ASPECTS

MUTUAL FUNDS AND PASSIVE INVESTMENTS

Q3 FY 2022

Northplains Capital Partners LLP

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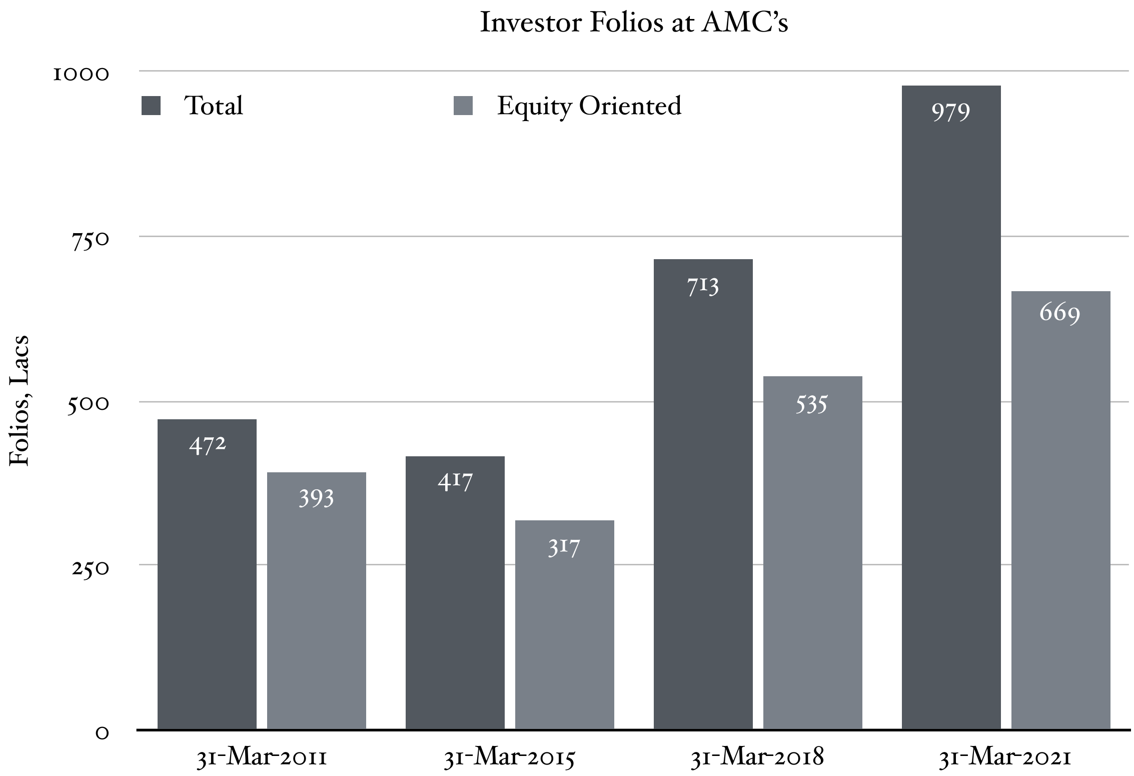
Mutual Funds have found increasing acceptance as a means of investing in Indian equities and other financial products[1]. The number of folios, or investor accounts, at asset management companies has shown strong growth over the last decade.



Central to the value proposition of most actively managed funds is that they invest with a defined strategy in select products, sectors and market capitalisation ranges. The fund makes decisions on which securities to buy/sell, at what prices and when, on an ongoing basis to provide competitive returns to fund investors and meet other fund objectives. Consequently, funds are classified as investing within a category and compare their performance with benchmarks chosen for that category.

Diligent investors on the other hand, are aware of their financial profiles and life goals and create diversified portfolios making investments across suitable asset categories. To the extent mutual funds are part of their financial portfolios, they are likely to invest time and resources in selecting appropriate funds. An important measure of fund performance for them,

[1] Equity Oriented Funds must invest more than 65% of their total assets in equity and equity related instruments. Source: www.amfiindia.com.
1 Lac = 100,000.

presumably, is whether their chosen funds provide returns as per their expectations over a given time horizon.

In this regard, it is noteworthy that return performance of funds within a category can vary significantly, and equally importantly, funds that provide returns above their benchmarks or at the higher end of their peer group may not necessarily be able to sustain that level of outperformance consistently.

To illustrate the assertion further, consider Exhibit A provided below, summarising the 3 year cumulative returns[2] from 25 leading actively managed large cap mutual funds over three successive time periods, 1-Jan-2012 to 1-Jan-2015, 1-Jan-2015 to 1-Jan 2018 & 1-Jan-2018 to 1-Jan-2021.

All the funds included have performance data across the three time periods, and are ranked for each time period in descending order of returns for that time period[3]. The NIFTY 100 Total Return Index, is chosen as the market benchmark[4] and index returns are provided at the bottom of the table.

[2] Reported total or cumulative returns.
Regular, Growth option returns for each included fund.
AUM, as of 03/9/2021. Source: www.moneycontrol.com.

[3] Discontinued, closed or merged funds are excluded, unless and to the extent their performance is implicitly included in one of the included funds.

[4] Several of the included funds have chosen the NIFTY 100 TRI as their benchmark in their prospectuses as of September 2021, while others have similar large cap market indices viz. BSE 100 TRI, NIFTY 50 TRI as their chosen benchmarks. For the purposes of our analyses, the NIFTY 100 TRI likely provides a consistent and inclusive benchmark, though for funds with a different chosen benchmark there may be different opportunities and constraints. They are still though marketed and reviewed as “Large Cap Funds”.
NIFTY 100 TRI is a market index, and assumes dividends received are reinvested. Index returns do not adjust for costs of managing a fund.

Exhibit A: 3 year total returns from Large Cap Mutual Funds

			1/1/2012-1/1/2015		1/1/2015-1/1/2018		1/1/2018-1/1/2021	
	Fund Name	**AUM, Cr**	**Total Return**	**Rank**	**Total Return**	**Rank**	**Total Return**	**Rank**
1	Franklin India Bluechip	6464	81.51%	20	35.97%	9	16.50%	22
2	Canara Robeco Bluechip Equity	3691	83.44%	18	32.12%	18	48.62%	2
3	UTI Mastershare Unit Scheme	8580	89.79%	14	32.61%	16	32.13%	6
4	Kotak Bluechip	2945	83.30%	19	37.18%	7	31.19%	7
5	Axis Bluechip	29161	110.69%	6	30.23%	19	52.70%	1
6	Edelweiss Large Cap	263	98.62%	8	34.54%	12	34.09%	3
7	Baroda Large Cap	45	70.03%	24	22.86%	24	26.14%	13
8	JM Large Cap	50	91.92%	12	20.35%	25	26.10%	14
9	Mirae Asset Large Cap	27435	122.79%	2	54.24%	1	28.91%	9
10	SBI Blue Chip	29244	120.14%	3	46.45%	2	25.76%	15
11	BNP Paribas Large Cap	1129	110.90%	5	34.69%	11	32.66%	5
12	L&T India Large Cap	685	92.11%	11	29.21%	20	26.70%	11
13	LIC MF Large Cap	568	92.78%	10	25.49%	23	32.77%	4
14	Aditya Birla Sun Life Frontline Equity	21020	115.55%	4	40.65%	6	20.39%	19
15	Navi Large Cap Equity	101	75.46%	22	44.23%	3	18.73%	20
16	PGIM India Large Cap	332	91.52%	13	33.29%	15	26.63%	12
17	Tata Large Cap	983	88.88%	16	34.14%	13	18.12%	21
18	ICICI Prudential Bluechip	28288	97.31%	9	41.78%	5	24.52%	17
19	IDFC Large Cap	823	79.53%	21	32.53%	17	25.50%	16
20	HSBC Large Cap Equity	746	71.79%	23	35.45%	10	30.39%	8
21	Nippon India Large Cap	10524	127.47%	1	42.10%	4	13.47%	24
22	Invesco India Largecap	369	89.23%	15	36.99%	8	26.71%	10
23	Taurus Largecap Equity	32	69.94%	25	26.46%	22	13.09%	25
24	DSP Top 100 Equity	2845	83.68%	17	28.07%	21	21.27%	18
25	HDFC Top 100	19957	102.16%	7	33.48%	14	15.49%	23
	NIFTY 100 TRI		92.94%		36.6%		34.65%	
	Number of Funds outperforming benchmark		9		8		2	

For example, for the 1-Jan-2012 to 1-Jan-2015 timeframe, Nippon India Large Cap Fund reported the highest total 3 year return and is ranked 1st for this period. Mirae Asset Fund reported the next highest total return and is hence ranked 2nd, and so on in descending order of total return.

A few key takeaways are worth taking note of. Firstly, returns vary significantly amongst the 25 funds within any of the given 3 year periods. While some funds have relatively similar performance, others' performance diverges widely.

Secondly, nine out of the 25 funds reported returns above those provided by the NIFTY 100 TRI in 2012 - 2015, eight did so in 2015 - 2018 and two managed to exceed benchmark returns in 2018 - 2021.

Thirdly, the relative performance of funds changes from one timeframe to the other. SBI Bluechip provided the 3rd highest returns in 2012 - 2015, 2nd highest in 2015 - 2018 and 15th highest in 2018 - 2021. Nippon India Large Cap was the highest ranked in 2012 - 2015, and 24th in 2018 - 2021; and while Axis Bluechip was ranked 19th in 2015 - 2018, it had climbed to the first spot in 2018 - 2021.

Such variations in fund performance may present a difficult situation for investors. While they may have chosen funds exercising due care, fund performance is subject to many factors, and could diverge over time[5]. One way investors can mitigate this risk is by periodically reviewing performance and outlook, and making thoughtful adjustments. Another way is by recalibrating their return and risk expectations and investing in passive funds.

PASSIVE FUNDS

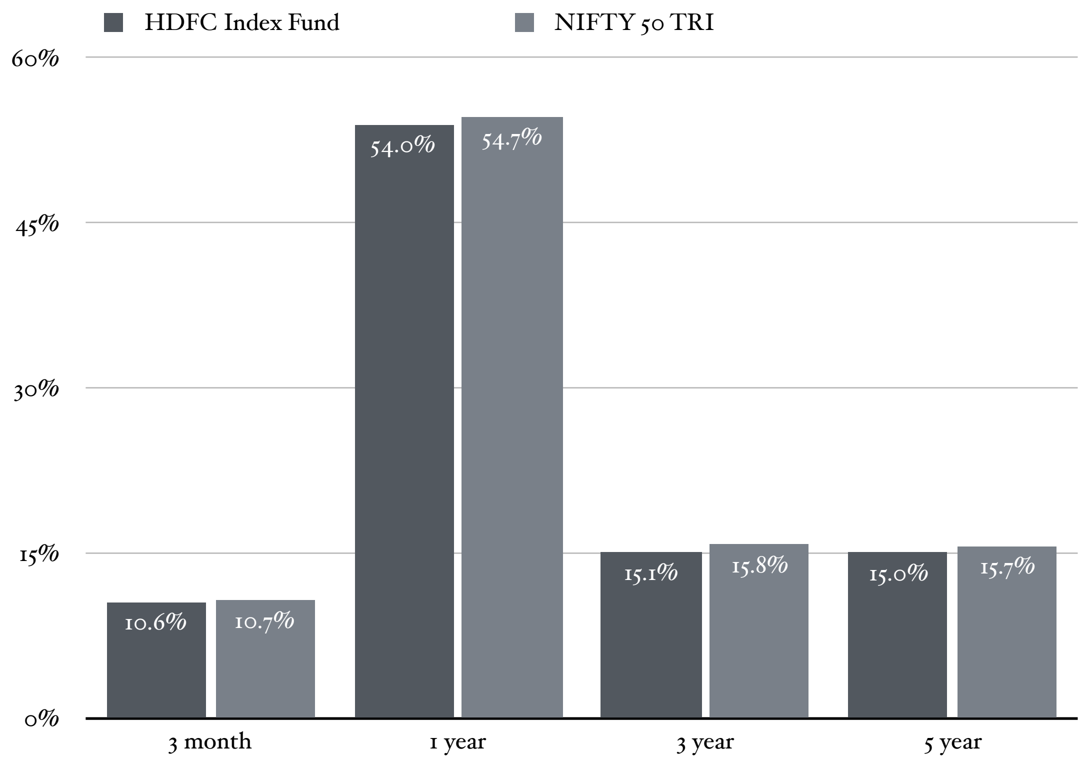
Passive Investing is gaining currency with investors in Indian markets. Passive funds, seek to mimic the performance of a given market category by selecting all, or a representative sample of securities that comprise that category, to consistently achieve returns comparable to overall category returns. In contrast to actively managed funds, passive funds do not aim to

[5] Investing in any asset class involves risk. Fund objectives, strategy, return expectations and risks of investing are included in fund prospectuses and should be reviewed before making investment decisions.

outperform their benchmarks, and in fact track and minimise[6] the extent to which they deviate from benchmark returns via the "Fund tracking error". They usually have lower expense ratios (~ .15% - 1%), lower turnover and accrue lower taxes relative to active funds.

For example, the NIFTY 50 Index mutual fund of any given fund house, would be expected to include all, or a representative sample of stocks from the NIFTY 50 such that the fund attributes and performance mimic the benchmark NIFTY 50. The fund would usually not make one-off buy and sell decisions on included stocks unless consistent with the fund's passive investment strategy.

Exhibit B: HDFC NIFTY 50 Index Fund: A passive mutual fund tracking the NIFTY 50 Total Return Index



EXCHANGE TRADED FUNDS

ETF's, or exchange traded funds, include a selection of stocks or bonds or other securities much like mutual funds do, but are actively traded on stock exchanges like listed stocks are.

[6] Not an absolute assertion, there may be exceptions.

So while mutual funds are traded based on their Net Asset Values (NAV's), which are computed at the end of every trading day, ETF's have readily available dynamic prices at any time during trading hours. This provides additional liquidity and price transparency to investors.

ETF's may be actively managed or passive just like actively managed or passive mutual funds. For example, HDFC NIFTY 50 Index Fund is a passive mutual fund tracking the NIFTY 50 Index, while the HDFC NIFTY 50 ETF is an exchange traded fund tracking the NIFTY 50. Both would be expected to provide returns comparable to the index, with expense ratios lower than many actively managed funds.

Several different passive funds and ETF's are available as investment options in Indian markets. A brief overview is provided in Exhibit C[7]:

Exhibit C: Passive Funds & ETF's

	Fund Name	Fund House or AMC	Objective
1	HDFC Index Fund - NIFTY 50 Plan	HDFC AMC	Achieve returns comparable to the NIFTY 50 total returns index
2	Nippon India Index Fund - Sensex Plan	Nippon India	Achieve returns comparable to the BSE Sensex 30
3	ICICI Prudential IT ETF	ICICI Prudential AMC	Achieve returns comparable to the S&P BSE IT total returns index
4	Axis AAA Bond Plus SDL ETF	Axis AMC	Replicate NIFTY AAA Bond Plus SDL April 2026 50:50 index
5	ICICI Bharat 22 ETF	ICICI Prudential AMC	Achieve returns comparable to the S&P Bharat 22 total return index

[7] Exhibit lists a few of the passive mutual fund and ETF investment options available across categories. These are not exhaustive, and nor does inclusion imply better or worse performance than other funds in that category.

Passive Investment strategies offer a compelling investment proposition providing returns comparable to overall returns from a given market sector, at a relatively low cost and with lower time and resource commitments. They are available as regular mutual funds, and as ETF's and cover several different sectors of the financial markets.

Investors, seeking returns comparable to market benchmarks or wanting to adopt a sound passive investment strategy, may benefit by considering passive funds and ETF's favourably.

APPENDIX

Sources

www.amfiindia.com
www.moneycontrol.com
www.valueresearchonline.com
www.nseindia.com
www.mutualfundssahihai.com
Northplains Research

Disclosures

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