

Concentrated stock bets help contra funds net the upside

Large calls in specific sectors and stocks and continuous exploitation of expectation gaps help them contain losses than the underlying benchmark during downturn

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A contra fund is based on contrarian approach to investing. A contrarian looks for mispriced investments, buys those that appear to be undervalued and possibly sells those that are overvalued. This appears similar to value investing. However, a thin line of distinction exists between the two. A value fund uses financial metrics such as the book value or P/E ratio to select a stock, whereas a contra fund uses additional factors including earnings forecasts, trading volume, media commentary and relevant company's business prospects to select a stock.

A contra fund focuses on two investment opportunities. First, it invests in those stocks that are identified by most investors and second in those stocks that are ignored or not yet identified. In the first case, since investment opportunities are identified by most, the stocks are overbought and, therefore, trade at expensive valuations. In the second case, the investment trend and valuation is just the opposite. A contrarian investor is more

interested in the second investment opportunity. In other words, a contrarian fund manager looks for a fundamentally sound stock that is wrongly priced and helps investors clock a return when the value of the stock tends to fall in line with its fundamentals.

Tata Contra Fund - Growth

Launched in 2005, the Tata Contra Fund has delivered an annualised return of 76.07%, which is considerably above the category average of 63.87%. The current success story, in terms of the fund's returns, can be attributed to the fund manager Sachin Relekar, who has held the helm since May 2008. The flavour of value investing exists in this scheme since the fund manager also manages the Tata P/E Fund. Additionally, the portfolio turnover ratio of the fund as on September 2010 is among the lowest in the category. The management, however, doesn't hesitate in taking large bets on companies; over the past one year, the scheme has maintained approximately 9% exposure to HDFC Bank alone.

UTI Contra Fund -

Scheme name	1 month	3 mths	6 mths	1 year	2 years	3 years
JM Contra Fund - Growth	-0.02	-5.87	7.00	5.07	19.69	-23.82
SBI Magnum Sector Umbrella - Contra - Growth	1.45	-3.88	8.56	9.22	42.54	-1.38
Tata Contra Fund - Growth	2.63	-0.74	16.69	20.07	53.80	0.84
UTI Contra Fund - Growth	1.62	-4.69	9.85	8.51	36.95	1.74
Average	1.19	-3.39	10.42	12.07	41.07	-3.74
Minimum	-1.22	-5.87	7.00	5.07	19.69	-23.82
Maximum	2.63	-0.74	16.69	20.07	53.80	5.05
Indices						
BSE200	1.52	-2.00	14.18	15.48	45.48	-2.44
CNX500	1.67	-1.64	13.11	13.50	44.16	-3.42
BSE100	1.77	-1.76	14.53	14.92	43.83	-2.31
BSE 500	1.37	-2.30	13.64	15.61	46.22	-3.38

(Table 1: Scheme performance as on Jan 4, 2011. Returns (in %) less than 1 yr are simple annualized and more than a year are compounded annualised)

Growth

The scheme has a low volatility and an ability to contain downside. It focuses more on these qualities rather than on an ability to deliver above average returns in a bullish market. Through 2008, when the market mostly remained negative, UTI Contra managed to contain its losses better than its peers. In terms of performance, the scheme delivered a CAGR return of 1.74%, while

the average category return dipped by 3.74%. The scheme is managed by Sanjay Dongre since June 2007. True to its mandate, the scheme does in fact manage a contrarian portfolio. Barring its high allocation to the banking sector, the scheme's sector bets are essentially contrarian. In the current market condition, the fund has chosen to maintain high allocations in sectors such as pharma (8.61%) and

textile (8.59%). In contrast, equity diversified funds maintained an average allocation of 2.65% in pharma and 3.13% in textiles during November 2010.

SBI Magnum Sector Umbrella - Contra - Growth

Launched in July 1999, SBI Magnum Sector Umbrella contra fund is the oldest scheme in the category and has seen two bear phases till now. In both these phases, the fund has managed to contain losses bet-

Scheme selection methodology

We have confined ourselves to those funds which are described as contra funds as per their offer documents. For our analysis, we have picked the top four contra schemes from this category based on Sharpe ratios, ascertained on a three-year daily rolling-return basis. This apart, we have selected only those schemes that have a corpus greater than the median of the category. The fund size of these contra funds was ₹104.53 crore at the end of September 2010 (as per latest Association of Mutual Funds in India guidelines and data)

Sharpe Ratio: Sharpe Ratio reflects the risk-adjusted returns, that is, returns per unit of risk. A high ratio is always better than a low ratio. The fund that does not beat the risk-free rate of return or the return on the whole market is worth leaving for the risk-free instrument itself. A contra fund may start with a lower ratio but gains progressively as its bets start to deliver results.

ter than its underlying benchmark. The fund's management philosophy centres on continuously exploiting expectation gaps, and not just simply betting against the crowd. The management believes in enabling entry and exit before the trend catches up, which, in turn, has placed the scheme's portfolio turnover ratio on the higher side compared to its peers. However, a large corpus has enabled the fund to maintain an expense ratio of below 2%, which is commendable for

an equity fund. Moreover, the fund actively manages its sectoral exposure, without having any bias towards any style (growth or value) or market capitalisation. The fund management has been extremely bullish on Reliance Industries. From September 2009 till July 2010 the scheme maintained a consistent allocation of more than 8% of assets in this stock.

JM Contra Fund

JM Contra Fund (JMCF) is an open-ended equity fund from JM Financial Mutual

Fund. The fund focuses on investing in fundamentally strong stocks by following contrarian style of investing with a primary objective to generate capital appreciation. In order to achieve its stated investment objective, the fund has taken active sector and stock calls. Under normal circumstances, at least 85% of the funds corpus is deployed in equities and up to 15% in debt and money market instruments. Portfolio-wise, the fund has taken highly concentrated sectors as well as stocks bets, that is, the top 5 sectors as well as the top 5 stocks accounted for 50.50% and 53.20%, respectively. Due to this peculiar nature, the fund has trailed its benchmark index as well as its peers in two- and three-year periods. Since inception, JMCF has generated negative returns of 14.12% CAGR for its investors. During March-December 2009, concentrated IT sector bet had helped the fund to gain significant return of 95%. During this tenure, BSE IT delivered 156.10% returns.

With a corpus of ₹200 crore, the fund is among the largest contra funds in terms of corpus.