ICICI direct Research

November 21, 2018

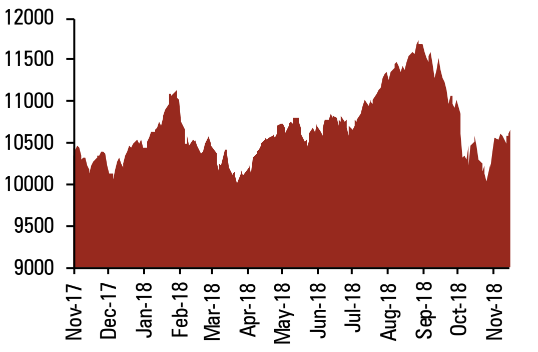
Mutual Fund Review

November 21, 2018

Note: Whenever, returns for the scheme are shown in the report, they are for the growth option of the scheme.

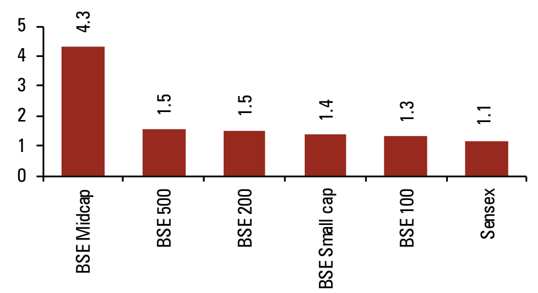
Equity Markets

Nifty 50: Subdued month for equity markets



Source: Bloomberg

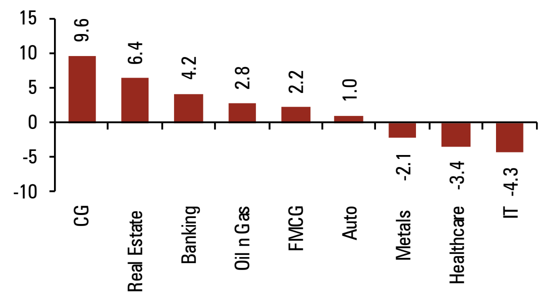
Midcap index outperforms …



Source: Bloomberg

One month returns till November 15, 2018

Capital goods and real estate sectors do well



Source: Bloomberg

One month returns till November 15, 2018

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Update

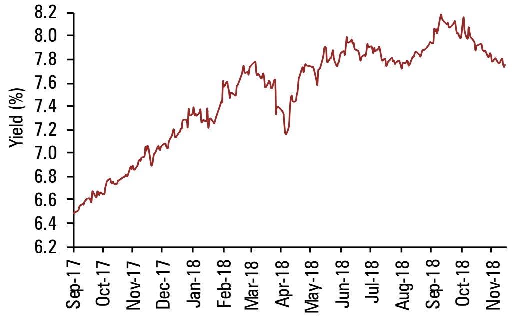
- After having witnessed a sharp correction in September and October, Indian equity markets rebounded in November and recouped almost half of the losses it suffered during the fall. The S&P BSE Sensex fell almost 14% from August all-time high levels but recovered and gained around 7.0% from lows in October. Relentless selling by foreign investors, especially during September and October to the tune of US$5 billion (bn) led to a sharp fall in Indian markets. However, the sharp rebound of the Nifty from levels of around 10000 indicates buying appetite among investors at lower levels
- Sectors like capital goods, banking and real estate have outperformed in the current rebound, which the market has witnessed. Sector rotation is happening at a faster rate amid market volatility. The return variation among various mutual funds is likely to be high in the short-term. Investors should give less weightage to near term returns
- Retail investors have shown noteworthy maturity in the last few years where they have invested more during market falls. During October, when market was falling, mutual funds saw higher inflows in equity oriented funds on the back of all-time high inflows through the SIP mode, which almost touched ₹ 8000 crore
- On the macro front, global crude oil prices corrected sharply from around US$85 per barrel to currently around US$67 per barrel. The rupee also stabilised and appreciated from around 74 per US dollar levels to below 72 per US dollar. The same, along with stable global markets, was the main reason for the rebound in Indian markets
- Foreign portfolio investors, who have been net sellers since the start of CY18, turned net buyers in November 2018. They sold Indian equities worth more than US$8 billion between February and October 2018. Selling intensified September and October when they were net sellers to the extent of around US$5 billion. However, in the first half of November they were net buyers and bought equities worth US$500 million (mn) indicating buying interest at lower levels. In US$ terms, Indian markets are far lower than in rupee terms
- Broader markets, represented by midcaps and smallcaps, have also recovered undoing their recent underperformance since the start of calendar year 2018

Outlook

- Overall, calendar year 2018 has been extremely volatile with returns in the first 10 months almost flat at around 1.0%. This was followed by a smooth one-way rally in 2017 where the Sensex delivered around 28% return with very low volatility. The markets may remain volatile in the near term in the wake of domestic events like state and general election that are lined up in a few months along with volatile crude oil prices
- From a long term perspective, we remain optimistic on Indian equity markets. We believe it will deliver superior returns compared to other asset classes over a period of time
- The time tested investment strategy has been to put more money during market falls and not get swayed by the volatility or sharp market falls. Investors who continued or put fresh money at every dip during 2018 are better off than investors who stopped their regular investment
- Continuing with the regular investment through SIP is of utmost importance to use market volatility to the advantage and help achieve the ultimate objective of wealth creation

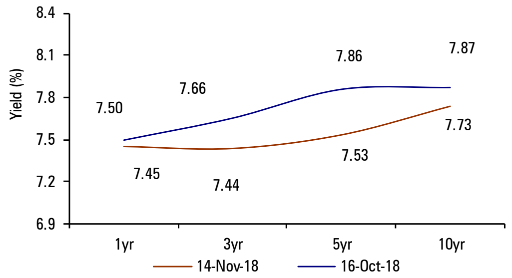
Debt Markets

G-sec yield cools off towards 7.75%



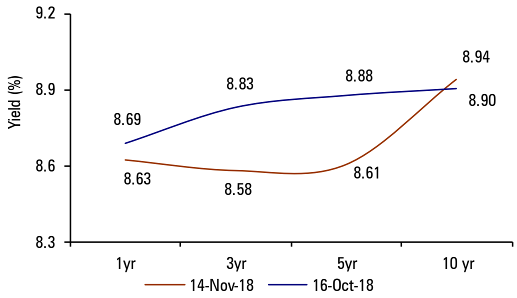
Source: Bloomberg

G-sec yield curve



Source: Bloomberg

AAA corporate bond yield curve



Source: Bloomberg

Update

- Indian debt markets witnessed a return to normalcy post October after a sudden tightening of liquidity in the NBFC space following a default by a particular entity. G-Sec yields continued to stabilise and drift downwards with the 10-year government bond yield down 7.80% from ~8.0% as crude fell, the rupee stabilised and the RBI continued its aggressive OMOs purchases
- Early on, defying market expectation of a 25 basis point rate hike, the RBI chose to keep rates stable. However, the central bank changed its stance from 'neutral' to 'calibrated tightening' indicating that, going forward, a rate cut seems unlikely until RBI changes its stance
- On a positive note, oil prices corrected to ~$67/barrel after rising to $85/barrel. Moreover, RBI announced open market operations (OMOs) to improve liquidity conditions. RBI had announced and conducted ₹ 360 billion of OMOs during October and followed up with another ₹ 400 billion OMO announcement for November. Total cumulative OMO purchases so far has been around ₹ 1.06 lakh crore. While this brought some respite to government bond yields, corporate bond yields stayed under pressure. NBFC HFC sectors continued to face liquidity crunch. The month also saw foreign outflows in both equity and debt markets
- We remain cautious on the NBFC sector, in general, as we believe that although there may not be credit risk concern, yield on papers may rise further and not subside in the near term. Similarly, low grade corporate bonds may find it difficult to borrow at rates at which they have borrowed in recent months. Yields may remain elevated in near term
- Inflation surprisingly remained benign. September headline print of 3.77% is materially below RBI's revised Q2FY19 inflation trajectory of 4%. The actual average for Q2FY19 is 3.88%, thus springing a surprise on the downside with CPI for September coming in at 3.77%

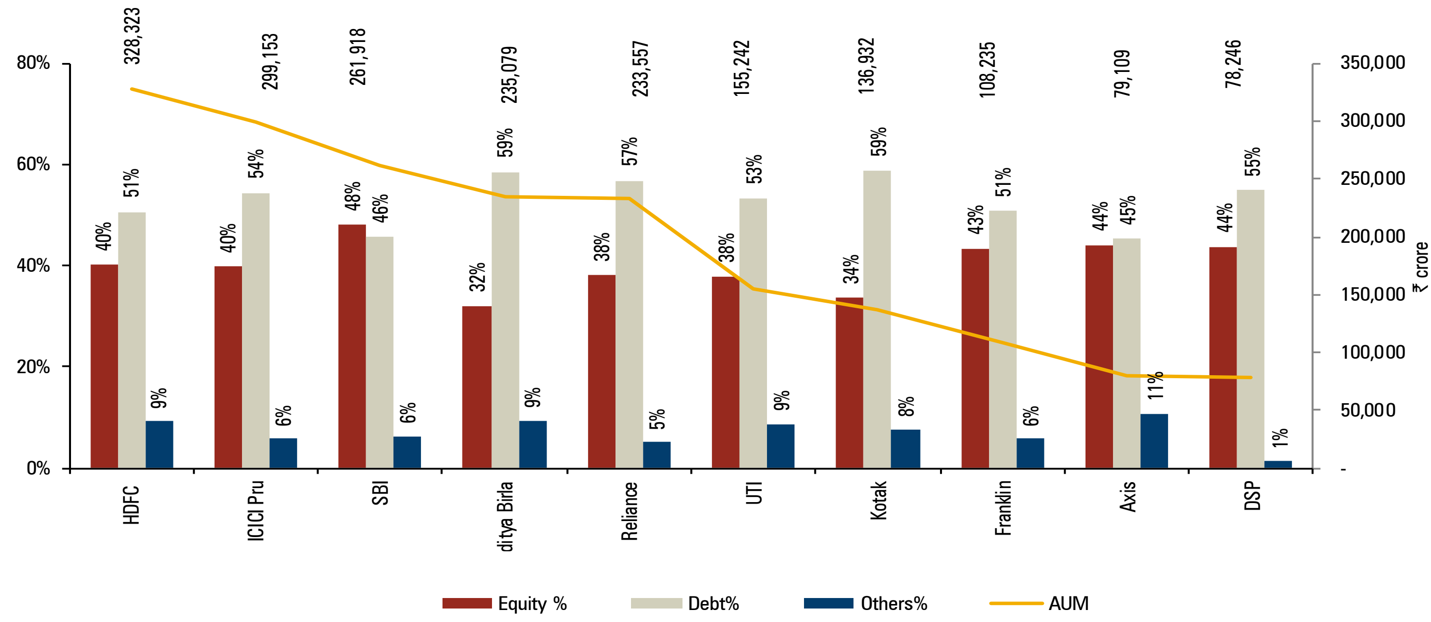
Outlook

- G-sec yields remained well behaved, particularly long dated securities. Benchmark 10-year G-sec yields fell almost 20 bps from around 8.0% to 7.8% in October. Corporate bond yields, however, remained elevated with one-year AAA yield increasingly trading around 8.5% and one year AA rated bonds trading at 9.1%. The same resulted in increased corporate bond spread with spread rising higher for lower rated bonds
- Structurally, interest rates have seen a sharp up move in the last year on the back of global factors like a rise in crude oil prices, commodity prices and currency depreciation across emerging markets. Interest rates offered by AAA-rated corporates have also seen a sharp up move with yield on three-year AAA rated bonds rising from 7.1% in September 2017 to 9.1% in September 2018, a rise of 200 bps in one year. Yield on corporate bonds has moved up to levels last seen in November 2014
- While inflationary concerns are legitimate, the sharp up move in interest rates is discounting higher concern than warranted. RBI expects inflations to move down from earlier estimate of 5% to 4.8% by Q1FY20. Inflation has structurally moved down and may remain below 5% levels over the medium term, going forward. With the inflation structurally likely to remain far lower than earlier years, corporate bond yields are unlikely to remain at 2014 levels
- The higher spread between inflation and bond yield is indicating that the current higher yield offered by good rated companies is a good investment opportunity

MF industry synopsis

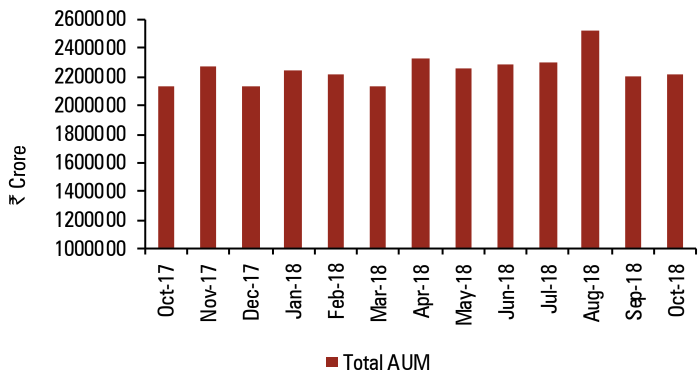
- MF industry AUM rose ~0.9% in October to ~₹ 22.23 lakh crore amid a pick-up in inflows into equity-oriented and liquid funds. Of the total AUM, ~31% was held by income funds, ~45% by equity and equity-oriented funds and ~20% by liquid funds
- During October, equity and equity oriented funds (i.e. equity, arbitrage, balanced, ELSS, non-gold ETFs) recorded ~₹ 18000 crore net inflows, bumping up the FY19TD monthly average to ~₹ 13970 crore against FY18 average of ~₹ 21000 crore
- According to AMFI data, SIP inflows for October touched a fresh high of ₹ 7985 crore. SIP inflows averaged ~₹ 5600 crore/month in FY18 vs. ~₹ 3600 crore/month in FY17, a rise of ~52%. The number of SIP folios has increased from 1.35 crore in March 2017 to 2.49 crore in October 2018

Exhibit 1: HDFC retains top spot in terms of total AUM while SBI has highest proportion of its AUM in equity-oriented schemes



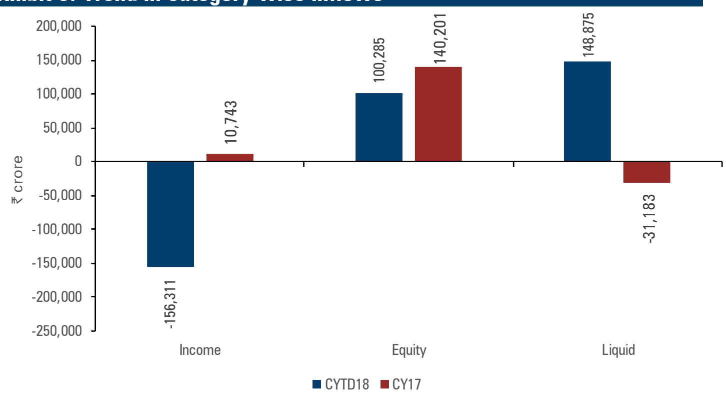
Source: ACE MF, ICICI Direct Research

Exhibit 2: Mutual fund AUM at ₹ 22.23 lakh crore



Source: AMFI, ICICI Direct Research

Exhibit 3: Trend in category-wise inflows

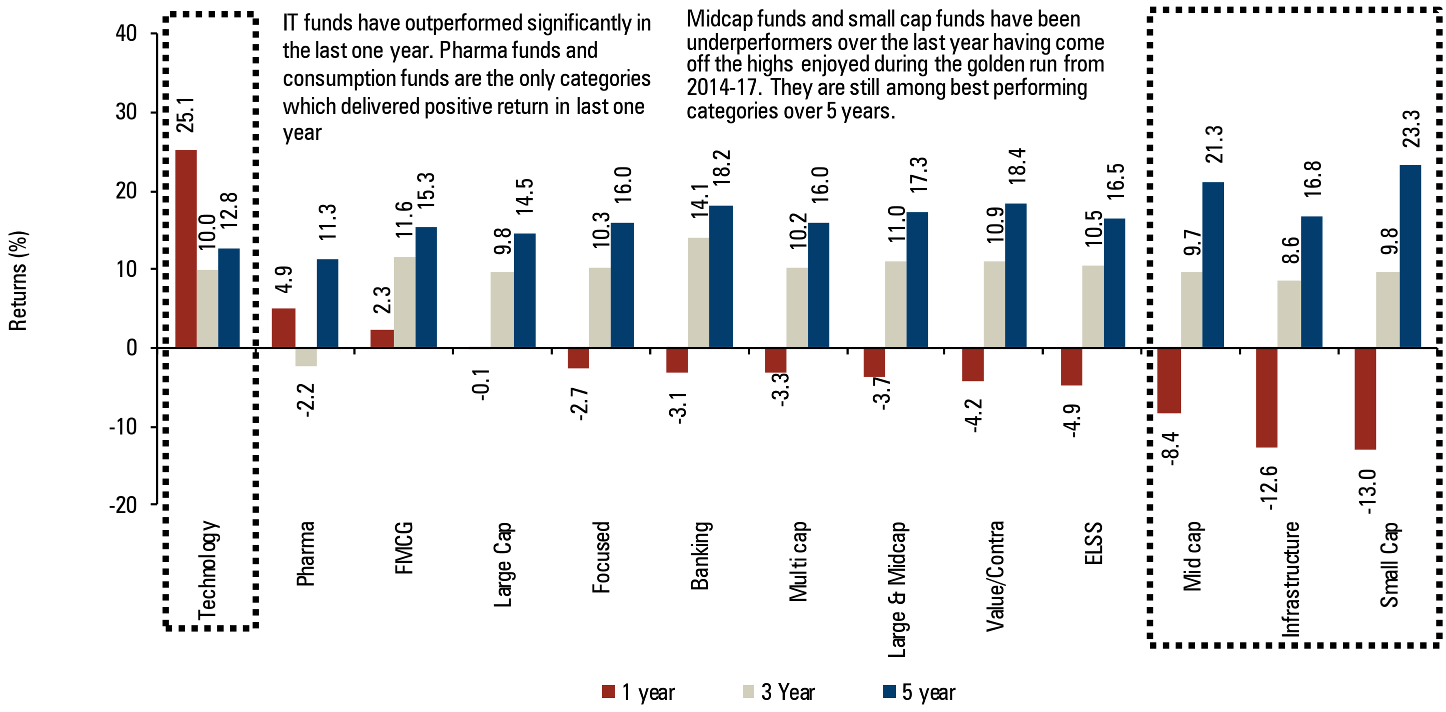


Source: AMFI, ICICI Direct Research

MF Category Analysis

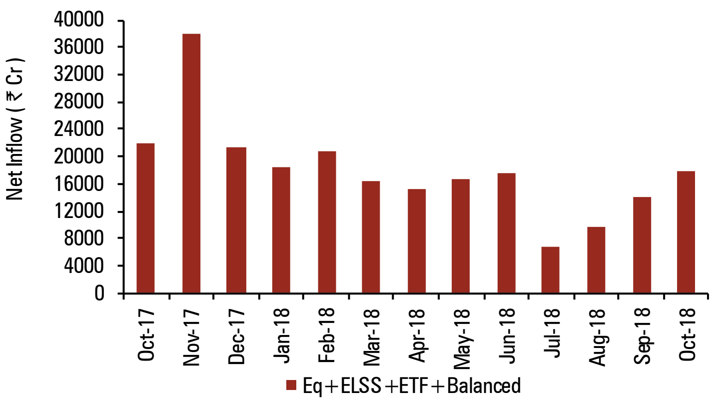
Equity funds

Exhibit 4: IT funds remain best performing category over last year (returns as of November 15, 2018)



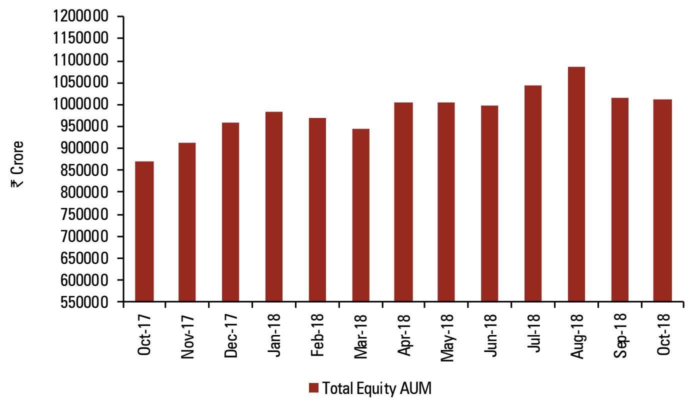
Source: Crisil, ICICI Direct Research ; Returns over one year are compounded annualised returns

Exhibit 5: Inflows into equity funds plunge post March



Source: AMFI, ICICI Direct Research

Exhibit 6: Equity funds AUM



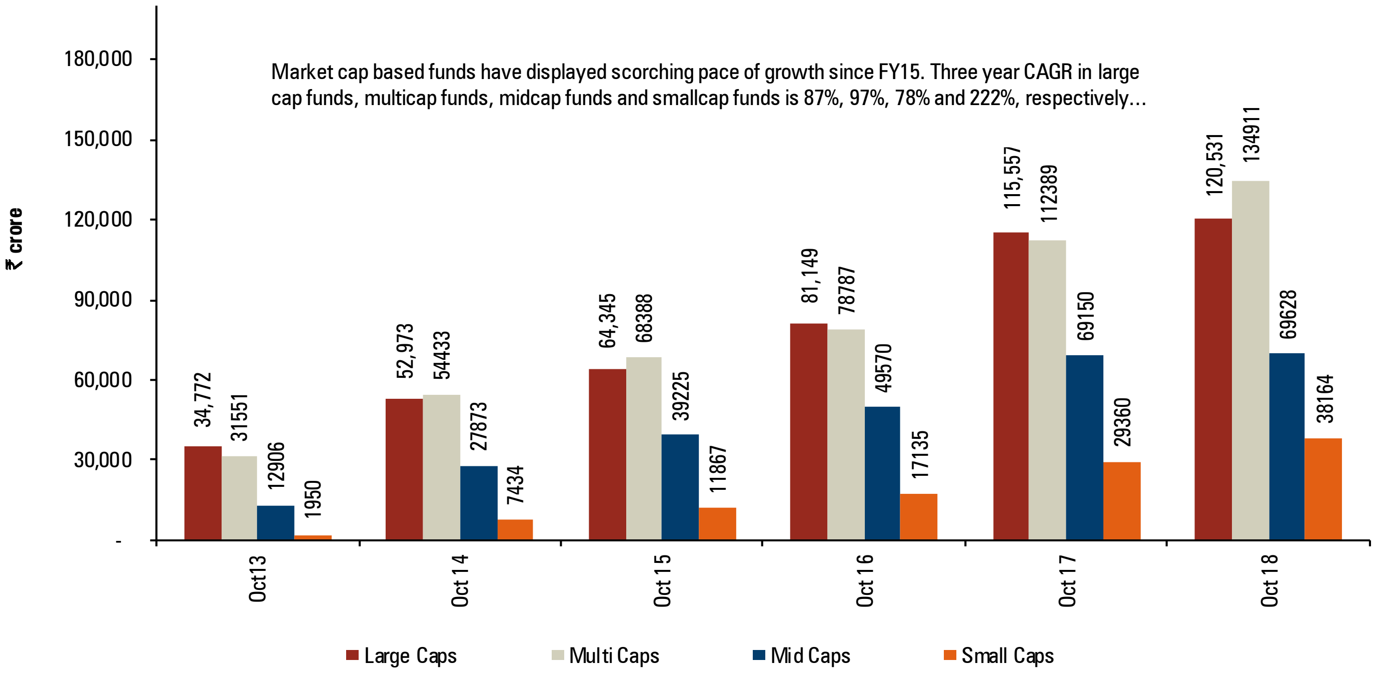
Source: AMFI, ICICI Direct Research

View
Short term: Positive
Long-term: Positive

Equity diversified funds

- In the present market scenario, bottom up stock picking across the market segment is more important than allocation to a particular segment or sub sector. Multicap funds offer fund managers flexibility to allocate funds across all market segments and are, therefore, relatively better placed

Exhibit 7: Equity diversified funds have grown at phenomenal pace over past few years …



Source: ACE MF, ICICI Direct Research

Pharma funds – in focus

View
Short-term: Positive
Long-term: Positive

Recommended Pharma funds:

- Reliance Pharma Fund
- UTI Healthcare Fund

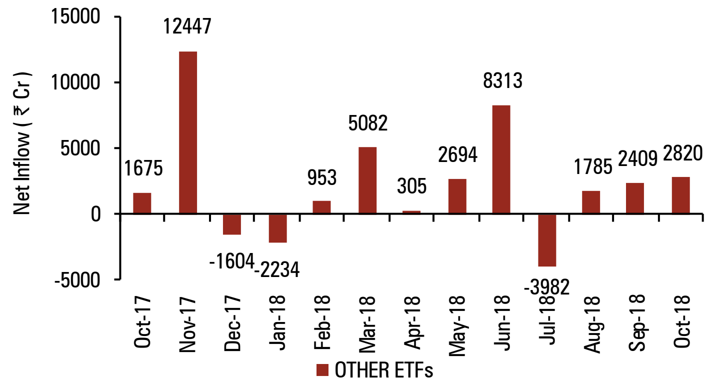
- Amid this year's market volatility, defensive sectors like IT and pharma have done better by protecting the downside. The pharma sector has witnessed increased investor interest in the last few months. We have been positive on the pharma sector for the last few months due to suppressed valuations, a smart recovery in the domestic market, normalisation of US market related issues like compliance and pricing pressure along with current tailwind. Although the growth trajectory has come down from 20-25% to 10-15% (normalised basis), we believe the visibility has improved. This offers reasonable return potential
- Most US centric pharma stocks witnessed a strong run up in FY12-16, thanks to stupendous growth in their US franchisee on the back of the impending patent cliff (scores of patent expiries) in the US supported by aggressive product filing as well as US focused capex and rupee depreciation. The pharma sector (NSE Pharma) traded between 30x and 35x one year forward PE band consistently during this period. However, in FY16-18, as the US situation became increasingly difficult due to compliance issues and persistent pricing pressure, there was sharp de-rating of the sector PE. While the Nifty PE currently is still trading at 25x one year forward, many stocks are trading below their 10-year average PE multiples

Exchange Traded Funds (ETF)

Traded volumes should be the major criterion that is used while deciding on investment in ETFs. Higher volumes ensure lower spread and better pricing to investors...

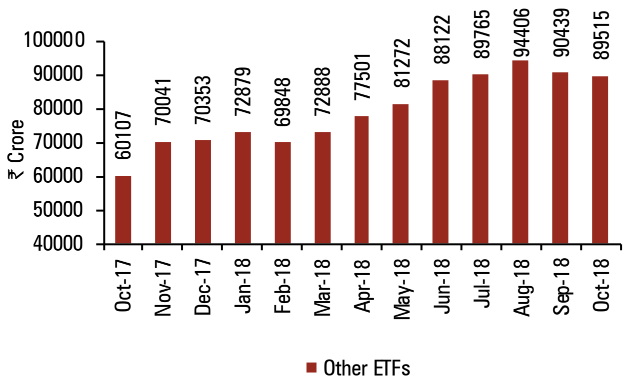
In India broadly three kinds of ETFs are available: Equity index ETFs, liquid ETFs and gold ETFs. An equity index ETF tracks a particular equity index such as the BSE Sensex, NSE Nifty, Nifty Junior, etc. Apart from these, lately there have emerged niche ETF products that track particular themes such as low volatility stocks, high growth stocks, high value stocks, etc, but the market for such ETFs is limited as seen from their modest AUM.

Exhibit 8: ETFs inflows intact



Source: AMFI, ICICI Direct Research

Exhibit 9: ETF AUMs remain strong



Source: AMFI, ICICI Direct Research

Bellwether index tracking ETF AUMs have increased sharply ever since the EPFO decided to invest a part of their incremental corpus in the equity markets in late 2015.

The performance of some of the available ETFs is as follows –

Exhibit 10: ETF performance as of September 30, 2018

Scheme Name	6 Months	1 Year	3 Years	5 Years
Aditya Birla SL Nifty ETF	(2.5)	1.8	10.1	11.7
Aditya Birla SL Sensex ETF	(5.8)	(5.4)		
Edelweiss ETF - Nifty 100 Quality 30	(5.0)	3.8		
Edelweiss ETF - Nifty Bank	(1.1)	0.9		
ICICI Pru Nifty Low Vol 30 ETF	(3.7)	4.6		
ICICI Pru NV20 ETF	6.3	12.2		
Kotak Banking ETF	(1.2)	0.7	13.7	
Kotak NV 20 ETF	6.5	12.5		
Kotak PSU Bank ETF	1.6	(23.2)	(1.2)	3.8
LIC MF ETF-Nifty 100	(4.1)	(0.1)		
Motilal Oswal Midcap 100 ETF	(14.8)	(12.1)	8.8	17.9
Reliance ETF Nifty BeES	(2.4)	1.9	9.9	11.6
Reliance ETF PSU Bank BeES	1.6	(23.3)	(1.3)	3.8

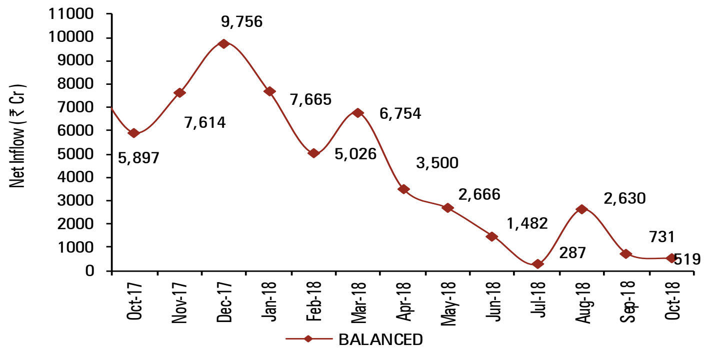
Source: ACE MF, ICICI Direct Research; Note – 6 month performance is absolute, rest is annualised.

View
Short-term: Positive
Long-term: Positive

Aggressive hybrid funds

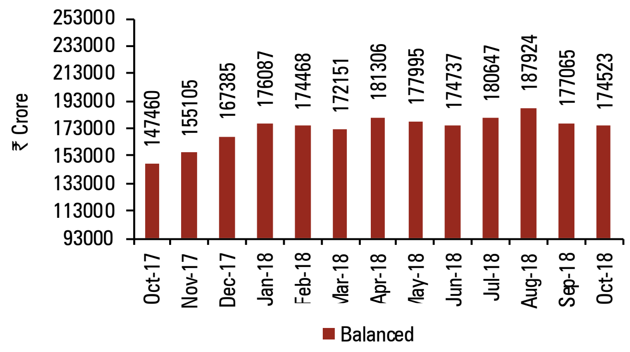
- Inflows into balanced funds have slowed considerably in this financial year. Average net monthly inflow in 2017 of ~ ₹ 7000 crore dropped to ₹ 3500 crore in April, ~₹ 2700 crore in May, ~₹ 1500 crore in June and ~₹ 300 crore in July, before recovering slightly to ~₹ 2600 crore in August and dropping again in September to ~₹ 730 crore and to ~₹ 519 crore in October. Imposition of dividend distribution tax (DDT) on equity mutual funds and re-introduction of LTCG tax seems to have dealt a double whammy to investor preference for balanced funds. With bond yields remaining elevated and equity markets also consolidating over the last few months, the performance of balanced funds has dipped recently

Exhibit 11: Inflows into balanced funds fall sharply in FY19



Source: AMFI, ICICI Direct Research

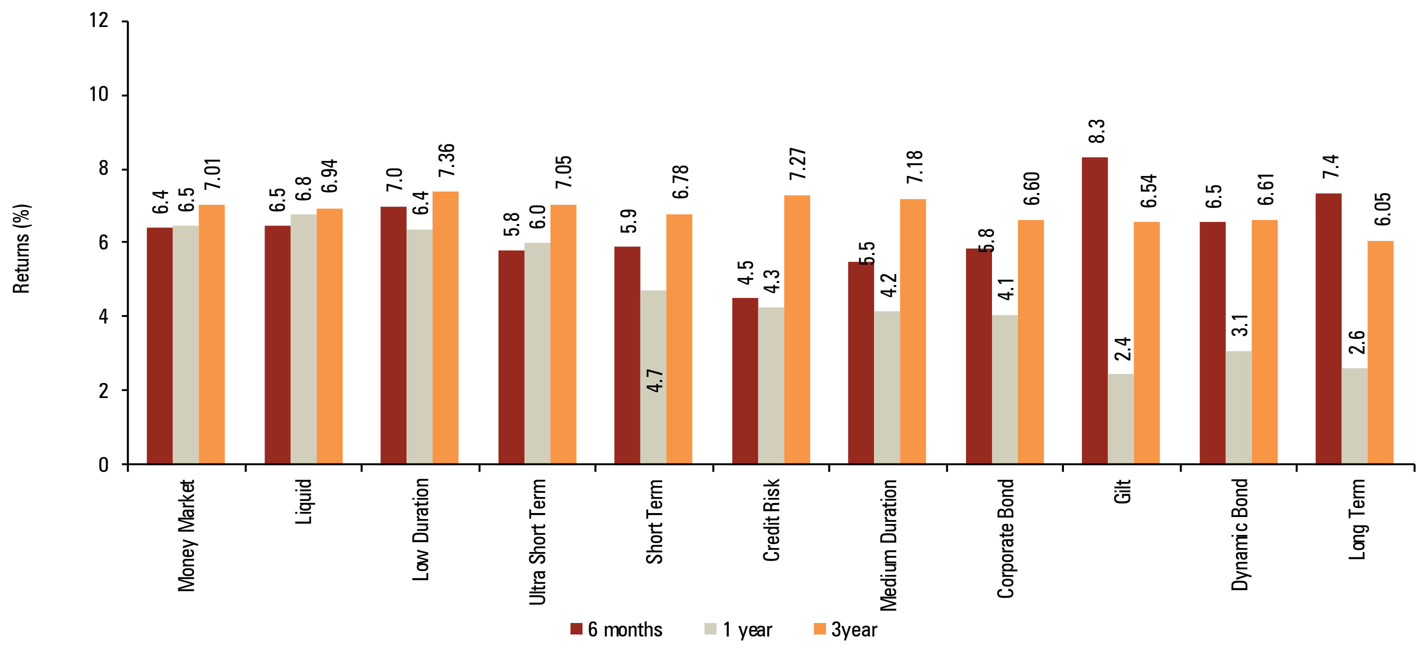
Exhibit 12: YoY 32% growth in AUM of balanced funds



Source: AMFI, ICICI Direct Research

Debt funds

Exhibit 13: Category wise performance (returns as on November 15, 2018)



Source: Crisil, ICICI Direct Research. All returns are compounded annualised.

Positive View
Ultra-short term
Low Duration

Short term commercial paper (CP) and corporate deposit (CD) rates have risen sharply in past few months thereby offering a good opportunity in these segments

Short-term fixed income allocation (less than a year)

- We believe that ultra-short term funds and low duration funds categories offer a relatively better investment opportunity
- Ultra short-term bond funds and low duration funds are an ideal option to park money temporarily compared to overnight or liquid fund categories. They offer higher return potential by investing a higher proportion in a mix of corporate bonds and commercial papers compared to overnight/liquid funds. At the same time, most funds in these categories do not have exit load restrictions, thereby making them liquid from an investors' perspective
- Money market funds are also a worthwhile option from liquidity and credit quality perspective, particularly for conservative investors. However, the return potential may be lower compared to ultra-short/low duration categories

Positive View

Medium Duration
Credit Risk

Allocation to pure G-Sec or duration funds should be avoided given their historical outperformance and G-sec yield trading at the lower end of its historical range. Crisil 10-year Gilt index has delivered 38% return in the last three years. It is likely the return will be significantly decline, going forward

Long term fixed income allocation (more than a year)

- We believe medium duration funds and credit risk funds categories offer relatively better investment opportunity. Short-term funds are also a worthwhile option for conservative investors. However, the return potential may be lower compared to medium duration and credit risk categories due to higher credit quality
- In the medium duration category, many funds offer an optimum mix of credit quality along with higher return potential. Credit quality in this category is lower than short duration funds but higher than credit risk category
- Credit risk funds are more suitable for aggressive investors as they fall within higher risk-higher return potential. However, few funds are offering optimal mix of credit risk for reasonable return potential and can be considered from a long term point of view

Exhibit 14: Categorisation of debt funds

Short Term	
Category	**Comment**
Overnight funds	Maturity upto 1 day
Liquid funds	Maturity upto 91 days
Ultra short funds	Maturity between 3-6 months
Low duration funds	Maturity between 6-12 months
Money market funds	Money market securities with maturity upto 1 year

Long Term	
Category	**Comment**
Short duration	Maturity between 1-3 years
Medium duration	Maturity between 1-4 years
Medium to long duration	Maturity between 4-7 years
Long duration	Maturity of more than 7 years
Dynamic bond funds	Across duration
Corporate bond funds	High rated instruments (AA+ and AAA)
Credit risk funds	Below high rated instruments (below AA+)
Gilt funds	G-secs across maturity

Source: Sebi, ICICI Direct Research

Gold: Outlook benign, avoid for absolute return

Gold prices in the near term may find support due to concerns on trade war and higher volatility in capital markets

The medium term outlook, however, remains benign given the rising global interest rate trajectory and reducing monetary stimulus

- Global gold prices continued to trade within a narrow range around the US$1200-1220 per ounce mark during October. Ending the month at ~US$1214 per ounce, prices are ~6.8% lower in YTD terms
- On the other hand, Indian prices have been doing far better and gained ~4.6% to end October at ~₹ 31700 per 10 grams. With that, Indian gold prices were better off by ~8.4% YTD till October. However, in early November, appreciation of the rupee has led to a fall in gold prices. They were trading at ~₹ 30800 per gram on November 14
- The US Fed raised rates at its September meeting as expected. Earlier, the Fed had raised rates thrice in 2017 and twice in 2018. Coupled with a tightening liquidity cycle begun late last year, higher interest rates are likely to prevent any sustained medium term rally in gold price
- Geopolitical fears continue to persist. Gold could provide a safe haven in the short-term in the event of a risk off environment. Worries surrounding tensions between US-Iran and US-China could lend support to the yellow metal
- The US dollar continued to remain strong against a basket of major currencies. The Dollar Index has ranged at 94-96 over the past several months. Dollar strength is negative for gold since the metal is priced in that currency

Gold prices have remained below US$1300 per ounce since May

Exhibit 15: Global prices remain range bound

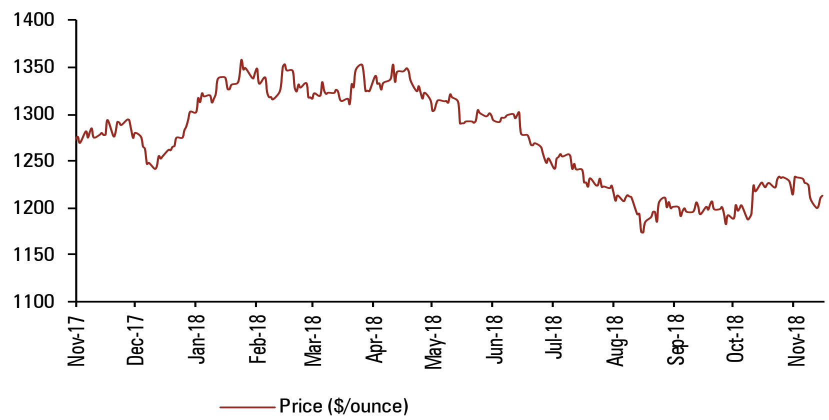
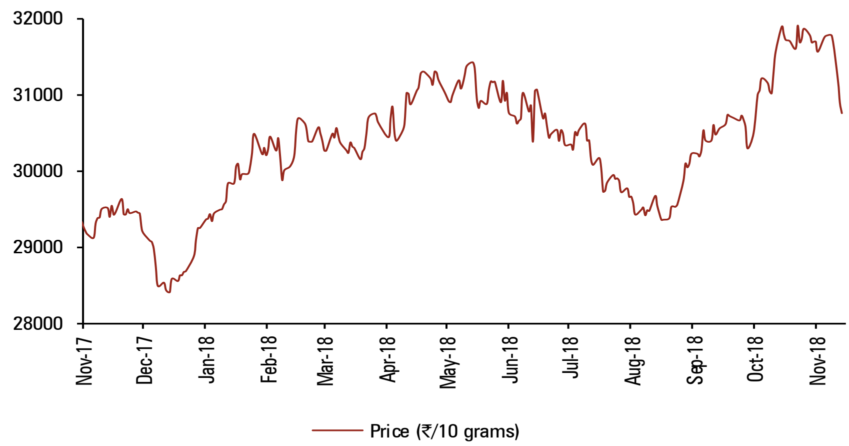


Exhibit 16: Indian prices drop off after recent rally



Source: Bloomberg

Model Portfolios

Equity funds model portfolio

What's In	What's Out
Aggressive	
Mirae Asset India Equity	HDFC Midcap Opportunities
L&T India Value	Kotak Standard Multicap
Moderate	
L&T Midcap	HDFC Midcap Opportunities
ICICI Pru Bluechip	Kotak Standard Multicap

(Note – The portfolio changes will be reflected in the performance from next month)

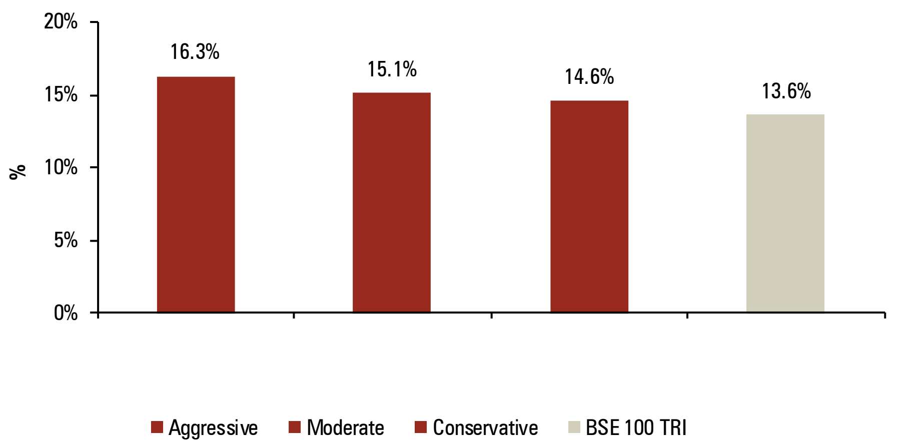
Investors who are wary of investing directly into equities can still get returns almost as good as equity markets through the mutual fund route. We have designed three mutual fund model portfolios, namely, conservative, moderate and aggressive mutual fund portfolios. These portfolios have been designed keeping in mind various key parameters like investment horizon, investment objective, scheme ratings, and fund management.

Exhibit 17: Equity model portfolio

Review Interval	**Monthly**	**Monthly**	**Quarterly**
Risk Return	**High Risk- High Return**	**Medium Risk - Medium Return**	**Low Risk - Low Return**
Funds Allocation		% Allocation	
Franklin India Focused Equity Fund	20	-	-
Principal Emerging Bluechip Fund	-	20	20
HDFC Smallcap Fund	20	20	-
SBI Bluechip Fund	-	-	20
L&T India Value Fund	20	-	-
L&T Midcap Fund	20	20	-
Mirae Asset India Equity Fund	20	20	20
ICICI Prudential Bluechip Fund	-	20	20
Reliance Large Cap Fund	-	-	20
Total	**100**	**100**	**100**

Source: ICICI Direct Research

Exhibit 18: Model portfolio performance since inception



Source: Crisil Fund Analyser, ICICI Direct Research; CAGR performance as on October 31, 2018 since inception, i.e. May 2009

Debt funds model portfolio

What's In	What's Out
0-6 months	
SBI Mag Ultra Short Duration	Aditya Birla SL Savings Fund
0-12 months	
SBI Mag Ultra Short Duration	Aditya Birla SL Savings Fund
0-12 months	
HDFC Corporate Bond Fund	Aditya Birla Sun Life Credit Risk

(Note – The portfolio changes will be reflected in the performance from next month)

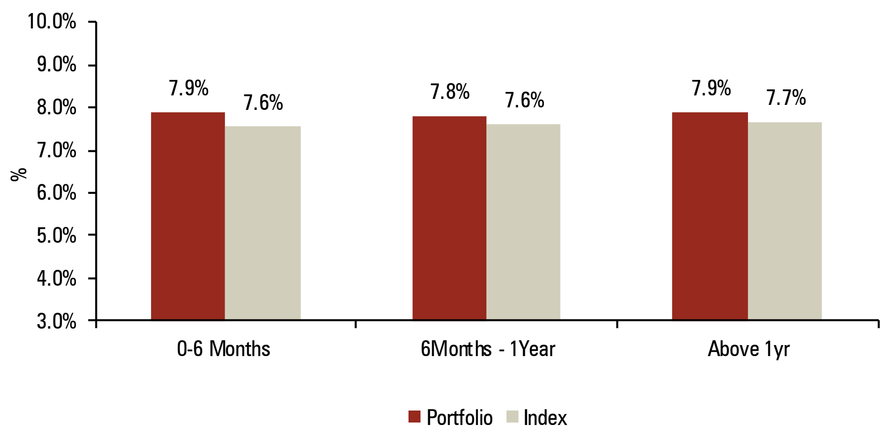
We have designed three different mutual fund model portfolios for different investment duration viz. less than six months, six months to one year and above one year. These portfolios have been designed keeping in mind various key parameters like investment horizon, interest rate scenarios, credit quality of the portfolio and fund management, etc.

Exhibit 19: Debt funds model portfolio

Objective	Liquidity	Liquidity with moderate return	Above FD
Review Interval	Monthly	Monthly	Quarterly
Funds Allocation		% Allocation	
SBI Mag Ultra Short Duration	20	20	
ICICI Pru Savings Plan	20		
Franklin India Ultra Short Bond Fund	20		
Axis Strategic Bond Fund		20	20
Kotak Low Duration Fund	20	20	
Franklin India Corporate Debt Fund			20
L&T Ultra Short Term Fund	20	20	
HDFC Corporate Bond Fund			20
UTI Medium Term Fund			20
L&T Low Duration Fund		20	20
Total	**100**	**100**	**100**

Source: ICICI Direct Research

Exhibit 20: Model portfolio performance since inception



Source: Crisil Fund Analyser, ICICI Direct Research; CAGR performance as on October 31, 2018 since inception, i.e. May 2009

**Index: 0-6 month's portfolio – Crisil Liquid Fund Index; six months-one year – Blended Index with 50% weight to Crisil Liquid Index, 50% weight to Crisil Short Term Bond Fund Index; Above 1 year: Crisil Short Term Bond Fund Index*

Top Picks

Exhibit 21: Category wise top picks

Equity Funds & Equity-oriented Funds	
Largecaps	ICICI Pru Focused Bluechip Fund
	SBI Bluechip Fund
	Reliance Large Cap Fund
Large and Midcaps	DSP Blackrock Equity Opportunities Fund
	IDFC Core Equity Fund
	Principal Emerging Bluechip Fund
Multicaps	HDFC Equity Fund
	L&T India Equity Fund
	Mirae Asset India Equity Fund
Midcaps	Invesco India Midcap Fund
	Kotak Emerging Equity Fund
	L&T Midcap Fund
Smallcaps	L&T Emerging Businesses Fund
	Reliance Small Cap Fund
	HDFC Small Cap Fund
Focused	ICICI Pru Focused Equity Fund
	Franklin India Focused Equity Fund
	Reliance Focused Equity Fund
ELSS	Aditya Birla Tax Relief 96 Fund
	DSP Blackrock Tax Saver Fund
	IDFC Tax Advantage Fund
Aggressive Hybrid	HDFC Hybrid Equity Fund
	ICICI Pru Equity & Debt Fund
	Principal Hybrid Equity Fund

Debt Funds		
Category	Fund	Category Comment
Overnight / Liquid / Ultra Short Term	SBI Magnum Ultra Short Duration Fund	Volatility - low
	Franklin India Ultra Short Bond Fund	Investment horizon - 0-6m
	L&T Ultra Short Term Fund	
Low Duration / Money Market	L&T Low Duration Fund	Volatility - low
	Kotak Low Duration Fund	Investment horizon - 0-12m
	ICICI Pru Savings Fund	
Short Term	HDFC Short Term Debt Fund	Volatility - low
	Aditya Birla SL Short Term Opportunities Fund	Investment horizon - more than 1 year
	L&T Short Term Bond Fund	Credit risk - low
Medium Term	UTI Medium Term Fund	Volatility - medium
	Axis Strategic Bond Fund	Investment horizon - more than 1 year
	HDFC Medium Term Debt Fund	Credit risk - medium
Medium to Long Term / Long Term	Aditya Birla SL Income Fund	Volatility - high
	ICICI Pru Bond Fund	Investment horizon - more than 1 year
	Reliance Nivesh Lakshya Fund	Credit risk - low
Dynamic Bond Fund	ICICI Pru All Seasons Bond Fund	Volatility - high
	UTI Dynamic Bond Fund	Investment horizon - more than 1 year
	IDFC Dynamic Bond Fund	Credit risk - medium
Corporate Bond	Franklin India Corporate Debt Fund	Volatility - low
	HDFC Corporate Bond Fund	Investment horizon - more than 1 year
	Aditya Birla SL Corporate Bond Fund	Credit risk - low
Credit Risk	Franklin India Credit Risk Fund	Volatility - medium
	SBI Credit Risk Fund	Investment horizon - more than 1 year
	Reliance Credit Risk Fund	Credit risk - high
Gilt	IDFC G-Sec Fund - Investment Plan	Volatility - high
	Aditya Birla SL G-Sec Fund	Investment horizon - more than 1 year
	ICICI Pru Gilt Fund	Credit risk - low

(Refer www.icicidirect.com for details of the fund)

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