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● DEPLOYMENT OF FUNDS TO BECOME MORE CHALLENGING

Problem of plenty for funds as smallcap kitty swells

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RECORD INFLOWS INTO smallcap funds in the past few months may create a problem of plenty for fund houses as deploying the amount in the right stocks at the right price is likely to become increasingly difficult.

Recently, Nippon India Small Cap Fund temporarily stopped accepting fresh lump sum investments and enforced a limit of ₹5 lakh per day for new SIPs. Tata MF also stopped fresh inflows into Tata Small Cap Fund. SBI MF has already suspended lump sum investments in SBI Small Cap Fund since September 2020 and is currently accepting SIP investments up to ₹25,000.

"The limit on subscription of units of the scheme is being proposed to facilitate gradual deployment of corpus in order to align with the nature of smallcap investing. The step is warranted considering the recent sharp rally in the smallcap space and increased investor participation through high-ticket investments," Nippon Life India Asset Management said in a notice to investors earlier this month.

Smallcap funds saw record inflows of ₹5,472 crore in June, taking the year-to-date flows in these funds to ₹17,868 crore. Between December and June, midcaps and smallcaps outperformed the Nifty 50 by 9% and 6%, respectively.

"We have been seeing strong

TOP SMALLCAP FUNDS

Fund	Return (%)			AUM (₹ crore)
	1 year	2 year	3 year	
Nippon India	36.10	45.87	21.15	28,779
SBI	24.90	34.99	19.10	17,572
HDFC	41.35	42.56	16.85	17,333
Axis	26.60	35.73	21.77	13,183
DSP	26.06	37.55	17.76	9,961
Kotak	21.52	40.72	19.70	9,883
HSBC	28.97	42.11	15.52	9,531
Franklin India	37.07	41.02	14.60	8,067
Canara Robeco	22.20	41.89	-	5,986
ICICI Prudential	25.10	41.17	19.49	5,466

Source: Value Research Regular plans considered

inflows in our smallcap fund. Deployment of smallcap funds, by their very nature, takes time. We have to wait for the right stock, right quantity and right price to deploy the money we get. This was getting increasingly difficult of late for the fund. And we thought it would be prudent not to accept lump sum investment because if there is lag in deployment, it can raise cash levels in the portfolio and impact performance," said Anand Varadarajan, business head – institutional clients, banking, alternate investments & product strategy, Tata Asset Management.

Tata MF, however, remains quite constructive on smallcaps as a category. "Valuations are reasonable and there are many opportunities in the

space in the long term. Investors coming in now would be well served through the SIP/STP route," said Varadarajan.

Interestingly, sister firm Tata AIA Life Insurance recently launched its first dedicated smallcap offering, Tata AIA Small Cap Discovery Fund. The new fund is open from July 10 to 24.

Harshad Patil, executive vice president and chief investment officer of Tata AIA Life Insurance, said: "The government is focused on formalising the economy, which will benefit small businesses immensely. Further, growth in consumption demand, rising disposable income, and support for manufacturing will catalyse several smaller companies to become dominant in their sectors. Given

these forces, our fund offers our policyholders a great opportunity to maximise their investment by spotting such opportunities early and investing in them over the medium to long term."

According to brokerage Motilal Oswal Financial Services, at the end of June, Nifty 50 and Nifty Midcap 100 indices were trading at a premium even as the Nifty Smallcap 100 index was trading at a discount (16.9x) to its long period average on a 12-month forward P/E basis.

As per Value Research, the category average 1-year, 3-year and 5-year returns of smallcap funds are 27.2%, 38.8% and 17.7%, respectively.

"Broadly, there are two major reasons for massive flows in smallcap funds. One is the valuation gap and the other is the performance. Investors should moderate return expectations going forward and should consider the category with a five-year-plus time horizon with a proper asset allocation framework," said Mukesh Kochar, national head – wealth, AUM Capital Market.

Several smallcap funds have grown in size and the challenge lies in managing such funds due to small quantum of free float available in the stocks and liquidity constraints, he said. Four funds have assets in excess of ₹10,000 crore.

Smallcap stocks are a significant part of the Indian equity market, with more than 4,500 companies. Among these, about 500 stocks have a market cap higher than ₹2,000 crore.