alphablock

EVA™ India Scorecard

AS OF FEBRUARY 8, 2023

India’s top mutual funds underperform despite concentration

We have seen the SPIVA scorecards and how Active Indexes underperform the S&P Indexes. This is brilliant work done by the S&P Global team as they have persistently articulated how it’s hard to select and beat the S&P Indexes around the world.

This feature is about introducing our scorecard and for simplicity we are calling it EVA, an acronym for Exceptional & Rich Indexes vs. Active. There is one primary reason for us to introduce a new scorecard. SPIVA scorecards don’t focus on concentration and its risks. Concentration is the single variable that works against passive investing. If an investment portfolio is concentrated, it’s not passive. Even if the bias towards concentration is market force driven, the methodology biases the winners which amplify the bias. For us at AlphaBlock, S&P Indexes are as concentrated as the Active it compares against and hence does not represent the market fairly and hence the need for a new scorecard.

In the world before Web 1.0, which was January 1983, when there was no internet, such an idea was never up for discussion. MSCI was just about 20 years old. Irving Fisher’s, 1922, “Making of Index numbers” was long forgotten and John Bogle’s first Vanguard Index fund was not even 10 years old. Hence, this talk about concentration in our investment portfolios, in everyone’s investing portfolios, needed to wait for Web 2.0 to come in full steam. It was the social web, which got the world talking. An idea could be tweeted by anybody, anywhere in the world, for anyone else to react to it. Even this was not enough to talk about concentration. We needed the passive revolution to happen and SPIVA to promote, year after year, the idea of inferior selections of Active Managers and how it was nearly impossible to beat the broad basket over 10 years. Now that almost everyone knows that Active does not beat Passive, it’s time for a new change to take root. Because nothing stays constant but change.

The rookie of 1975 is the incumbent and is leading the USD 50 trillion passive revolutions and has 30 years of ETF manufacturing to back it up. The seat is warm and cozy, and talk about concentration is the last thing the incumbent wants to hear, but then life is not perfect. Times have changed and investors are awake. So here we go, launching an EVA scorecard for India in our debut issue.

Mutual funds are the predominant method of Investing in India. We took the top performing funds of the last 5 years and classified them according to performance numbers of the last 1, 3, and 5 years, labeled them according to their benchmarks, their basket size, distribution across market capitalization categories, turnover, the type of fund and compared them to the market capitalized weighted benchmark in question i.e. S&P BSE 100 and plugged it with our Exceptional & Rich India Index.

1. Characteristics of the top mutual funds, BSE 100 and E&R 100

Out[19]:

	Nr./Name	2Y Performance (%)	3Y Performance (%)	Benchmark	Turnover	Large Cap Allocation (%)	Mid Cap Allocation (%)	Small Cap Allocation (%)	Micro Cap Allocation (%)	Basket size	Top 10 (%)
0	Aditya Birla SL Frontline Equity Fund (G)	10.50	16.82	Nifty 100 [TR]	44	75.05	9.22	0.74	12.08	74	49.28
1	BSE 100	11.23	12.50	Benchmark	0	100.00	0.00	0.00	0.00	100	44.19
2	DSPBR Equity Opportunities Fund - Reg (G) 10.67%	14.76	20.18	Nifty 50	41	48.42	28.58	8.89	14.11	71	35.72
3	E&R Index	26.94	20.58	BSE 100	0	100.00	0.00	0.00	0.00	100	22.23
4	Franklin India Bluechip Fund (G)	10.29	18.98	Nifty 100	54	71.36	5.81	0.00	19.26	43	49.27
5	ICICI Pru Focused Bluechip Equity Fund (G)	11.03	16.78	Nifty 100 [TR]	25	78.64	4.78	0.37	9.30	71	57.79
6	Invesco India Dynamic Equity Fund (G)	10.59	15.49	Nifty 50	160	52.31	3.04	4.32	0.00	49	43.25
7	Invesco India Growth Opp Fund (G)	13.34	19.46	Nifty 50	74	45.31	19.74	12.88	22.07	69	37.28
8	Mirae Asset India Equity Fund - Reg (G)	13.71	20.76	Nifty 100 [TR]	22	51.00	8.98	3.79	36.23	60	54.70
9	SBI BlueChip Fund - Reg (G)	11.50	18.15	BSE 100 [TR]	10	68.30	7.28	0.90	17.26	49	48.19
10	SBI S&P BSE 100 ETF	16.46	11.44	BSE 100 [TR]	0	80.70	7.99	0.24	11.14	102	49.86

2. Comparison of the various mutual funds, BSE 100 and E&R 100 across various measures

Though they have higher performance returns vs. the BSE 100, this is not a real apples-to-apples comparison as the Active funds are assuming more risk that the benchmark, owing to small basket size, more mid-small-micro cap exposures, more concentration in the top selections and large portfolio turnover.

On the top 10% weight allocation, an important criterion to illustrate concentration, E&R Index was the least scored at 22%. The S&P BSE 100 weighted 10 components out of 100 at 44% of the portfolio value. ICICI Pru Focussed Blue Chip was the highest concentration among the top 10 nearing 58%.

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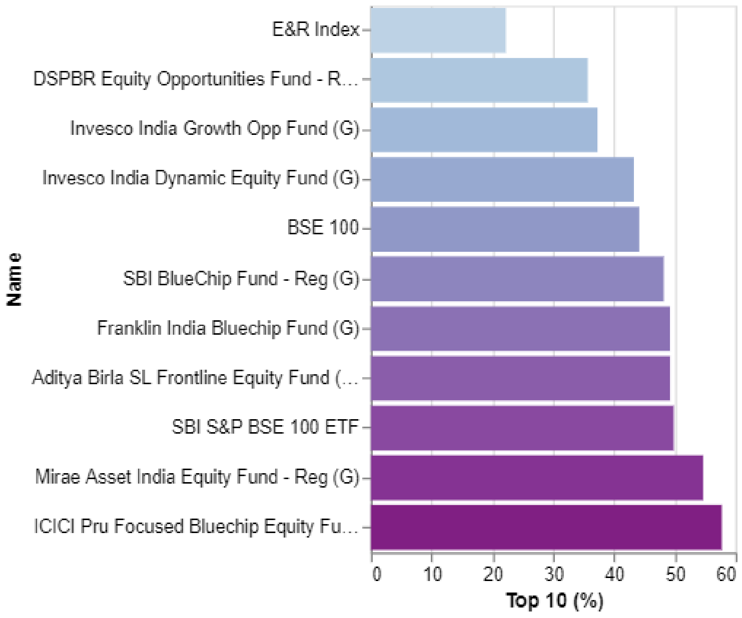

We compared the funds for basket size, an important criterion to illustrate concentration. Franklin India Bluechip Fund (G) has the fewest components among all the funds at 43 names. The lesser the number of the stocks more active the fund and more active the fund means more risk it is taking to stay ahead.

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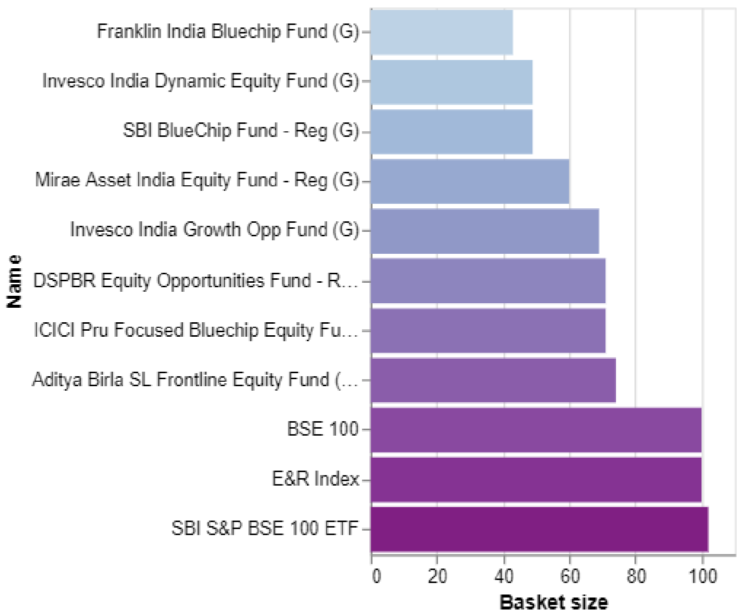

On the large cap allocation, an essential criteria to see if the funds were carrying large cap quality stocks, we saw a varied list of allocations. Invesco's India Growth had the least allocation in large cap at 45%. Naturally, if a fund has allocated less to large cap, it means it is allocated more to mid, small or micro cap. This makes the fund more risk and not comparative in analysis to a benchmark.

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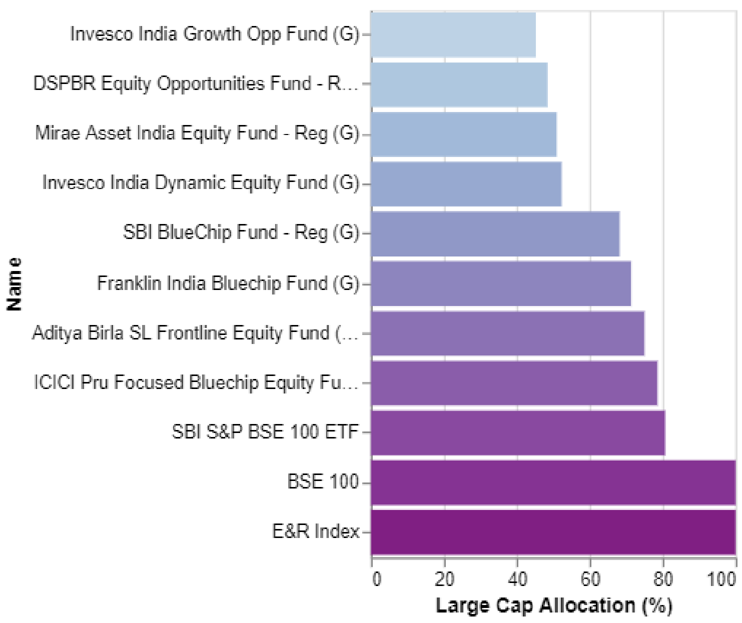

On the mid cap allocation, an essential criteria to see if the funds were carrying large cap quality stocks, we saw a varied list of allocations. Invesco's India Growth had the least allocation in large cap at 45%. Naturally, if a fund has allocated less to large cap, it means it is allocated more to mid, small or micro cap. This makes the fund more risk and not comparative in analysis to a benchmark.

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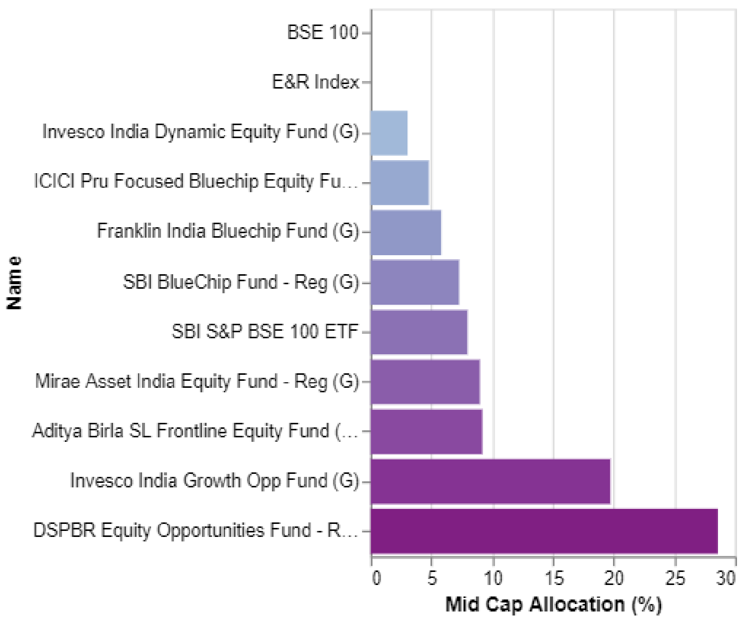

On the small cap allocation, an important criterion to illustrate concentration, E&R Index and BSE 100 was the highest scored at 100%. The S&P BSE 100 weighted 10 components out of 100 at 44% of the portfolio value. ICICI Pru Focussed Blue Chip was the highest concentration among the top 10 nearing 58%.

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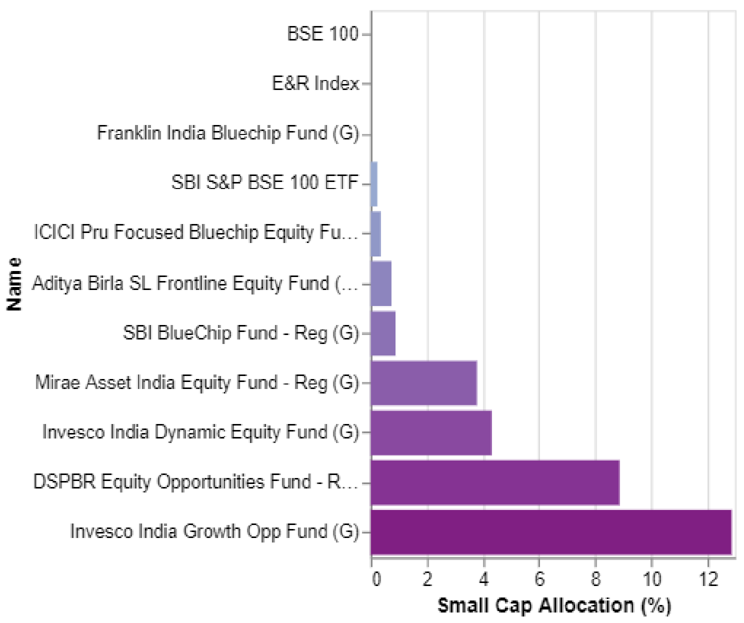

On the micro cap allocation, an important criterion to illustrate concentration, E&R Index and BSE 100 was the highest scored at 100%. The S&P BSE 100 weighted 10 components out of 100 at 44% of the portfolio value. ICICI Pru Focussed Blue Chip was the highest concentration among the top 10 nearing 58%.

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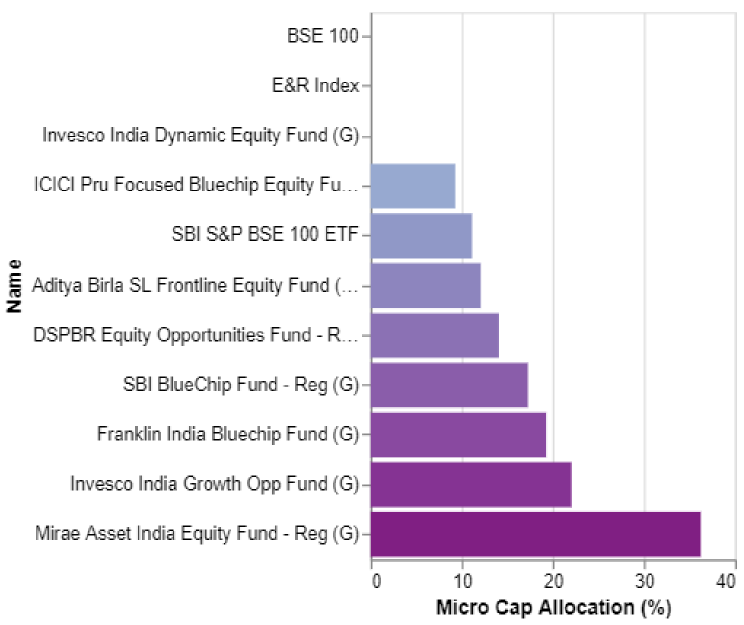

On the turnover allocation, an important criterion to illustrate activeness. Invesco India dynamic Equity fund had the highest turnover at 160%.

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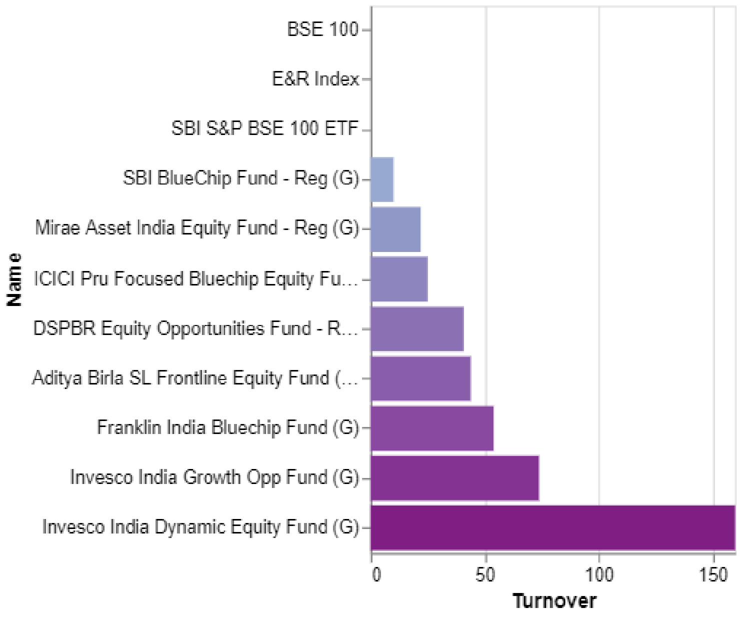

Despite all the activity and concentration, E&R India 100 Index least concentrated method delivered the best 2 year returns.

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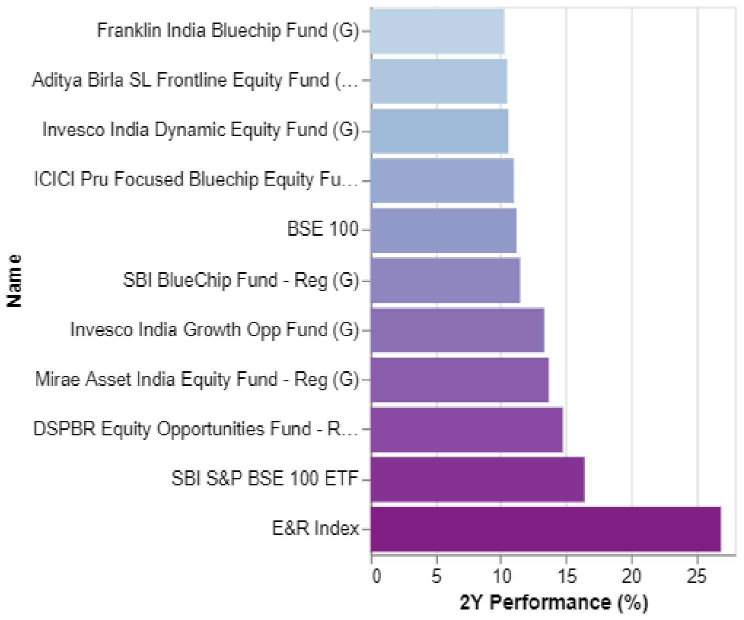

On the 3 year performance comparison, E&R may seem to have matched the performance of the best performing Mirae Fund, but considering Mirae's low large cap allocation, extreme 10% allocation, and the total return approach, India's best fund took on significant concentration risk and can't be really compared with the passive Index E&R India 100.

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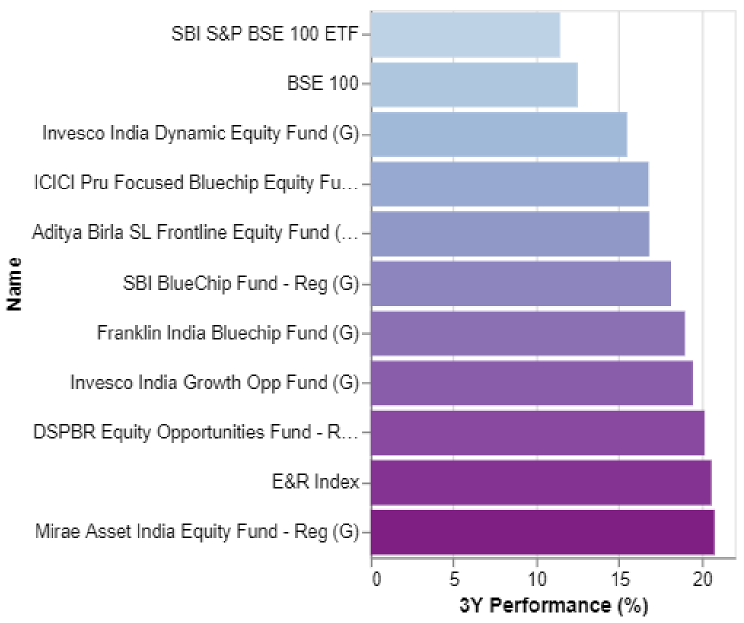

3. E&R India 100 was the least concentrated

When you prequalify the fund performance for mid-mid-micro cap exposure, high turnover, highest top 10% allocation, and basket sizes, the real comparatives emerge. Smaller baskets are less diversified and prone to more selection risks for investors.

The funds with smaller baskets generally have to take more risk to generate more returns. The top 10% allocations of more than 50% concentration create non-diversified funds, which assume more risk to generate the return. The funds referenced to total return benchmarks are adding the annual dividend to the returns and hence should be compared after netting for annual dividends. We have only considered funds with the following benchmarks for the study - BSE 100, CNX 100, Nifty 100, and NIFTY 50 and their total return versions. We have ignored funds based on larger groups like CNX 200.

Studying fund performance without analyzing concentration risks is incomplete research. Investing is about diversification, and investment funds that are concentrated are active and hence riskier. The analysis above on the one side reinforces the SPIVA thesis that the few Active funds that may seem to outperform when compared on the concentration metric, fail to stand up to their passive benchmarks.

The EVA India scorecard indicates that S&P BSE 100 is indeed better than many of the active funds when adjusted for the various concentration variables. However, E&R India 100 with the least concentration in the top 10 stocks at 22%, is the more diversified and better benchmark.

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