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SMALLCAP FUNDS' BIG MOVE:
EXPANDING INTO MICROCAPS



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Smallcap funds tap into ‘microcaps’ as AUM expands, mkt gains depth

Average smallcap fund exposure to beyond top 500 stocks rises to 31% from 22% in three years

ABHISHEK KUMAR
Mumbai, 29 January

Smallcap funds are increasingly tapping into the ‘microcap’ space amid a multifold jump in their assets and improved liquidity conditions in stocks beyond the largest 500.

In the past three years, the average exposure of smallcap funds to such stocks has increased from 22.4 per cent to 31.3 per cent, according to data from Morningstar Direct.

While the mutual fund (MF) industry recognises only three market capitalisation (mcap) baskets — largecap, midcap, and smallcap — the term ‘microcap’ is widely used by market analysts to refer to stocks beyond the largest 500 companies by mcap.

Smallcap funds have remained among the investor favourites for the past two years. In the two years ending December 2024, the category witnessed net inflows of over ₹75,000 crore. The aggregate assets under management (AUM) of smallcap funds have surged 2.53x during the two years to ₹3.3 trillion.

The interest in smallcap funds has been driven by a sharp rally in the smallcap space over the past two years. The resultant increase in valuations has forced many fund houses to place limits on inflows. Among other measures to reduce risk, funds have increased the number of shares in their portfolio to reduce concentration and liquidity



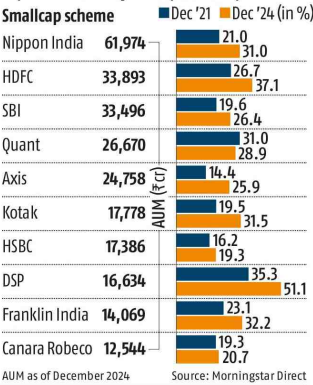
risk. These measures are also seen as one of the reasons behind increased MF exposure to microcap stocks.

According to fund managers, the shift towards microcap stocks is not a planned move but a result of their expanding universe and increasing market depth.

“There is no category called microcap in the current definition. In the smallcap fund, we take a bottom-up approach and focus on

GROWING UNIVERSE

Exposure to the beyond top 500 companies



identifying high-growth companies available at attractive valuations. The total universe for the fund is very large,” said Chandraprakash Padiyar, senior fund manager at Tata Asset Management.

Mahesh Bendre, fund manager of LICMF Smallcap Fund, said that while the fund house does not differentiate between smallcap and microcap stocks, its philosophy of investing in under-researched and under-

owned companies may have led to higher ‘microcap’ exposure.

“In our fund, the focus is on identifying high-quality, under-researched, and under-owned companies to take advantage of their low valuations. The fact that liquidity conditions have improved in the smallcap space has also led to the expansion of our universe,” he said.

The growing market depth is evident from the surge in mcap of smallcap stocks in the past three to four years.

Data from the Association of Mutual Funds in India shows that the average mcap of the largest smallcap company (251st stock in the mcap ranking) has surged from ₹15,926 crore during the second half (H2) of 2021 to ₹32,800 crore in H2 2024. The average mcap of the 501st company has risen from ₹4,500 crore to ₹11,300 crore.

“The value of the stock that was ranked 251st in December 2019 has increased by 4x as of Wednesday. Similarly, the 500th company has grown 8x and the 1000th company has seen 8x growth. Thus, with the current mcap, the 500th company would have been classified as a midcap stock in December 2019,” said Ventura Securities in a recent report.

In the report, the brokerage noted that as of December 2024, only 8 per cent of the exposure of smallcap funds is in largecap stocks, 11 per cent in midcaps, and 80 per cent in smallcaps.