

Should you bet on banking sector funds?

As the economy revives, credit growth gathers pace and NPAs decline, banking and financial sector funds are likely to do well

Sanjay Kumar Singh

Rajiv Rajendran, a 40-year-old Bangalore-based IT executive, has for some time been hunting for investment products that will benefit directly from the economic recovery. He has been advised to invest in banking and financial sector funds. But Rajendran has reservations about the prospects of these funds after the market's recent run-up.

Why invest

The banking and financial services sector benefits directly from a pick-up in economic activity. According to Venkatesh Sanjeevi, fund manager, ICICI Prudential Banking and Financial Services Fund: "The Indian economy is at a stage where a number of macro-economic parameters like GDP growth, IIP growth, current account deficit and inflation are improving. With a new government in place we expect this trend to continue. The banking sector, being the economy's backbone, stands to benefit as the macro environment improves." In such times, a lot of equity and debt capital is raised as corporates undertake fresh capital expenditure. Being the conduit for these activities, the sector tends to benefit from these activities.

From 2008 onward, investors had begun shifting away from financial assets and towards phys-

ical assets. But now with the environment turning conducive—equity markets are rising and real interest rates have turned positive—financial assets are expected to outperform gold and real estate. The banking and financial sector is expected to benefit from investors' shift towards financial assets.

A few concerns

One concern within the banking space is the high level of non-performing assets (NPAs), especially among PSU banks. You can circumvent this problem by opting for funds that have avoided banks which are hobbled by high levels of NPAs.

Currently investors are also worried about whether they should take additional exposure to the banking, financial services and insurance (BFSI) space when they already have considerable exposure to it via diversified funds. Sanjeevi says that with these funds, apart from banks, you get exposure to the entire gamut of financial services, like life and general insurance companies, housing and vehicle finance companies and credit rating agencies. **Vishal Dhawan, chief financial planner at Mumbai-based Plan Ahead Wealth Advisors, suggests that investors who already have a portfolio comprised of diversified equity funds should limit their exposure to these sector funds to 5%.**

Another concern is whether after the sector's

recent run-up—the S&P BSE Bankex is up 79.33% (26 August) over the past one year—there is any upside left. Sanjeevi contends that to look at only one-year return is misleading. "Last year most macro parameters were at a weak level. The one-year return has got affected by the low base," he says. In his view, current valuations are fair. He believes that as the economy improves, the sector will witness considerable upside, both via earnings growth and valuation re-rating. **Says Dhawan: "Investors should not expect past returns to be repeated in the near future. And investments should be made via SIPs, and not lump sum, and for 3-5 years."**

Selecting the right fund

Compare a fund's one-, three- and five-year trailing returns with its benchmark and category average returns. Also evaluate the fund for consistency by looking up its performance vis-à-vis benchmark and category average returns over the past five calendar years. Next, examine the fund's portfolio. It should not be too heavily concentrated in the top one or three stocks—a common failing among sector funds. It should also be diversified among all the sub-sectors within the BFSI space. Finally, an exposure to a sector fund should be tactical. When interest rates are rising or when the economy is at the peak of a cycle, this sector tends to

underperform. Dhawan advises investing via shorter-duration SIPs of one or two years. When an SIP ends, decide afresh whether you want to invest more, leave the money already invested with the fund, or withdraw it.



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