REVIEW OF RESEARCH

IMPACT FACTOR : 5.7631(UIF) UGC APPROVED JOURNAL NO. 48514 ISSN: 2249-894X

VOLUME - 8 | ISSUE - 5 | FEBRUARY - 2019

SECTOR-SPECIFIC MUTUAL FUNDS IN INDIA: A STUDY ON THE PERFORMANCE OF 'DIRECT PLANS' OF BANKING FUNDS

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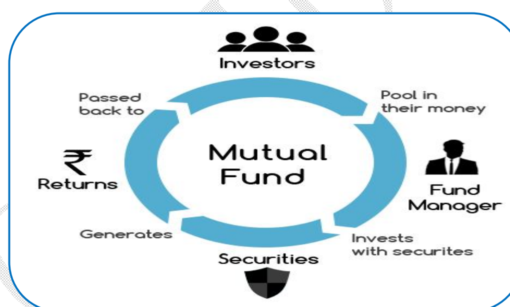
ABSTRACT :

Sector-specific funds are volatile as their investments are very narrow and concentrated. Since the investment is focused mainly on one sector, the risk is definitely higher. Therefore, sector-specific funds generally attract risk-takers who are aggressive. These funds are for savvy and seasoned investors who are familiar with equities and understand the unique investment proposition offered by such funds. 'Direct Plan' has a lower expense ratio than the 'Regular Plan' because of the non-involvement of the intermediaries. As a result, the returns from the 'Direct Plan' are on the higher side than that of the 'Regular Plan' due to the absence of the intermediary commission. But investment in the 'Direct Plan' requires substantial skill and knowledge.



In this background, the main objective of this research paper is to examine the performances of 'Direct Plans' of four banking sector funds, namely, Aditya Birla Sun Life Banking and Financial Services Fund (ABSLBFSF), ICICI Prudential Banking and Financial Services Fund (ICICIPBFSF) Reliance Banking Fund (RBF), and UTI Banking and Financial Services Fund (UTIBFSF) from the perspective of different parameters like risk, return, aggressiveness, diversification, stock-picking skills of the fund managers etc.

Results reveal that all the funds are inclined heavily towards equity. ICICIPBFSF, ABSLBFSF and RBF outperformed the benchmark index and UTI underperformed the benchmark during the study period in terms of return (CAGR). RBF is the least risky fund and ABSLBFSF remains the riskiest amongst the chosen funds. ABSLBFSF, ABSLBFSF and RBF outperform the benchmark index in terms of risk-adjusted return. But UTIBFSF underperforms the benchmark index during the period of study. The chosen funds are defensive or conservative in nature with respect to the benchmark index. The chosen funds are adequately diversified within the sector. The fund managers of the chosen funds are successful in picking quality stocks. Overall, ICICIPBFSF is the best performing fund followed by RBF, ABSLBFSF and UTIBFSF.

KEYWORDS : Banking Sector Funds, Direct Plan, Diversification, Sector-Specific Funds, Stock-Picking Skills. (JEL Code: G11, G23)

1. INTRODUCTION

When a retail investor invests money through a mutual fund, he wants, above all, security and returns. Sector-specific funds, because of their high risk and volatility, have not found favour in the columns of most analysts. According to experts, diversified funds work well for retail investors. Various macroeconomic and microeconomic factors determine the fate of different sectors. However, these

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fluctuations get ironed out in the long term. Investors should keep in mind that sector-specific funds carry a higher risk than diversified or balanced funds. Identifying relevant sectors requires specific market experience and expertise.

The first sector-specific fund was launched in the year 1999 by Kothari Pioneer and it was a technology fund. The initial performance of the fund was good but it got a deadly blow in 2000-2001 because of the burst of the dotcom bubble. Many people suffered a huge loss but at the same time, the savvy investors made a good amount of profit since they were able to exit before the crash. This is the reason why sector-specific funds are still popular, at least to a particular type of investors.

Sector-specific funds are volatile as their investments are very narrow and concentrated. Since the investment is focused mainly on one sector, the risk is definitely higher. In good times, such funds have the potential of delivering fantastic returns to investors. But in bad times, these funds may lead to, possibly, even bigger losses. Therefore, sector-specific funds generally attract risk-takers who are aggressive. These funds are for savvy and seasoned investors who are familiar with equities and understand the unique investment proposition offered by such funds. These investors know when to enter into and when to exit from sector-specific funds. First-timers should begin with diversified equity funds.

Sector funds are so much focused on a particular sector that they give up broad diversification and some of these funds can be as volatile as individual companies. The names of narrowly focused sector funds often appear in the list of the quarter's best and worst performers. Moreover, their returns do not move in sync with the market. "Dollar Cost Averaging" through gradual or systematic buying over times can work well for these volatile funds (Fredman & Wiles, 1997)

According to "core" and "satellite" concept, less volatile funds like diversified equity funds are called core funds whereas sector-specific and thematic funds are known as satellite funds. In the opinion of some experts, one can add sector funds in one's portfolio depending upon one's risk appetite to add some aggression in the overall portfolio.

The main characteristics of sector-specific funds can be summed up as follows:

(a) Sector-specific funds are equity funds.

(b) Sector-specific funds are open-ended funds in the sense that one can enter into or exit from the funds at any point of time.

(c) Such funds are tax-efficient. If the units of such funds are held for more than 12 months, the gains arising from such funds are treated as "Long-term Capital Gains" (LTCG) which are tax-free to the extent of Rs. 100,000 in the hands of the investors in a financial year. LTCG in excess of Rs. 100,000 is taxable at the rate of 10% without the benefit of indexation. The Government introduced this in Budget 2018. But if equity funds are held for a period less than 12 months, gains from such funds are treated as "Short-term Capital Gains" (STCG) and are taxable @15% plus 4% education cess on them.

(d) Sector-specific funds are volatile and hence these are riskier.

(e) Sector-specific funds are suitable for investors having high risk-appetite.

2. BRIEF SURVEY OF LITERATURE

Sundar (2014) opined that investment in banking sector funds is the best avenue which guarantees stable return with medium risk when compared to other sectors. **Ward (2014)** cautioned investors that they should approach these funds with care because these funds can differ widely in strategy. **Adajania (2014)** stated that sectoral and thematic funds are the riskiest of all mutual fund schemes. A sector fund is riskier than a thematic fund because the former's performance depends on the fortunes of just one to three sectors. A thematic fund is less risky comparatively as its fortune is dependent on many sectors. **Bose (2018)** opined that sector funds could be a great long-term investment option for investors. Further, sector funds can be risky in the medium-term period of 3-5 years but such funds have the potential to enhance portfolio returns over a longer time frame. **Rustagi (2018)** opined that as a thumb rule if one has a decent exposure to equity funds and is conversant with equity markets, around 10-15% of one's portfolio can be invested in the

sector and thematic funds. The key is to select funds carefully and keep an eye on the progress over the investment period. Besides, one must review one's portfolio to ensure that one is not invested in a sector/theme that already has a sizeable exposure through other funds. Moreover, one should have the capacity to hold these funds for the longer term, if required and must curb the urge to switch from one sector/theme to another.

There is a dearth of comprehensive study of sector-specific funds in general and Banking sector funds in particular in the Indian context. The present research paper attempts to fill in the void.

3. OBJECTIVE OF THE STUDY

The main objective of this research paper is to examine the performances of 'Direct Plans' of four banking sector funds, namely, Aditya Birla Sun Life Banking and Financial Services Fund (ABSLBFSF), ICICI Prudential Banking and Financial Services Fund (ICICIPBFSF) Reliance Banking Fund (RBF), and UTI Banking and Financial Services Fund (UTIBFSF) from the perspective of different parameters like risk, return, aggressiveness, diversification, stock-picking skills of the fund managers etc.

4. DATA AND METHODOLOGY

The study is based on secondary data which have been obtained from journals, periodicals, books, magazines, dailies and web materials. The period of study is from January 2015 to January 2019. Here, those funds are selected which have AUM of more than Rs. 650 crore as on 8th February 2019. Only actively managed funds are taken into consideration for the purpose of this study. In other words, index funds or passively managed funds are not considered in this study. Four funds satisfy the above norm. All of these funds are taken into account for the purpose of the study. "Growth" option of the chosen funds has been considered, and not the "dividend" option. The impact of exit load, brokerage, taxes, and inflation has not been considered. The month-end NAVs of the funds have been obtained from the official website of the AMCs and from bluechipindia.co.in. BSE Bankex has been taken as the benchmark index. The month-end closing values of the benchmark index have been obtained from the official websites of the Bombay Stock Exchange (BSE). The monthly returns of the funds (R_p) and that of the benchmark (R_b) have been calculated in the following manner:

$$\mathbf{R_p = [(NAV_t - NAV_{t-1}) / NAV_{t-1}] *100}$$
$$\mathbf{R_b = [(Value_t - Value_{t-1}) / Value_{t-1}] *100}$$

Where, NAV_t = Closing NAV of the fund for month t, NAV_{t-1} = Closing NAV of the fund for the preceding month (t-1), $Value_t$ = Closing Value of the Benchmark Index for month t, $Value_{t-1}$ = Closing Value of the Benchmark Index for the preceding month (t-1).

Annualised Standard Deviation of the funds (SD_p) and that of the benchmark (SD_b) have been computed to examine total risk. Compounded Annual Growth Rate of the funds ($CAGR_p$) and that of the Benchmark ($CAGR_b$) have been computed in the following way:

$CAGR_p = [(\text{Closing NAV} / \text{Opening NAV})^{(1 / \text{Number of years})} - 1] * 100$
$CAGR_b = [(\text{Closing benchmark value} / \text{Opening benchmark value})^{(1 / \text{Number of years})} - 1] * 100$

The average annualised risk-free rate is taken as 8% for the purpose of the study. It is the current rate of interest offered by the Public Provident Fund (PPF) for the quarter January to March 2019. Measures like Sharpe Ratio, Jensen alpha, beta and R-squared (R^2) have also been applied in the study.

5. RESEARCH QUESTIONS

The present study tries to address the following research questions:

(1) How is the extent of inclination of the funds towards equity?

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(2) How are the returns of the chosen funds and that of the benchmark during the study period?
(3) How risky are the funds with respect to the benchmark?
(4) How is the performance of the funds in terms of risk-adjusted return?
(5) Are the funds aggressive with respect to the benchmark index?
(6) Are the funds adequately diversified?
(7) Are fund managers successful in picking quality stocks?
(8) How is the overall performance of the funds?

6. RESULTS AND DISCUSSION

6.1 Fund Snapshot

Before examining the risk and return associated with the fund and the benchmark it may be worthwhile to have a glance at the fund portfolio. Table 1 presents brief particulars of the selected funds.

Table 1: Fund Snapshot

Fund	Net Assets as on 31.01.2019 (Rs. Crore)	Total Stocks as on 31.01.2019	Composition		
			Equity (%)	Debt (%)	Cash (%)
Aditya Birla Sun Life Banking and Financial Services Fund (ABSLBFSF)	1545.3	25	93.41	6.72	-0.14
ICICI Prudential Banking and Financial Services Fund (ICICIPBFSF)	2639.4	31	94.67	0.00	5.33
Reliance Banking Fund (RBF)	2796.9	23	94.22	0.00	5.78
UTI Banking and Financial Services Fund (UTIBFSF)	652.8	25	98.96	0.04	1.00

Source: www.valueresearchonline.com

It is evident from Table 1 that all the funds are tilted heavily towards equity. Equity component is more than 93% in all the funds. The debt and cash components are negligible in all the funds. Only ICICIPBFSF and RBF have cash in excess of 5%. In terms of size, RBF is the largest fund, followed by ICICIPBFSF, ABSLBFSF and UTIBFSF. Total stocks vary between 23 and 31 in the selected funds.

6.2 Top 5 Stocks in the Fund Portfolio

Table 2 exhibits then top 5 stock-holding in the fund portfolio.

Table 2: Top 5 Stocks in the Portfolio of the Funds

ABSLBFSF		ICICIPBFSF		RBF		UTIBFSF	
Stock	%	Stock	%	Stock	%	Stock	%
HDFC Bank	19.13	ICICI Bank	14.04	ICICI Bank	15.16	HDFC Bank	17.20
ICICI Bank	13.37	HDFC Bank	9.38	SBI	11.06	ICICI Bank	14.24
SBI	6.92	SBI	8.57	HDFC Bank	10.97	Axis Bank	10.18
Bandhan Bank	6.08	HDFC	4.85	Axis Bank	6.82	SBI	8.10
Bajaj Finance	5.93	Bajaj Finserv	4.82	Bank of Baroda	5.88	HDFC	7.66
Total	51.43		41.66		49.89		57.38

Source: www.valueresearchonline.com

Table 2 reveals that three stocks are common in the portfolio of top five stocks of the chosen fund. These common stocks are ICICI Bank, HDFC Bank and State Bank of India (SBI). Top five stocks account for

51.43 in ABSLBFSF, 41.66% in ICICIPBFSF, 49.89% in RBF and 57.38% in UTIBFSF. As such, it can be said that the portfolio of UTIBFSF is heavily concentrated.

6.3 Compounded Annual Growth Rate

Compounded Annual Growth Rate (CAGR) of the funds and the benchmark index are presented in Table 3.

Table 3: Compounded Annual Growth Rate of the Funds and the Benchmark Index

Fund and Benchmark Index	CAGR (%)	Rank
ABSLBFSF	11.375	2
ICICIPBFSF	12.151	1
RBF	8.661	3
UTIBFSF	7.462	5
BSE BANKEX	7.849	4

Source: Calculations made by the Researchers

It is observed from Table 3 that ICICIPBFSF remains the best performing fund in terms of CAGR during the period of study. ABSLBFSF stands second, RBF stands third and UTI is the worst performing fund. Further, ICICIPBFSF, ABSLBFSF and RBF outperform the benchmark index and UTI underperforms the benchmark during the study period.

6.4 Total Risk

Standard Deviation (S.D.) measures total risk. The higher S.D. figure implies higher risk and the lower S.D. figure denotes lower risk. Table 4 depicts the total risk of the funds and the benchmark index.

Table 4: Total Risk of the Funds and the Benchmark Index

Fund and Benchmark Index	Standard Deviation (%)	Rank
ABSLBFSF	20.401	5
ICICIPBFSF	19.020	4
RBF	18.296	1
UTIBFSF	18.415	2
BSE BANKEX	18.549	3

Source: Calculations made by the Researchers

It is seen from Table 4 that RBF and UTIBFSF outperform the benchmark index whereas ICICIPBFSF and ABSLBFSF underperform the benchmark in terms of total risk. RBF is the least risky fund and ABSLBFSF remains the riskiest amongst the chosen funds.

6.5 Risk-adjusted Return

Risk-adjusted returns (RaR) of the funds and the benchmark index are shown in Table 5. Here, the higher figure is always preferred since it signifies higher risk-adjusted returns. Sharpe Ratio is used to measure risk-adjusted returns. Sharpe Ratio is meaningful only when one fund's sharpe ratio can compared with the sharpe ratio of another fund or a group of funds. The higher the sharpe ratio the better is the fund's risk-adjusted performance.

Table 5: Risk-adjusted Return of the Funds and the Benchmark Index

Fund and Benchmark Index	Risk-adjusted CAGR	Rank
ABSLBFSF	0.1654	2
ICICIPBFSF	0.2183	1
RBF	0.0361	3
UTIBFSF	-0.0292	5
BSE BANKEX	-0.0082	4

Source: Calculations made by the Researchers

It is evident from Table 5 that ABSLBFSF, ABSLBFSF and RBF outperform the benchmark index in terms of risk-adjusted return. But UTIBFSF underperforms the benchmark index during the period of study. Moreover, ICICIPBFSF remains the best performing fund with respect to risk-adjusted return, followed by ABSLBFSF and RBF. However, the negative Sharpe Ratio of BSE BANKEX and UTIBFSF is an indicator of the fact that these two fail to deliver risk-adjusted return in excess of risk-free rate.

6.6 Aggressiveness / Defensiveness of the Fund with Respect to the Benchmark

Beta measures the systematic risk associated with the fund. Beta > 1 implies that the fund is aggressive in relation to the benchmark. If Beta = 1, then volatility in fund return is identical with volatility in benchmark return. Further, 0 < Beta < 1 implies that the fund is defensive or conservative in relation to the benchmark. Table 6 shows the aggressiveness or defensiveness of the funds with respect to the benchmark index in terms of beta values of the chosen funds.

Table 6: Aggressiveness / Defensiveness of the Funds

Fund	Beta	Remarks
ABSLBFSF	0.9615	Defensive
ICICIPBFSF	0.9396	Defensive
RBF	0.9274	Defensive
UTIBFSF	0.9322	Defensive

Source: Calculations made by the Researchers

It is observed from Table 6 that the chosen funds are defensive or conservative in nature with respect to the benchmark index during the period of study since all the funds exhibited beta value less than 1.

6.7 The Extent of Diversification

The degree of diversification which reduces the extent of unsystematic risk is measured by R-squared or coefficient of determination. There exists an inverse relationship between the degree of diversification and the degree of unsystematic risk. The value of R-squared ranges between 0 and 1. It can never be negative. R-squared value of 1 implies completely diversified portfolio having zero unsystematic risk. On the other hand, R-squared = 0 signifies the complete absence of diversification. R-squared values of the funds are presented in Table 7.

Table 7: The Extent of Diversification of the Funds

Fund	R-squared	Rank
ABSLBFSF	0.7642	4
ICICIPBFSF	0.8396	3
RBF	0.8840	1
UTIBFSF	0.8817	2

Source: Calculations made by the Researchers

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Table 7 reveals that the chosen funds are successful in minimising the unsystematic or unique risk component to a great extent (between 76.42% and 88.40%). As such, it can be said that the chosen funds are adequately diversified within the sector. RBF remains the best performing fund in terms of R-squared value followed by UTIBFSF, ICICIPBFSF and ABSLBFSF.

6.8 Stock-picking Ability of Fund Managers

Jensen Alpha is expressed as:

$$\text{Alpha} = R_p - [R_f + \text{Beta} * (R_b - R_f)]$$

Where, Alpha = Differential return earned by the fund out of the ability of the fund manager in selecting correct stocks; Beta= Systematic risk of the fund.

This measure shows the competence of the fund manager in picking the quality stock. A positive alpha value indicates superior stock selection ability on the part of the fund manager, and a negative alpha value means poor stock picking by the fund manager. Alpha values of the chosen funds are presented in Table 8.

Table 8: Stock Picking Ability of the Fund Managers

Fund	ALPHA	Rank
ABSLBFSF	0.331	2
ICICIPBFSF	0.383	1
RBF	0.117	3
UTIBFSF	0.022	4

Source: Calculations made by the Researchers

It is observed from Table 8 that the fund managers of the chosen funds are successful in picking quality stocks. Fund managers of ICICIPBFSF remain the best performer in this regard followed by ABSLBFSF, RBF and UTIBFSF.

6.9 Overall Fund Ranking

On the basis of five parameters, the overall ranking of the chosen funds is presented in Table 9.

Table 9: Overall Fund Ranking

Fund (1)	Rank					Sum of Ranks (7) [Sum of (2) to (6)]	Average Sum of Ranks (8) [(7)/5]	Final Rank
	CAGR (2)	S.D. (3)	Sharpe Ratio (4)	RSQ (5)	Alpha (6)			
ABSLBFSF	2	4	2	4	2	14	2.8	3
ICICIPBFSF	1	3	1	3	1	9	1.8	1
RBF	3	1	3	1	3	11	2.2	2
UTIBFSF	4	2	4	2	4	16	3.2	4

Source: Calculations made by the Researchers

It is evident from Table 9 that on the basis of the selected five parameters, ICICIPBFSF is the best performing fund followed by RBF, ABSLBFSF and UTI.

7. CONCLUSION

Based on research questions, the findings of the study can be summarised as follows:

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(1) All the funds are inclined heavily towards equity. Equity component is more than 93% in all the funds (Table 1).
(2) ICICIPBFSF, ABSLBFSF and RBF outperformed the benchmark index and UTI underperformed the benchmark during the study period in terms of return (CAGR). ICICIPBFSF remains the best performing fund in terms of CAGR during the period of study and UTI is the worst performing fund (Table 3).
(3) RBF is the least risky fund and ABSLBFSF remains the riskiest amongst the chosen funds. Further, RBF and UTIBFSF outperform the benchmark index whereas ICICIPBFSF and ABSLBFSF underperform the benchmark in terms of total risk (Table 4).
(4) ABSLBFSF, ABSLBFSF and RBF outperform the benchmark index in terms of risk-adjusted return. But UTIBFSF underperforms the benchmark index during the period of study. Moreover, ICICIPBFSF remains the best performing fund with respect to risk-adjusted return, followed by ABSLBFSF and RBF (Table 5).
(5) The chosen funds are defensive or conservative in nature with respect to the benchmark index during the period of study since all the funds exhibited beta value less than 1 (Table 6).
(6) The chosen funds are successful in minimising the unsystematic or unique risk component to a great extent (between 76.42% and 88.40%). As such, it can be said that the chosen funds are adequately diversified within the sector (Table 7).
(7) The fund managers of the chosen funds are successful in picking quality stocks. Fund managers of ICICIPBFSF remain the best performer in this regard followed by ABSLBFSF, RBF and UTIBFSF (Table 8).
(8) On the basis of the selected five parameters, ICICIPBFSF is the best performing fund followed by RBF, ABSLBFSF and UTI (Table 9).

'Direct Plan' has lower expense ratio than the 'Regular Plan' because of non-involvement of the intermediaries. The returns from the 'Direct Plan' are also more than that of the 'Regular Plan' due to the absence of the intermediary commission. But investment in the 'Direct Plan' is not a cup of tea for beginners or inexperienced investors since it requires considerable skill and knowledge.

Sector-specific funds are a different ball game altogether. If chosen properly, these funds are capable of delivering fabulous returns. But in rough periods, these funds are very much vulnerable. Nevertheless, investment in sector-specific funds by way of "SIP" (Systematic Investment Plan) can protect the downside risk to some extent. At the same time, SIP is an instrument which has the potential of generating spectacular returns over a longer time horizon. Experts are of the opinion that knowledgeable and seasoned investors having high risk tolerance level can add a small percentage of sector-specific funds in their portfolio.

7.1 Limitations of the Study

Some of the limitations are mentioned below.

1) Mergers and Acquisitions (M&A) between the funds and the same between the fund houses are not taken into consideration.
2) The effect of a change in fund managers is not considered.
3) The impact of exit load, brokerage, taxes, and inflation has not been taken into consideration.

7.2 Scope for Future Research

Further research in the following areas could be considered as an extension of the present study.

- Research can be carried out on an investor's perception towards investment in equity mutual funds.
- A detailed study can be made to judge the impact of expense ratio on fund performance.
- A comparative study on the performance between sector-specific funds and diversified equity mutual funds can be an area of research.

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DISCLOSURE: The second author has investment in the 'Direct Plan' of ICICI Prudential Banking and Financial Services Fund (ICICIPBFSF) but the first author does not have any investment in any of the funds discussed here.

DISCLAIMER: The views expressed by the authors are educative and suggestive in nature. Readers and investors should take advice from their financial advisors or apply their own judgement before taking a final call. In no case, the authors can be held responsible for financial or other losses caused to readers and investors.

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