

# Mutual Fund Category Analysis

June 15, 2012

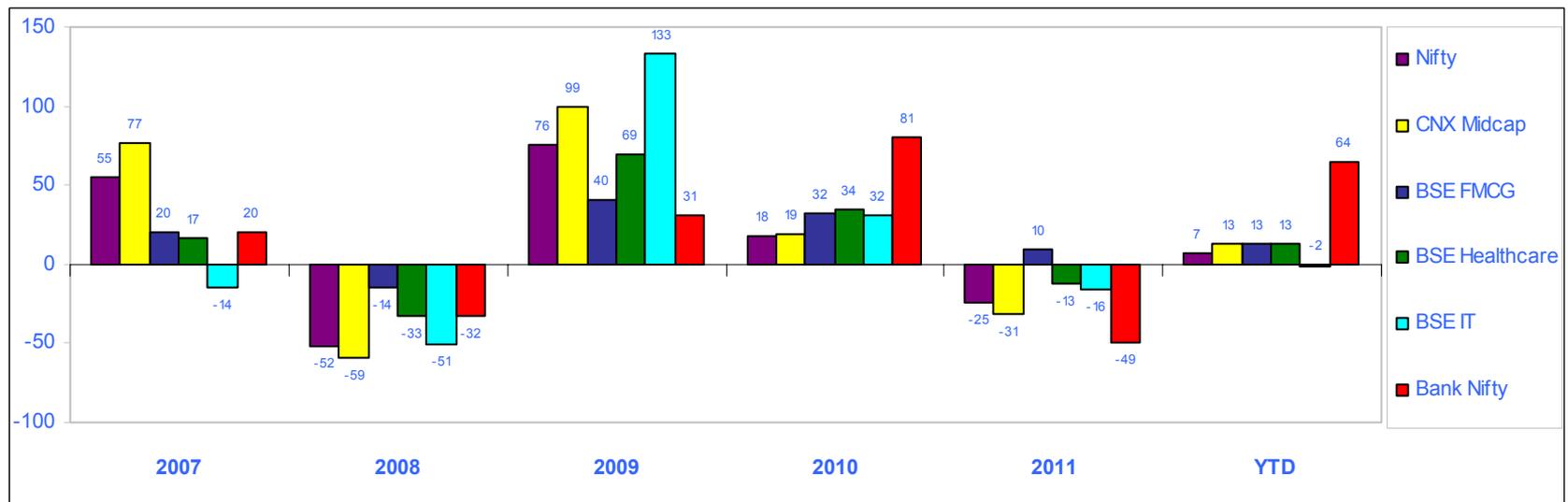
## MF Category Analysis - Banking Sector Funds

**Introduction:** Equity Sector funds are riskier categories among the equity oriented mutual funds spectrum, as these maintain concentrated portfolios by investing in particular sectors as mandated. The performance of the sector funds are cyclical in nature and sensitive to change in their respective sectors. They have managed to deliver good returns in times when their respective sectors or industries performed well. These are suited for high risk profile investors who are well-versed with the stock market and understand the sectors and their moves.

Sector funds are high risk - high return funds. They are more risky than diversified equity oriented funds. Diversified equity funds mitigate the downside risk by diversifying their portfolios across sectors, while the sector funds are exposed to higher risk as they are narrow in terms of asset allocation on particular sector. Further, diversified equity funds have the leeway not only to pick the best performing and growth sectors but also to remove poor performing sectors. But in case of sector funds, they have mandate to invest only in the sectors as specified in their offer documents and to adhere with the objective irrespective of market conditions.

### Performance of key indicators of various sectors over years:-

(Absolute Returns in %)



# Mutual Fund Category Analysis

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## Performance of various mutual fund categories - YoY returns:

Category	2006	2007	2008	2009	2010	2011	2012 YTD
Equity - Banking	25.04	71.72	-41.82	84.23	37.41	-31.87	24.96
Equity - FMCG	15.09	35.57	-38.95	65.81	36.50	10.57	21.93
Equity - Auto	11.92	-0.97	-48.77	132.13	26.56	-19.28	19.09
Midcap	33.07	66.13	-61.47	103.16	22.71	-25.27	15.67
Large Cap	40.17	57.52	-52.24	79.03	17.84	-23.65	10.83
Equity Theme - Infrastructure	49.26	81.93	-58.42	81.11	6.69	-33.29	9.92
Equity - Media	44.38	83.56	-62.44	70.71	15.58	-18.97	8.46
Equity - Pharma	12.54	22.87	-36.38	89.87	32.79	-8.71	6.86
Equity - Infotech	47.52	16.09	-58.89	115.88	26.83	-18.53	2.71

1st Rank
2nd Rank
3rd Rank

Even though sector funds have a potential to fetch better returns compared to other equity oriented funds based on developments in the sectors, one can not expect consistent returns over periods since their investment strategy hovers within a limited sphere.

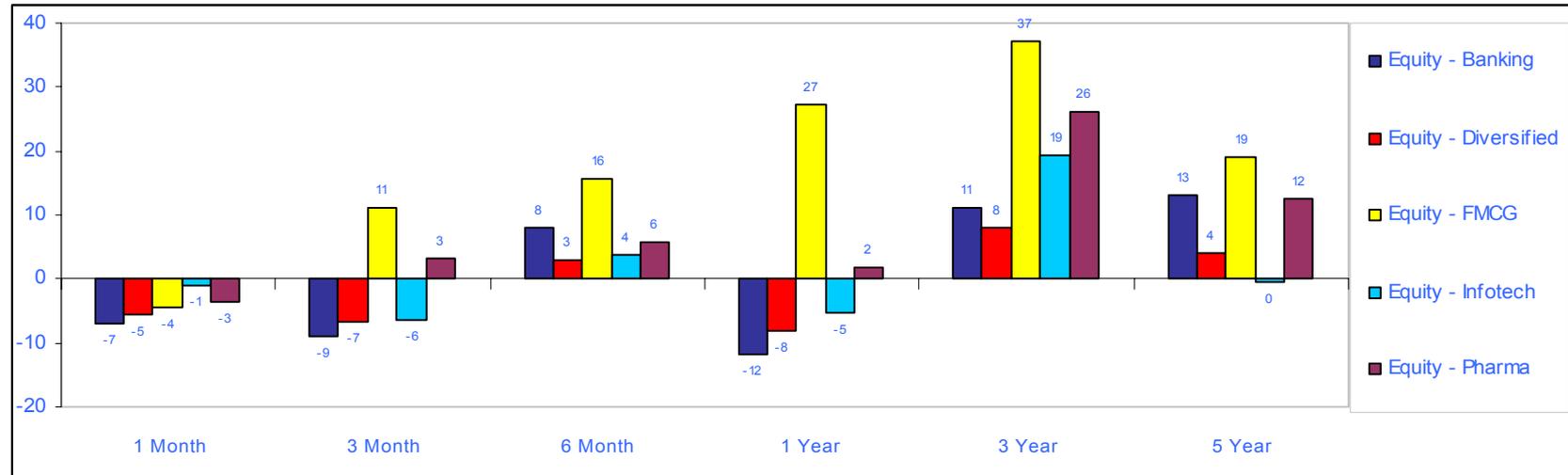
The sector fund performance moves in cycles. Every cycle will have a new out-performer and an under performer. For example, the Information Technology sector was at peak while compared to other sectors during the year 2005-06. But it was seen at the bottom during 2007-08. The sector came to the top slot in 2009 again. Likewise, 2007-08 was the best performing period for infrastructure industry. But recent periods show that this sector is currently out of favour. The banking sectors outperformed during 2009 but underperformed in 2010.

Hence, the performance of these funds is linked to the fortunes of the sectors. The funds do well if the respective sectors perform well. Interestingly, some of sector funds over the long run outperform even the diversified equity funds. The below chart proves this fact as the sector categories such as FMCG, Pharma and Banking delivered better returns for the three and five year time frames than diversified equity category.

# Mutual Fund Category Analysis

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## Relative performance of various mutual fund categories on different time frames:



Indian mutual fund companies have come up with various sector specific schemes focusing on sectors like Banking, FMCG, Pharma, Auto and Information technology.

In this note we have done a small study on the dynamics and performance of the banking sector.

**Banking Sector Funds:** There are seven schemes and four Exchange traded funds (ETFs) that invest predominantly in the banking stocks. ICICI Pru Banking & Financial Serv, Reliance Banking, Religare Banking, Sahara Banking & Financial Services, Sundaram Fin Serv Opport, Taurus Banking & Financial Serv and UTI-Banking Sector are mutual fund schemes while GS Bank BeES, GS PSU Bank BeES, Kotak PSU Bank ETF and Reliance Banking ETF are ETFs. These invest primarily in the stocks of PSU & private banks and financial institutions.

The banking sector funds have witnessed growth over short term as well as long term periods. The above diagram shows the comparable performance of the category over the long run with equity diversified categories and other defensive sectors categories such as FMCG and Pharma. The performance of the banking funds during the short term is also notable (see the table in slide.2) even in times of high inflation and rising interest rates.

# Mutual Fund Category Analysis

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## Banking Industry:

Banking industry is one of the key drivers of a nation's economy and its growth is dependent on the overall growth in the economy. It plays a significant role in the development of trade, commerce and industry of a nation.

The banking sector in India stands on strong foundations of prudent policy framework laid by the regulators. This excellence has been proved in a scenario where the Indian banking industry managed to overcome all the headwinds from the global financial turmoil when the U.S sub-prime mortgage crisis occurred which resulted in bankruptcies and/or writing-off debt by some of well-known global banks.

In the last decade, Indian banks and financial services companies have not only expanded their client base but have also brought in efficiency in their operations which results in better quality of services. Public sector banks have been proactively restructuring their balance sheets. There has been steady consolidation in retail lending and demand for credit has increased.

Banks' focus on low-to moderate risk segments and the increased diversification in their loan portfolios should help maintain their asset quality. The banking sector remains a favorite for a majority of equity funds. The following is the table showing the deployment of funds by the whole equity MF industry among sectors. Banking sector has been in the first position over times.

Sector Classification	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
BANKS	14.38%	12.99%	13.80%	13.90%	15.42%	16.12%	17.20%	17.31%	16.65%	15.47%	17.57%
SOFTWARE	6.89%	7.97%	6.92%	6.99%	6.60%	8.49%	8.71%	9.07%	8.48%	10.50%	9.39%
CONSUMER NON DURABLES	6.25%	6.73%	5.97%	6.26%	6.07%	6.38%	6.61%	7.29%	7.37%	7.86%	7.92%
PHARMACEUTICALS	5.72%	6.09%	6.36%	6.73%	5.90%	6.85%	6.24%	7.51%	7.25%	8.20%	7.55%
PETROLEUM PRODUCTS	6.86%	5.73%	5.74%	6.62%	5.13%	5.68%	6.36%	6.42%	6.82%	6.26%	5.82%
AUTO	3.16%	3.32%	2.96%	3.70%	3.84%	4.12%	3.97%	3.92%	4.34%	4.56%	4.87%
FINANCE	4.35%	4.61%	4.72%	4.81%	4.23%	3.79%	3.45%	3.99%	4.11%	4.16%	4.75%
POWER	6.10%	6.34%	6.23%	6.47%	5.48%	4.81%	4.34%	4.32%	4.12%	3.98%	3.71%
INDUSTRIAL CAPITAL GOODS	7.57%	7.60%	7.42%	7.32%	6.63%	6.55%	5.52%	5.23%	4.53%	3.57%	3.29%

1st Rank

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## Mutual Fund Category Analysis

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### Banking Sector Outlook:

**Key Challenges:** The banking sector has been facing a lot of issues like non-performing assets (NPA), exposure to sectors like aviation, power, infrastructure etc. Weakening asset quality and credit concentration build up are also putting pressure on the downside. Given the lowering of GDP forecast for the FY 2013, where the Indian economy is facing challenges on the growth aspects, coupled with the macro economic factors such as high inflation and higher interest rates, the asset quality as well as earnings of the banks may come under further pressure.

The asset quality of the banks is likely to be under pressure in the medium term on the back of slowdown in the economy and depreciating rupee. Deterioration in asset quality witnessed for most of the PSU banks owing to higher slippages and restructuring. However, high Provision Coverage Ratio by the banks will cushion against the deteriorating asset quality. Slower growth, high cost term deposits, deregulation of saving rate and NRE interest rates would keep NIM under check. Spike in short-term rates due to liquidity tightness can affect NIMs in the near term. Lower credit growth could also pose problem due to signs of slowdown.

Restructuring of Non Performing Assets is also a major concern for Indian Banking Industry. Exposures to the struggling sectors such as aviation, state power utilities and infrastructure projects have brought recurring trouble for the industry. While the immediate outlook on the above mentioned sectors is negative, the long-term viability which is still intact, may help limit credit losses. The announcement of certain regulations and discussion papers (Basel III, priority sector, dynamic provisioning etc) has increased challenges for banks which will impact the earnings in the medium term. Though interest rates have gone up 375bps from the bottom, the cycle could now turn down. Inflation has been a concern and stays above the RBI's comfort zone of 5.0-5.5%. The RBI will not be able to cut rates as aggressively as will be needed in the near term to support growth and kick-start the investment cycle in FY13.

However, Banks are expected to perform well once rate cuts start. Net interest margins are also likely to improve in the coming quarters. Even though there are short term concerns of higher inflation, rising interest rates, slowing growth momentum and possible rise in slippages from select sectors, the banking sector is likely to perform well and play an important role in India growth story in the following years. The banking sector is likely to see healthy growth over the long term due to rise in rural incomes, increased spread of banking services and considerable credit offtake.

# Mutual Fund Category Analysis

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## Category Performance:

The category managed to deliver consistent performance in different market conditions like bullish, bearish and volatile periods. The category posted 35% negative returns during the market crash in 2008 which was lesser than that of equity diversified category returns of -44%. The category outperformed equity diversified schemes with huge margin for three and five year time frames by registering 13.45% and 13.75% of CAGR returns respectively where the equity diversified category posted 7% and 5% of CAGR returns respectively.

ICICI Pru Banking & Financial Service, Reliance Banking and UTI-Banking Sector are the top performing schemes from the category. Investors with high risk appetite and willing to take more exposure on banking sector can consider investing in the above mentioned schemes for the period of at least 2 years. Accumulating the units through SIP is advisable given in the current volatile scenario.

## Relative performance of banking category over various time frames:

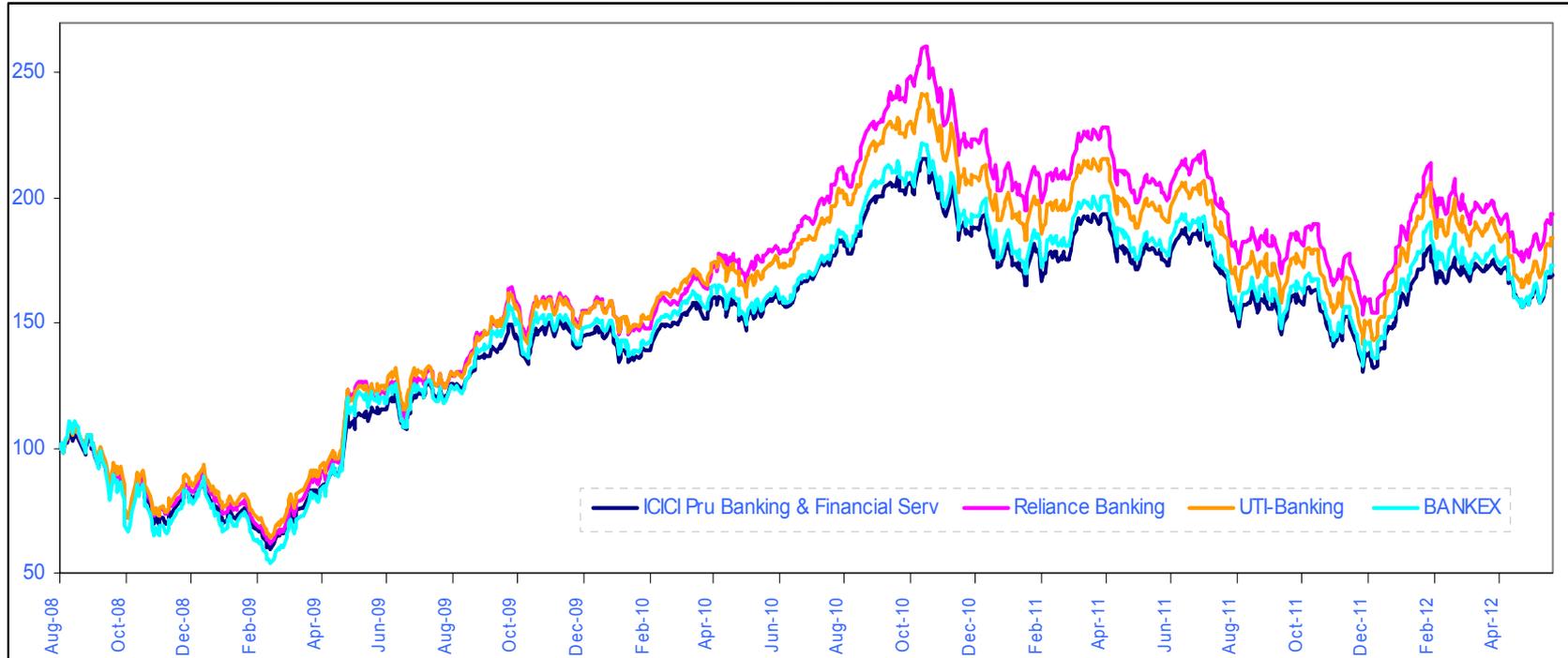
Scheme Name	Latest Corpus (Rs Crs)	Expense Ratio(%)	3 Month	6 Month	1 Year	3 Year	5 Year	Standard Deviation	Sharpe	Beta	Alpha	Tracking Error
<b>ICICI Pru Banking &amp; Financial Serv (G)</b>	<b>141</b>	<b>2.44</b>	<b>-2.64</b>	<b>18.18</b>	<b>-5.02</b>	<b>13.85</b>	-	<b>1.58</b>	<b>-0.02</b>	<b>0.88</b>	<b>-0.01</b>	-
<b>Reliance Banking Fund - (G)</b>	<b>1731</b>	<b>1.93</b>	<b>-5.47</b>	<b>15.43</b>	<b>-6.01</b>	<b>17.01</b>	<b>17.51</b>	<b>1.54</b>	<b>-0.02</b>	<b>0.84</b>	<b>-0.01</b>	-
<b>UTI-Banking Sector Fund (G)</b>	<b>366</b>	<b>2.31</b>	<b>-6.07</b>	<b>17.17</b>	<b>-5.85</b>	<b>14.53</b>	<b>12.23</b>	<b>1.76</b>	<b>-0.02</b>	<b>1.21</b>	<b>0.02</b>	-
Religare Banking Fund (G)	40	2.50	-4.58	16.54	-6.59	16.10	-	1.51	-0.03	0.84	-0.01	-
Sahara Banking & Financial Services	21	2.50	-5.98	12.43	-6.60	13.81	-	1.57	-0.02	0.86	-0.01	-
Sundaram Fin Serv Opportunities (G)	197	2.36	-10.06	9.34	-11.00	9.83	-	1.63	-0.03	1.11	-0.01	-
Taurus Banking & Financial Services	5							-	-	-	-	-
<b>ETFs</b>												
GS Bank BeES	53	0.50	-4.60	17.55	-5.90	13.03	11.53	-	-	-	-	0.08
GS PSU Bank BeES	9	0.74	-9.02	12.63	-11.56	11.24	-	-	-	-	-	0.80
Kotak PSU Bank ETF	12	0.65	-9.05	12.57	-11.65	11.57	-	-	-	-	-	0.80
Reliance Banking ETF	11	0.35	-4.32	18.61	-4.40	13.55	-	-	-	-	-	0.06
<b>Benchmarks</b>												
Nifty	-	-	-5.67	6.68	-6.57	3.76	4.48	-	-	-	-	-
Bankex	-	-	-5.17	18.29	-4.64	13.20	9.62	-	-	-	-	-
CNX PSU Banks	-	-	-9.77	11.86	-12.96	9.05	10.45	-	-	-	-	-
CNX bank or Bank Nifty	-	-	-4.58	18.68	-5.32	12.69	10.50	-	-	-	-	-
Average of Banking Category	-	1.63	-6.18	15.05	-7.46	13.45	13.75	1.60	-0.02	0.96	0.00	-
Average of Equity Diversified Category	-	2.26	-5.73	7.00	-7.77	6.77	4.75	1.07	-0.04	0.71	-0.01	-

Note: Trailing Returns up to 1 year are absolute and over 1 year are CAGR. NAV/index values are as on June 14, 2012.

# Mutual Fund Category Analysis

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## Performance of top schemes from Banking sector category:



The category seems to be more risky as compared to equity diversified schemes as per the standard deviation which was calculated for last one year period. The standard deviation for the category is at 1.60% while the standard deviation for equity diversified is at 1.07%.

The AUM of the category stood as on 31 March 2011 at Rs. 2,587 crore. Average expense ratio as per latest data was at 1.63%. Exit load is charged by the schemes as 1% if the units are redeemed before one year of allotment. ETFs do not charge any loads. The average turnover ratio of the category was at 112.39%. UTI Banking, Goldman Sachs PSU Bank BeES and Sahara Banking and Financial Services are the schemes have churned the portfolio actively as they account for high turnover ratio of 319%, 295% and 173% respectively.

## Mutual Fund Category Analysis

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### Portfolio:

The schemes in the category invest in the stocks of banking and non-banking finance companies (NBFC). Higher exposure towards the stocks of the private banks has been visible while looking at the latest portfolios of all the schemes. Taurus Banking & Financial Services and ICICI Pru Banking & Financial Service are the two schemes having lesser exposure into PSU banks by allocating only 17% and 19% of net assets respectively. Taurus Banking & Financial Services, ICICI Pru Banking & Financial Service and Reliance Banking allocated close to 15% of net asset into NBFCs. ICICI, SBI and HDFC Bank are the most preferred stocks by the banking schemes as they hold Rs. 433 crore, Rs. 369 crore And Rs. 240 crore respectively (as per March 2012).

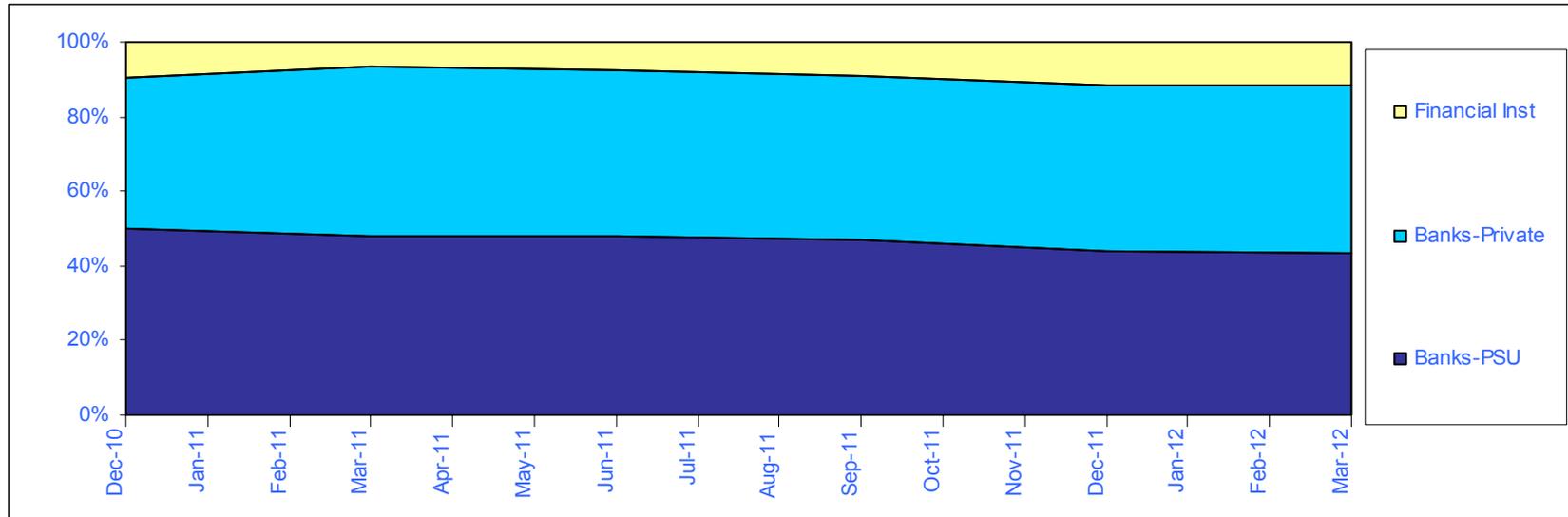
Banking sector stocks are high beta stocks as they are more volatile in relation to the broader index. High beta stocks rise more (outperform) than the index in a rising market but fall greater (underperform) the index in a falling market. The below table shows the weightage of the each banking stocks in the broader indices as well as sector specific indices.

Name of Company	BSE Code	NSE Symbol	Weightage				Beta	
			BSE Bankex	Bank Nifty	Sensex	Nifty	Sensex	Nifty
Axis Bank Ltd	532215	AXISBANK	7.41	7.57	-	1.68	-	1.49
Bank of Baroda	532134	BANKBARODA	3.9	3.78	-	0.84	-	0.96
Bank of India	532149	BANKINDIA	1.77	1.74	-	-	-	-
Canara Bank	532483	CANBK	1.66	1.62	-	-	-	-
Federal Bank Ltd	500469	FEDERALBNK	1.96	-	-	-	-	-
HDFC Bank Ltd	500180	HDFCBANK	25.87	26.41	6.87	5.84	0.91	0.92
ICICI Bank Ltd	532174	ICICIBANK	25.92	27.53	6.88	6.09	1.52	1.53
IDBI Bank Ltd	500116	IDBI	0.91	-	-	-	-	-
IndusInd Bank Ltd	532187	INDUSINDBK	2.91	3.05	-	-	-	-
Kotak Mahindra Bank Ltd	500247	KOTAKBANK	6.16	6	-	1.33	-	1.18
Punjab National Bank	532461	PNB	2.55	2.84	-	0.63	-	0.96
State Bank of India	500112	SBIN	15.5	15.81	4.11	3.5	1.28	1.3
Union Bank of India	532477	UNIONBANK	1.27	1.29	-	-	-	-
Yes Bank Ltd	532648	YESBANK	2.23	2.34	-	-	-	-
<b>Total</b>	-	-	<b>100</b>	<b>100</b>	<b>17.86</b>	<b>19.91</b>	-	-

# Mutual Fund Category Analysis

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## Sub-sector break up of portfolios of banking sector:



Analyst: Dhuraivel Gunasekaran.

(Database sources: AMC Sites, NAVIndia and Ace MF)

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