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Mutual Funds and Market Turmoil – Role of Fund Managers

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Abstract

Mutual Funds family ensure retail investors' easy access to capital market, institutional investors parked funds in diversified schemes suitable to their investment objectives. The industry became anemic in view of global financial meltdown followed by low investors' confidence. Equity schemes are worst affected and lagged in attaining benchmark returns. Debt scheme witnessed fluctuation too as corporate giants using this route for their specific purposes. However, the fund managers being professionals have not added value to the unit holders. Jensen's alfa lies in the range of 0.03 – 0.61. This has warranted fund managers to evolve strategies for restructuring need based product with a differentiation hedging market risk and ensuring better return for investors.

Key words: ***Mutual fund, performance, unit holders' value.***

1. Introduction:

Mutual Funds in the financial market have emerged as harbinger of opportunities to the investors adopting to diversified investment styles. There exists plethora of schemes in the MFs family to serve varied needs of investors of different strata.As on March 2013, MF family comprises 1178 number of schemes in the equity segment, Debt and balanced fund that is Hybrid besides sectoral funds like Banking, Pharma, FMCG. etc.MFs ensure small investors' access to the capital market at a comparatively low cost with legal protection, high level of transparency, liquidity and flexibility in investment. Since global meltdown the industry however turned to be anemic. Asset under management (AUM) gradually dissipated, schemes lagged to respective benchmarks in respect of returns and retail investors deserted equity schemes because of rampant market manipulation, poor performance and ingenious miss-selling, lethargic complaint redressal mechanism and so on. Under this backdrop, an endeavor has been made in the paragraphs hereafter to assess whether the fund houses are managing pool of funds on behalf of the investors for their benefit despite financial turmoil over the period. In this respect we have considered a study period fiscal 2008-12, a period of most financial market volatility, to reveal the suitability of fund houses in achieving the specific objective of the funds. Financial measures like Sharpe's Index, Treynor's ratio, Jensen's Alfa besides, statistical techniques were used to draw inferences.

2.1. Mutual Fund Industry in India – A Glimpse :

Mutual Fund industry has already traversed long way more than five decades since establishment of UTI in 1963. As on 31st March,2013, 43 AMCs commanding with Average AUM (AAUM) of Rs.816,657 cr. operating in India under following three different categories :

a) Bank sponsored MFs with AAUM of Rs. 150980 cr. comprising of (a) Joint Venture – Predominantly Indian (4 Nos.), Joint Venture – Predominantly Foreign (1 No.) and Others (2 Nos.).
b) Institutions predominantly Indian consisting of only single fund house i,e. LIC Nomura Mutual Fund with AAUM Rs. 7185 cr. and
c) Private Sector MFs covering 35 AMCs with AAUM Rs. 658,492 cr. comprising of Indian (17 Nos.) with AAUM Rs. 22,649 cr., Foreign (8 Nos.) with AAUM 1 Rs.57247 cr., Joint Venture-Predominantly Indian (6 Nos.) with AAUM of Rs. 343943 cr. and Joint Venture-Predominantly Foreign (4) with AAUM of Rs. 27653 cr.

The McKinsey report, 2012, (Report, 2012), exhibited stagnationin the growth of AUM (4% CAGR) during 2010-12, declined fromRs. 614546 cr in April 2010 to Rs.587658.7 cr in March 2012. The reasons of such retardation in its pace of growth may be attributed to shift of FIIs preference towards the debt instruments and redemption pressure in view of global financial crisis in their home country.Besides, the retail investors offloaded their stakes in equity scheme from Rs. 33298.4cr to Rs. 123548.5cr during end March 2010-12. Significantly, these disinvestment proceeds routed into balanced funds of MFs, Gold ETF and other ETF which had registered considerable escalation in the growth during the period under consideration. This indicates investors' confidence regarding equity schemes of MFs were tanked over the period in the context of global financial turmoil. On the contrary, liquid/money market MFs, being considered as better option for corporate investors than that of short term equity investment for cash management purposes, grew at CAGR 11.60 pc despite market doldrums. The other financial investors particularly banks have also booked their profit during 2010-12 as financial crisis still looms large resulting in market volatility. The HNI investors opted debt segment too which grew at 68.83pc in 2012 over 2010 from Rs. 62530.71 cr to Rs. 105572.4 cr in absolute term.

2.2. Growth of asset class of MF Family :

Fund managers' approach to asset allocation encompasses equities, fixed income instruments and a host of alternative investment class like real estate, ETFs, commodities based on objectives of specific funds. They enjoy a degree of flexibility in allocation of mobilized funds into different asset class of the portfolio for maximizing return. On the contrary, volume of flows of funds exclusively depends on investors' preferences towards the asset class of the funds; debt, equity and others. In view of global financial crisis and corresponding declining in commodity prices and low investors' confidence in equity market, there was reallocation of funds in favor of debt funds, gold ETF and money market mutual funds (MMMFs), Table -1. It is observed that equity segment witnessed outflow pressure (negative coefficient of variation)in the domestic market. However, investors irrespective of their nature turned towards Gilt edged securities for stable return. Skewness and Kurtosis also indicate the similar pattern of outflow of funds. Banks, Financial Institutions (FIs), and corporate sectors have contributed more than 95 percent of such assets of MFs. The corporate sectors generally use these avenues for short term cash management purposes which are considered as beneficial in comparison to holding equities for short term. Unlike equity funds the NAV of debts are subject to fluctuation to the interest rate. Investors prefer long term funds like; Fixed Maturity plan (FMP), long term bondsetc. in case of rising in interest rates.

Table 1: Classification of asset class (Figures in ` Cr.)

YEAR	2007	2008	2009	2010	2011	2012	CAGR	COV	SKEW NESS	KURT OSIS
Income	100894	764095	146712	-83470	-12165	56745	-43.757	188.726	2.058	4.609
Equity	-175781	80310	-81	-16179	6848	- 14152	-91.9490	-424.699	-1.384	3.369
Balanced	4812	6588	-879	750	1319	-358	-107.439	146.865	0.831	-1.058
Liquid/M oney market	6260	4450891	-302	6218	19643	36259	479.217	240.527	2.449	5.998
Gilt	-201	5877	-2315	343	-1140	3038	-1611.442	322.58	0.936	0.116
ELSS-Equity	5367	1357	1444	341	813	-1472	-127.4268	172.288	1.1614	2.753
Gold ETFs	415	194	482	1727	4046	1826	340	100.260	1.334	1.629
Other ETFs	-417	7092	-847	489	264	-160	-61.630	279.239	2.309	5.478
FOF Investing Overseas	0	453	-825	-941	48	-352	-177.704	-200.63	-0.087	-1.446
Total	-58651	5316857	143389	-90722	19676	81374	-238.742	239.977	2.440	5.966

Source: self-compiled

Equity funds, irrespective of their lineage and size, have witnessed outflows in the 12 months period between July31, 2011and June30, 2012. Reliance growth fund, SBI magnum tax gain, Fidelity equity (now sold to L&T), UTI master share, Sundaram select mid cap , Franklin flexicap , Birla Sunlife tax relief, HDFC growth, IDFC sterling equity, and HDFC Long term advantage funds are among the large funds that have lost 5-15pc of their assets over past one year. AMFI data shows that a little over Rs 3700 cr drop in HNI assets and as well as closure of 39000 folios. On the other hand 65percent of equity oriented MFs' assets in India are held by the retail investors (Bose, 2012). This indicates retail investors' portfolios remain less volatile irrespective of market volatility and became worst sufferers particularly when financial institutions, HNIs, and FIIs were resorted to offloading their investment in equity oriented mutual funds.

3. Determinants of growth of AUM :

The mutual fund industry flourishes with positive sentiments prevailing in the market and high investors' confidence. However, growth of GDP remained immune to expansionary policy measures adopted in context of bringing down key interest rate to combat financial crisis. The lowering interest rate strategy for reviving capital market liquidity however paved the way to higher valuations of debt funds. The Indian stock markets experienced a sharp downturn in the line with global volatility followed by weak domestic prospects till March 2009.The decline of AUM was further accentuated by ban on entry loads on all mutual funds by SEBI effective from August 2009. It has declined about 4pc till March 2011 and industry faced netoutflows pressure. During FY 2011-12, surge in capital market was, however, due to, *inter-alia*[1], large valuation effect leading to increasing in equity prices. The shift in the investors' sentiment was reflected in Indian benchmark index which surged past the psychological 19000 marks-rally from the sub-10,000 levels at end-March 2009, and 17,500 at end-March 2010. Most of the equity funds have managed to outperform benchmark indices only after the market rally when indices gained 8pc between September 2011 and September 2012. The value research data as on September 30 , 2012 shows that return on Equity –large cap on average beat BSE Sensex return while, 55 out of 83 large cap equity funds outperformed their benchmark over a one year period. Generally, quantum flow of funds to MF family largely depends on FIIs inflows followed by domestic household and corporate savings.In this respect, impact of these variables on AUM in the same group at different time period is assessed by applying Paired Samples T test procedure. The results in the table-2, show low significance of "r (correlation coefficient)" (typically less than .05) value for 't' test (except in pair 4) indicating significant difference between the two variables. This is further confirmed by the difference between confidence interval is not zero. Thus, AUM of the industry as a whole is impacted by FIIs inflows, GDS (Gross Domestic Savings), Household savings in financial assets and corporate sector savings.

It may be worth mentioning that, FIIs are taking fancy investment decision for equity oriented MFs. Their investments in equity funds stood at Rs 1212 cr over 87 folios as on March31, 2012 against Rs 1027cr as on same date of the previous year. The reasons of such increase, despite market turmoil, may be attributed to the FIIs have crossed their investment limit in specific sector and want to derive benefits from second line stocks. Besides, government has allowed to foreign retail investors to invest in domestic equity mutual funds.

Table 2: Paired Samples Test

	Paired differences					t Value	Sig. (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	95% Confidence interval of the Difference			
				Lower	Upper		
Pair 1 Asset under Management -Inflow of files	2344.700	1872.381	468.095	1346.978	3342.422	5.009	.000
Pair 2 Asset under Management - Gross Domestic Savings (Base 2000/05)	-8436.002	5222.587	1348.466	-11328.175	-5543.829	-6.256	.000
Pair 3 Asset under Management - Household gross Domestic savings	-1382.603	518.679	133.922	-1669.838	-1095.368	-10.324	.000

[1] In the current fiscal foreign investors started coming back to India without any major policy initiative and stayed invested (net buyers) in seven out of 10 months pumping Rs 93696.20crore up to October 2012. The reason may be attributed to increase in external liquidity in the context of liquidity injection by ECB and US Federal Reserve. Besides, Government of India since September 2012 announced positive steps in connection with; hike in subsidized diesel price, allowing up to 49percent FDI in multi brand retail. 49 pc in aviation by foreign carriers, 74pc various streams of broadcast services,49pc insurance sector, reducing withholding tax on overseas borrowings to 5pc from 20pc, clearing companies bill 2011.

Pair 4 Asset under Management - Private sector gross Domestic savings	76.181	340.118	87.818	-112.170	264.532	.867	.400
Pair 5 Asset under Management - Public sector gross Domestic savings	1908.408	1619.600	418.179	1011.503	2805.312	4.564	.000

Source: Self-compiled

4. Role of Fund Managers :

The operational efficiency of the AMCs is reflected funds' performance in terms of return and risk in the respective benchmark. Of 44 AMCs that reported their results for March 2012, 16 earned profits in the past one year and 28 of them are yet to make any profit. To see the role the fund managers we have considered 21 number of equity oriented funds with a rider of at least three years duration of operation since their inception and measured their performance in terms of return[2] and compared with excess of average market return[3] by using descriptive statistics. The reason behind of such selection is that these schemes have only focused on long term capital appreciation by investing in the equities, since fund managers have distinguished role in managing these portfolio than that in Balanced and debt funds. The results are tabulated in Table-3. It is revealed that, 14 out of 21fund houses considered for the analysis could beat the benchmarks returns i.e., market return over risk free return, treasury bills rate. JM Equity on average found to be worst performer during its entire period of operation. The HSBC Equity topped the list in terms of return during its entire period of operation followed by ING, Baroda, and Fidelity and so on. The negative magnitude of Skewness along with comparatively lower value of Kurtosis and higher value of Standard deviation indicate respective volatility in returns of the funds.

Table 3: Fund performance as on March 31, 2012: Descriptive statistics

Name of Funds	Year of operation considered	Average return in%	Skewness	Kurtosis	Expense ratio % of AUM as on 30/10/2012
HSBC Equity (large cap)	9	24.866	-0.538	1.181	2.20
ING Large cap equity (large cap)	8	21.8	-1.146	1.217	2.65
HDFC index sensex (large cap)	9	18.512	-0.482	0.064	2.20
Baroda pioneer growth(large cap)	8	18.044	-0.849	0.447	2.50
Fidelity Equity (large cap& mid cap)	8	17.836	-1.179	1.106	1.85
Deutsch Alfa Equity reg (large cap)	8	17.828	-0.804	0.261	2.50
Quantum Long term Eq (large &mid cap)	5	13.095	-0.462	0.493	1.25
Mirae Asset India oppor (large &mid cap)	4	12.971	0.724	0.273	2.35
BNP Paribas equity (large cap)	8	12.961	-1.377	2.241	2.44
SBI magnum equity (large cap)	10	11.541	-0.708	0.004	2.03
KotakEmrg equity(mid & small)	5	11.36	-1.531	2.179	2.49

[2] $R_t = \frac{NAV_t - NAV_{t-1}}{NAV_{t-1}} * 100$, R_t– return in t^{th}period, t-1= previous period, NAV- Net asset value

[3] Excess Return= Market return *less* risk free return= Return from Sensex *less* average risk free rate i.e., average treasury bills rate for the period.

LIC Nomura MF growth (large cap)	14	10.949	-0.656	0.16	\1.76
DSPBR Equity (Multi cap)	8	9.497	-0.531	-0.398	1.87
Sundaram Equity Multi(mid & small)	5	9.079	-0.729	-0.103	2.36
Benchmarks return (Sensex)	**14**	**7.955**	**0.1156**	**-1.094**	
ICICIPru focused bluechip (large cap)	4	6.577	-1.027	0.828	1.83
Edelweiss Equity enhancer (large cap)	3	5.982	-1.959	3.866	2.31
UTI Equity (large & mid)	10	5.466	-0.456	-0.537	1.45
Goldman Sachs Nifty ETS (large cap)	10	4.866	-0.365	0.657	0.50
CanaraRobeco Nifty Index(large cap)	6	4.388	-0.354	0.468	1.50
Axis Equity (Large cap)	3	2.676	1.677	-	2.21
JM Equity (large cap)	8	-28.276	-2.334	5.555	2.50

Source: self compiled

The schemes under consideration clearly exhibited that except LIC Nomura MF growth (4.039), SBI Magnum Equity (4.062) and Sundaram equity multiplier (4.439) most of the schemes had not performed well in connection with earning excess return over the market return. The reason of such non performance may be attributed to market volatility during financial year 2011-12 and low investors' confidence. This raises very pertinent question regarding fund managers' effectiveness in portfolio management for attaining best return.

Table 4: Performance of Fund Houses -Equity MFs as on March31, 2012

TYPE	NAME OF SCHEME	STNDRD DEVIATION	BETA	JENSEN ALFA	SHARPE	TREYNOR
LARGE CAP	DSPBRK TOP 100	1.430829	-12.8877	0.389567945	-0.00384	0.000426
	ICICI PRU TOP 200	1.610663	-14.8224	0.433537855	-0.01028	0.001117
	KOTAK 50	1.502258	-12.9897	0.377935189	-0.01333	0.001542
	SBI MAGNUM	1.567711	-15.4141	0.451882817	-1.12254	0.000976
	SUNDARAM SELECT FOCUS	1.605884	-13.729	0.387584731	-0.01956	0.002288
	TATA INDEX NIFTY PLAN A	1.731625	-14.8803	0.404939338	-0.0106	0.001234
	LIC NAMURA TOP 100	1.487716	-12.0506	0.309810046	-0.02208	0.002726
	JM EUITY	1.821328	-13.964	0.374129502	-0.0283	0.003691
	BARODA PIONEER GROWTH	1.651752	-15.5953	0.457178008	-0.00902	0.000956
	UTI MASTERSHARE	1.439452	-13.6503	0.400712676	-0.01114	0.001175

LARGE & MID CAP	HDFC TOP 200	1.576657	-15.1798	0.467159153	0.004374	-0.00045
	ICICI PRU DYNAMIC	1.331387	-13.1057	0.399169358	-0.00157	0.00016
	UTI DIVIDEND YIELD	3.458707	-7.43176	0.281785027	0.012123	-0.00564
	CANARA ROBECO EQ. DIVERSIFIED	1.688567	-16.0832	0.489888971	0.002327	-0.00024
	DSPBRK OPPORTUNITIES	1.478558	-15.6056	0.454880957	-0.01183	0.001121
	LIC NOMURA MF INDIA VISION	1.636935	-11.5294	0.289121891	-0.04111	0.005837
	QUANTUM LONG TERM EQUITY	1.362493	-16.1177	0.4978187	0.007983	-0.00067
	SUNDARAM REGULAR GROWTH	23.49816	19.14992	0.170826028	0.029242	0.035882
	TATA PURE EQUITY	1.455571	-13.7256	0.407056372	-0.00813	0.000863
	SBI MAGNUM CONTRA	1.519432	-14.9795	0.432492968	-0.01453	0.001473
MULTI CAP	DSPBRK EQ	0.703133	0.142717	0.035082024	0.006891	0.033949
	SBI MAGNUM MULTIPLIER	1.408499	-15.3783	0.446001735	-0.01413	0.001294
	KOTAK OPPORTUNITIES	1.619364	-14.9536	0.431679441	-0.01368	0.001481
	TATA EQ PE	1.43424	-16.8671	0.495029627	-0.00923	0.000785
	HDFC PREMIER MULTICAP	1.473398	-17.3237	0.507812872	-0.00912	0.000776
MID & SMALL CAP	HDFC MID CAP OPPORTUNITIES	1.291987	-15.0543	0.464580222	0.006105	-0.00052
	SUNDARAM SELECT MIDCAP	20.26937	-3.29842	0.780593888	0.032478	-0.19959
	ICICI PRU DISCOVERY	1.390542	-18.4397	0.565550989	0.009028	-0.00068
	DSPBRK S&M CAP	1.388806	-18.1954	0.544063857	-0.00143	0.000109
	SBI MAGNUM GLOBAL	1.470147	-18.8168	0.545945048	-0.01209	0.000945

CANAR ROBECO EMERGING EQ	1.730462	-21.022	0.617527396	-0.00516	0.000425
KOTAK EMERGING EQUITY	1.466529	-14.4738	0.404847511	-0.02409	0.002441
TATA DIVIDEND YIELD	1.352098	-15.7193	0.472925529	-0.00198	0.000171
UTI MASTER VALUE	1.436002	-18.9259	0.557058474	-0.0068	0.000516

Source: self-compiled

To examine the efficiency of fund managers in attaining specific objectives of funds particularly during the market turmoil, we have used tools like Standard Deviation, Sharpe's Index, Treynor's ratio and Jensen's Alfa. Standard deviation measures total risk of the scrip whereas beta indicates the systematic risk of the fund. The analysis of risk; standard deviation and beta indicated that mutual funds in the large cap category fall comparatively highest risk zone of 1.43-1.82 followed by large & mid cap (1.33-1.68) and Medium and Small cap (1.29-1.73). The multi cap mutual funds exhibited the lowest risks during the period under consideration. The reason of such lowest risk may be attributed to diversification approach of the funds in different segments based on their potentiality. Other sector specific funds didn't fare well in the context of financial crisis. This fact has also been revealed by the results of beta analysis. It depicted that multi cap segment is comparatively less systematic risk prone than that of the fund belonging to specific segments.

To compare the premium per unit of total risk (SD) and systematic risks (β), we applied Sharpe and Treynor ratio respectively. Sharpe ratio representing excess fund return over the market return for a unit of total risk (SD) i.e. associated volatility. The Sharpe ratio for mutual funds is typically between 0.5 and 3. A rule of a thumb is that if the annualized Sharpe Ratio is over 1.0, the fund had a 'pretty good'year (Timotej Jagric ,2007).Treynor's model is used as equity growth scheme is expected to be a well-diversified portfolio devoid of unsystematic risk. It was seen that during 2008-12, the performance of select funds considered in the study was found to be poor as revealed by the risk adjusted measure of Treynor. The similar results also found in the analysis of Sharpe's index. Thus, risk adjusted return of the funds remained volatile along with market volatility during the period under consideration.

This analysis perhaps is sufficient enough to infer conclusion against the prevailing market belief that the fund managers are able to assess properly the risks and potential returns associated with alternative investment opportunities and able to meet their investment objectives fairly well (Donald E Fischer, 2011). However, the equity segment of fund houses was deserted by the investors due to global financial crisis which led to deceleration in the growth of AUM over the period of the study. Moreover, the measures like ban on load factors, imposition of restriction on minimum subscription of NFOs, concentration of fund houses in Tier I and Tier II cities only and the like, aggravated woes of equity oriented mutual funds.

Under this situation, to test the managers' efficiency in increasing in unit holders' value, Jensen's Alfa is applied. The **Alfa value** which measures quality of management performance; positive *Alfa* represents superior extra return because of management talent or vice versa

The econometric analysis in Table – 4 showed interesting result that none of the fund houses in the specific segment attained covetable results in the context of creating value for the unit holders. It is found that Jensen Alfa is lowest in DSP Blackrock Equity Fund (0.0350) and highest in Canara Robeco emerging equity in the mid and small cap. Thus, irrespective of segment, Jensen Alfa found to be less than unity (0.03 to 0.61) indicating the fact that fund managers have not done much for the unit holders during the period under study 2008-2012. It can be inferred that the performance of fund houses is susceptible to the macro fundamentals and fund managers have little scope for enhancing value of unit holders.

It may be mentioned that domestic equity funds which were invested overseas have not performed well (annualized average return 9.3pc compared to Sensex return 7.4pc). Value Research statistics revealed that 19 out of 32 of such funds could earn more than BSE sensex return (4.5%) for a year duration ending on October 30, 2012, while 6 funds witnessed negative return. The reasons may be attributed to declining of global equity markets, softening commodity prices in the context oftightening of fiscal policy across the countries, weakening of emerging market and financial crisis developed in the operational area fund houses' particularly in the countries like Australia, Brazil, and Indonesia during the fiscal 2012.

5. Conclusion:

In fine, the fund houses regarding poor performance may defend and assign the reasons to market sluggishness, financial crisis, low investors' confidence, scrapping of entry load and so on. The fact in this respect remains that they failed to sail through troubled water. Being manufacturer of products onus lies on the fund houses to perform and ensure better returns for the investors. The root cause of this moribund industry would remain unresolved by the claims for reviving entry load and increasing in expense ratio. Because, there are ample evidences that financial institutions; Lehman Brothers, Fannie Mac, World .com, Enron and so on with high incentive structure run into trouble.

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