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BANKING SECTOR FUNDS

Invest now to capitalise on credit growth pickup

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1 Banking and financial sector funds, which lagged other equity fund categories in 2023 and 2024, are attractively positioned. Valuations are appealing. These funds could reward investors handsomely when credit growth picks up.

Causes for underperformance

Banking sector funds underperformed in the past couple of years due to multiple factors. "The key ones were regulatory actions around the loan-to-deposit (LDR) ratio and increased risk weights in unsecured segments; uncertainties around slippages in unsecured loans; and concerns over slowing credit growth," says Roshan Chutkey, senior fund manager, ICICI Prudential Banking and Financial Services Fund.

Earnings growth and valuations also played a part. "Three years ago, earnings growth in the banking sector was around 13-14 per cent. However, many other sectors

were growing at around 20-25 per cent, and their valuations were also cheaper," says Amey Sathe, fund manager, Tata Asset Management.

The sector bore the brunt of selling by foreign institutional investors. "Approximately 40 per cent of the selling has happened in financials," says Sathe.

The insurance sector has experienced de-rating due to regulatory pressures.

Positive drivers

Loan growth: Fund managers

expect corporate loan demand to rise as private capital expenditure (capex) gathers pace over 12-18 months. "Going forward, corporate loan growth is expected to complement retail loan growth," says Sathe.

Gaurav Kochar, fund manager-equity, Mirae Asset Investment Managers (India), expects capex to recover significantly in the second half of FY25 and in FY26. Rate cuts are also on the horizon. "Our base case scenario is two rate cuts in FY26. This could propel growth and consumption, both of which will benefit credit growth," says Kochar.

Valuations: Valuations are at historic lows. "The Nifty Bank's discount to the Nifty 50 is at a lifetime high. Many largecap banks are trading even lower than the lows seen during the Covid-19 pandemic or the global financial crisis," says Sathe.

According to Hemang Kapasi, director, Sanctum Wealth, "Pre-Covid, financial services and banks traded at 2.3-2.5 times price-to-book on a one-year forward basis but are

now trading at 1.7-1.8 times. Non-banking financial companies (NBFCs), previously at 3-3.5 times price-to-book, now trade at 2.3-2.5 times."

Risks to watch out for

The performance of these funds depends heavily on credit demand. "Slowing gross domestic product (GDP) growth in recent quarters could adversely impact the performance of BFSI funds," says Abhishek Kumar, a Securities and Exchange Board of India (Sebi)-registered investment advisor and founder, SahajMoney.com.

Sathe warns that a sharp rise in corporate credit stress or a significant slowdown in GDP growth — from 6.5-7 per cent to 3.5-4 per cent — would hurt the sector.

These funds would also be hurt if NPA concerns become broad-based. "The key risk lies in this issue spilling from unsecured into secured loans," says Kochar.

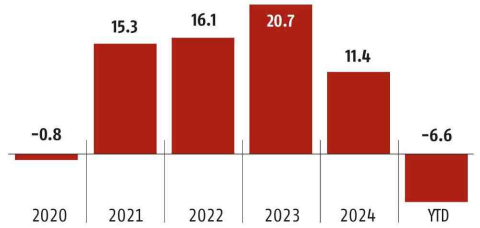
Should you invest now?

The ideal time to invest in a sector fund, according to Kapasi, is during a downturn so that one can capitalise on a turnaround.

"Valuations are at one standard deviation below the long-term average. Mean reversion and re-rating are expected as the growth outlook improves," says Kochar. If you decide to invest, remember that sector funds carry concentration risk. "Be prepared for volatility in returns," says Kumar. He recommends limiting exposure to 10-15 per cent of the equity portfolio and having a horizon of three to five years.

SET FOR A TURNAROUND?

Category average returns (%)



Returns are of active funds, regular-growth plans.

Source: Navigation RA