2 sectoral mutual fund categories offer 23% return each in five years. Should you invest

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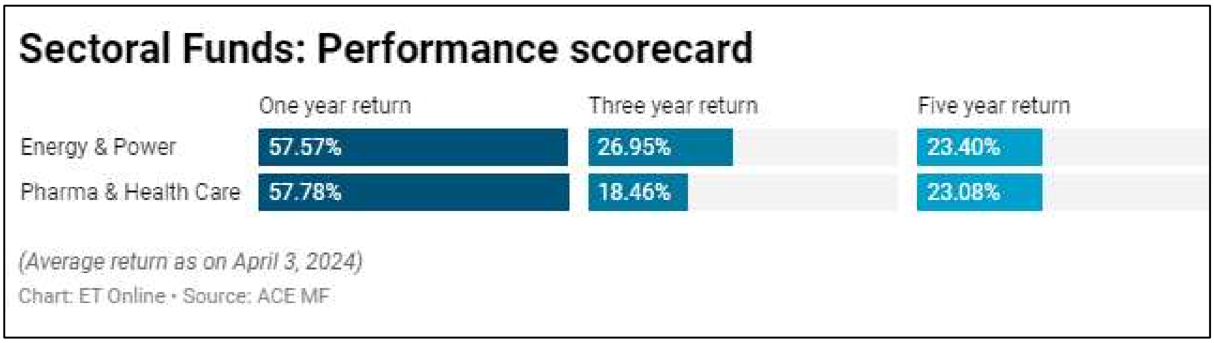
Two sectoral mutual fund categories delivered average returns of around 23% each in a five-year period, an analysis of performance by the categories showed.

Energy & power based mutual funds gave an average return of 23.40% in five years (April 2019-April 2024). There were around three schemes in the category that completed five years of existence. Nippon India Power & Infra Fund gave 26.35% return. Tata Resources & Energy Fund and DSP Natural Resources & New Energy Fund gave 22.87% and 20.98% returns respectively in the same time period.



The other sectoral category that gave 23% return in five years was Pharma & Health Care sector-based funds. These funds gave an average return of 23.08% return in a five-year period. There were eight schemes in the category that completed five years in the market. DSP Healthcare Fund, the topper in the category, gave 25.82% in five years. LIC MF Healthcare Fund gave the lowest return of 19.01% return in five years.

Are you wondering what factors contributed to this performance by both the categories? “The Pharma sector has outperformed on the back of a stable pricing environment in the United States. Valuations in the pharma/healthcare sector are currently trading at a forward PE multiple that is well above long term averages. Energy and Infrastructure mutual funds have performed well as a result of both an increase in order books and capex spending from the government,” said Vishal Dhawan, CEO, Plan Ahead.

The two categories gave similar returns in one year (April 2023 to April 2024) period as well. Both the categories offered 57% each in the said period. Energy & power funds gave 57.57% return and pharma & healthcare funds gave 57.78% return on a one-year trailing return basis. In a three-year horizon (April 2021 - April 2024), energy & power funds and pharma & healthcare funds gave 26.95% and 18.46%, respectively.

However, looking at the one-year performance by these two categories, and getting excited about making investments? Should you invest? “Thematic or sectoral funds should be a part of portfolios only if investors have a higher risk tolerance and an investment horizon of 10+ years,” recommends Dhawan.

He adds, “It is very important to get cycles right whilst investing in a thematic fund as there may be a prolonged period of underperformance if the timing is incorrect. As a result, we recommend limiting exposure to 10% of the overall portfolio to a theme. Sectoral/thematic funds should be in the satellite part of a portfolio, and one should consider profit booking in themes/sectors that are trading in excess valuations.”

Energy and power funds are benchmarked against S&P BSE Oil & Gas Index, Nifty Infrastructure Fund, and Nifty Commodities - TRI which gave 13.63%, 22.95% and 20.93% respectively in five years.

Pharma and healthcare funds are benchmarked against S&P BSE HealthCare - TRI, and NIFTY PHARMA - TRI which gave 20.75% and 16.51%, respectively.

What strategy should one follow? “If we look at current valuations both energy and power are also trading above their long-term forward earnings. Thus, we would suggest caution for investors looking to add to both these sectors now,” says Vishal.

Note, we considered regular and growth options. The returns for a five-year horizon were calculated from April 2019 to April 2024.

One should always make investment decisions based on risk appetite, investment horizon, and goal.