

# Banking and financial Services sector mutual fund



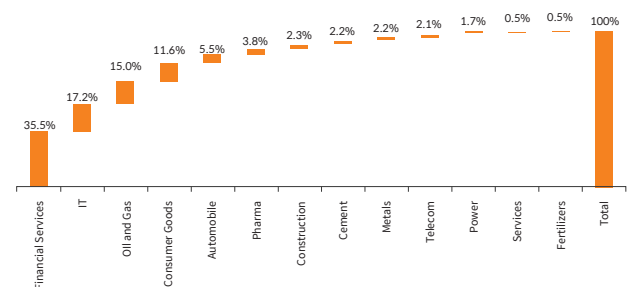
Banking and financial services sector is the lifeblood of any economy. Banks provide payments ecosystem for carrying out financial transactions. Banks collect deposits and provide credits to individuals and businesses. Companies borrow from banks to fund their working capital and capex. A robust and well regulated banking system is critical for functioning of the economy.

## Banking sector in India

The Indian banking system consists of 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks and 96,000 rural cooperative banks, in addition to cooperative credit institutions. The Government has taken a number of steps to reform and strengthen the banking sector. The Pradhan Mantri Jan DhanYojana aimed at providing financial inclusion to all Indians has brought 41 crore Indians under the banking system. The Government has also enacted a number of reforms for public sector banks including mergers, recapitalization, recognition of NPAs and recoveries. The Government has made a major thrust for digitization of payments through the Jan Dhan, Aadhaar and Mobile (JAM) trinity. Unified Payments Interface (UPI) recorded 1.25 billion transactions in March 2020, valued at Rs 2.06 lakh crores. These reforms are likely to provide further impetus to India's banking sector.

## Banking sector and stock market

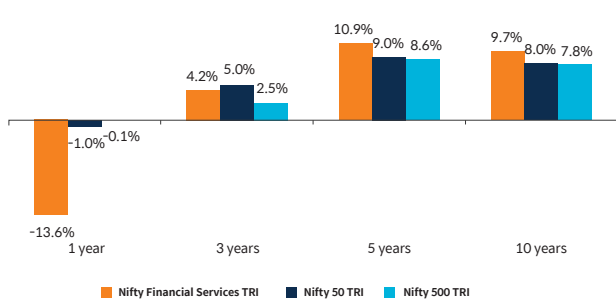
The weight of Banking & Financial Services in the Indian stock market has been going up steadily over the last decade or so and it is now the largest sector in the key equity market benchmarks such as Nifty 50 (see the chart below, as on October 2020). There were 5 banking and financial services companies in the Top 10 companies by market cap in Nifty.



Source: National Stock Exchange, October 2020

## Financial Services have outperformed the broader market

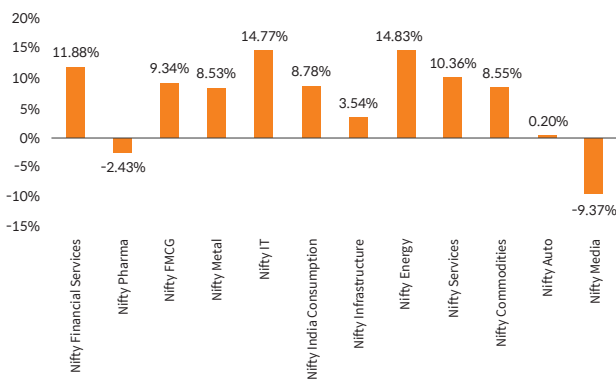
Nifty Financial Services Index which comprises of the 20 largest financial services companies by market cap in the NSE has outperformed the broader market over long investment horizons. The chart below shows the trailing returns of Nifty Financial Services TRI versus Nifty 500 TRI and also Nifty 50 TRI over different investment periods (ending 30<sup>th</sup> October 2020)



Source: National Stock Exchange, October 2020.  
Disclaimer: Past performance may or may not be sustained in the future.

## One of the best performing sectors

The chart below shows the 5 year returns of different sectoral indices in NSE (as on 31st October 2020). You can see that, Financial Services has been one of the best performing sectors in the market.

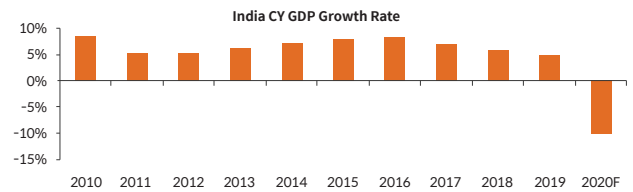
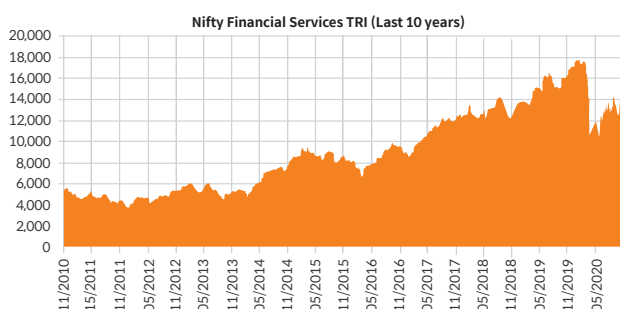


Source: National Stock Exchange, 31st October 2020. Disclaimer: Past performance may or may not be sustained in the future.

## Financial Services performance in economic cycles

Financial Services sector is closely related to the overall economy. The sector does well when demand is increasing (economic expansion) and underperforms when demand slows down or contracts (economic slowdown or recession).

The charts below show the growth of Nifty Financial Services Total Returns Index over the last 10 years (ending 31st October 2020) in relation to India's real GDP growth rate over the same period. The sharp fall in the Financial Services index in 2020 corresponds with the economic contraction as the aftermath of COVID-19 and the ensuing lockdown. Previous corrections in financial services were also linked with GDP slowdown e.g. demonetization, 2011 slowdown due to high inflation, policy paralysis etc.



Source: Nifty Financial Services TRI data from National Stock Exchange (as on 31st October 2020), GDP data from World Bank (2010 to 2019), CY 2020 GDP forecast based on IMF estimates. Disclaimer: Past performance may or may not be sustained in the future

While COVID-19 has undoubtedly had a severe economic impact, economic indicators suggest that recovery is gradually underway. Though there are considerable uncertainties regarding near term outlook including corporate earnings, we have seen a strong bounce back in price terms from the Nifty Financial Services Index.

## Not just banks

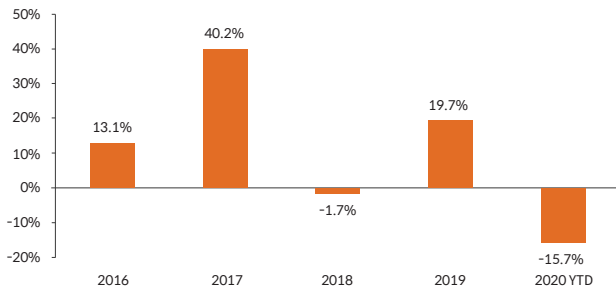
Many investors associate financial services primarily with banks. While banks are a very important part of financial services, the financial services sector is much broader than purely the banking sector. The financial services sector includes the following sub-sectors :-

- Term lending institutions
- Housing finance companies
- Leasing and hire purchase companies
- Life insurance companies
- General insurance companies
- Asset management companies

Out of the 20 companies comprising the Nifty Financial Services Index, just 5 are banks and only one PSU bank. The rest of the index constituents are from the non-banking sectors in financial services. Several of the index constituents went public only in the last couple of years. The risk profiles of the different financial services sub-sectors are very different e.g. bank versus AMC, insurance and the financial services can be fairly diversified from a risk/return perspective. Over time, we can expect this sector to evolve more from a capital markets standpoint with new players like credit card, payments businesses etc.

## How have banking & financial services funds performed?

Banking and financial services, being a cyclical sector can be highly volatile but has the potential to give good returns. The chart below shows the calendar year average returns of banking and financial services fund category. While 2020 is an exceptional year due to the global pandemic, this sector has good wealth creation opportunity over long investment horizons.



Source: Advisorkhoj Research (2020 YTD returns as on 3rd November 2020). Disclaimer: Past performance may or may not be sustained in the future.

## How to allocate money to financial services fund?

Financial advisors suggest that diversified equity funds should be the core of your equity investment portfolio. However, you can also add sectoral or thematic funds to your portfolio with an aim to augment returns. The sectoral allocation can be tactical to take advantage of market opportunities and/or can be helpful in meeting long term wealth creation goals. Investing in banking and financial services funds at this point of time makes sense both from a tactical perspective since you can

take advantage of the deep correction and may also help you create wealth for your long term financial goals, since it proxies India's long term secular economic growth story. The percentage allocation to sector funds will depend on your risk appetite; financial advisors suggest that one can allocate 5 – 15% of their portfolios to individual sectors.

## Conclusion

The COVID-19 pandemic has had a severe impact on the economy, but markets are forward looking and will align to the phase of recovery. After every major economic crisis, equity has turned out to be the best asset class. The Banking and Financial Services Sector is expected to be at the forefront of the recovery. The long term outlook of the sector is positive on the back of the Government reforms in this sector and overall long term outlook on the Indian economy. You need to have high risk appetite and long investment horizon (at least 5 years) for banking and financial services funds. Investors should consult with their financial advisors if banking and financial services funds are suitable for their investment needs.

Source: Advisorkhoj Research. 31<sup>st</sup> October 2020

An investor education initiative by Mirae Asset Mutual Fund.


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