Where does your MF stand in a rising market?

The current bear phase has given an insight into investment styles of many managers, which the investors can use while picking up funds

ICRA Online Research Desk

Since the beginning of the year the Sensex has gained 23% (as of May 8, 2009). It has been a steady rise with a few scary hurdles along the way. The Satyam saga had most analysts fearing many more episodes of greed waiting to be unearthed as the market left no room to escape.

While it is too soon to say whether we are out of the woods, the present scenario has brought much needed relief. Some investors will also be breaking even on mutual fund investments made systematically over the years.

But for most investors the wait is likely to be longer. We decided to look at how mutual funds have fared over the past four months into the New Year.

Before beginning this report, most of our mutual fund analysts didn't expect to see a phenomenal return trail by the average diversified equity fund; reason being that most funds have preferred to play it safe and limited their exposure to equity instruments.

This, in turn, would imply that equity diversified schemes won't in effect capture this rally in its entirety. And, in fact, the average return delivered by the diversified equity category has been just about 15% since the beginning of this year.

Quite disappointing as a mere 10 funds out of an eligible universe of 170 have been able to beat the Sensex!

There are also schemes which continue to report losses in the current scenario. Of course schemes which are focused on the mid- and small-cap segment will have to contend with a 16% appreciation given that the respective benchmark indices have risen by about that much.

Index name	Year to date
BSE Sensex	23.11
S&P Nifty	22.36
BSE MID CAP	16.55
BSE SMALL CAP	16.13

Absolute return in %

But the pertinent question is whether a high equity allocation necessarily means a higher chance of benefiting from any sort of rally. A look at the data reveals that of the top quartile performers only eight funds actually reduced their equity allocation (less their exposure to Nifty futures) between December 2008 and March 2009.

The rest all increased their allocation to equity instruments. Among the best performers (top 20), the increase in exposure to equity was anywhere between 2 percentage points to 14 percentage points.

Having said that, there have also been schemes that have managed to do better than their peer group on a much lower equity base. UTI Opportunities Fund has managed to return 26% year to date on an equity allocation of 70%. SBI Magnum Comma Fund has also managed to achieve a similar result. In case of SBI Magnum, its presence in the right sector at the right time proved to be beneficial. Given the mandate of the scheme to invest in commodities, the fund had dedicated 9.3% of its assets to metals while 21% of its assets were dedicated to the oil & gas sector at the end of December 2008. These two sectors were in the list of top three best performing sectors year to date.

Schemes that beat the Sensex	Return in % Year to date
Templeton India Equity Income Fund	30.52
Principal Emerging Bluechip Fund	29.35
Principal Junior Cap Fund	28.89
UTI Opportunities Fund	26.60
SBI Magnum COMMA Fund	26.06
Templeton India Growth Fund	25.98
Principal Large Cap Fund	25.47
ICICI Prudential Focused Equity Fund- Retail	24.33
DSP BlackRock Natural Resources & New Energy Fund - Ret	24.18
SBI Magnum Midcap Fund	23.55
Average return by diversified equity schemes	15.85
Minimum return by diversified equity schemes	-15.55

Other diversified categories

Top five global funds	Return in % Year to date
Mirae Asset Global Commodity Stocks Fund	35.97
Birla Sun Life Commodity Equities Fund - GA - Ret	32.02
PRINCIPAL Global Opportunities Fund	25.21
Franklin Asian Equity Fund -Growth	23.85
Tata Growing Economies Infrastructure Fund - Plan A	22.23
Average global fund category return	18.71
Minimum global fund category return	1.57

Top five ELSS	Return in % Year to date
Edelweiss ELSS Fund - Growth	24.10
Franklin India Index Tax Fund	21.77
Birla Sun Life Tax Relief 96 - Growth	20.30
DBS Chola Taxsaver Fund - Growth	18.76
SBI Magnum Tax Gain Scheme 93 - Growth	18.65
Average	15.17
Minimum	-1.85

Logically speaking, a higher equity allocation predisposes a portfolio to capture better returns at the time of a rally, but even on a low equity base one can manage to beat market returns provided you get your sector and stock picks absolutely correct and invest in these areas with conviction.

Given the nascence of this rally, it has been highly skewed to a few sectors, which has made it even more difficult for an average diversified equity fund to beat market returns. Metal, auto and oil & gas sectors have clearly dominated the charts year to date. Hence, over the last four months picking the right sector has proved to be the deciding factor. This is quite unlike the last long rally (end 2002 to beginning 2008) where the rally was more participative with each sector contributing a significantly.

Other diversified categories

A look at the performance of other categories of equity mutual funds shows that the global funds have put up a decent show. Again the commodities strength has paid off for Mirae Asset Global Commodity Stocks Fund, with the scheme delivering an impressive 35.9% over the past four months. Among the infrastructure funds only two schemes have shown some promise. But what has truly been disappointing is the tax-planning category. Only one scheme has been able to deliver market-beating returns. A look at the performance of dividend yielding schemes which in the bear market proved to contain losses again displays very average numbers, with the average scheme delivering 15%. The contrarian category of schemes has also performed in the 15% vicinity. SBI Magnum Contra, ING Contra and Tata Contra have managed to deliver 19-22%.

Road ahead

The question everyone is asking is whether fund managers will now jump into the foray and finally give up the large cash holdings maintained in their portfolios. As of end April, fund managers are still holding out, the net investment in equity over April 2009 amounted to a meagre Rs 38 crore. After being net sellers in January and February 2009, there has definitely been an improvement in sentiment with the net flow of investments turning positive.

Fund managers by and large still remain sceptical as to the nature of this rally whether it is indeed the beginning of the bull-run or a mere bear market correction. What does this in effect mean for the investor? In this respect the investment community remains divided on whether the decision to invest or not should rest with the fund manager. One school of thought believes that the investor will make the decision of whether or not to participate in the rally while others believe that by investing in a fund all decisions have been delegated to the fund manager. It is for the investor to decide whether he will leave all decisions to the fund manager.

The current bear market phase has been a lesson in understanding the investment styles of many managers. Some have very purposefully stuck to their primary mandate of investing in equities while others have preferred to use the flexible asset allocation provisions present in their mandate. Armed with this knowledge investors can make better investment decisions and choose an investment style best suited to them.

At our end we would like to revisit this list of early starters once the rally has matured, and would review whether the headstart has been beneficial for these schemes.