

MONEY

TIME TO SHUFFLE
MUTUAL FUNDS ARE
CHANGING THEIR
EXPOSURE TO MANY
SECTORS ON HOPES
THE NEW GOVERNMENT
WILL WORK TO TURN
AROUND THE ECONOMY



Decoding the Churn

An analysis of what equity mutual funds have been buying and selling of late. By TANVI VARMA

The formation of a stable government at the Centre has lifted stock markets out of years of stupor. The Bombay Stock Exchange (BSE) Sensex has risen 20 per cent since January and touched a high of 26,190 points on July 8. This, in turn, has put life back into the mutual fund industry. According to the Securities and Exchange Board of India (SEBI), the industry's assets under management (AUM) crossed ₹10 lakh crore in May, up seven per cent from ₹9.45

AMC, says the risk of a high current account deficit is also fading. This means banks, which usually benefit when the economy improves, will do well. A fall in interest rates and inflation may further encourage funds to add bank stocks. Naren manages one of the largest equity schemes, ICICI Prudential Focused Bluechip Fund, a large-cap fund with assets of ₹6,000 crore. The fund increased exposure to banks from 21 per cent in January to 27 per cent in May.

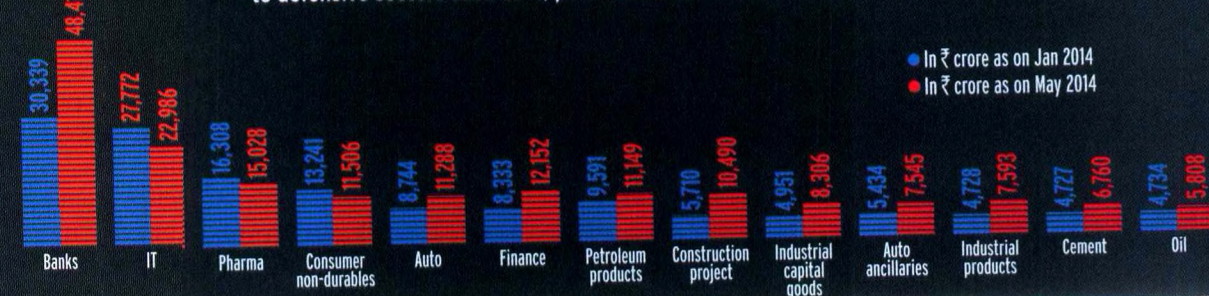
HDFC Equity fund and HDFC Top 200 fund, which together manage

finance, construction project, industrial capital goods and cement sectors, whose share has risen since January. The decline could be due to the recent change in investors' preference for high-beta stocks that move more than the overall market. These are the opposite of defensive stocks, which are stable and so in demand when stock markets are under pressure.

Naren says among the three components of gross domestic product (agriculture, industry and services), industrial growth could see the

CHANGE IN SECTORAL DEPLOYMENT

Mutual funds' investment in bank, auto, finance and cyclical stocks has gone up while there has been a reduction in exposure to defensive sectors such as IT, pharmaceutical and consumer non-durables



lakh crore in April.

Let's look at the sectors and stocks which equity mutual funds have been buying and selling to get clues about their expectations from the stock markets.

Favourite Sectors

SEBI data show banks are the top asset in portfolio of equity funds; they have invested ₹48,000 crore in banks, 22 per cent of their assets.

Banks were under a lot of pressure till a few quarters ago due to rising interest rates and piling up of bad loans. That's why the funds pared allocation to the sector. But this changed a few months ago as inflation eased and economic growth showed signs of picking up, improving banks' asset quality.

Sankaran Naren, Chief Investment Officer, ICICI Prudential

₹25,000 crore, also reflect this trend. Banks account for 26 per cent assets of HDFC Equity fund, whose top picks are SBI (nine per cent) and ICICI Bank (seven per cent). These two are the top picks of HDFC Top 200, too.

One reason for the increased exposure is the sharp rise in bank stocks in the last few months. ICICI Bank, for instance, rose 20 per cent in April.

The next favourite sector of mutual funds is information technology (10 per cent), followed by pharmaceutical (seven per cent), and finance, consumer non-durables and automobile (five per cent each). Although defensive sectors such as IT, pharmaceutical and consumer non-durables still account for a big chunk of funds' assets, their overall contribution has fallen since the start of the year (see *Change in Sectoral Deployment*).

This is in contrast to auto,

maximum traction, which should drive earnings and stock prices over the next three years. Further, the government's thrust on infrastructure will boost power generation and road construction and provide cascading benefits to manufacturing and services sectors. In fact, many projects stuck at various stages will be the first beneficiaries of this trend.

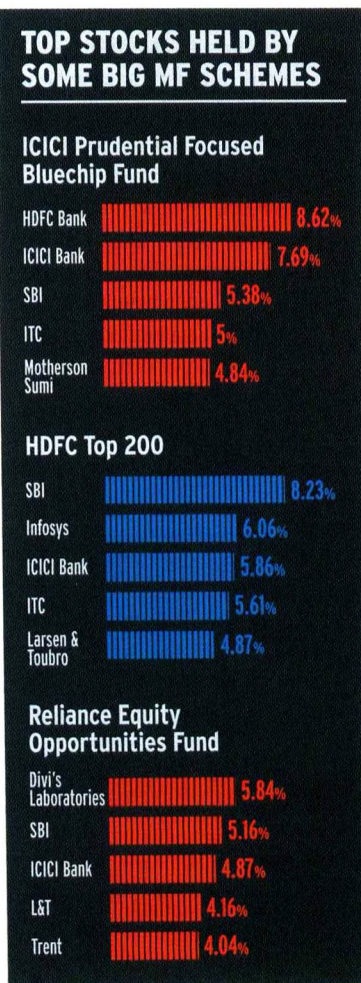
The new government is expected to reduce stress in the financial sector, revive capital expenditure, get stalled projects going, remove investment bottlenecks and increase investment in railways and roads. The finance ministry estimates that lack of good infrastructure has been holding back economic growth by 1.5 to two percentage points every year. This is likely to change and, hence, bring enormous benefits to companies allied to the infrastructure sector.

Going by this view, besides banking, ICICI Prudential Focused Bluechip Fund has increased exposure to power utilities and construction project company Larsen & Toubro and halved exposure to pharmaceutical (from seven per cent in January to three per cent in May). Exposure to IT is down from 17 per cent to 12 per cent. Naren says these changes did not happen due to election results. This was a gradual process that started once the country's current account deficit started falling. "We saw opportunities in domestic cyclical and reduced exposure to metals and global cyclical stocks," he says.

Domestic cyclical companies whose stock prices are affected by ups and downs of the overall economy. The sectors include infrastructure, capital goods, engineering, cement, auto and banking. Global cyclical companies in IT, pharmaceutical, and oil and gas sectors. The fall in IT sector exposure could be due to rising rupee and lower earnings guidance given by most companies for the year.

Anand Radhakrishnan, CIO, Franklin Equity, Franklin Templeton Investments India, says many infrastructure stocks have fallen because of their huge debt. Besides, slowing economic growth has been especially tough on these companies. If the macro environment improves and interest rates fall, the burden on their balance sheets will come down and the stocks will start to deliver better returns. "If government policies in power, road, railway and defence sectors become more clear, we will have a lot of investable ideas," he adds.

Among the large schemes, Reliance Equity Opportunities, too, has increased exposure to domestic cyclical. Sunil Singhanian, CIO, equities, Reliance AMC, says the fund was fairly invested in capital goods companies before elections as their valuations were lower than that of consumer companies. After elections, the propensity to invest in the domestic sector has gone up owing to ex-



pectation of improvement in the economy, he adds. He says a big shift in sector preferences seems to have occurred due to an increase in stock prices and not entirely due to selling or buying of shares. The fund has a 13 per cent exposure to pharmaceutical, which Singhanian still believes in, while its exposure to IT has fallen.

Commenting on valuations after the recent rise in stock prices, Singhanian says past profits (trailing price-to-earnings ratio) are not the correct way to judge the present stock prices since the environment was not conducive then. Valuations, he says, must be based on future profits, which are expected to rise.

Popular Stocks

ICICI Bank is the largest contributor to assets of equity mutual funds

(₹12,700 crore, as against ₹10,000 crore in April), followed by HDFC Bank (₹9,000 crore) and State Bank of India (₹8,400 crore). Banks account for 50 per cent top 10 stocks held by mutual funds by market value. I&T has taken the fourth place by contributing ₹8,200 crore (from ₹6,600 crore in the previous month) owing to a sharp surge in its stock price. Infosys, used to ruling the roost, has fallen to the fifth place (₹7,900 crore). Reliance Industries has slipped owing to slow rise in its stock price. ITC, too, has lost its place as funds are shying away from consumer companies and focusing on cyclical. The exposure to TCS is ₹4,100 crore. The figure for Maruti and Axis Bank is ₹4,000 crore each.

Most of the above stocks account for a large part of mutual fund portfolios since they have a high weight in benchmark indices as well. One of the largest equity schemes by market capitalisation, Birla Sun Life Frontline Equity, which manages ₹5,300 crore, is benchmarked against the BSE 200 index. "There would be sector weight deviation vis a vis the benchmark of not more than three per cent absolute or 25 per cent over the sector or portfolio weights, whichever is higher," says Mahesh Patil, Co-CIO and fund manager, Birla Sun Life Frontline Equity fund. This means if the weight of the banking sector in the benchmark is 10 per cent, the fund will invest seven to 13 per cent funds in bank stocks.

Clearly, hope of a turnaround in the fortunes of the economy after the elections would have led mutual funds to increase exposure to many sectors. "While it is good for investors to know the stocks bought and sold by mutual funds, they may not follow it for their direct equity portfolio considering that funds buy/sell at different prices and are adept at tracking them," says Gaurav Mashruwala, a certified financial planner. The job, he says, is best left to fund managers. ♦

Courtesy: Money Today