70-80% active large-cap funds underperform benchmarks

2022 INERTIA: Weak returns from minority allocation in small- and mid-caps, limited Adani exposure

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Most active large-cap mutual fund (MF) schemes underperformed their benchmarks in 2022 owing to a range of reasons — from underperformance of their minority allocations in mid- and small-caps to limited-to-nil exposure in Adani Group stocks which were among the top performers in large-cap benchmarks last year, observed investment advisors and analysts.

An analysis of Value Research data shows that 83 per cent of active large-cap funds underperformed the S&P BSE 100 Total Returns Index (TRI) and 69 per cent failed to beat the Nifty 100 TRI. The two large-cap indices went up 6 per cent and 5 per cent, respectively, last year, according to *Bloomberg* data. This implies that 83 per cent of active large-cap funds delivered less than 6 per cent last year.

"In 2022, most returns came from select stocks — and Adani Group shares were among them. The high dispersion in returns is bound to negatively impact diversified active funds. Also, active large-cap funds can invest up to 20 per cent in mid- and small-cap stocks. This allocation creates a drag on returns when mid- and small-cap stocks underperform large-caps. Lastly, the higher expense ratio of active funds also weighs on returns," says Vishal Dhawan, founder and chief executive officer, Plan Ahead Wealth Advisors.

Adani Group stocks were among the leading performers in the large-cap space. The Nifty 100 has five Adani Group companies in Adani Ports and Special Economic Zone, Adani Enterprises, Adani Transmission, Adani Green, and Adani Total Gas. Together, they have a weighting of 3.8 per cent on the index at present.

Two of these companies — Adani Power and Adani Enterprises — delivered over 150 per cent returns last year.

However, most MFs went with nil-to-light exposure in these stocks due to steep valuations and high debts.

"The concern has been mostly on the valuation side. As fund managers, we have to go by the set process and at least in our case, Adani Group stocks didn't make the cut," says a fund manager.

"The underperformance could also be due to a change in stock market trend in 2022. Growth as a strategy was doing much better than value for several years but that trend reversed in 2022. Many fund managers continued with the growth strategy, leading to their underperformance," he adds.

Record selling by foreign investors could also have gone against the investment plan of active fund managers, believes Vijai Mantri, chief mentor and co-promoter, JRL Money.

"Some of the good large-cap stocks expected to outperform failed to do so due to indiscriminate selling by foreign investors. Active fund managers were overweight on these companies and one cannot fault them for it," says Mantri.

Comparatively, 2021 was much better for active large-cap fund managers. Over 62 per cent of schemes had outperformed the S&P BSE 100. In 2020, 55 per cent succeeded at it, while in 2019, only 32 per cent of schemes had outperformed.

In the past few years, experts have highlighted that room to generate alpha (outperformance over benchmark) in the large-cap space is diminishing, with rising efficiency in the market.

According to market observers, the large-cap space is where the interest of large institutional players, including foreign portfolio investors, is concentrated. As a result, there is little information asymmetry or the possibility of making outsized gains.

This trend has led to an increase in the popularity of exchange-traded funds (ETFs) and index funds. Since March 2020, the average assets under management of index funds and ETFs has nearly quadrupled to ₹6.5 trillion (as of November 2022), shows data from the Association of Mutual Funds in India.

However, even a lot of passive funds trail their benchmarks, albeit at a much lower margin.

In 2022, 44 per cent of the Nifty50 and Sensex index funds and ETFs delivered at least 20 basis points lower than their indices — Nifty 50 TRI and Sensex TRI.

ILLUSTRATION: BINAY SINHA

ETFs LEAD THE LONG-TERM RACE

Four of the top five best-performing large-cap funds are passive

Fund	5-year return (% CAGR)
Canara Robeco Bluechip Equity Fund	14.62
HDFC S&P BSE Sensex ETF	13.52
LIC MF S&P BSE Sensex ETF	13.52
SBI S&P BSE Sensex ETF	13.52
ICICI Prudential S&P BSE Sensex ETF	13.51

CAGR: Compound annual growth rate, returns as on December 30, 2022

Source: Value Research