

# PORTFOLIO

## SAVE SMART

# Why you should invest in index funds

Active large-cap funds have underperformed their benchmarks over the long term

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BL Research Bureau

Index funds have been gaining popularity in the recent times thanks to the underperformance of the actively managed large-cap funds against their benchmarks. The underperformance is now visible in ten-, twelve- and fifteen-year timeframes also, though marginally.

Data shows that the regular plans of actively managed large-cap funds delivered 7.3 per cent and 14.3 per cent compound annualised returns in twelve- and fifteen-year periods, respectively, while the Nifty 50 TRI posted 7.6 per cent and 14.5 per cent

returns, respectively. The other large-cap benchmark, Nifty 100, TRI clocked 8 per cent and 14.9 per cent returns, respectively (see graph).

Large-cap funds are actively managed equity funds investing at least 80 per cent of their assets in the top 100 listed stocks by market capitalisation. They aim to perform better than benchmark due to active management of the portfolio.

On the other hand, index funds are passively managed mutual funds that try to replicate the performance of the underlying benchmark. They imitate the portfolio of an index (say



Index funds can be a better bet for investors ISTOCK

Nifty 50) by investing in stocks that are a part of the Index in the same proportion as in the index. The other variant, Exchange traded funds (ETFs) are also passively managed mutual funds traded on the BSE and the NSE. Investors need demat and broker accounts to buy and sell the ETF units.

Since the actively managed large-cap funds have underperformed their large-cap indices, many financial advisors are suggesting index funds tracking Nifty 50, Sensex and BSE 100 indices to investors instead of large-cap funds.

### Why the underperformance

The move towards TRI-based (Total Return Index) benchmarking in the early 2018, is one of the reasons for this underperformance of the actively managed funds. Normally, TRI returns are about around 1.5 percentage points higher than normal index returns.

The expenses charged by actively managed funds are around 1.7-2.8 per cent, which is higher compared to 0.2-1.2 per cent charged by the passively managed funds. The higher expense ratio eats into the returns in the active funds.

The SEBI's reclassification norms have standardised the allocations in the large-cap funds.

Earlier, significant portion in the actively managed large-cap funds was invested in mid and small cap stocks that spiced-up extra returns. With their hands tied, returns of large-cap funds are declining.

Over the last two years, the returns from Sensex and Nifty were mainly from a handful of stocks. The active large-cap funds which had lower or nil exposure to these stocks lost out as they need to hold a diversified portfolio.

Index funds in India are largely dominated by the institutional players. Flows in to these funds improved after the EPFO and pension funds were allowed to invest in them. The government's divestment plan through ETF route also brought in more flows.

### The kitty

Index funds can be a preferred option for investors wanting index linked returns. Investors new to equity market can also consider opting the index funds route.

Currently, there are 32 index funds available in the market. You have a wide choice of index funds based on the broader in-

dices, including Nifty 50 (15 funds), Sensex (5), Nifty Next 50 (4), Nifty 100 Equal Weighted index (2). Banking sector, mid-cap, small-cap and Nifty 500 index funds are also part of offering.

Apart from the returns, the efficacy of index funds is measured through the Tracking Error (TE), which measures how closely an index fund tracks its chosen index. In simple language, TE is the difference in returns between an index fund and its benchmark. Index funds with lower TE are preferred choices.

Under the index funds tracking Nifty 50 index, the index funds with lower TE are SBI Nifty Index, Franklin India Index Fund-NSE Nifty and IDFC Nifty Fund. Under Sensex index funds, HDFC Index Fund-Sensex and Tata Index Fund-Sensex Plan have closely tracked their benchmark. IDBI Nifty Junior Index and ICICI Pru Nifty Next 50 Index Fund are the preferred index funds that track Nifty Next 50 index.

### Index funds versus ETFs

Index funds score over the ETFs on various counts. First, liquidity has been a major issue when trading in ETFs. But index funds are directly bought and sold from the AMC hence liquidity would not be an issue. Demat and broker accounts are mandatory while transacting

in ETFs on the exchange. But, buying an index fund is like buying any mutual fund. Investors in ETF's pay brokerage costs (on buying and selling) in addition to the expense ratio which lead to higher total cost of ownership in ETFs. Normally, there is no such cost included in the index funds other than expense ratio.

Systematic Investment Plan (SIP) is not allowed in ETFs. SIP is allowed in index funds.



### How they score

- No liquidity issue
- Demat and broker accounts are not mandatory
- SIP is allowed

### The advantage

Index funds are passively managed mutual funds that try to replicate the portfolio and performance of the underlying benchmark

## Meaningful



**Standstill agreements:** MFs enter into these pacts with promoters to not sell the pledged shares for a certain period even when default occurs

## Investment alert

### Mobile banking for PO accounts

The Department of Posts (DoP) recently launched a mobile banking facility for post office savings accounts. Eligibility criteria includes having savings account in post office and valid login and transaction credentials for internet banking. DoP, about a year back, had launched internet banking facility for its savings account customers.

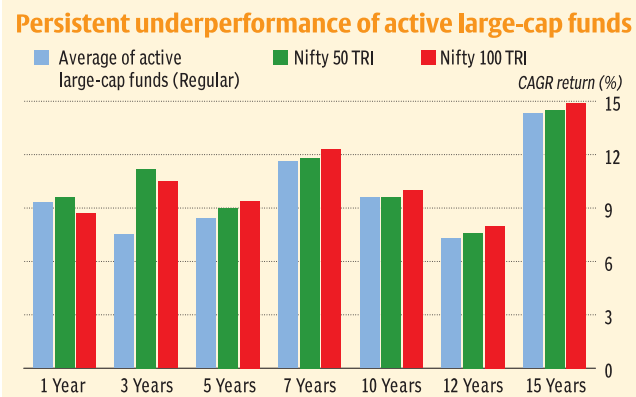
Eligible account holders can apply for the facility at any head/sub post office, but not in branch offices. Once the duly-filled form is submitted, the mobile banking facility will be enabled after 24 hours.

One can download the 'India Post Mobile Banking' app from Google Play store. Note that unique mobile number should be submitted by each customer and the same should not be used by any other for the mobile banking facility.

## Coming Up



- Friday** (Oct 18)
  - Credit cards
- Tuesday** (Oct 22)
  - Insurance



### Worth a look

Scheme	Corpus	Expense	Return (CAGR) (%)				Tracking
	(₹ cr)	ratio (%)	1-Year	3-year	5-year	7-year	error (%)*
NIFTY 50 - TRI							
SBI Nifty Index Fund	430	0.7	1.6	7.5	6.5	9.3	0.02
Franklin India Index Fund-NSE Nifty	266	1.1	1.2	7.0	6.3	9.3	0.02
IDFC Nifty Fund	170	0.3	2.0	8.0	7.1	10.2	0.04
NIFTY NEXT 50 - TRI							
IDBI Nifty Junior Index Fund	50	1.1	-2.2	2.8	8.4	12.1	0.03
ICICI Pru Nifty Next 50 Index Fund	582	0.9	-2.4	3.6	9.1	12.7	0.08
S&P BSE SENSEX - TRI							
HDFC Index Fund-Sensex	468	0.3	3.6	9.4	7.4	10.6	0.01
Tata Index Fund-Sensex Plan	11	0.5	3.8	9.1	6.8	9.8	0.03

\*Daily Tracking Error is calculated from the last three years NAV history

Source: ACEMF, NAVINDIA

# BANKING

## Federal Bank Q2 profit surges 56%

### OUR BUREAU

Mumbai, October 16

Private sector lender Federal Bank posted a 56.6 per cent rise in net profit at ₹416.70 crore in the second quarter of the fiscal, led by strong growth in income and lower bad loans. Its net profit was ₹266.04 crore in the same period a year ago.

For the July to September 2019 quarter, its total income grew by a robust 19.02 per cent at ₹3,675.15 crore, against ₹3,087.81 crore in the same period a year ago.

### Net interest income

The bank earned a net interest income of ₹1,123.77 crore for the quarter ended September 30, which was a near 10 per cent increase from ₹1,022 crore a year ago. Net interest margin at 3.01 per cent, as on September 30, was slightly lower than the

3.1 per cent a year ago. "This has been the highest-ever net profit," said Shyam Srinivasan, Managing Director and CEO, Federal Bank.

The bank's gross non-performing assets amounted to ₹3,612.11 crore at the end of the September quarter this fiscal, which, as a percentage of gross advances, stand was 3.07 per cent. This is marginally better than the 3.11 per cent it posted a year ago.

Provision coverage ratio (including technical write-offs) was 66.16 per cent. Taking advantage of the reduction in corporate tax rates, Federal Bank's tax expense in the second quarter of the fiscal came down to ₹50 crore from ₹142.74 crore a year ago.

The bank's scrip closed 2.78 per cent, lower at ₹82.15 apiece on the BSE on Wednesday.

## Marsh India to buy JLT Independent Insurance Brokers

### OUR BUREAU

Mumbai, October 16

Marsh India Insurance Brokers has reached an in-principle agreement to acquire JLT Independent Insurance Brokers.

"The transaction, which is subject to regulatory approvals and the execution of a definitive purchase agreement, is expected to close in the first quarter of 2020," Marsh India said in a statement on Wednesday, adding that this follows the acquisition of JLT Group by Marsh & McLennan Companies, which was completed on April 1. JLT Independent has appointed Mohit Agarwal as its CEO. Agarwal was previously the Employee Health and Benefits Leader at Marsh India.

Alex MoczarSKI, Chairman of Marsh and McLennan International, and Chairman of the Board of Marsh India, said: "This combination of Marsh India and JLT Independent will enable us to bring the very best global expertise to clients across India."

## Aadhar Housing Finance targets ₹4,000-cr disbursements in FY20

### SURABHI

Mumbai, October 16

Shrugging off the problems it had with its previous promoter, Aadhar Housing Finance is now upbeat about its future prospects and expects to see higher disbursements from this month.

"We expect the loan book to grow 25 per cent to 26 per cent and disbursements to increase by about 20 per cent this fiscal. We will be better than last fiscal, but I can't say if I will meet my business plan, which was made about five years ago," said Deo Shankar Tripathi, Managing Director and CEO, Aadhar Housing Finance.

Faced with the liquidity crisis after the default at IL&FS and troubles at Wadhawan Global Capital and DHFL, Aadhar saw negative growth in disbursements last fiscal, although its loan book grew by about 26 per cent over 2017-18. Speaking to *BusinessLine*,

Tripathi said it expects disbursements of about ₹4,000 crore this fiscal, which, otherwise, would have been at ₹6,000 crore. Total disbursements by the company amounted to ₹3,192 crore last fiscal.

"The growth we had in 2016-17 or 2017-18 may not be there as it is only after June 2019 that we were able to start out business."

"We will start full scale business from this month. We are fine," Tripathi stressed, noting that many smaller HFCs are still finding it difficult to raise funds.

Aadhar had about ₹9,000 crore of assets under management in September last year, and was able to sell its pool to banks, honour commitments and make disbursements.

"Aadhaar did ₹1,400 crore of disbursements between October 2018 to March 2019, and that was entirely funded by the sale of pool and the re-

finance from NHB," said Tripathi.

### Economic slowdown

With the ongoing economic slowdown, there is also some strain on repayments by borrowers and a marginal increase in delinquencies, he noted. "Till now, our NPA and delinquency have been well in control, but from April onwards, I am seeing some distress," he said. Aadhar had reported retail gross NPAs of 0.58 per cent last fiscal.

With its sale to private equity major Blackstone, the affordable housing player now has a comfortable capital position. Tripathi said that Blackstone infused ₹800 crore of primary equity on June 11 this year, a day after the management control was transferred to Blackstone.

"So, on June 11, the company's leverage or debt equity ratio came down to 3.5 per cent," he said.

## Mastercard aims to up its game on 'contactless' cards in India

### KR SRIVATS

New Delhi, October 16

Mastercard, a technology company in the global payments industry, will soon up its game on 'contactless' (tap and go) cards in the Indian market, a top official said.

"You will soon see bit more action on 'contactless' cards," Manasi Narasimhan, Vice-President, Marketing and Communications, Mastercard, told *BusinessLine* on Wednesday.

To begin with, the focus will be on getting more retail chains, including big supermarkets, adopt contactless cards, she said.

"Contactless will be a focus area for us in the Indian market. The reason we are investing in this is that given our global experience in other markets, we believe that once contactless becomes a behaviour changing tool, it will transform the ecosystem. It may take two years, three years or even five years, but

eventually we will get there," she said. Mastercard is already nudging its partner banks to issue more contactless cards, said Manasi. Both the government and the RBI also want more such cards to be issued.

Across the world, contactless cards (those with near-field communication capabilities) have proven to be a significant catalyst in improving consumer stickiness for digital payments. With more banks currently issuing contactless cards, Indian consumers are now experiencing a faster way to pay at supermarkets, dining, entertainment venues, and retailers.

Transit has been Mastercard's most successful use case worldwide. Recently, Mastercard became the preferred partner for Singapore metro.

With more Indian affluent travelling abroad throughout the year, Manasi said that efforts would be taken to drive the usage of Mastercard during their overseas trips.

# SBI Life delivers strong performance

## ANALYSIS

### RADHIKA MERWIN

BL Research Bureau

Strong growth in new business premium, improvement in value of new business (VNB) margin and management's continual focus on product diversification have kept SBI Life's performance in good stead in the latest September quarter.

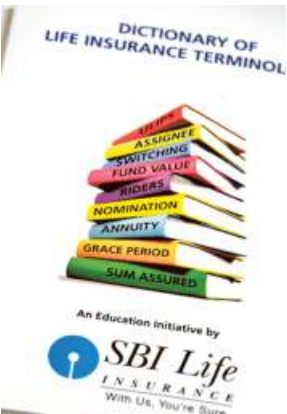
The life insurer reported growth in gross written premium (GWP) and new business premium (NBP) of 36 per cent and 40 per cent, respectively, in the first half of FY20, led by protection, annuity and individual non-par savings businesses.

While SBI Life's expansion in VNB margins, aided by health-

ier product mix and improvement in market share within private players are key positives, the insurer's profit after tax was impacted by new business strain and provision of about ₹70 crore for diminution in the value of investments in shareholder's account.

Of the ₹70-crore provision, ₹67 crore pertained to DHFL exposure. As a result, SBI Life's net profit declined by 48 per cent y-o-y to around ₹130 crore in the latest September quarter.

Nonetheless, product diversification, leadership position, strong distribution network, and improvement in cost efficiencies are key positives that augur well for the stock over



the long run. SBI Life continued its focus on the protection business, and grew the business at a healthy clip in the September quarter, aiding margins.

Its protection new business premium increased by 59 per cent y-o-y in the first half of FY20 and share of protection NBP has inched up from 11 per

cent last fiscal to 12 per cent as of September quarter. This has aided the robust 33 per cent growth in VNB, with 100 basis points expansion in VNB margin in the first half of FY20.

Driving VNB is important for life insurance players. Since premium payments for life insurance policies are typically spread out over by a period of time, cost of new customer acquisition is high, leading to new business strain in the year of sale.

Hence, VNB is a key measure to assess the financial performance of insurers.

VNB is essentially a measure that values future profit streams of the new business written during the year.

SBI Life's 100 basis point improvement in VNB margin was led by 400 basis points improvement from change in product mix, offset by 300

basis points negative impact from fall in interest rates.

### Some concerns

In the September quarter, SBI Life's profit was impacted by the provision for diminution in the value of investments - ₹67 crore pertained to DHFL exposure, which is 48 per cent of its exposure to the housing finance player. The rest would be provided for in the subsequent quarters.

SBI Life has exposure of ₹380-400 crore to stressed companies such as Indiabulls Housing and YES Bank, which are standard accounts as of now. The management is looking to reduce pricing in its term plan to be more competitive.

While this would lead to loss in VNB margins, the management expects this to be partially offset by increase in volumes.

## Short-term outlook weak for rupee

## CURRENCY CALL

### AKHIL NALLAMUTHU

BL Research Bureau

The rupee, which had been holding between 70.75 and 71.4 against the dollar since the beginning of October, came under considerable selling pressure from the beginning of this week. On Wednesday, it closed at 71.43.

The rupee is the weakest Asian currency this month and year-to-date the currency has declined by 2.4 per cent against the dollar. This was despite FPIs pumping money into the financial markets.

Until October 16, they have made net investments of ₹2,799 crore in the equity segment but net sold ₹566 crore in the debt segment. Thus, the combined net investments stand at a positive ₹2,238 crore. The rupee came under pres-

sure when the World Bank cut India's growth forecast for the current fiscal to 6 per cent and the IMF slashed the projections to 6.1 per cent for 2019. The weak India Industrial production data, which registered a de-growth of 1.1 per cent for August, too, weighed on the rupee.

The trade balance data provided some relief for the domestic currency, as the trade deficit for September came in at \$10.86 billion, against \$14.95 billion in the same month of the previous year.

Also, the CPI increased to 3.99 per cent for September, against 3.7 per cent in the same period last year. But there was a significant reduction in WPI as it came at 0.33 per cent for September, versus 5.22 per cent for the corresponding month last year.

There was some relief fol-

lowing the initial phase of trade talks between the US and China. The prevailing geopolitical unease in West Asia may keep the dollar demand intact on the back of its safe-haven status.

The dollar index is currently trading above a crucial support of 98. If the index breaks below that level, it could face some pressure, possibly correcting to 97 levels. On the upside, the index faces resistances at 99 and 100 - an important psychological level. An appreciation in the dollar index could impact the rupee negatively.

By studying the chart of the rupee, one can safely assume that the short-term outlook has turned weak for the rupee, as it has breached a key support at 71.4, breaking below the range between 70.75 and 71.4.

This increases the chance for further depreciation.