

A Comparative and Independent Analysis of Mutual Fund Categories

Positioning Mutual Fund categories

Here is a discussion on how each mutual fund category is positioned independently and comparative to each other, in terms of the extent of overweight underweight sector exposures vis a vis respective Benchmarks, relative active share of underlying stocks away from the Benchmark, market cap exposures, concentration, nuances while remaining true to the theme in case of sector funds and ideal stack-up of return attribution

Sector / Thematic funds- *A brilliant goal does not happen, it gets created !*

In case of a Sector or a thematic fund, as per SEBI categorisation, minimum 80% needs to be invested in the said sector or theme. 20% of the AUM can be outside of the sector or the theme.

Being overweight and underweight certain sectors as compared to the Benchmark / peer funds, being closer to the theme and not diverting too much from the core theme while taking exposures even in the 20% bucket, is how sector funds can be created and curated. Underweight positions can impact the fund but the positive contribution made to excess returns by all overweight and active positions could be far beyond.

To turn a close competing tennis match in your favour, you only need one serve break! Imagine 7-6 6-7 7-6 6-7 7-5 !!! Sector funds can identify those few basic industries or sub-segments to place overweight positions on.

The idea of sector funds is also to bring out a unique portfolio, offering exposures to certain micro areas of the market which find presence in diversified funds to a small extent. Also, some sector or thematic funds can offer exposure to low volatility and stable earnings while certain niche and emerging themes can offer high risk - high return equation.



*By: Shaily Gang, Head-Products,
Tata Asset Management*

Midcap and Smallcap funds - *Great things happen in the long run!*

Luton Club became the first club in May 2023 to go from non-league to the Premier League in 9 years crossing 5 tiers of English football, dealing with hurdles in their journey like relegation of the club even. Usain Bolt trained for 4 years to run for only 9 seconds. Most people quit if they do not see results in 2 months or few months.

If one takes positions in only those stocks where one can see results in 2 months or 6 months, pay-offs may not be in one's favour. Taking a long term perspective can be the key. In case of the smallcaps and midcaps space, the universe is wide, the Benchmark too is wide and many basic industries find exposures only in the midcap, smallcap and microcap space. Thus there is enough room to go for active exposures away from the Benchmark and outside the Benchmark. However, having patience to ride through the portfolio journey is of utmost importance. A good chunk of returns in these fund categories could come from rerating of stocks.

Multicap and Flexicap funds – *Where the Desert meets the Ocean...the magical spot....the marketcap mix*

The deviation from the Benchmark at sector and stock level in case of other category funds

having wider Benchmarks like Flexicap funds and Multicap funds could be steeper than Large cap funds but lower than Smallcap category, where the Universe is very large and the space quite unresearched. Multicap fund category needs to have minimum 25% in each of the three marketcaps by mandate.

Focused funds – Concentration to work its best

Under this category, the fund needs to choose its orientation between large cap or multicap. Accordingly, this category would be a concentrated large cap portfolio or a concentrated multicap portfolio (max upto 30 stocks).

Large cap Funds – Each of the Big three in Tennis held the highest no of grand slams at some point in time

Most common discussion is whether most Large cap funds can beat the Benchmarks. They would not have extreme deviation at the sector level but stock level deviation would be there in an endeavour to achieve outperformance over Benchmark.

For other categories, where Benchmarks are broader and has many stocks, the fund ends up skipping more stocks. The fund can only hold say 35-60 stocks, while the Benchmark is wide. In Large cap category, the universe of the Benchmark is 100 stocks only and sector deviation cannot be much. Thus the active share in case of large cap funds is limited. However, large cap funds can be more agile. The key role of large cap funds would be offering an investing experience with lower volatility.

Balanced Advantage funds – Talent on the table!

Talent is not just about the ability to do things or a skill. it is equally about courage, handling pressure, having the right temperament, discipline. Talent is a life skill to be able to deal with any kind of situation, endure, stay in the game and emerge a winner.

A great fund is not just about the return number. It is more about risk adjusted return, how the fund manages its risk, what risks it does not take,

consistency of returns and importantly, it is about the strength of returns. Strength of the returns comes from the fact that there is no sector which has a steep negative contribution to excess returns while multiple sectors came together contributing positively towards fund's excess returns.

True test would be if the fund can have consistent presence in the first 2 quartiles consistently, be 'Balanced' to the core in terms of net equity exposures, sector and stock diversification, cyclical and defensive sector mix with a mix of steady return stocks and rerating stocks.

Arbitrage funds – Threads to tie well for Spreads

As the market Open Interest rises along with the price, it implies fresh participants which leads to spike in equity arbitrage roll over Spreads. An opportune scenario for Arbitrage funds would be when the price is increasing, breadth is improving, stock-wide open interest increasing trend looking strong with volumes and participation rate holding well. Additionally, certain macro, domestic and global factors would be the drivers of volatility, which fares well for equity arbitrage roll spreads and keep them elevated. RBI MPC and global central banks action too contribute to volatility around the event / announcements.

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Mutual Fund investments are subject to market risks, read all scheme related documents carefully.