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What to do when mutual funds underperform

By *Narendra Nathan*, ET Bureau | 25 Apr, 2016, 08.00AM IST

To generate wealth, it is important that investors monitor their portfolio regularly and replace the underperformers with better schemes.

We invest in mutual funds expecting decent returns. And even as most mutual fund schemes continue to outperform their respective benchmarks, there are some which grossly underperform, even after long holding periods. For instance, Sundaram Growth Fund has only generated annualised return of 3.19% in the past five years compared with 6.67% generated by its benchmark—Nifty 50. The category average stands at 9.3%.

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Comments

People continue to stay invested in underperforming schemes either out of lethargy or in the hope of their turnaround. Investors need to shed this attitude because it can significantly harm their finacial health. While Rs 1 lakh invested in Sundaram Growth Fund five years ago would have grown to just Rs 1.21 lakh, the same would have grown to Rs 1.56 lakh, if invested in an average performing fund—considering the category average return and not that of the best-performing schemes.

Investing regularly is only one part of building wealth, monitoring your investment is the crucial other part. This is where most long-term investors go wrong. "Long-term investing doesn't mean that you have to hold the same mutual fund scheme for a very long time," says Vidya Bala, Head, Mutual Fund Research, FundsIndia. So, monitoring your portfolio and taking remedial actions on a regular basis is crucial to long term wealth generation.

But, how to identify the underperformers in one's portfolio? Should a fund's performance be measured relative to its benchmark or relative to the category average? Experts say that investors should focus more on the benchmark. "If the scheme is beating its benchmark comfortably, and if it goes below the category average for few quarters, it is not a big concern," says Gajendra Kothari, MD and CEO, Etica Wealth Management.

For instance, HDFC Top 200 and HDFC Equity have underperformed the category average, but they have beaten their respective benchmark during the past five years. Another problem with category average is that rating agencies, based on their different yardsticks, often group the same fund in different categories.

This can be confusing and can lead to incorrect conclusions. "Investors should use

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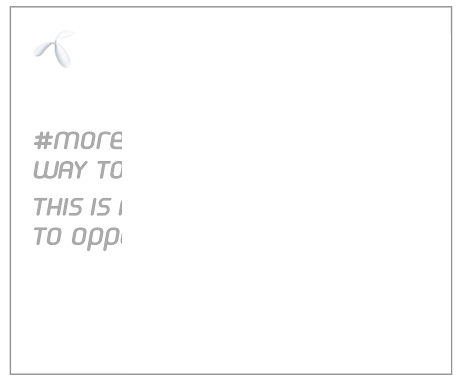

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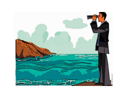

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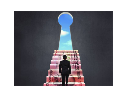

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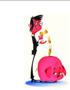

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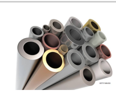

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category average carefully, especially for the multi-cap category," says Vishal Dhawan, CEO, Plan Ahead Wealth Advisors. Investors also need to be careful about the profile of a fund within a particular fund category. For intance, both Franklin India BlueChip and SBI BlueChip fall under the large-cap category. However, while Franklin India BlueChip is benchmarked against Sensex and is truly a large-cap scheme, SBI BlueChip is benchmarked against BSE 100 and has leeway to invest in mid-cap stocks.

THE BIG UNDERPERFORMERS

These funds have underperformed both their benchmark and the category average over the past five years.

SCHEME	AUM (₹ Cr) MARCH 2011	AUM (₹ Cr) MARCH 2016	CATEGORY	BENCHMARK INDEX	NAV (₹)	5-YEAR CAGR (%)	UNDER PERFORMANCE (%)*
Sundaram Growth Fund	190	189	Large-cap	Nifty 50	108.41	3.19	**-3.48**
IDFC Imperial Equity Fund	474	108	Large-cap	Nifty 50	24.97	4.96	**-1.71**
HDFC Premier Multi-Cap Fund	471	259	Multi-cap	Nifty 500	39.13	6.09	**-1.46**
Birla SL India Reforms Fund	186	214	Multi-cap	Nifty 500	13.56	6.19	**-1.36**
HDFC Large Cap Fund	1,646	1,099	Large-cap	Nifty 50	83.15	5.85	**-0.82**
Reliance Quant Plus Fund	91	79	Large-cap	Nifty 50	18.48	5.97	**-0.70**
Sundaram Select Focus	906	315	Large-cap	Nifty 50	118.93	6.17	**-0.50**
HSBC Equity Fund	967	567	Large-cap	S&P BSE 200	144.55	6.76	**-0.41**
Baroda Pioneer Growth Fund	60	259	Large-cap	Nifty 100	73.26	6.93	**-0.36**
HDFC Core & Satellite Fund	432	383	Large-cap	S&P BSE 200	57.40	6.89	**-0.28**

Source: ACE MF; NAV and returns data as on 18 April. **compared with respective benchmark index*

When to rejig?

Most experts suggest that you should do this as part of your annual portfolio review. "Investors should get alerted if their scheme is underperforming significantly (by 2-3%) for the past one year," says Bala. Investors don't need to dump all underperformers in one year though. Underperforming schemes should be monitored on a quarterly basis.

You also need to take help from your adviser and probe deeper. Investors also need to keep a close watch on the events likely to impact fund performance—fund manager changes, fund house's acquisition, etc. Some of the underperformance in schemes from fundhouses such as HSBC and IDFC (see table) is attributable to recent fund management changes. Investors need to shift these schemes to a separate watch list and monitor them on quarterly basis.

Most of the underperforming schemes are from the large-cap category. "Alpha generation (generating returns better than the benchmark) from the large-cap segment has become very difficult now, but alpha generation continues in the mid-cap segment," says Dhawan. "Most underperforming schemes have low AUM, their high expense ratio may also be an issue," says Kothari. So, investors should concentrate on reasonably large schemes, preferably the flagship schemes of a fund house. "Most fund houses give more attention to their flagship schemes. So we advice our clients to focus their core investments with flagship schemes," says Dhawan.

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