Seek to get more out of large cap investments by investing in Nifty Next 50 Index

Equity as an asset class is an attractive investment avenue for investors with a high risk appetite and long-term investment horizon. The safety quotient draws investors to large cap companies and often away from higher possible returns by small/ mid-caps. But what if investors can get a blend of both – stability (large caps) along with potentially higher returns (midcaps)? The answer lies in Nifty Next 50 ETF (exchange-traded fund i.e. investor may consider investing in the portfolio of NIFTY Next 50 Index). This article discusses the investment opportunity offered by this index.

Understanding Nifty Next 50 Index

Nifty Next 50 index consists of 50 large cap stocks which comes after the top 50 (Nifty 50) in order of free float market capitalisation (cap) in Nifty 100. The index was introduced on December 24, 1996, with a base date of November 4, 1996. It predominately captures the performance of blue chip companies in the large cap universe along with a few midcaps. Thus, the index enables investors to enjoy the twin benefits of probable stability (from large caps) and potential returns (from mid-caps).

What's in it for investors?

Let's take a look at the qualitative and quantitative benefits for investors.

Qualitative: Seek Safety through investment in large companies

Investors find comfort in the safety of fundamentally sound large cap companies. Blue chip investments offer many benefits (highlighted in figure 1). Further, the NIFTY Next 50 index provides an opportunity for investors to invest in companies that are potential candidates for inclusion in Nifty 50 index in the future. Over the past 18 years, 41 stocks have been upgraded to Nifty 50 index, out of which 27 currently form the part of Nifty 50 index.

Figure 1: Some of the key benefits on Investing in large caps

NIFTY Next 50 Table: 1

Nifty Next 50	Sector Weightage
Financial services	31.81.%
Consumer goods	23.17%
Pharma	11.82%
Cement and cement products	6.88%
Energy	5.80%
Auto	5.43%
Services	3.65%
Chemicals	2.70%
Metals	2.09%
Textile	1.74%
Industrial manufacturing	1.70%
Construction	1.83%
IT	0.81%
Telecom	0.57%
Total	100%

NIFTY 50 Table: 2

Nifty 50	Sector Weightage
Financial services	41.98%
Energy	14.46%
IT	12.77%
Consumer goods	11.24%
Automobile	5.72%
Construction	3.20%
Metals	3.25%
Pharma	2.11%
Telecom	2.15%
Cement and cement products	1.49%
Fertilisers and pesticides	0.64%
Services	0.56%
Media and entertainment	0.44%
Total	100%

Source: NSE, as on December 2019.

Diversified portfolio

Nifty Next 50 index is the well-diversified index compared to Nifty 50 index.

Index composition of Nifty Next 50 and Nifty 50

Chart 1: NIFTY Next 50 v/s NIFTY 50 index portfolio

Nifty Next 50

- Number of sectors = 15
- Share of top 5 sectors = 79%
- Financial services and consumer goods are the top sectors with share of 29% and 25%
- Share of the top 10 stocks is 34% with individual stock weightage ranging from 2% to 4%

Nifty 50

- Number of sectors = 14
- Share of top 5 sectors = 86%
- Financial services is the top sector with 41% weightage
- Share of the top 10 stocks is 61% and individual stocks' share ranges from 3% to 11%

Source: NSE, Nifty 50 and Nifty Next 50 factsheet, as on December 2019.

Sector weightage

Table 1: Nifty next 50 index

Nifty Next 50	Sector Weightage
Financial services	29.13%
Consumer goods	24.93%
Pharma	11.67%
Cement and cement products	6.90%
Energy	6.74%
Auto	5.12%
Services	3.97%
Chemicals	2.81%
Metals	1.98%
Textile	1.97%
Industrial manufacturing	1.94%
Construction	1.49%
IT	0.96%
Telecom	0.38%
Total	100%

Table 2: Nifty 50 index

Nifty 50	Sector Weightage
Financial services	41.25%
Energy	15.39%
IT	12.36%
Consumer goods	11.47%
Automobile	5.65%
Construction	3.31%
Metals	3.04%
Pharma	2.19%
Telecom	2.16%
Cement and cement products	1.59%
Fertilisers and pesticides	0.63%
Services	0.60%
Media and entertainment	0.36%
Total	100%

Source: NSE, Nifty Next 50 and Nifty 50 factsheet, December 2019.

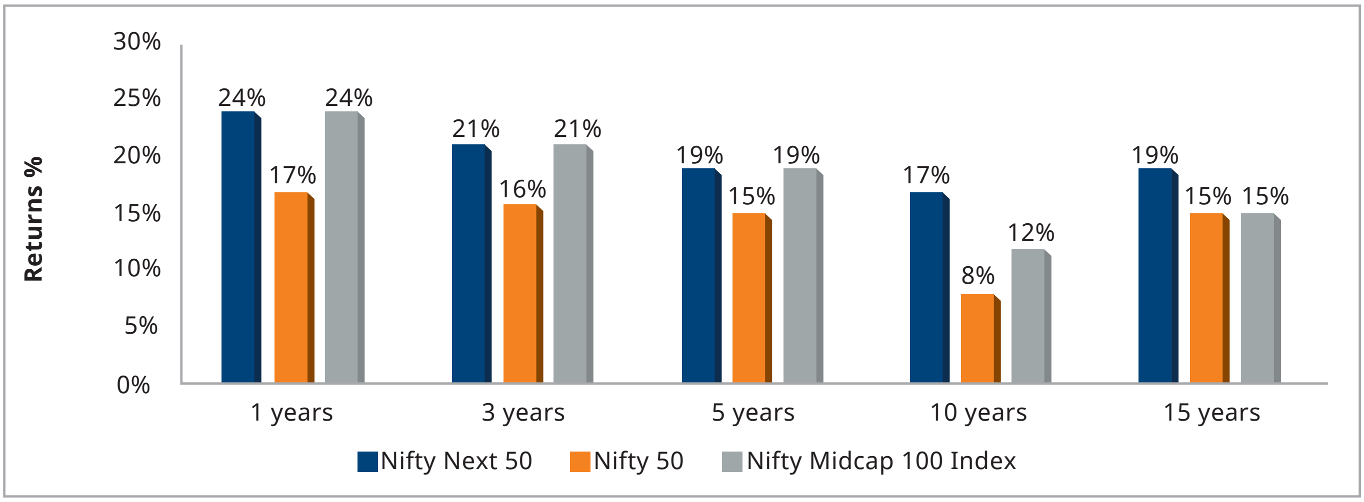
Analysis of the aforementioned sector weightages of the Nifty Next 50 index and Nifty 50 index and portfolio composition of large cap funds reveal portfolio composition of large cap funds is in line with Nifty 50 index wherein banking, financial services, information technology and energy are the top sectors. Nifty Next 50 is for investors looking for a more diversified portfolio, wherein the top sectors include financial services, consumer goods, pharma, cement and energy.

CRISIL Ranked large cap funds for the quarter ended September 2019 (27 count), Portfolio as on December 2019.

Quantitative: Appealing performance

Here's a look at some numbers: CRISIL analysed and compared the returns of Nifty Next 50 with Nifty 50 and Nifty Midcap 100 to showcase its performance compared with both the benchmarks. To corroborate, we (CRISIL) also did the rolling returns analysis compared with point-to-point returns to showcase the performance at any point in time since the turn of the millennium. And, numbers don't lie, doesn't it?. The Nifty Next 50 has outperformed Nifty 50 across all the time frames analysed as per the rolling returns analysis (chart 2). Nifty Next 50 has also outperformed Nifty Midcap 100 over the long term of 10 and 15 years, while maintaining its performance in line with Nifty Midcap 100 index over one, three and five years period.

Chart 2: Rolling returns analysis of Nifty Next 50 vis-à-vis Nifty 50 and Nifty Midcap 100

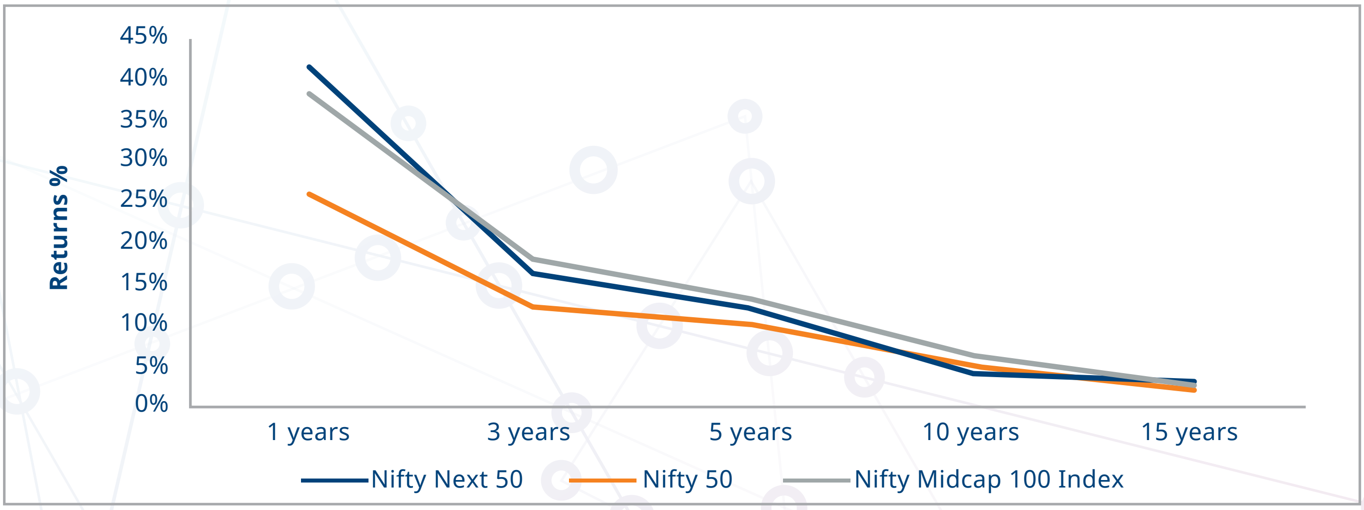


Source: CRISIL Research, December 2019.
Daily average rolling return period of analysis January 1, 2001, to December 26, 2019. Returns above one year are annualised, otherwise absolute

Market phase and volatility put Nifty Next 50 between Nifty 50 and midcaps

Since the stocks in the underlying Nifty Next 50 fall between Nifty 50 and mid-caps, volatility associated with the index also lies between these two indices. Analysis shows that in terms of volatility (measured by standard deviation), Nifty Next 50 is more volatile than Nifty 50 but less than Nifty Midcap 100 across three, five and 10 years; and slightly more volatile over one year and 15 years. However, investment over the long term tends to reduce volatility as evident in chart 3.

Chart 3: Volatility of Nifty Next 50 vis-à-vis Nifty 50 and Nifty Midcap 100



Source: CRISIL Research, as on December 2019.
Volatility is represented by standard deviation Time period of analysis is January 1, 2001, to December 26, 2019

Further, market phase analysis reveals that Nifty Next 50 has fallen more than Nifty 50 in the bear phases (2008 subprime and 2011 Eurozone crises). During the bull phases, Nifty Next 50 index rebounded to positive cues and recorded superlative performance vis-à-vis Nifty 50 index, as evident during the post subprime and Eurozone crises. Its performance vis-à-vis Nifty Midcap 100 index has been mixed during the bull and the bear phases. During the recently witnessed market volatility, Nifty Next 50 index underperformed Nifty 50 index, but the downfall was less than for Nifty Midcap 100 index (which lost 11%).

Table 3: Market phase analysis

Period	Nifty Next 50	Nifty 50	Nifty Midcap 100 Index
Subprime crisis (Jan 2008-Mar 2009)	-57.60	-43.42	-55.67
Sharp bounce-back post subprime crisis (April 2009-December 2010)	79.60	48.77	71.87
European crisis (January 2011-June 2013)	-2.29	-1.94	-7.25
Post European crisis (July 2013-February 2015)	35.48	28.07	39.83
Chinese slowdown (March 2015-February 2016)	-13.35	-21.03	-12.19
Global liquidity and domestic reforms (March 2016-December 2017)	35.87	22.88	37.14
Mixed domestic and global scenario (January 2018-December 26, 2019)	-4.36	7.87	-10.70

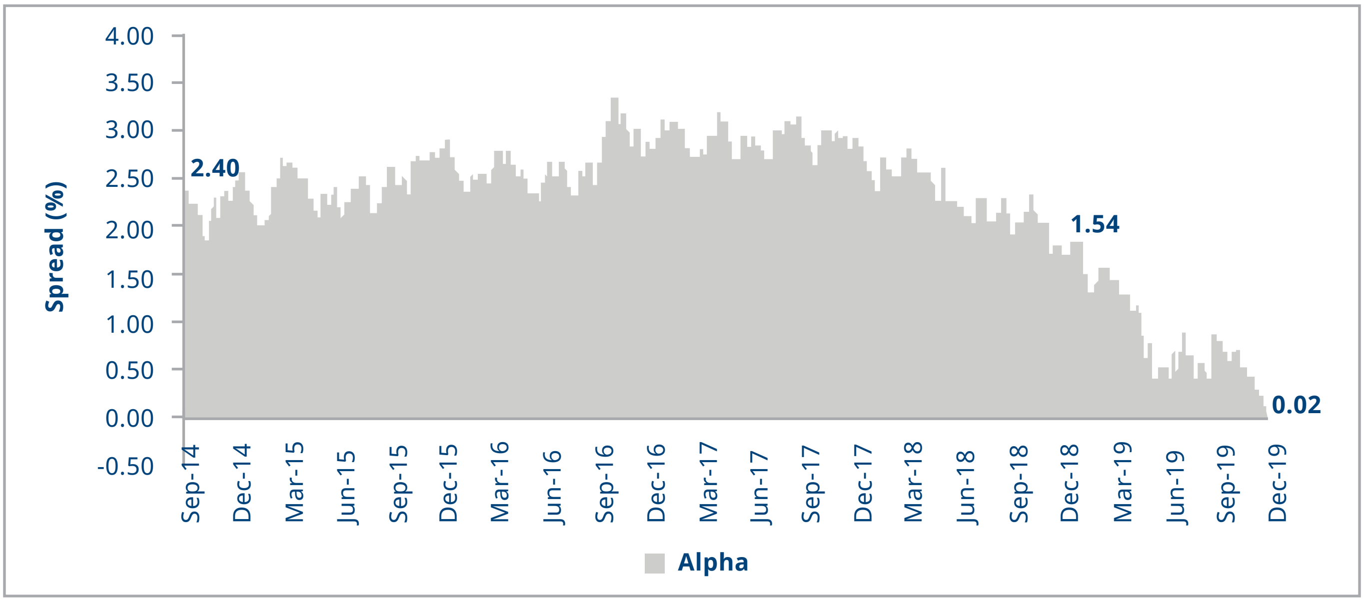
Source: CRISIL Research, December 2019.
Returns above one year are annualised, otherwise absolute

Dip in alpha makes investing through ETFs a better option

Having built a case for Nifty Next 50 as an attractive investment option, let's see how a dip in alpha from actively managed funds over benchmarks makes a case for investing in the index through exchange traded funds (ETFs).

For analysis of the alpha spread, CRISIL analysed the five-year daily rolling returns of large cap funds versus the Nifty 50 index and the results show that there has been a gradual decline in the alpha over the years; it fell from 2.40% as on September 30, 2014 to a mere 0.02% as on December 26, 2019 (see chart). The fall in alpha makes investing through ETFs in the index, one of the better option for investors.

Chart 4: Dip in alpha returns of actively managed funds versus benchmark



Source: CRISIL Research, December 2019.
Alpha is the difference in the daily five-year annualised rolling returns of a weighted large cap fund performance index based on CRISIL-ranked large cap funds and Nifty 50 as on December 26, 2019.

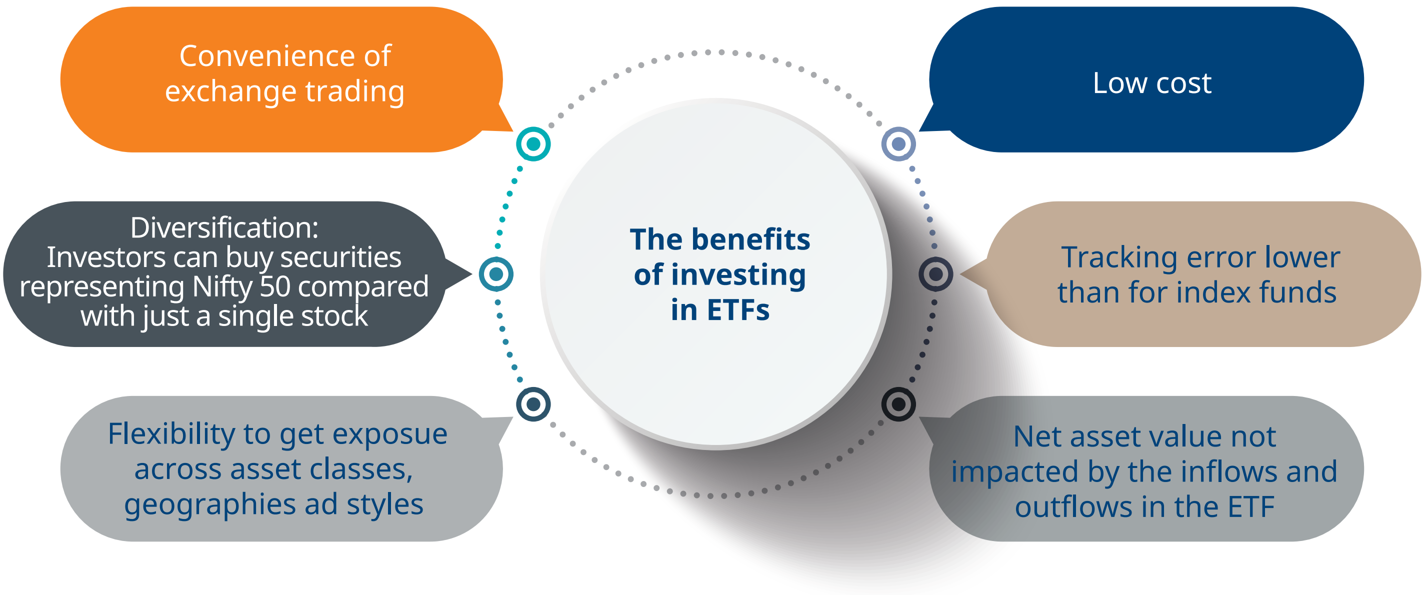
Passive versus active

Passive investing assumes that alpha generation is extremely difficult under the premise that all securities in the market are priced correctly. Therefore, the passive strategy abandons the attempt to outperform the market benchmarks (generate alpha) and instead tracks a market index / portfolio of stocks. As a result, the investor is exposed only to the broad market risk. When equities fare poorly, the fund's losses are restricted to around as much as the designated benchmark. On the flipside, when sentiment for stocks is buoyant, the upside appreciation of the fund is capped to roughly as much as the benchmark's gains.

In contrast, the active approach focuses on trying to beat the market assuming that asset mispricing exists. This is achieved by the fund manager tactically managing exposure of the scheme's constituents at the sector and stock level, thereby positioning the portfolio for optimal returns in response to changing micro and macro developments. It is not uncommon for an active fund's returns to rise significantly above its benchmark, signifying that the right calls were made with respect to stock selection. Misjudgement in this regard, however, as has been seen historically, results in adverse consequences.

The passive investing philosophy looks to keep the aforementioned stock selection risk in check.

Some of the benefits of investing in ETFs



Why consider Nifty Next 50 index at this juncture?

In the backdrop of recent volatility in equities and not forgetting the quintessential unpredictable nature of the asset class, a more diversified, low-cost passive investment approach can supplement the existing active investment portfolio. Besides a conventional broad market index like Nifty 50, investors can consider investing in Nifty Next 50. However, before investing they should examine the risk appetite and returns expectations, conduct due diligence of the cost involved in terms of expense ratio, tracking error (a measure of how closely the index fund's returns match its benchmark's returns) and the fund house's track record.

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