All you wanted to know about Total Return Index or TRI of mutual funds

BY SHIVANI BAZAZ, ET ONLINE | JAN 09, 2018, 02.20 PM IST

Big Change:
The end of Five-Year Plans: All you need to know

Come February, mutual fund industry is going to get a new index to benchmark. From February 1 , mutual fund schemes are mandated by Sebi to use Total Return Index or TRI to benchmark their performance. The shift from plain vanilla index to TRI is supposed to give a clearer picture of the scheme performance versus its benchmark. Already some studies say schemes may struggle to beat their TRIs. ET.com Mutual Funds spoke to ***Vishal Dhawan*** , Founder, Plan Ahead Wealth Advisors, to find out what it means for investors and the mutual fund industry.

Everybody is speaking about TRI or total return index. There are a lot of jargon going around. What is TRI?
The current benchmark indices are exclusive of dividends. Typically, the dividend in an index is around 1.5 per cent annually. Since the current indices are exclusive of the dividends, it understates the returns of the indices by about 1.5 per cent annually. Now, the TRI (Total Return Index) includes the dividends by the indices. The TRI is basically an index which will track both the capital gains of a scheme and assumes that any cash distribution, such as dividends, are reinvested back into the index.

How is TRI going to change the benchmarking of equity schemes?
With TRI coming in, the returns of the index will go up by 1-1.5 per cent yearly by default. Let us say that there was a particular scheme which claimed to beat the benchmark by 2.5 per cent in a year. That outperformance will now come down to one per cent. What used to happen was that the funds used to include dividends in their NAV and this helped to push up returns against the benchmark.

Is the TRI going to change the existing benchmarks of schemes?
Apart from the evaluation part, nothing is going to change. For example, if a scheme was benchmarked against Nifty 50 earlier, it will be benchmarked against the Nifty 50 TRI after February. Some fund houses are already using the TRI. For example, Quantum, Edelweiss and DSP BlackRock. TRI is only a better and transparent way of showcasing how the schemes have done.

How will the move impact mutual fund investors?

Many investors use active mutual funds because of the significant outperformance. And the amount of outperformance is also substantial. Once the new benchmark becomes the TRI index, the level of outperformance will reduce and in some cases it will become underperformance. Now, investors in many schemes might look at whether their schemes were actually outperforming the benchmark. They now need to evaluate whether they need these active fund or should they look at some passive funds or ETFs. Obviously, one should keep in mind the long-term performance of the fund while evaluating.

Sebi is already in process of re-categorising mutual fund schemes. How will the mutual funds space change with both these changes coming up simultaneously?

Yes, scheme categorisation is changing. Both these factors are going to change the mutual fund space. The indices of many of the schemes might change with Sebi's definition of, say, a midcap scheme. So, the schemes are going to be scrutinised on the basis of the kind of assets they hold and categorised accordingly. This will in turn change the benchmark of the scheme and then TRI is also there. So, I guess there is a lot of scrutiny. It means more transparency for the investors.

Should the mutual fund investors make any changes in their portfolio at this time?
No. I think we need to wait and watch the combined impact of re-categorisation and introduction of TRI. Sure, investors sure can look at index funds, but not right now. We have to look at the performance of the schemes in the long term and then take a call.