accounts in the country, are investors taking the right decision by parking their hard-earned money in equity mutual funds? Are equity mutual fund schemes giving returns that investors are aspiring for? It is one thing to beat the benchmark index and another to give absolute higher returns. An investor's decision to allocate more funds to any asset class is a function of the absolute returns that asset class generates.

Business India has studied data provided by Morningstar, an independent investment research firm, on all the equity schemes in the country with a minimum existence of three years. Our study shows that the weighted average CAGR returns by equity schemes has been in the region of 20 per cent for the three years ended December 2016. Three years is a good period to judge whether your scheme is moving in the right direction or not. It would give a good indication of whether the fund manager's strategy is working or not – be it a sector call or company call. Ashwini Kumar, fund manager, Reliance AMC, suggests that investors should look at investments in mutual funds in blocks of three years. "It normally takes 2-3 years for any fund manager's strategy to play out." However, Mrinal Singh, deputy CIO, equity, ICICI Prudential AMC, believes a 3-5 year horizon is better, with a slant towards five years. "The longer the period of investment, the better the probability of making money," he says. All the fund managers we spoke to, say that one should not look at equity mutual fund schemes with a one year horizon. A shorter time span increases the chances of your expectations of returns not being met. In that sense, it's good to know that most SIPs that are for a minimum three year period. The Indian retail investor has matured.

Our study further shows that equity mutual fund schemes in last three years have beaten other asset classes by huge margins – be it real estate, gold or debt schemes. The most sought after asset class, real estate, in fact in last three years have either given no returns or negative returns based on the micro markets one has invested in. The government policies to discourage investment in real estate – like the latest budget announcement where it has restricted the interest paid on a second home loan to only ₹2 lakh per annum – are a clear signal that the government wants to restrict investment flow to real estate. The government's focus is on people buying house for self-use rather than investment. On the other hand gold has gone nowhere in last three years – point to point giving marginal negative returns.

The beauty of investing in mutual fund schemes is that the returns are tax free. The kind of alpha Indian fund managers have generated shows that India continues to be a market where active fund management plays a meaningful role despite the fact that globally passive funds have started gaining traction. In India passive investments are still at a very nascent stage. The normal argument against active fund management is that the fund manager charges higher fees but the returns generated by active funds are also higher. The industry deserves kudos for this excellent performance.

As per data available on the NSDL Website, the Indian mutual fund industry has total equity assets of ₹5.07 lakh crore (December 2016) as against India's market cap of ₹105 lakh crore (*source: bseindia.com*). On the other hand, the present value of FPI equity investments (not investment value) as on 31 December 2016 is ₹20.39 lakh crore; FPIs hold 20 per cent of India's market cap while Indian mutual funds hold only 5 per cent. This mutual fund percentage can't remain so low. In the last one year, this gap is narrowing with more money flowing into equity schemes via SIPs.



CAGR returns ended Dec 2016. Source: Morningstar

Schemes' performance

Equity schemes come with various investment options: large cap, mid and small cap and even sectoral funds. Among the large cap funds Kotak Select Focus has given the best returns in the last three years (CAGR: 21.17 per cent). The fund is of a decent size in excess of ₹7,000 crore. It is managed by Harsha Upadhyaya,

Our scheme mandate is that we will concentrate on only 7-8 sectors. Our sectoral calls were right and that helped us generate alpha for our investors. Despite doubling our AUM in the last three years we have not changed our parameters for selecting companies

Harsha Upadhyaya
Kotak Select Focus

who also manages two other schemes – Kotak Opportunities and Tax Saver. Upadhyaya has done equally well in both schemes, giving CAGR returns in excess of 19 per cent. Normally on a bigger asset size it becomes difficult for a manager to perform, but Upadhyaya has done well. "Our scheme mandate is that we will concentrate on only 7-8 sectors. Our sectoral calls were right and that helped us generate alpha for our investors. Despite doubling our AUM in the last three years we have not changed our parameters for selecting companies," says Upadhyaya, explaining his investment strategy for the Select Focus Scheme. "We invest in 40-50 companies with low churn ratios." In terms of sector allocation (January 2017) Kotak Select Focus has the highest weightage in banking and finance (28 per cent) followed by oil & gas (16 per cent) and auto and ancillaries (13 per cent). The top three sectors account for 57 per cent of the AUM. The top three picks in the portfolio are HDFC Bank, Reliance Industries and ITC. "We have consistently outperformed the benchmark index by 600-900 basis points irrespective of a bull or bear phase," announces Upadhyaya proudly. Due to the nature of the scheme, it takes a higher weightage on fewer sectors, it becomes more risky.

Best performed schemes in last three years

Scheme	AUM (₹ crore)	3 years CAGR (%)
Large Cap		
Kotak Select Focus Reg Gr	7,181	21.2
SBI Bluechip Reg Gr	10,104	18.7
Birla Sun Life Frontline Equity Gr	13,973	16.3
Flexi Cap		
ICICI Pru Value Discovery Gr	14,919	24.2
Franklin India High Growth Cos Gr	5,116	24.1
Franklin India Prima Plus Gr	9,365	19.8
Mid and Small cap		
DSP BlackRock Micro Cap Reg Gr	4,323	39.9
Reliance Small Cap Gr	2,651	33.9
Mirae Asset Emerging Bluechip Gr	2,921	33.2
ELSS-Tax Savings		
Reliance Tax Saver Gr	5,871	22.8
Axis L/T Equity Gr	10,409	20.8
Birla Sun Life Tax Relief 96 Gr	2,433	20.4

Note: Cut off AUM for ELSS and Mid cap and small is Rs 2000 crore and rest Rs 5000 crore.
Source: Morningstar

Amongst all equity schemes DSP BlackRock Micro stood out with CAGR returns of almost 40 per cent for a three year period. The scheme recently announced that it has stopped accepting new subscriptions. "While we continue to find interesting investment opportunities for the fund to invest in, its current size poses the bigger challenge of liquidity. It is challenging to incrementally build positions, i.e. to increase stock weightage of companies to a meaningful size in the portfolio," Vinit Sambre, senior vice-president and fund manager, DSP BlackRock had stated. The scheme had an AUM of more than ₹4,300 crore; a relatively big corpus to invest in small sized companies. As in January 2017, its top three holdings were Sharda Cropchem (3.45 per cent, market cap ₹4,300 crore), SRF (3.37 per cent, market cap ₹9,500 crore) and Atul (3.02 per cent, market cap ₹6,500 crore). In total it had 76 companies in its portfolio.

ELSS is another category of interest to investors – especially as it provides a tax rebate. Here, Reliance Tax Saver has been the best performer (22.80 per cent CAGR returns). It has a significant AUM of ₹5,800 crore (segment AUM: ₹50,000 crore) accounting for more than 10 per cent of the market (December 2016). Reliance Tax Saver has the highest sector allocations in banking (22 per cent), industrial capital goods (12 per cent) and auto (9 per cent). Explaining the strategy behind the scheme Kumar says that they take a meaningful stake in a

The longer the period of investment, the better the probability of making money

Mrinal Singh,
Deputy CIO, equity,
ICICI Prudential AMC

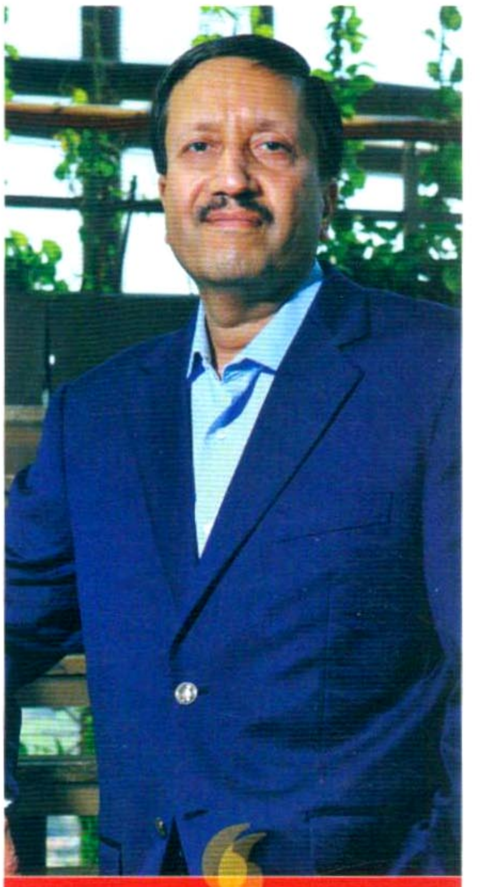
company and hold for the long term. Its top three picks in the scheme are TVS Motors (8.85 per cent weightage), Tata Steel (6.53 per cent) and SBI (6.25 per cent). Axis has the largest AUM in the ELSS category at ₹10,000-plus crore and 21 per cent CAGR returns.

Best returns

Another flavour of the season is Flexicap where fund managers switch between mid-caps and large caps depending on the outlook. The largest scheme in this space is the ICICI Pru Value Discovery scheme with an AUM of ₹14,918 crore (December 2016). This is the second largest AUM in the country, marginally lower than HDFC's Equity Growth large cap scheme at ₹15,500 crore. The Pru Value scheme has given 24.21 per cent CAGR returns (highest in its category), which is very good returns on an AUM of this size. Industry sources suggest that this scheme has given the best SIP returns in the last 10 years. "We are benchmark agnostic and hence our sector allocations are not a function of benchmark sector weightage. For us price is more important than anything else," says Singh, explaining the strategy; he is the fund manager of the scheme. In 2013, the scheme had 75 per cent of its assets in mid-caps, but today large caps account for 75 per cent. Singh believes that risk return ratios are not in favour of mid-caps. "The shift from mid-caps to large caps also happened as many of our mid-caps graduated to large caps due to price appreciation." The interesting thing about the Pru Value scheme is that it has given the highest weightage to L&T (8.41 per cent), Wipro (7.80 per cent) and HDFC Bank (7.72 per cent). No leading scheme has given L&T the highest weightage in the last few years. While the Pru Value scheme has given the highest weightage to the IT sector, it is interesting to note that TCS does not form part of the portfolio; an interesting strategy from Singh on betting big on IT and on Larsen.

What is unique this time is that some of the schemes mentioned above have different themes and yet they have been able to generate alpha for their investors with different companies in their portfolio. This proves that different investment styles can generate returns for investors.

There is a common thread that has been observed among all these schemes. Most have done extremely well in 2014 but with not-so-great returns in 2015 and 2016. The DSP BlackRock Micro scheme gave returns of 102 per cent in 2014 but remained muted in 2015 and 2016 at 20 and 12 per cent respectively (but higher than benchmark). But there is no reason to take credit away from the fund manager as mutual fund scheme performance is not a function of one or two years' returns.



It normally takes 2-3 years for any fund manager's strategy to play out.

Ashwini Kumar,
fund manager, Reliance AMC

With global developments impacting local stock market investments in equity, the market has become complex. But many investors still believe in investing on their own. However, normal investors neither have the time nor depth of understanding of the impact of global events on their investments; and with the kind of returns being generated there is little reason for investors to invest on their own. They should assess their performance against the performance of mutual funds. If they have performed poorly, it makes a lot of economic sense to get experts to generate alpha for them. We believe the mutual fund industry will keep generating good returns for investors for at least the next three years.

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