The Mutual Fund Show: Funds To Invest For Potential Capex Cycle Gains (excerpts)

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India may be on the cusp of a multi-year capex cycle as signalled by growth in capital goods orders, the supply chain shifting from China, and companies pledging investments to avail production-linked incentives.

Gains for companies linked to the investment cycle will be selective and not across the board, according to Kshitiz Mahajan, co-founder, Complete Circle Consultants.

Vishal Dhawan, founder and chief executive officer of Plan Ahead Wealth Advisors, considers infrastructure funds to be a good investment option.

There are two types schemes in this segment: core infra funds that invest in capital goods and basic materials; and diversified funds, which invest in the ecosystem benefiting from the cycle including financials, said Dhawan. He prefers core infrastructure funds because of the focused approach.

Dhawan's top fund choices are Kotak infrastructure and Economic Reforms Fund and the L&T Infrastructure Fund. Both the schemes have around 70-75% exposure to materials and capital goods sectors, and the remaining to utilities and telecom. They have been performing consistently within the category and have outperformed peers, said Dhawan. They may seem expensive valuation-wise, but the quality focus protects from a downside, he said.

However, instead of buying infrastructure-focused funds, Mahajan recommends flexi-cap funds and diversified funds, such as the Aditya Birla Sun Life Pure Value fund, the DSP Tiger fund and the HDFC Focussed 30 Fund, which offer a capex beneficiary portfolio and a margin of safety in case capex plays take time to deliver.

Mahajan and Dhawan consider the newly launched SBI CPSE Bond Plus SDL Sep 2026 50:50 Index Fund to be a good option for investors looking for a target maturity option.

Both recommend skipping auto ETFs in a week which saw two launches— the Nippon India Nifty Auto ETF and the ICICI Prudential Nifty Auto ETF. With startups taking aggressive bets in the two-wheeler space, and listed and larger players finding it difficult to cope with the competition, they advise investors to avoid taking sectoral bets as the theme can also be invested in via diversified funds.

Here are the edited excerpts from the interview:

Vishal, if someone believes that the capex cycle is underway, how does one play by the mutual fund route?

Vishal Dhawan: There is this fear around capex because people got it so wrong in previous cycles. They are very hesitant to become bullish on that cycle at all.

What we've historically seen is that, when you have a consensus view that exists, that something is not necessarily going to do well, that's the time where you can be surprised. We therefore think that it's probably one of those few times where it's good to look at this theme in a slightly narrow manner, where you start to go back to infrastructure funds and look at them once again.

If you look at infrastructure funds as a category there are obviously two methodologies (around which) the funds are put together. One of them is where they are purely focused around capex companies, materials, and a little bit in utilities and telecom for example. So those are what we would call the pure play funds.

On the other side, you have these diversified infra funds, which also include, for example, the financials, because they are financing a lot of this infrastructure in theory.

Therefore, if you want to play infra and the capital goods space appropriately, then it's good to go to the pure play players rather than going to the more broad-based exposure.

There are probably a couple of funds within that space that stand out from the research that we do across funds. One is the Kotak Infrastructure and Economic Reform Fund and the second is the L&T Infrastructure Fund. Both of these are driven by the fact that they've had consistent track records, they stayed pure play, they focused on quality because this is a space in which a lot damage historically has happened. Players have taken more risk on the balance sheet than what they could handle. You want to be careful about not repeating the same mistake.

So even though these funds may look a little more expensive from a valuation perspective, these have actually worked well historically in protecting (from) downsides as well.

An additional factor is that people may have to build this exposure gradually, to cut the risk that maybe this cycle happens later than what we are imagining or maybe the investment phase of that cycle doesn't make you money as an investor. You start making money when a lot of these infrastructure assets are actually deployed, and cash flow starts to come in. So, getting in gradually would be an important part of the strategy as well.

If somebody wants to play with an infra fund or a couple of funds that you mentioned, what's the extent of the portfolio? Let's say you are bullish on this cycle but you will still have some risk balancing in mind. So, what's the extent of your mutual fund portfolio?

Vishal Dhawan: So, we will typically not go beyond 10% because there will be a lot of diversified funds in the portfolio also, which will be taking some of these bets by default or by choice. Therefore, we look at it as a 10% exposure plus whatever you're getting through other managers would actually end up being quite sizeable.

SBI Mutual Fund announced the launch of the SBI CPSE Bond Plus SDL index fund. What is this fund about and what kind of investors should choose this? Are there better options available in that category?

Vishal Dhawan: This is a category of target maturity or target date funds which is gaining a lot of prominence. We've seen a lot of funds come into that space over the last few months.

It's clearly created a new category, garnered assets and it's appealed to some very basic principles which fixed income investors always have tended to have. They've been used to investing in products like fixed deposits, saying "when will this mature and what kind of return should I reasonably expect out of this?" Both of these questions were always a struggle to answer in the traditional debt fund world, simply because they were all largely open-ended products, and they didn't have a date.

Therefore, the kind of return that you would make depended on so many different variables, which were very complex for retail investors to understand. So, this category has one more player come in through the SBI Fund.

Most of them are very, very similar, looking at a four-five years of duration, because that seems to be the part of the yield curve which is relatively attractive from a medium-term perspective.

The other advantage is because you're holding to maturity, you can probably overlook a lot of the mark-to-market that will happen along the way as interest rates move up on the back of what's happening on the inflation side.

Last but not the least, the low expenses are very useful in these categories. What tends to happen for debt-fund investors is that in a low-interest rate environment, if you have a lot of expenses on the fund, you further end up losing money. Therefore a lot of the funds coming in there, including SBI, are priced at about 15 basis points for direct plans. We think it's a good space. Unfortunately, there is not a lot of differentiation there. All of them are doing similar stuff. They're tracking a similar index. 50% is going to state development loans, 50% is going to PSUs. Obviously, that index gets reconfigured every six months, at which point, if there is any rebalancing to be done, that will happen.

We've seen only one little variation from Birla come in more recently where they tried to change the weightages. But otherwise, these are all fairly similar products. So, for investors depending on when they probably require the money, say 2026-27 or whenever, they actually go in and buy one of them.

Two large fund houses have launched an auto ETF. Should investors, who have a bullish view on autos, take an exposure to either of them? Is this ETF an good way to do it because it could be lower expense than an average fund? What do you advise?

Vishal, is your view similar or different?

Vishal Dhawan: Yes, it is broadly similar. The EV disruption by startups is certainly a risk that exists. You don't know where that next Tesla in India is going to come out of, and therefore, you're just going out and diversifying across a lot of players.

What's fairly interesting though is that, as a space that sector has struggled through the last few years. Therefore, for a lot of investors who are both aggressive on one side as well as want to be contrarian, that segment may find there is merit to come in here because at the end of the day, it is a relatively lower cost solution.

Coming through the ETF route, the costs are likely to be between 20 and 25 basis points. So, if you want to be contrarian and aggressive, and say that 'some of the big guys who've been there will also figure out how to solve this problem, like they figured out how to solve so many other problems in the past', then you could allocate a portion of your money. Otherwise, you're just better off playing this through a diversified portfolio.

What is the one key theme in mutual funds that you believe people should latch on to? It could be a debt scheme, an equity scheme, etc. What is it that each of you like, and why?

Vishal Dhawan: I remember being on your show in 2016-17 and actually talking about exactly the same scheme. It's interesting that while you're looking for a new idea, sometimes there are ideas that have played themselves out very well which need to continue to get allocation.

So, the scheme that I'm going to refer to is called the Parag Parikh Flexi Cap Fund. At that time it used to be called by a different name, before the recategorization by SEBI happened. In essence, the fund has always been run the same way. What they've done successfully over the years is taken advantage of the fact that on the India side, they've bought into businesses that they've had a lot of conviction on. They've obviously held on to them for long periods, which is why we like the fact that they have a below 20% portfolio turnover ratio showing that conviction through long cycles.

On the other side, they've had about 30% allocations to international stocks. A lot of them are plays which you can't really buy into India through. Therefore, that has been very helpful in this cycle. So, the value orientation from an India perspective, maybe a little bit of growth orientation internationally, have combined well together. You've had a very consistent fund management team.

You've had them sticking to philosophy; you had skin in the game far before Sebi made it mandatory. All of that goes well for investors who want to take a forward view as well. Not only for 2022, maybe five years later, we'll be talking again and still saying that this is a good option.

The AUM four years back was much lower than the AUM now. Typically, people tend to correlate the size of the fund with the ability of the fund to outperform. Do you think that could be a hindrance?

Vishal Dhawan: We don't think so. In fact, you know, it's very interesting that when used to have this conversation five years ago what we used to hear back was, you know, it's such a small fund. You know, really is this going to be getting enough attention.

Today that conversation has turned around. If you look at the size of the fund, it's about Rs 17,000-18,000 crore now. The size of the market has become so much larger that we think a Rs 17,000-18,000 crore fund, which is not biased towards any market cap style, has enough opportunities to really participate in. What does work well for them is they haven't shied away from taking cash calls if needed unlike a lot of other managers. So, if there is overvaluation, which I'm sure there will be at some point across the journey, you would expect that they would take some of those decisions to hold back on investing.

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