Market rally a pick-me-up for Nifty 50 Equal Weight Fund, say experts

Make a small allocation, enhance exposure as more live data becomes available

Sanjay Kumar Singh | New Delhi Last Updated at May 27, 2021 06:10 IST

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The new fund offer of Aditya Birla Sun Life Asset Management Company's (AMC's) Nifty 50 Equal Weight Index Fund is on at present. it will close on June 2.

DSP Mutual Fund has a fund based on the same smart-beta index, which has given a return of 81.7 per cent over the past year, beating all actively-managed large-cap funds. The best-performing active fund gave a return of 77.2 per cent over the past year, while the average for the category stood at 62 per cent.

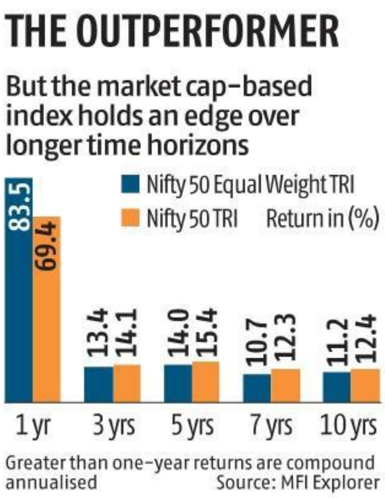
An equal weight index has a different constitution than a market-based index (like the Nifty50). In the latter, the weight of individual stocks is determined by their free-float market capitalisation (m-cap). The Nifty Equal Weight Index holds the same stocks as the Nifty50. But each stock has an equal weight of 2 per cent.

Outperforms in broad-based rally

When market sentiment is poor, generally the rally tends to be narrow and only a few top stocks do well. But when the economy is emerging from a recession (or is expected to), there is a broad-basing of the market rally.

"An equal weight index tends to perform better than a market-based index in a broad-based market rally – in a market where the momentum is not behind just the top four-five companies," says A Balasubramanian, managing director and chief executive officer, Aditya Birla Sun Life AMC.

He adds that when the relatively smaller companies within the index outperform their larger peers, an equal weight index tends to outperform a traditional floating m-cap-driven index.
Investing in this index allows a retail investor to buy quality companies that are sector leaders. The investor also gets a more diversified index.



"The Nifty 50 Equal Weight Index is better diversified across sectors and stocks than the Nifty50," says Anil Ghelani, head of passive investments at DSP Investment Managers.

This, according to him, improves the risk profile of this index and allows it to offer better downside protection during market declines, as witnessed during last year's downturn.

On a five-year rolling return basis (rolled daily), the Nifty 50 Equal Weight Total Returns Index (TRI) holds a slight edge over the Nifty 50 TRI with a median return of 13 per cent vis-à-vis 12.7 per cent, respectively (the data is for April 29, 2002 to February 17, 2021; source: DSP MF).

Inadequate live data

The DSP Equal Nifty 50 Fund was launched in October 2017. The second fund is being launched now.

“We need live data for a longer period on this index fund to have greater confidence in it,” says Vishal Dhawan, chief financial planner, PlanAhead Wealth Advisers.

Investors should also bear in mind that there will be periods when this index underperforms the Nifty50, as happened in 2013, 2018, and 2019.

A smart beta index tends to be more expensive. The DSP Equal Weight Fund has an expense ratio of 80 basis points (bps) for the regular fund and 39 bps for the direct fund.

A Nifty50 fund has an average expense ratio of 70 bps for regular funds and 22 bps for direct funds (many funds are available for 10-20 bps).

Should you invest?

Financial planners say this fund can supplement a Nifty50-based index fund, not replace it.

“Suppose you have Rs 100 invested in equities and your allocation to the large-cap segment is Rs 50. Start by allocating Rs 5 to this fund, which will be 10 per cent of your large-cap allocation. As more live data becomes available, increase allocation if this fund continues to perform,” says Dhawan.

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