

# Watch the churn: Your fund is shifting preference

RAJESH GAJRA

FC Research Bureau

**W**HEN you invest in a diversified equity fund, you expect the diversity to mean that the portfolio contains such stocks that represent a play on a wider spectrum of the economy. That can be achieved only if the sectors and stocks in the portfolio are varied and multiple.

During the latter half of 2009 and a large part of the past year, many domestic fund managers showed a tendency to have a larger exposure to just one or two sectors that were perceived to be hot. The most preferred one was the banking sector, and a few fund managers even went over-weight on them. Not surprisingly, banking shares shot up like there was no tomorrow.

Therefore, it was inevitable for banking stocks to get adversely affected when food inflation rose from November

onwards and interest rates started moving up.

“Ideally, a fund manager should avoid a high sectoral exposure and not focus too much on one sector going up or down,” says Syed Sagheer, senior manager for equity research at IDBI Asset Management.

From November onwards till early this month, the stock market was declining steadily, with banking and realty stocks taking the biggest hit. The intensity spread to the broader market in January.

An analysis of fund managers’ actions in January showed the highest erosion in fund managers’ exposure to financial, retailing, construction (realty), banks and auto stocks. This was mainly on account of active selling on these counters and partly due to a continuous slide in the prices of these stocks.

For instance, CNX Realty index fell 10 per cent from its December average daily closing

of 374.13 to its January average of 337.46. Bank Nifty saw a fall of 6.2 per cent. The November-December period was also marked by scams relating to 2G spectrum and fraudulent financing of dubious realty players.

The analysis covered 91 diversified equity funds, comprising multi-cap, large-cap, mid-cap and small-cap schemes, and looked at their portfolios at the end of January compared with that at December end.

“Banks lost favour due to rising interest rates and there was flight of funds to sectors with better free cash flows, such as IT and FMCG,” said Anand Shah, an equity fund manager at Canara Robeco Asset Management. There was an increase in fund managers’ exposure to IT, energy (oil and gas), consumer goods and pharma sectors in January.

But should fund managers run away from affected sectors during adverse times after having rushed in to these sec-

tors and taken excessive exposure? “A stock-specific approach is better than a sectoral one,” said Bhupinder Sethi, co-head, equities, at Tata AMC. However, Sethi believes there is an umbilical cord-like link between the two, as valuations of stocks can get driven by perceptions of the sector.

This can give rise to opportunities as well. Says Sethi: “Very often when a sector’s prospect does not look good, some good stocks in that sector will be undervalued and one could buy them cheap.”

The inverse is also true. When bank stocks continued to be on fire for the second consecutive year last year till September-October, valuations of all stocks, intrinsically good or not, looked expensive and should have deterred fund managers from going over-weight on some of those stocks. But most went overboard and, therefore, they rushed to

reduce the exposure, a bit belatedly, in January this year.

Last month was indeed eventful with regard to active churning. But it may not be a good idea for investors to be watchful of such month-on-month volatility.

Canara Robeco’s Shah said, “The top 10 holdings of a diversified equity fund tends to stay undisturbed 10 times a year and only occasionally, such as in the past two months, the month-on-month changes can get significant.”

There are about 20 sectors and some companies operate across multiple sectors. Investors should be alert that their funds’ portfolios stay consistently well-diversified throughout. Though there is no scientific figure, the thumb rule is that if a fund takes more than 10-15 per cent exposure to stocks of one sector, investors should turn vigilant. ■