



**CFA Society
India**

Webinar

Practitioners' Insights: Manager Selection Techniques

By Kaustubh Bhelapurkar

10th April 2020

Performance Drives Investments

- Investors tend to display typical behavioral biases- Recency Bias, Herd Mentality.
- Globally Average investor returns have been lower than Fund Returns anywhere between 50-125 bps in Equity funds.
- Recent performance is an important factor in selecting funds and often the only criteria.
- Indian Equity fund flows data suggests that an astounding 80% flows have been into Q1 & Q2 funds based on recent 1year returns!

But can you solely rely on
fund performance?

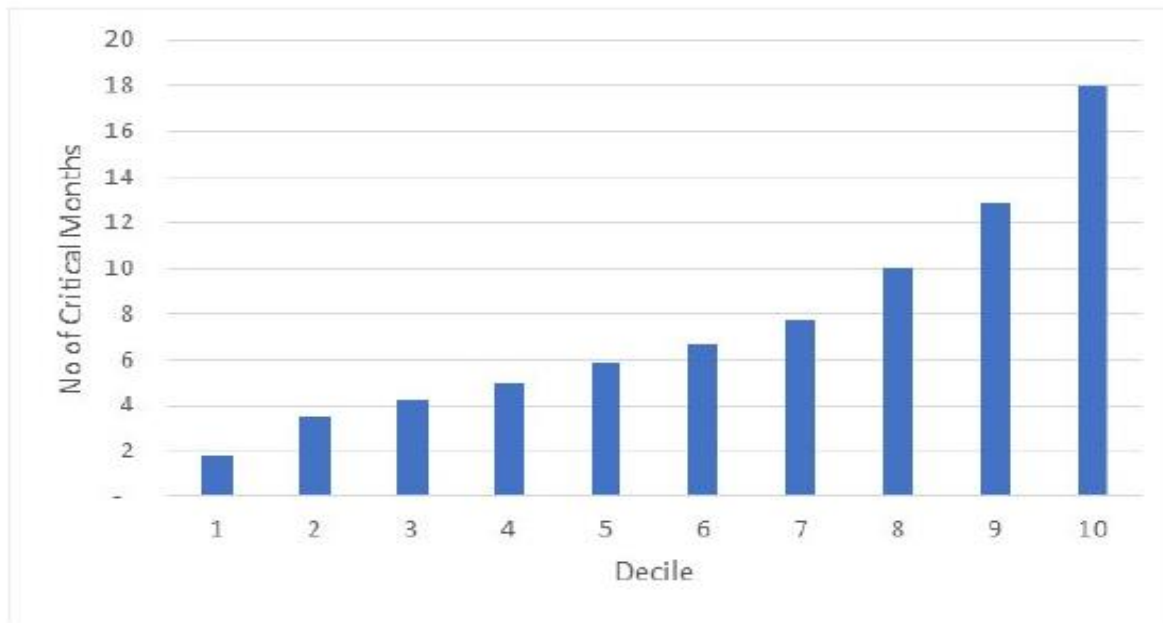


Morningstar Study: Is there a 'Good time' to Buy or Sell Actively Managed Funds

- In the 10-year period from July 2009 to June 2019, Indian stocks owed all their outperformance to just 8 months, or 6.7% of all months.
- We performed the same test against Indian actively managed diversified equity funds to determine if the phenomenon applied to them as well.
- We found that on an average Indian actively managed diversified equity funds' outperformance was attributable to a similar small proportion of months: 8 months or 6.7% of all months. Although this number varies across categories.
- The implication is that investors should not try to time investments in actively managed funds. Staying invested is the name of the game.

Critical Months – Actively Managed Equity Funds

	Mean	Median	25th Percentile	75th Percentile
Overall	8	6	4	10
ELSS	7	6	4	9
Large Cap	7	5	3	7
Multi Cap	7	6	5	8
Mid Cap	11	13	6	15



Methodology

Month	Monthly Return %		Geometric Excess Returns %		
	Axis Bluechip	S&P BSE 100 TR	All Months	All Months (-Highest)	All Months (- 2 Highest)
Jan-18	1.064	3.559	0.976	0.976	0.976
Feb-18	(2.613)	(4.699)	1.022	1.022	1.022
Mar-18	(1.081)	(3.171)	1.022	1.022	1.022
Apr-18	6.559	6.196	1.003	1.003	1.003
May-18	2.128	(0.813)	1.030	1.000	1.000
Jun-18	0.930	(0.322)	1.013	1.013	1.013
Jul-18	5.713	6.056	0.997	0.997	0.997
Aug-18	0.384	3.516	0.970	0.970	0.970
Sep-18	(7.815)	(7.238)	0.994	0.994	0.994
Oct-18	(5.162)	(4.213)	0.990	0.990	0.990
Nov-18	6.714	4.403	1.022	1.022	1.000
Dec-18	0.633	0.429	1.002	1.002	1.002
			1.038	1.008	0.986

Fund Performance vs Flows

Calendar Year Returns

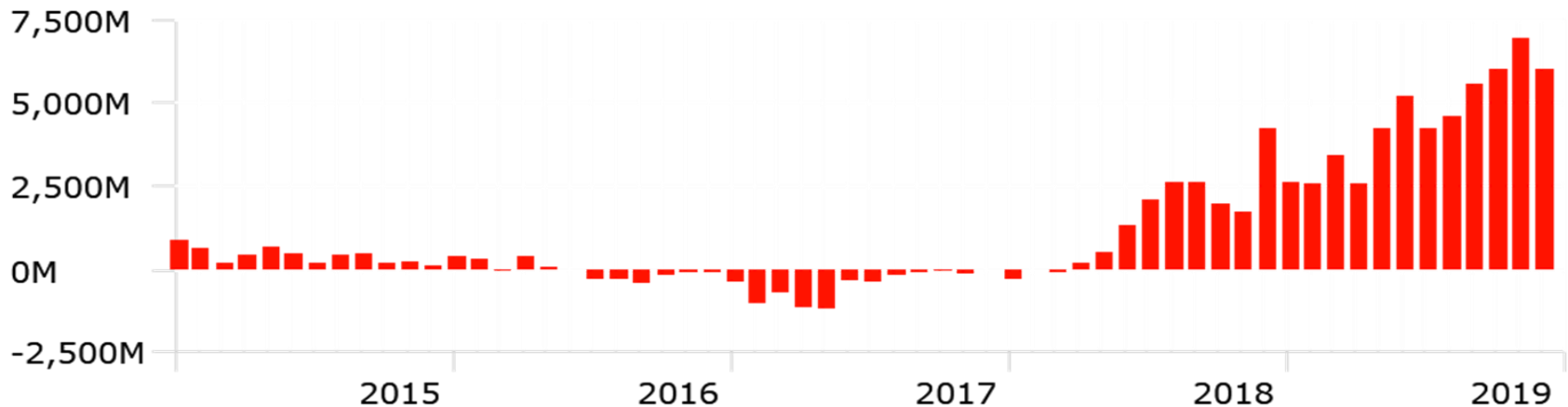
Data Point: Return Currency: BASE

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Axis Bluechip Fund Gr	-22.55	31.73	13.49	40.85	-1.24	-3.62	38.03	6.54	18.57
+/- Benchmark	2.20	-0.48	5.94	6.63	0.71	-8.64	4.76	3.92	7.66
Peer group percentile	49	21	3	49	69	96	10	6	2

Estimated Net Flows - Fund Level (Comprehensive)

Time Period: 1/1/2015 to 12/31/2019

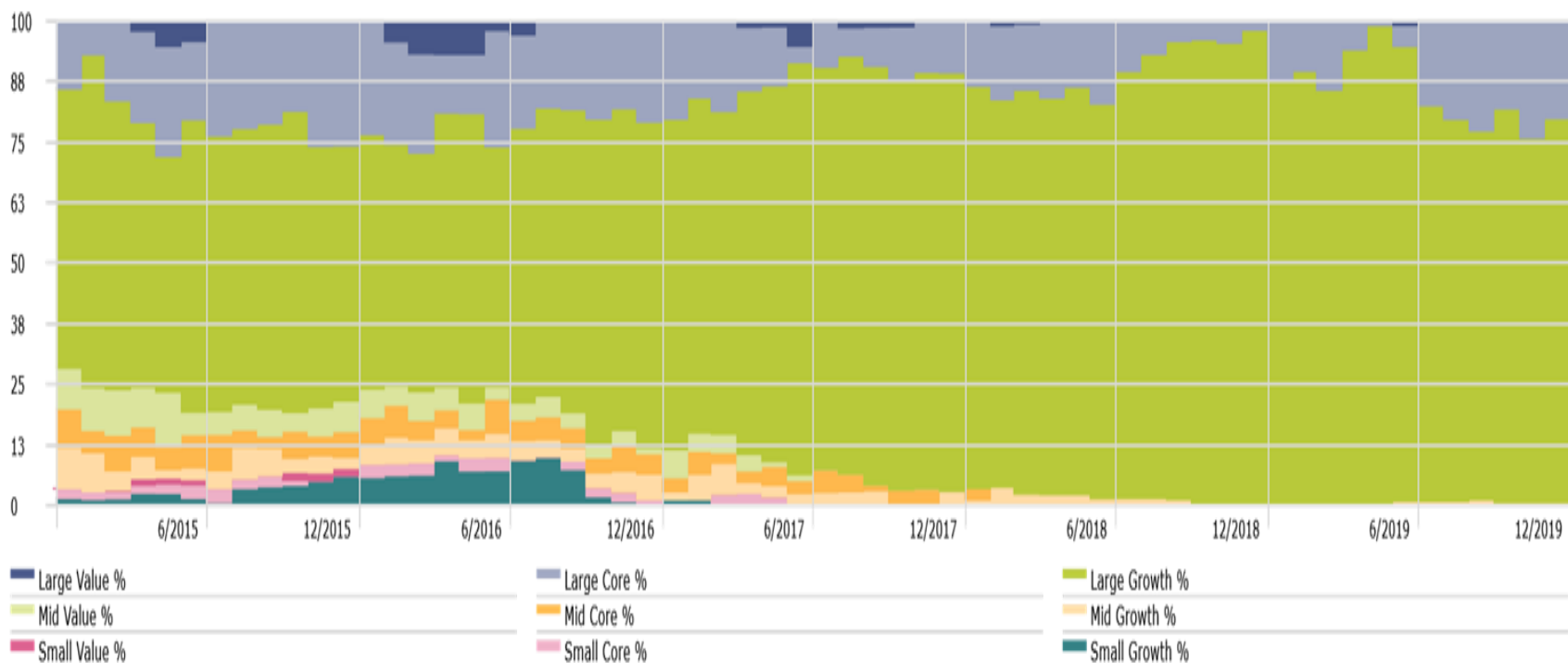
Currency: BASE



Axis Bluechip : Consistent Framework reaping dividends

Equity Style

Time Period: 1/1/2015 to 12/31/2019



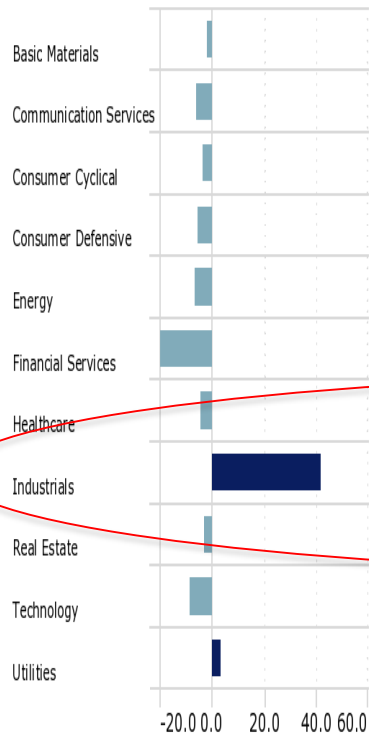
Performance Attribution can tell you a lot

- ✗ Fund's outsized exposure to the Industrials sector which delivered significant returns resulted in outsized performance. Repeatable in the future? Highly unlikely!

Relative Weights

Time Period: 1/1/2007 to 12/31/2007

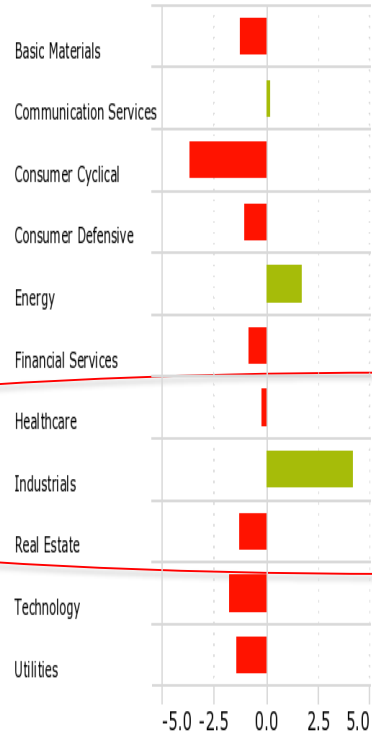
Currency: BASE Calculation Benchmark: S&P BSE 500 India TR INR



Allocation Effect

Time Period: 1/1/2007 to 12/31/2007

Currency: BASE Calculation Benchmark: S&P BSE 500 India TR INR



Selection Effect

Time Period: 1/1/2007 to 12/31/2007

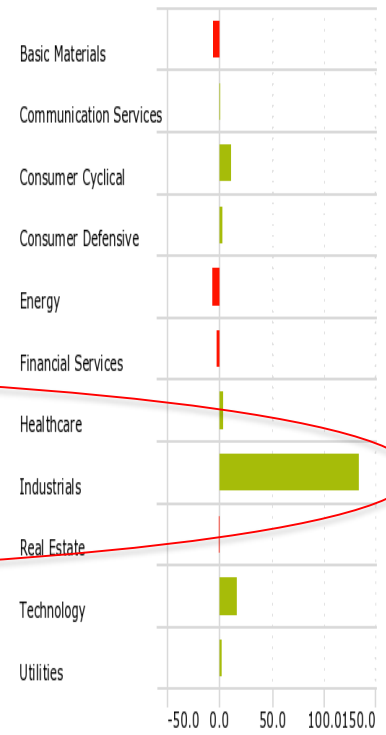
Currency: BASE Calculation Benchmark: S&P BSE 500 India TR INR



Active Return

Time Period: 1/1/2007 to 12/31/2007

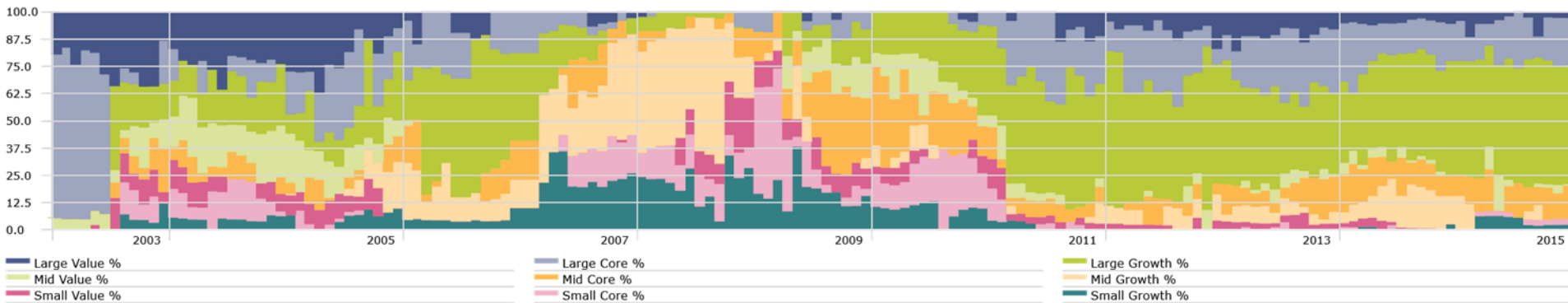
Currency: BASE Calculation Benchmark: S&P BSE 500 India TR INR



Inconsistent Management- No defined investment framework

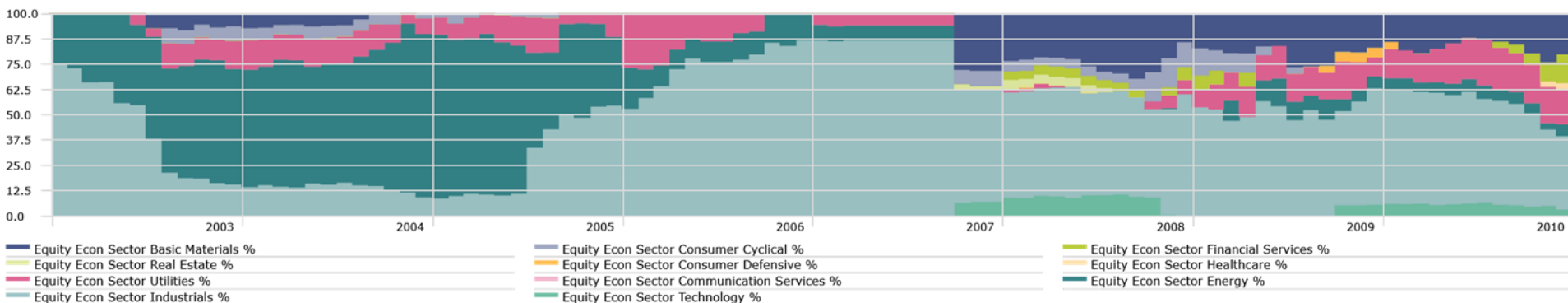
Equity Style

Time Period: 1/1/2003 to 12/31/2015



Equity Sectors (Morningstar)

Time Period: 1/1/2003 to 12/31/2010



Mutual Fund Selection Techniques

Whilst Asset Allocation is the building block for efficient investment portfolios. Fund selection can add significant alpha to a portfolio.

Quantitative Analysis

- × Historical Performance remains the most common method for fund evaluation.
 - × Does using historical performance as a selection tool work efficiently?
- × Risk return ratios and similar parameters are commonly used
 - × Quantitative rating frameworks could be used to shortlist funds for further evaluation.

Qualitative Analysis

- × Evaluating the People & Process driving the strategy
 - × Studying fund manager historical styles, can give you insights on the consistency of the process and how repeatable has it been.
 - × Skill or Luck? Evaluating the performance attribution of funds can give you better insights on the sources of alpha as well as linking
-

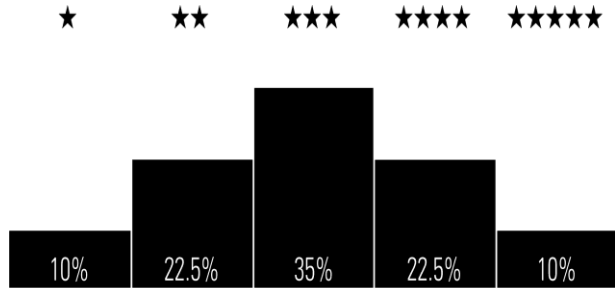
¹² it back to investment style.

- × Building a portfolio of diverse managers styles.

Morningstar Fund Ratings



Morningstar Ratings



Backward-Looking / "Achievement" Test

- ★ Gold
- ★★ Silver
- ★★★ Bronze
- Neutral
- Negative

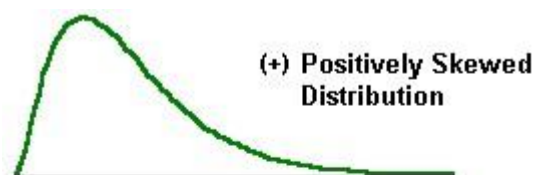
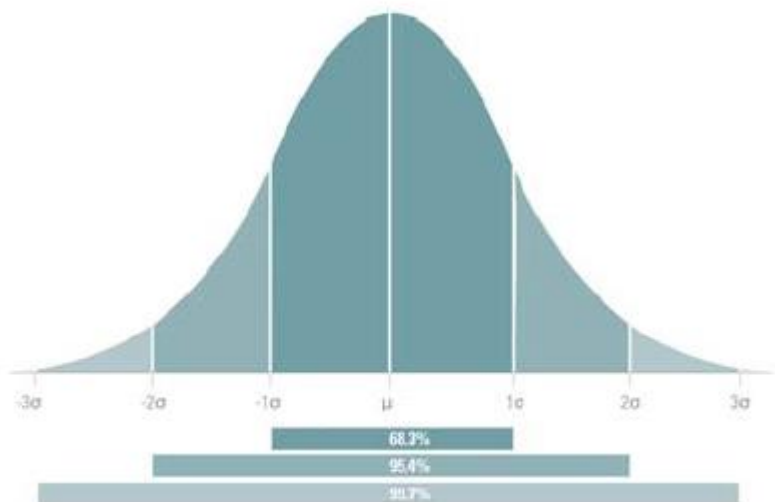
– Forward-Looking / "Aptitude" Test

– Subjective

Why Morningstar Risk Adjusted Return (MRAR)?

- ✓ Any risk-adjusted return measure that is based on standard deviation assumes that the fund's excess returns are normally or lognormally distributed, which is

Normal Distribution



(-) Negatively Skewed Distribution

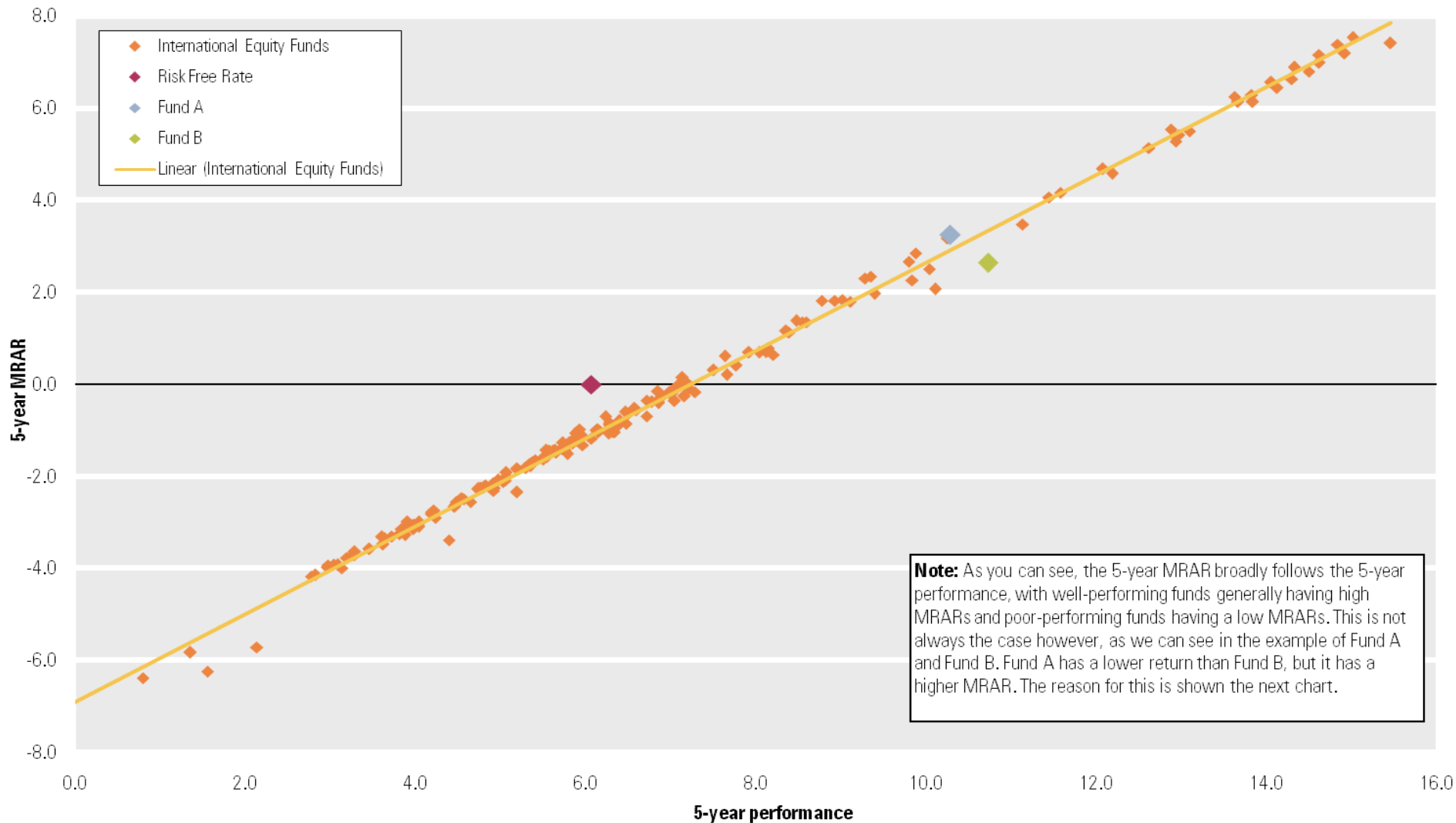


- ✓ Also, standard deviation measures variation both above and below the mean equally. But, investors are generally risk-averse and dislike downside variation more than upside variation.
- ✓ Morningstar gives more weight to downside variation when calculating Morningstar Risk-Adjusted Return and does not make any assumptions about the distribution of excess returns.

About Morningstar Risk Adjusted Returns (MRAR)

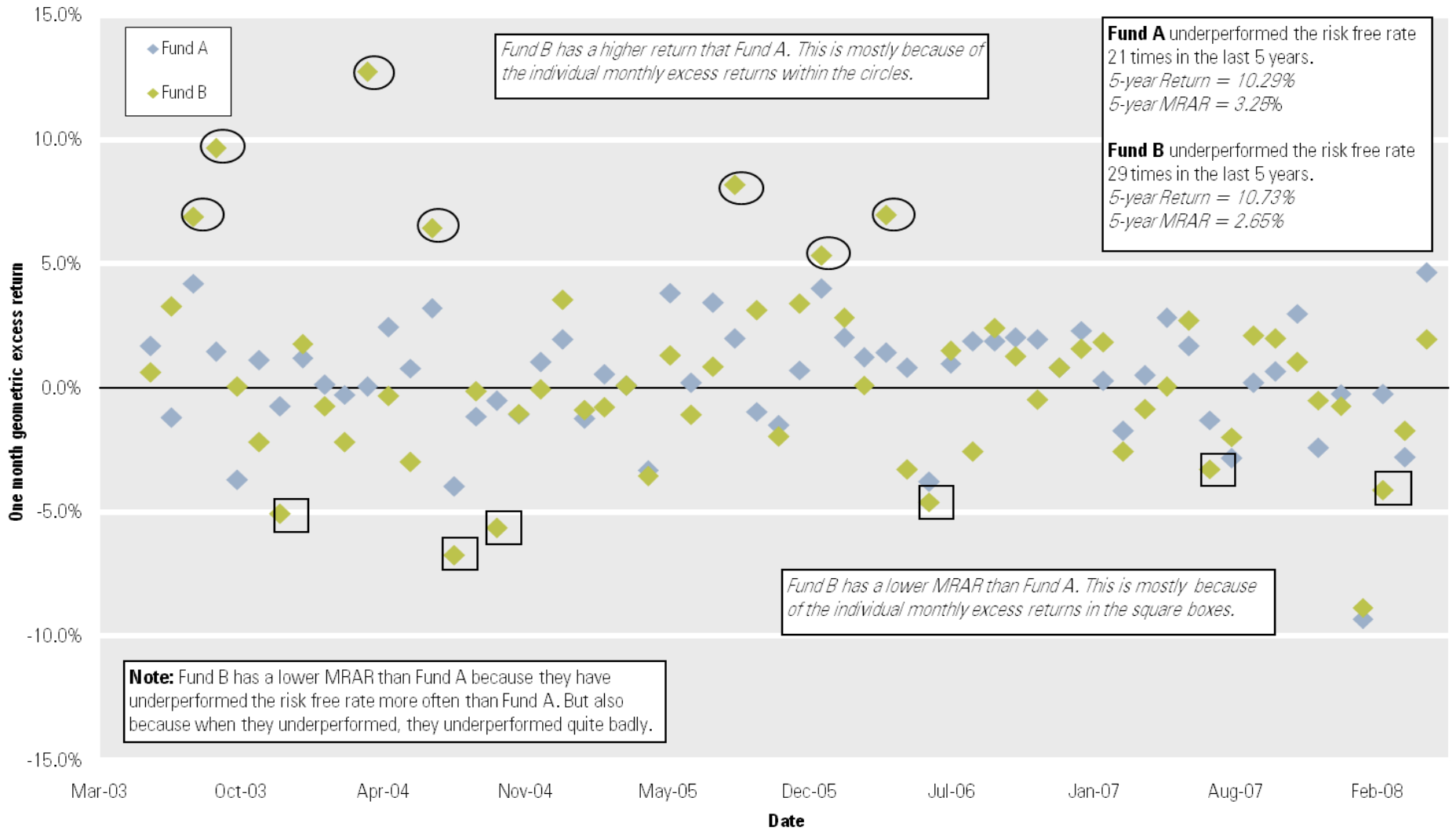
- ✓ **MRAR** is adjusted for risk by calculating a risk penalty for each investment's return based on "expected utility theory".
- ✓ Although the math is complex, the basic concept is relatively straightforward.
- ✓ It assumes that investors are more concerned about a possible poor outcome than an unexpectedly good outcome; and those investors are willing to give a small portion of an investment's expected return in exchange for greater certainty.
- ✓ A "risk penalty" is subtracted from each investment's total return, based on the variation in its month-to-month return during the rating period, with an emphasis on downward variation.
- ✓ The greater the variation, the larger the penalty. If two funds have the exact same return, the one with more variation in its return is given the larger risk penalty.

Graphical Illustration of MRAR



Note: As you can see, the 5-year MRAR broadly follows the 5-year performance, with well-performing funds generally having high MRARs and poor-performing funds having a low MRARs. This is not always the case however, as we can see in the example of Fund A and Fund B. Fund A has a lower return than Fund B, but it has a higher MRAR. The reason for this is shown the next chart.

Risk Adjustment Example



Morningstar – Analyst Ratings Three Pillar Framework

Our three-pillar research framework reinforces a consistent, long-term investment process and gives investors/advisors/gatekeepers/consultants the resources they need to provide justified recommendations that are well suited to client needs.



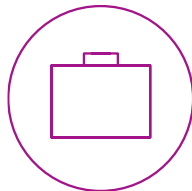
People

Team
Quality/Experience

Team Depth

Team Continuity

Alignment of Interests



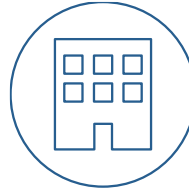
Process

Security Selection/Idea
Generation

Valuation Discipline

Portfolio Construction/
Risk Management

Capacity



Parent

Structure/Ownership

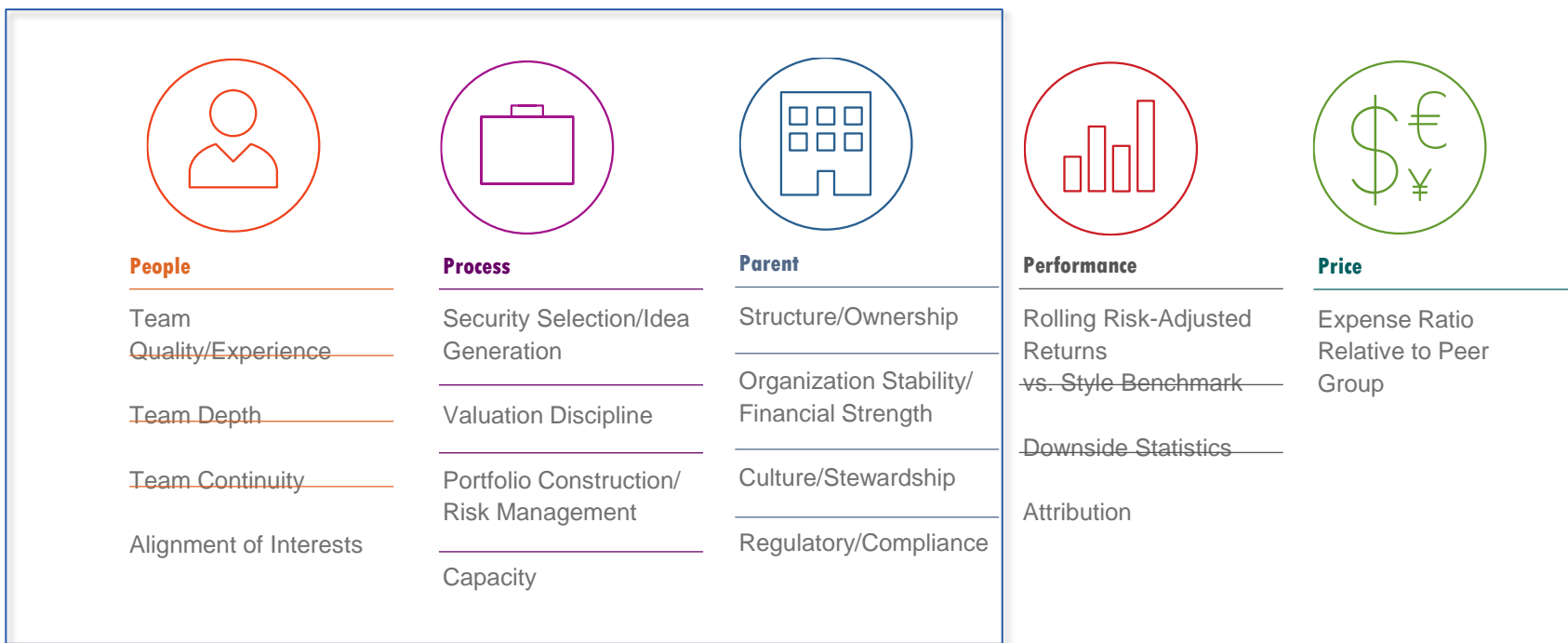
Organization Stability/
Financial Strength

Culture/Stewardship

Regulatory/Compliance

Morningstar – Analyst Ratings Three Pillar Framework

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Good fund performance, but
are there other risks lurking?

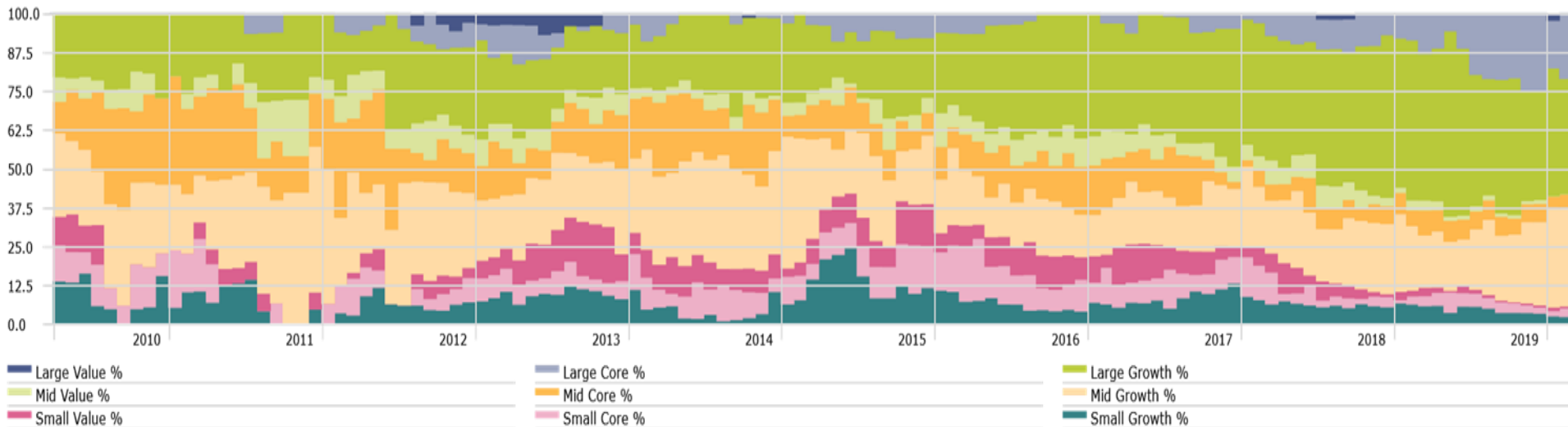


Manager Centric Process – Key Man Risk!

	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD
IDFC Multi Cap Gr	-18.00	40.84	5.62	58.91	8.29	-2.70	38.04	-8.75	7.58	-25.38
S&P BSE 500 India TR INR	-26.42	33.41	4.93	38.93	0.45	5.15	37.60	-1.81	8.98	-28.81
S&P BSE Midcap TR INR	-33.25	40.65	-4.03	56.91	8.72	9.28	49.90	-12.53	-2.06	-29.04

Equity Style

Time Period: 4/1/2010 to 2/29/2020



Good Manager & Process,
but recent performance
doesn't stack up



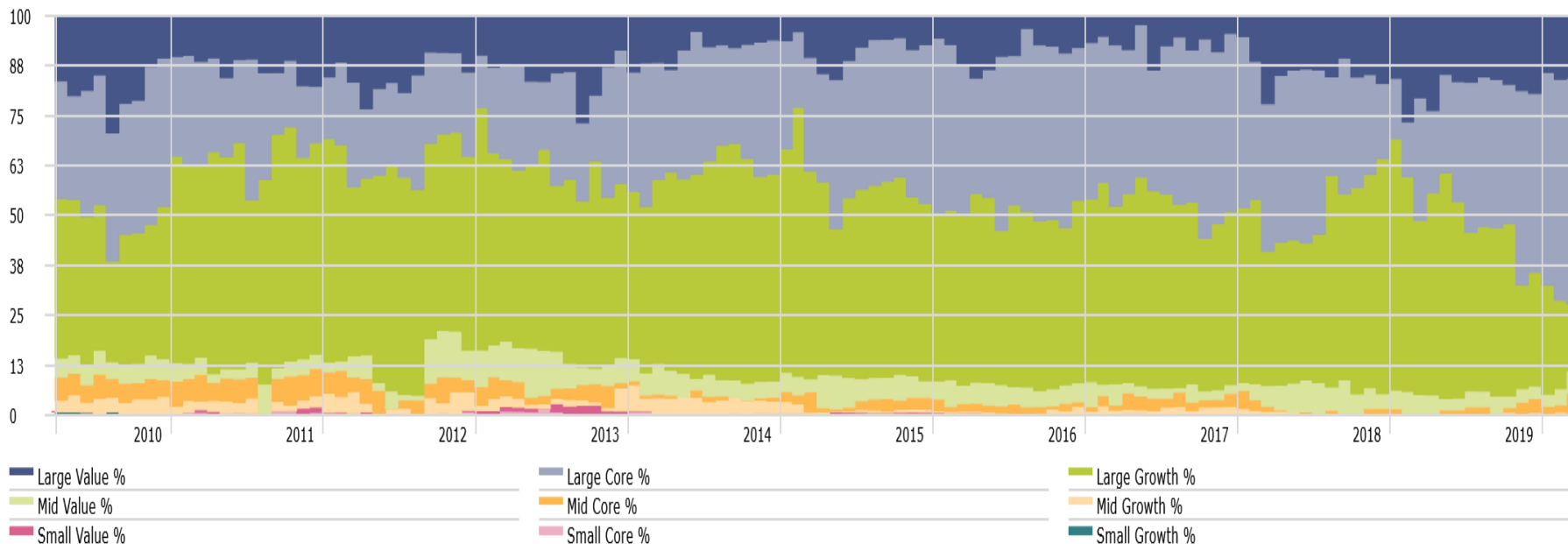
Fund Style Analysis (HDFC Top 100)

✗ There is an inherent value bias in the investment framework

	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD
HDFC Top 100 Gr	-24.30	32.43	4.05	46.52	-6.09	8.52	31.97	0.13	7.70	-31.07
S&P BSE 100 India TR INR	-24.75	32.21	7.56	34.21	-1.95	5.02	33.27	2.62	10.92	-28.82
India Fund Large-Cap	-24.35	28.71	3.92	42.42	-1.05	4.31	32.12	0.06	9.15	-26.89

Equity Style

Time Period: 4/1/2010 to 3/31/2020



HDFC Top 100– Performance Attribution

Performance Attribution - Sectors

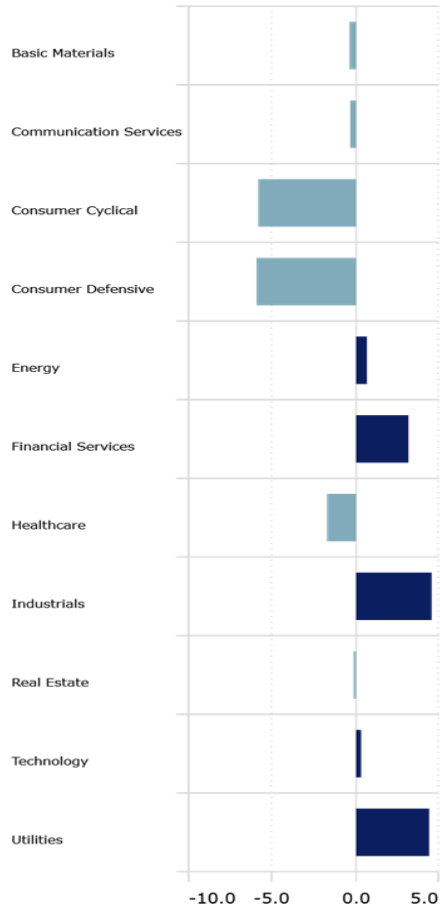
HDFC Top 100 Gr



Relative Weights

Time Period: 4/1/2015 to 3/31/2020

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



Allocation Effect

Time Period: 4/1/2015 to 3/31/2020

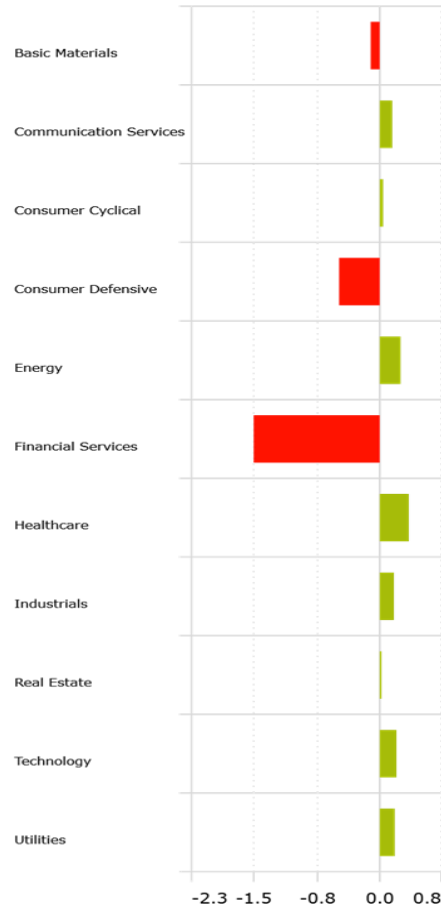
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Selection Effect

Time Period: 4/1/2015 to 3/31/2020

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



Active Return

Time Period: 4/1/2015 to 3/31/2020

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



HDFC Top 100: Style Attribution

Performance Attribution - Style

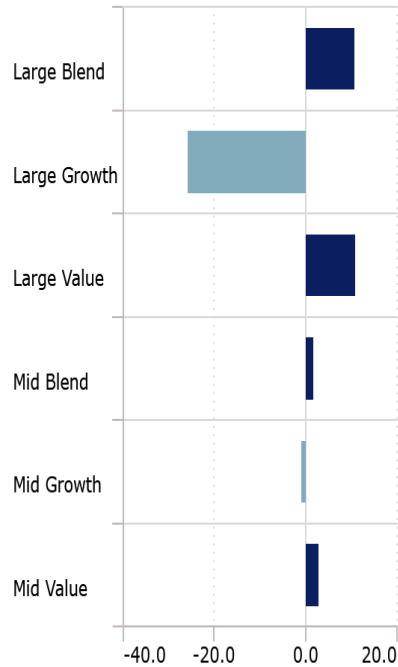
HDFC Top 100 Gr



Relative Weights

Time Period: 1/1/2019 to 12/31/2019

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



Allocation Effect

Time Period: 1/1/2019 to 12/31/2019

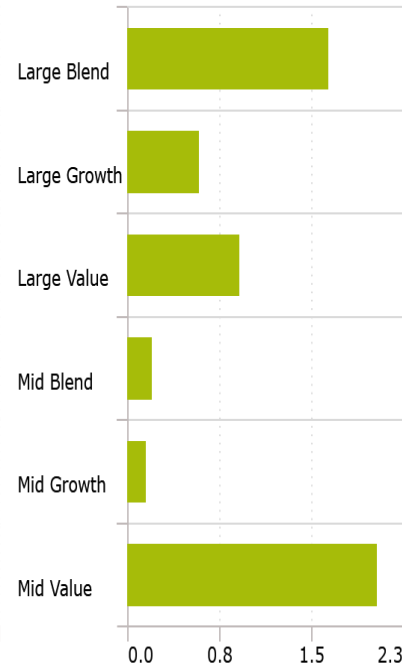
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Selection Effect

Time Period: 1/1/2019 to 12/31/2019

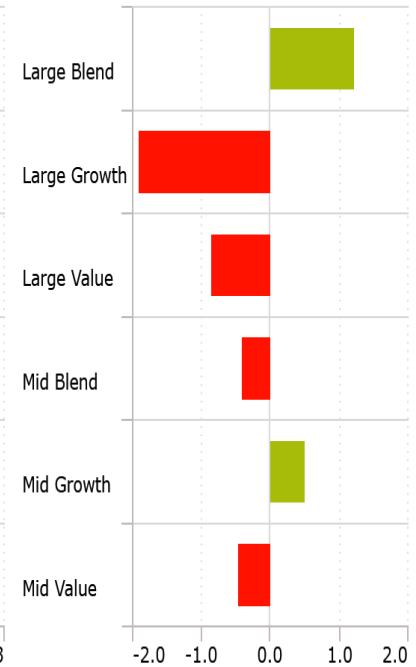
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Active Return

Time Period: 1/1/2019 to 12/31/2019

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



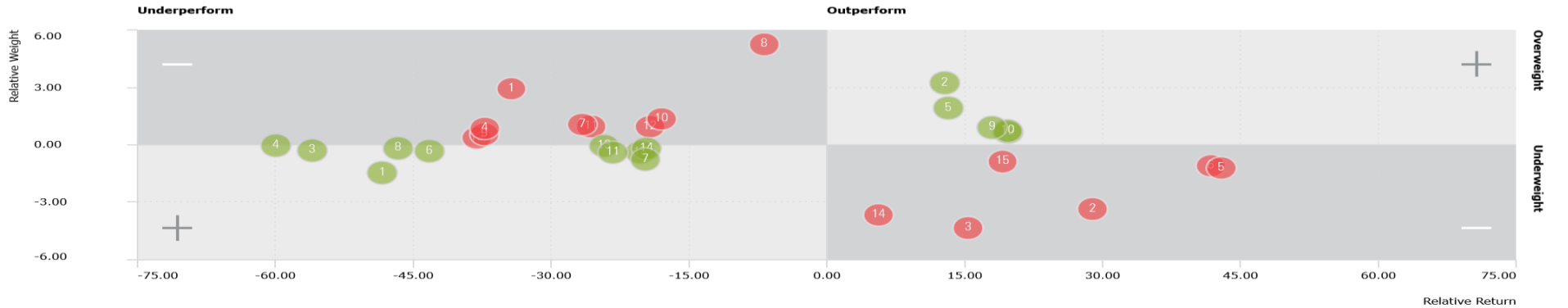
Performance Attribution- Stock Contributions

✘ Understanding the underlying sources of alpha

Selection Effects

Time Period: 4/1/2019 to 3/31/2020

Currency: BASE



Best Selections	Morningstar Sector	Weight +/-	Return +/-	Effect	Worst Selections	Morningstar Sector	Weight +/-	Return +/-	Effect
1 IndusInd Bank Ltd	Financial Services	-1.47	-48.35	0.93	1 ITC Ltd	Consumer Defensive	2.93	-34.32	-1.07
2 ICICI Bank Ltd	Financial Services	3.23	12.81	0.41	2 Kotak Mahindra Bank Ltd	Financial Services	-3.37	28.92	-0.87
3 Indiabulls Housing Finance Ltd	Financial Services	-0.29	-56.00	0.30	3 Housing Development Finan...	Financial Services	-4.35	15.37	-0.60
4 Yes Bank Ltd	Financial Services	-0.04	-59.94	0.30	4 Canara Bank	Financial Services	0.86	-37.22	-0.44
5 Power Finance Corp Ltd	Financial Services	1.92	13.21	0.27	5 Hindustan Unilever Ltd	Consumer Defensive	-1.21	42.89	-0.41
6 Piramal Enterprises Ltd	Healthcare	-0.33	-43.25	0.19	6 Asian Paints Ltd	Basic Materials	-1.10	41.77	-0.40
7 Tata Power Co Ltd	Utilities	-0.77	-19.75	0.19	7 Bank of Baroda	Financial Services	1.07	-26.61	-0.38
8 RBL Bank Ltd	Financial Services	-0.18	-46.66	0.18	8 State Bank of India	Financial Services	5.25	-6.83	-0.33
9 Tata Chemicals Ltd	Basic Materials	0.91	17.98	0.18	9 Bank of India	Financial Services	0.56	-37.26	-0.31
10 Bharat Electronics Ltd	Industrials	0.73	19.67	0.13	10 Tata Steel Ltd	Basic Materials	1.36	-18.00	-0.29
11 Indian Oil Corp Ltd	Energy	-0.39	-23.27	0.12	11 Aurobindo Pharma Ltd	Healthcare	0.97	-25.63	-0.27
12 ABB India Ltd	Industrials	0.65	19.72	0.12	12 Axis Bank Ltd	Financial Services	0.95	-19.25	-0.26
13 Hindalco Industries Ltd	Basic Materials	-0.05	-24.22	0.10	13 Union Bank of India	Financial Services	0.36	-38.08	-0.22
14 UPL Ltd	Basic Materials	-0.19	-19.62	0.10	14 Reliance Industries Ltd	Energy	-3.66	5.63	-0.21
15 JSW Steel Ltd Shs Demateri...	Basic Materials	-0.39	-20.31	0.09	15 Power Grid Corp Of India Ltd	Utilities	-0.87	19.12	-0.21

Standout Performer – Skill or
Luck?

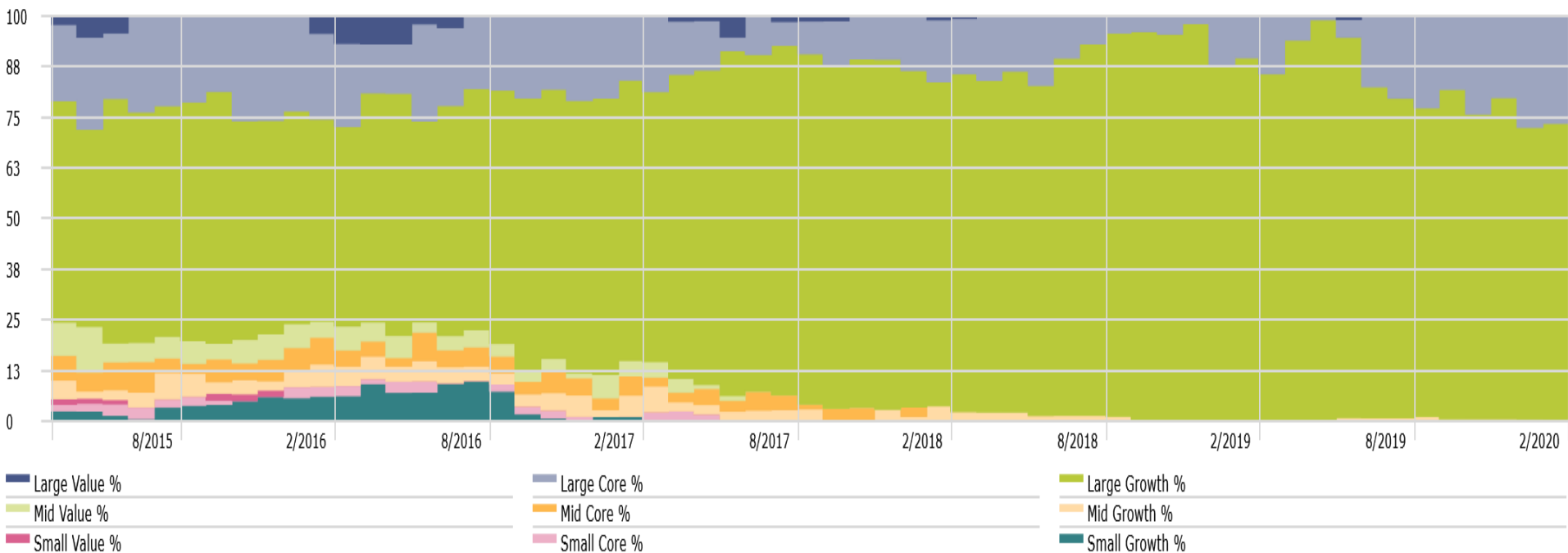
MORNINGSTAR®

Fund Style Analysis (Axis Bluechip)

- ✗ Consistent process and focus towards quality high growth companies, which has paid rich dividends recently.

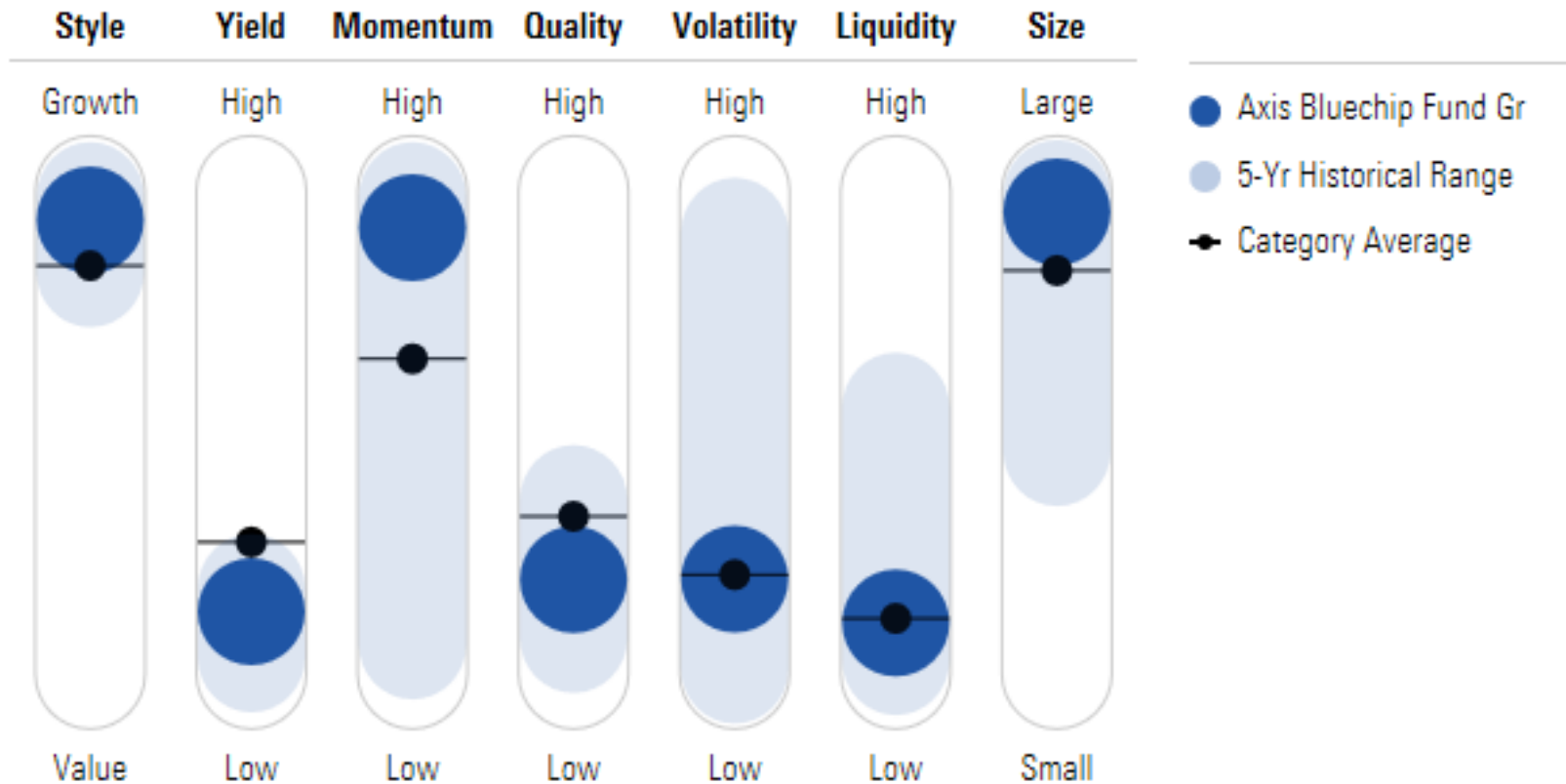
Equity Style

Time Period: 4/1/2015 to 2/29/2020



Factor Profile for Funds

- ✗ Greater focus towards the “Growth” style as compared to the peer group.



Fund as of Feb 29, 2020 | Category: Large-Cap as of Feb 29, 2020

Axis Bluechip– Performance Attribution

Performance Attribution - Sectors

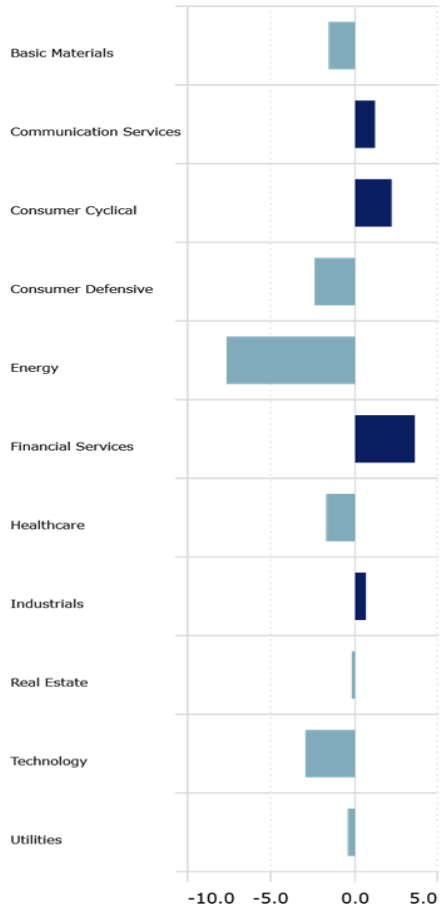
Axis Bluechip Fund Gr



Relative Weights

Time Period: 4/1/2015 to 3/31/2020

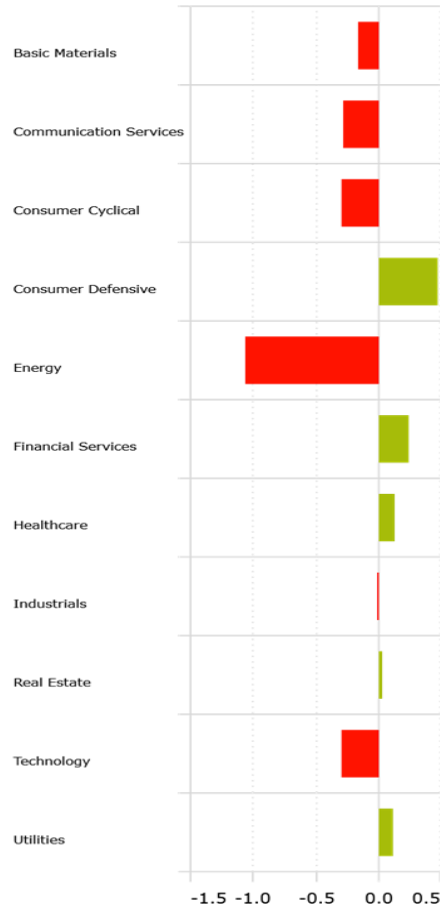
Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



Allocation Effect

Time Period: 4/1/2015 to 3/31/2020

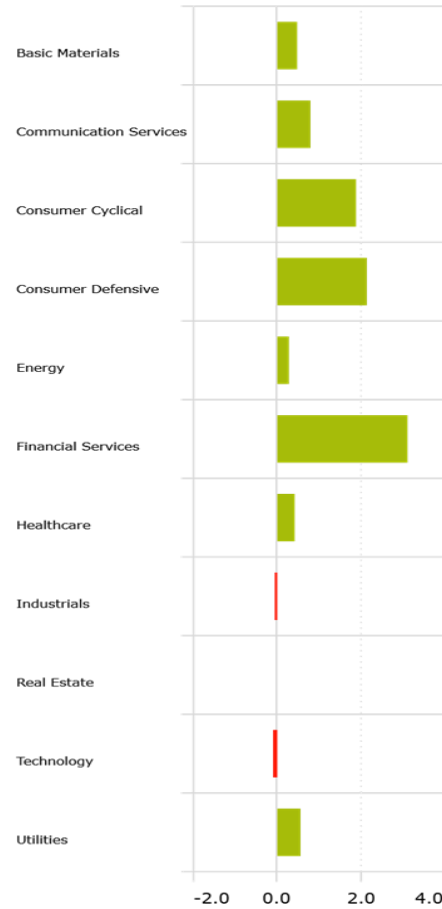
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Selection Effect

Time Period: 4/1/2015 to 3/31/2020

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR



Active Return

Time Period: 4/1/2015 to 3/31/2020

Currency: BASE Calculation Benchmark: S&P BSE 100 India TR INR

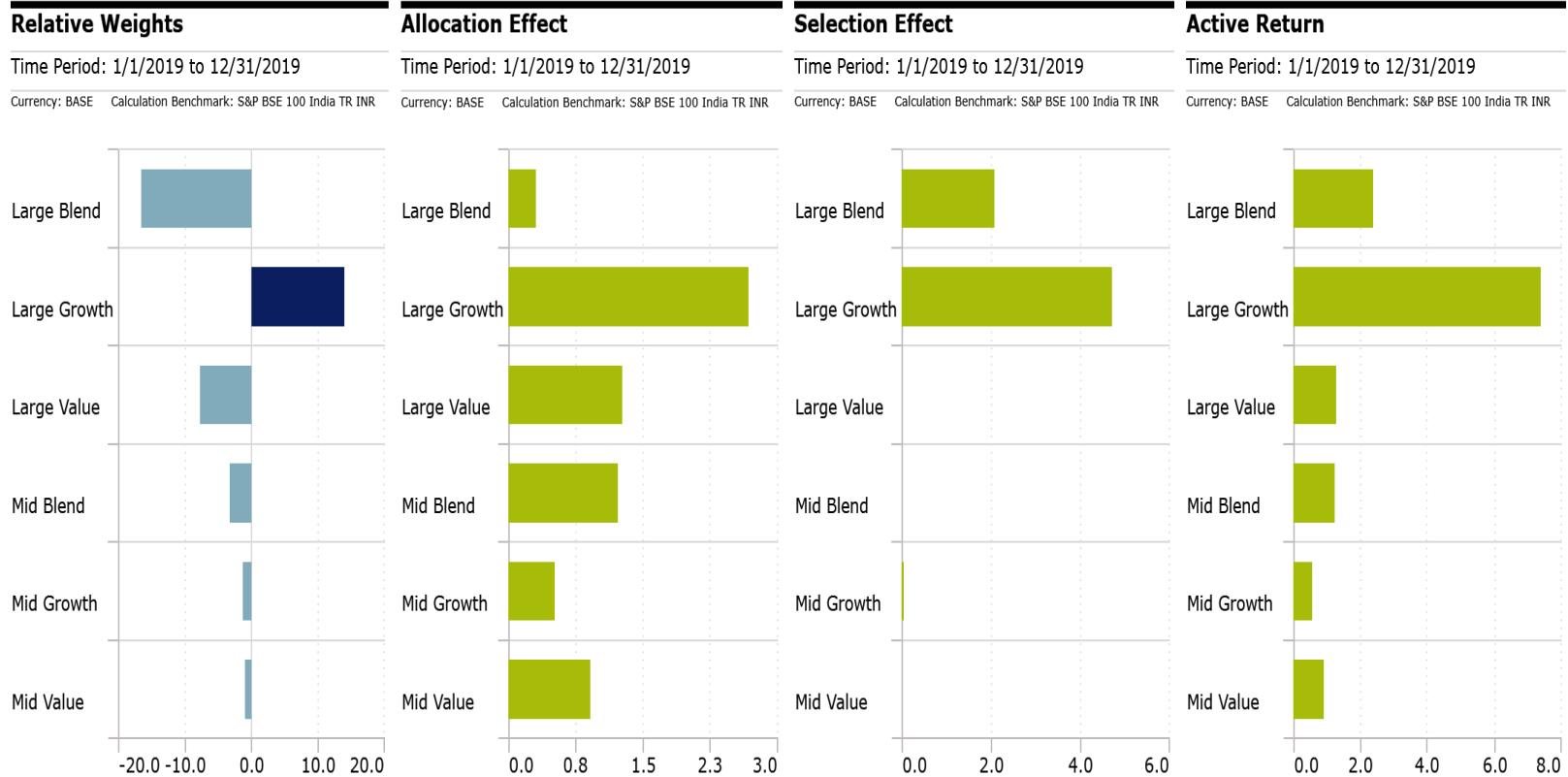


Axis Bluechip : Style Attribution



Performance Attribution - Style

Axis Bluechip Fund Gr



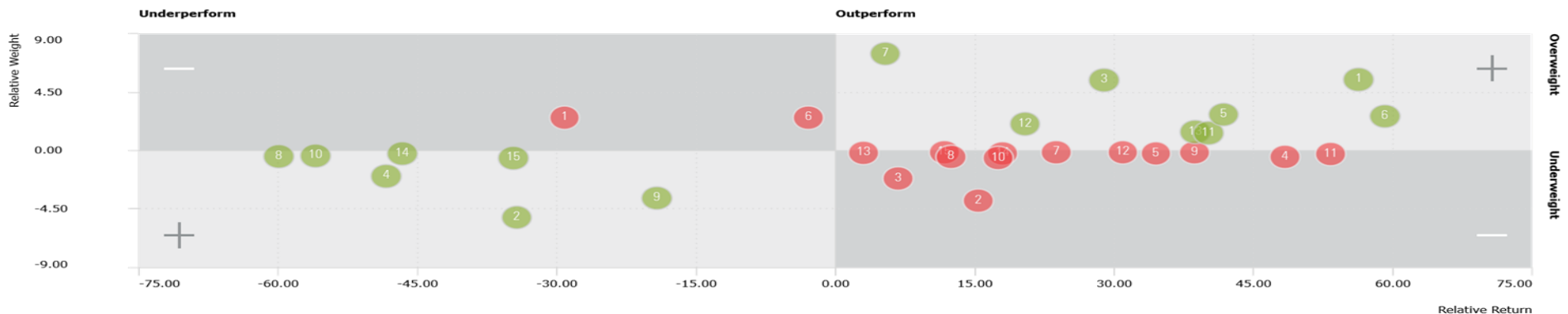
Performance Attribution- Stock Contributions

✘ Understanding the underlying sources of alpha

Selection Effects

Time Period: 4/1/2019 to 3/31/2020

Currency: BASE

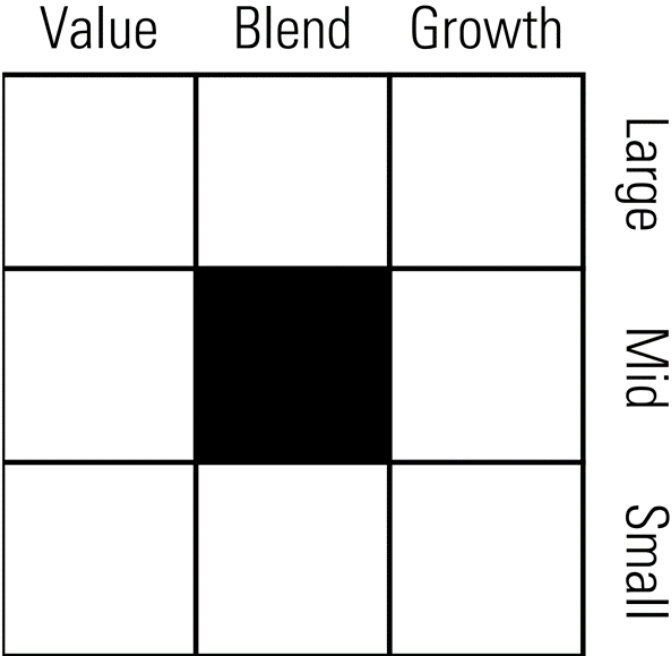


Best Selections	Morningstar Sector	Weight +/-	Return +/-	Effect	Worst Selections	Morningstar Sector	Weight +/-	Return +/-	Effect
1 Avenue Supermarts Ltd	Consumer Defensive	5.48	56.31	2.39	1 Bandhan Bank Ltd	Financial Services	2.53	-29.17	-0.84
2 ITC Ltd	Consumer Defensive	-5.15	-34.32	1.95	2 Housing Development Finan...	Financial Services	-3.86	15.37	-0.50
3 Kotak Mahindra Bank Ltd	Financial Services	5.43	28.92	1.57	3 HDFC Bank Ltd	Financial Services	-2.16	6.75	-0.29
4 IndusInd Bank Ltd	Financial Services	-1.97	-48.35	1.38	4 HDFC Life Insurance Co Ltd	Financial Services	-0.50	48.38	-0.09
5 Asian Paints Ltd	Basic Materials	2.78	41.77	1.21	5 Dr Reddy's Laboratories Ltd	Healthcare	-0.23	34.47	-0.08
6 Nestle India Ltd	Consumer Defensive	2.64	59.12	1.11	6 Bajaj Finserv Ltd	Financial Services	2.54	-2.91	-0.08
7 Bajaj Finance Ltd	Financial Services	7.46	5.34	1.04	7 Shree Cement Ltd	Basic Materials	-0.12	23.75	-0.08
8 Yes Bank Ltd	Financial Services	-0.45	-59.94	0.94	8 Bajaj Auto Ltd	Consumer Cyclical	-0.49	12.41	-0.08
9 Axis Bank Ltd	Financial Services	-3.66	-19.25	0.88	9 MRF Ltd	Consumer Cyclical	-0.16	38.64	-0.07
10 Indiabulls Housing Finance Ltd	Financial Services	-0.38	-56.00	0.46	10 Dabur India Ltd	Consumer Defensive	-0.58	17.51	-0.07
11 Divi's Laboratories Ltd	Healthcare	1.34	40.14	0.41	11 Tata Consumer Products Ltd	Consumer Defensive	-0.28	53.29	-0.06
12 Titan Co Ltd	Consumer Cyclical	2.05	20.39	0.39	12 Crompton Greaves Consume...	Consumer Cyclical	-0.13	30.91	-0.05
13 Pidilite Industries Ltd	Basic Materials	1.43	38.72	0.33	13 Eicher Motors Ltd	Consumer Cyclical	-0.17	3.02	-0.04
14 RBL Bank Ltd	Financial Services	-0.24	-46.66	0.28	14 Tata Chemicals Ltd	Basic Materials	-0.23	17.98	-0.04
15 Vedanta Ltd	Basic Materials	-0.57	-34.68	0.27	15 Voltas Ltd	Industrials	-0.12	11.69	-0.03

Deciphering Fund Manager Styles



Equity Styles : Morningstar Style Box



Birla Frontline Equity

Morningstar Style Box - Aditya BSL Frontline Equity Gr

Portfolio Date: 12/31/2019

	Value	Blend	Growth	Market Cap	%
Large	8.2	40.9	38.2	Market Cap Giant %	62.6
				Market Cap Large %	24.7
				Market Cap Mid %	12.1
Mid	1.3	6.2	4.6	Market Cap Small %	0.5
				Market Cap Micro %	0.1
Small	0.3	0.3	0.0		

HDFC Top 100

Morningstar Style Box - HDFC Top 100 Gr

Portfolio Date: 12/31/2019

	Value	Blend	Growth	Market Cap	%
Large	19.6	44.6	28.5	Market Cap Giant %	60.6
				Market Cap Large %	32.1
				Market Cap Mid %	7.3
Mid	3.3	3.5	0.6	Market Cap Small %	0.0
				Market Cap Micro %	0.0
Small	0.0	0.0	0.0		

Mirae India Large Cap

Morningstar Style Box - Mirae Asset Large Cap Reg Gr

Portfolio Date: 12/31/2019

	Value	Blend	Growth	Market Cap	%
Large	6.5	33.4	46.7	Market Cap Giant %	59.3
				Market Cap Large %	27.3
				Market Cap Mid %	11.9
Mid	0.0	5.0	6.9	Market Cap Small %	1.5
				Market Cap Micro %	0.0
Small	0.0	0.5	1.0		

Axis Bluechip

Morningstar Style Box - Axis Bluechip Fund Gr

Portfolio Date: 12/31/2019

	Value	Blend	Growth	Market Cap	%
Large	0.0	20.1	79.5	Market Cap Giant %	81.4
				Market Cap Large %	18.2
				Market Cap Mid %	0.5
Mid	0.0	0.0	0.5	Market Cap Small %	0.0
				Market Cap Micro %	0.0
Small	0.0	0.0	0.0		

Diversification needs to be done scientifically

Common Holdings

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1 ICICI Pru Bluechip Gr		0.49	0.60	0.52	0.42	0.54	0.42	0.47	0.55	0.46	0.55	0.55	0.36	0.59	
2 SBI Bluechip Reg Gr	0.49		0.59	0.45	0.38	0.51	0.36	0.47	0.48	0.34	0.57	0.55	0.21	0.54	
3 Aditya BSL Frontline Equity Gr	0.60	0.59		0.56	0.47	0.61	0.39	0.49	0.56	0.43	0.59	0.55	0.29	0.60	
4 HDFC Top 100 Gr	0.52	0.45	0.56		0.78	0.59	0.28	0.59	0.47	0.45	0.46	0.52	0.29	0.53	
5 HDFC Equity Gr	0.42	0.38	0.47	0.78		0.45	0.22	0.55	0.40	0.44	0.38	0.41	0.25	0.40	
6 Mirae Asset Large Cap Reg Gr	0.54	0.51	0.61	0.59	0.45		0.36	0.48	0.51	0.32	0.59	0.59	0.21	0.60	
7 Axis Bluechip Fund Gr	0.42	0.36	0.39	0.28	0.22	0.36		0.28	0.45	0.22	0.48	0.46	0.12	0.48	
8 Nippon India Large Cap Gr	0.47	0.47	0.49	0.59	0.55	0.48	0.28		0.50	0.42	0.44	0.44	0.29	0.45	
9 UTI Mastershare Unit Reg Gr	0.55	0.48	0.56	0.47	0.40	0.51	0.45	0.50		0.36	0.50	0.60	0.26	0.58	
10 Franklin India Bluechip Gr	0.46	0.34	0.43	0.45	0.44	0.32	0.22	0.42	0.36		0.42	0.34	0.31	0.32	
11 DSP Top 100 Equity Reg Gr	0.55	0.57	0.59	0.46	0.38	0.59	0.48	0.44	0.50	0.42		0.59	0.18	0.56	
12 Kotak Bluechip Reg Gr	0.55	0.55	0.55	0.52	0.41	0.59	0.46	0.44	0.60	0.34	0.59		0.22	0.64	
13 ICICI Pru Value Discovery Gr	0.36	0.21	0.29	0.29	0.25	0.21	0.12	0.29	0.26	0.31	0.18	0.22		0.26	
14 S&P BSE 100 India TR INR	0.59	0.54	0.60	0.53	0.40	0.60	0.48	0.45	0.58	0.32	0.56	0.64	0.26		

■ 1.00 to 0.80 ■ 0.80 to 0.60 ■ 0.60 to 0.40 □ 0.40 to 0.20 □ 0.20 to 0.00

Portfolio Date

1 2/29/2020	4 2/29/2020	7 2/29/2020	10 2/29/2020	13 2/29/2020
2 2/29/2020	5 2/29/2020	8 2/29/2020	11 2/29/2020	14 3/31/2020
3 2/29/2020	6 2/29/2020	9 2/29/2020	12 2/29/2020	

Recent Regulatory Changes

- Fund Recategorization
- Rationalization of Expense Ratio Slabs
- Ban of Upfront Commissions

THANK YOU!

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