NFO Insight: Does it make sense to add DSP Nifty Private Bank Index Fund to your portfolio now? Experts offer help.

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DSP Mutual Fund's new fund offers or NFO of DSP Nifty Private Bank Index Fund is open for subscription and will close on February 28. The scheme is an open-ended scheme replicating/tracking the Nifty Private Bank Index aiming to provide investors with a focused approach to investing in the private banking sector.

The scheme will reopen for continuous sale and repurchase on March 10. The investment objective of the scheme is to generate returns that are commensurate with the performance of the Nifty Private Bank Index, subject to tracking error.

The scheme will be benchmarked against Nifty Private Bank TRI (Total Returns Index) and will be managed by Anil Ghelani and Diipesh Shah.

Fund house comment on launch: Investors can choose between lump-sum investments or systematic investment plans (SIPs) to align with their financial goals. Investors who are bullish on the banking sector can invest in this fund, whose concentrated approach gets them exposure to the four largest private banks which comprise approximately 80% of the index.

The fund house believes that the concentration of larger banks within the Nifty Private Bank Index can be an advantage. Customers tend to trust and prefer larger banks more than other smaller peers. This facilitates higher credit growth, better access to capital and economies of scale – thereby helping these banks sustain and grow further.

Fund managers take on fund: We believe the concentration of larger banks within the Nifty Private Bank Index can be an advantage, mirroring global trends where leading banks tend to demonstrate sustainable growth due to customer trust, access to capital, and economies of scale. This fund offers investors a streamlined approach to participate in the potential of India's private banking sector," said Anil Ghelani, CFA, Head of Passive Investments & Products at DSP Mutual Fund.

"The DSP Nifty Private Bank Index Fund presents a tax-efficient way to access the private banking sector unlike investing directly in these stocks, as owning through a mutual fund does not incur capital gains tax while rebalancing between them or on receipt of dividends. Furthermore, current valuations of several index constituents are below their historical averages, potentially offering investors an attractive entry point," said Diipesh Shah, Fund Manager at DSP Mutual Fund.

Does it make sense to allocate: Experts typically ask investors to avoid investing in NFOs unless they offer something unique. The uniqueness could be that the scheme is offering an investment option that is not available in the market or offering something extra to an existing option. Otherwise, the experts believe investors are better off with an existing scheme with a long performance record. This is because you have some historical data to base your investment decision. You don't have any data when it comes to new offering.

According to an expert, private banks are trading at an attractive valuation compared to their long-term averages and adding a private bank fund in the portfolio can be a contrarian call and a good addition to the portfolio.

"Private Banks are trading at an attractive valuation compared to their long-term averages. The Gross nonperforming assets and net nonperforming assets have been on a declining trend which is a positive for the sector. The banking sector has relatively underperformed compared to other sectors in the recent rally. Within the banking sector Private sector banks has underperformed PSU banks, and thus adding a private bank fund in the portfolio can be a contrarian call and a good addition to the portfolio. The private banking sector is currently trading at a forward P/B ratio of 2.2x, below the Nifty 50's forward P/B of 3.2x and the sector's last 10 years averages," said Vishal Dhawan, CEO of Plan Ahead Wealth Advisors, a wealth management firm in Mumbai.

Though another expert is optimistic about the private bank sector but recommends refraining from investing in sectoral and thematic based funds as they are highly concentrated in a single sector.

“DSP Nifty Private Bank Index is a passive sectorial fund that aims to replicate the composition of the underlying index, which is the private bank index. Investing in passive funds is not recommended as they tend not to generate the alpha, and that too investing in the passive sectorial fund will come with additional risk as passive funds will follow the portfolio of the underlying index, whereas the underlying index will rebalance its portfolio only once in six months, this will restrict investor to stay invested the stocks for a long while even if they are underperforming,” recommends Chethan Shenoy, Director & Head - Product & Research, Anand Rathi Wealth Limited.

“However, we are optimistic about private bank sector and banking theme, but we don’t recommend investing in sectorial/thematic-based funds as they are highly concentrated to single sector, this will increase the performance risk associated with particular single sector and sectors will always undergo cyclical performance so investors need to take tactic calls to make timely entry and exit to ride the sector, which is not suitable regular investors,” he added.

According to Dhawan, the recent underperformance of the private banks is attributed to factors like reduced credit growth due to rising inflation and interest rates and as inflation falls and demand picks up, these concerns are expected to ease. Historically the banking sector has outperformed Nifty 50 on a rolling return basis and a potential turnaround is expected in the coming quarters and in the last 5 years the BFSI sector has underperformed the Nifty 50 by approximately 4% per annum, he added.

“Early signs of recovery can be seen in Q3 results where banks in the sector continue to have adequate capital adequacy ratios and for Q3FY25, the earnings of Private banks were better than expected with NPAs are at a multi-year low. With the government trying to push urban consumption it is expected that this could trigger an increase in credit growth with higher loans being disbursed and private banks could gain: Private banks are at a favourable valuation providing a margin of safety,” Dhawan further added.

Apart from DSP Nifty Private Bank Index Fund, there is only one existing fund following this index. UTI Nifty Private Bank Index Fund was launched on September 20, 2024, and in the last four months the scheme has lost around 5.28%. There are four ETFs based on Nifty Private Bank, and all of these have delivered negative returns in the five-to-six-month period.

Allocation and strategy to follow: With the other options available in the same category but not having a long track record and this new fund launching, experts recommend investing a lumpsum provides immediate and full exposure and can lead to substantial gains if the sector performs well. However, those with less conviction can opt for SIP or STP as its better approach to mitigate volatility.

“These funds are often launched at sector peaks, increasing the risk of entering just before underperformance. If you choose to invest in sectoral or thematic funds, stick to small allocations of not more than 8-10% of the portfolio. For less experienced investors with limited research capabilities and low risk tolerance, diversified equity funds like a flexi cap may be a safer choice to ensure consistent returns across market cycles,” recommends Dhawan.

“Investing a lump sum provides immediate and full exposure to the chosen sector or theme, which can lead to substantial gains if the sector performs well shortly after the investment. However, this requires precise market timing and may not work during volatile markets thus when an investor has high conviction in the sector may enter through a lumpsum investment. While those with less conviction can opt for an SIP or STP as it’s a better approach to mitigate market volatility,” he further advises.

According to Chethan Shenoy, investors can consider investing in active diversified equity funds which gives exposure across the range of categories, sectors and market caps and investors can diversify the portfolio various equity mf categories like value funds, contra and focused which will enhance the diversification and reduce the performance risk associated with any single sector or theme.

One should always choose a scheme based on risk appetite, investment horizon, and goals.