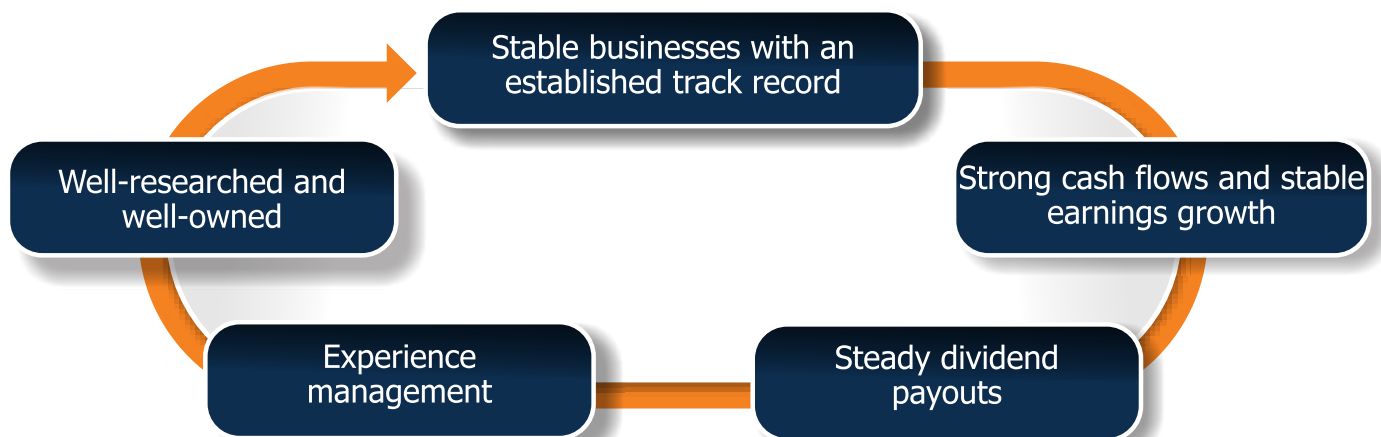


LARGE CAP FUND : AIMS GROWTH WITH STABILITY

Equity is one of the best asset class for wealth creation in the long run. The broader market, represented by the S&P BSE Sensex, has returned 15% annually on a 15-year rolling basis since 1979 (Source: Crisil research, as on Feb 28, 2019). Within equity, there are various market capitalization segments. In this article, we look at how large cap stocks may form an important and integral part of the core portfolio of the investor and how large cap funds provide an avenue for investors to benefit from the investment opportunity over the long term.

Investing through large cap funds

Equity asset class consists of companies (stocks) broadly classified in terms of its market capitalization viz. large cap, mid cap and small cap stocks. Large cap stocks are popularly known as blue-chip stocks. The S&P BSE Sensex, Nifty 50, S&P BSE Large cap, S&P BSE 100 and Nifty 100 indices are good representations of large cap stocks.



¹Maximum and minimum prices of stocks in the Nifty 50 index.

Large cap firms are usually characterised by stable businesses with an established track record, strong cash flows and stable earnings growth in the long run. They have experienced management and some also pay dividends. These features make large cap stocks great compounders in the long term and relatively less volatile during market downtrends, compared with their mid and small cap counterparts. In general, it is always advisable for an inexperienced investor to invest in stock markets only through experienced financial advisor. Further, it is important to know that within large cap stocks, there is a long list of securities available to invest. Further, they may trade at high price (the maximum and minimum stock price of Nifty 50 stocks range from Rs 150 to Rs 22,600), thus adding to the cost factor for investors. Investors can instead consider the mutual fund route for investing into large cap stocks as it comes with plethora of features such as – professional management, diversification, lower ticket size, low cost, liquidity, convenience, SIP feature etc.

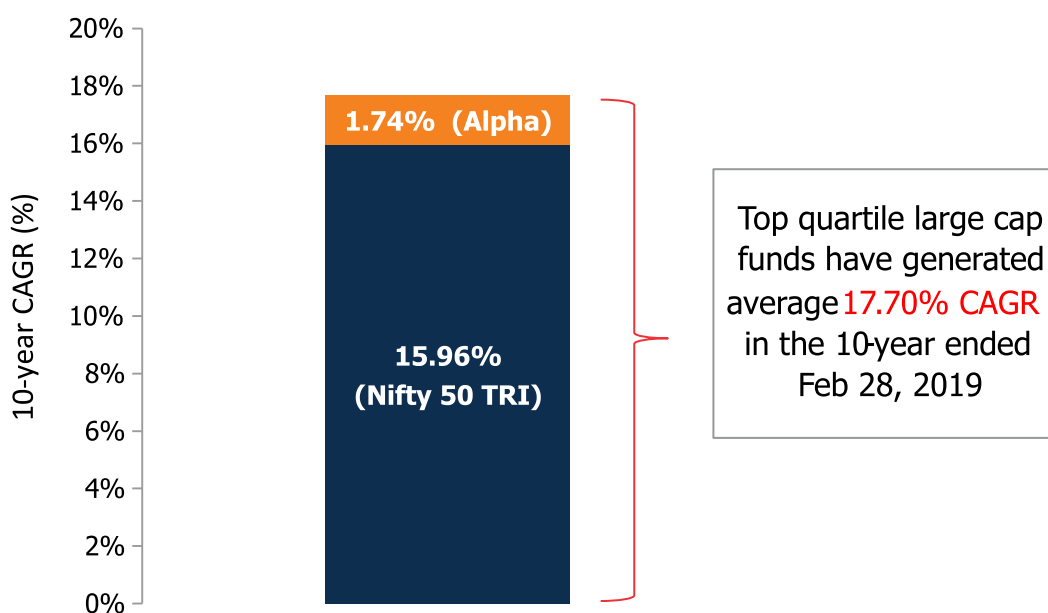
Large cap funds: Aims for consistency and limited downside risk

The Securities and Exchange Board of India (SEBI), the capital-markets regulator, has reclassified and standardised the norms for all mutual-fund categories. Under the new norms, large cap equity funds are those that can only invest in the top 100 listed companies based on the average full market capitalisation of the previous six months. These funds invest across sectors and companies to derive the benefits of diversification.

Ability to generate alpha

By investing in a large-cap fund, an investor mostly gets an opportunity to generate alpha over the market return. For instance, in the past 10 years to February 28, 2019, the top 2 quartile (first and second quartile) large cap funds outperformed the Nifty 50 Total Return Index (TRI) by 174 bps (Source: Crisil research). Thus, can be assumed that Rs 1 lakh invested might have grown to Rs 5.10 lakh during the period, compared with Rs 4.39 lakh returned by the Nifty 50 TRI.

Chart 1: Scope for alpha generation (For illustration purpose only)

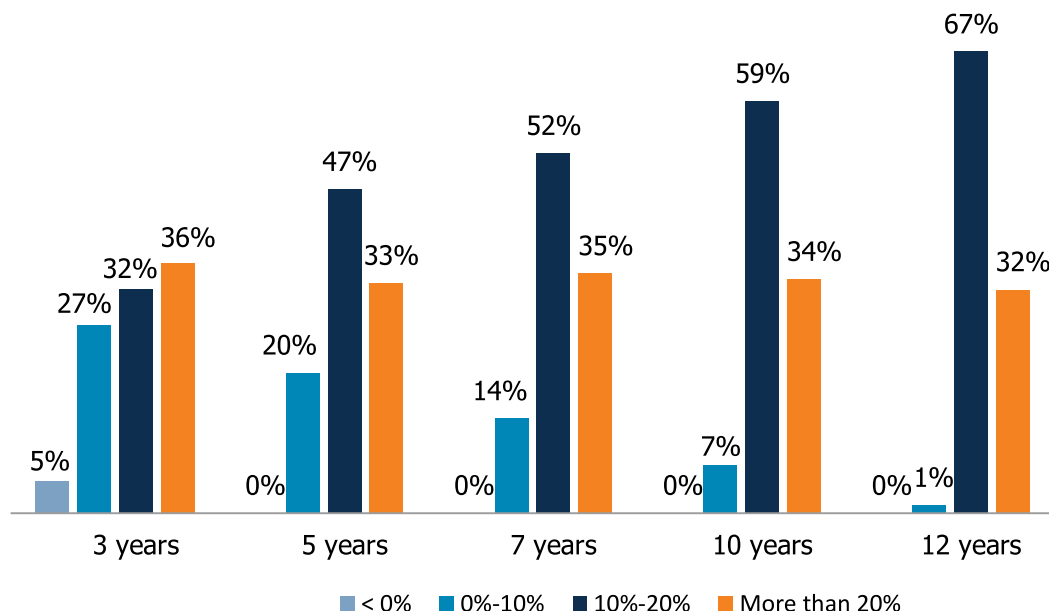


Average returns of top-quartile (first and second quartile) large-cap funds is considered for analysis

Seeks Stable and consistent performance

As large cap funds invest in well-established companies with stable businesses, they usually have the ability to generate consistent returns over long periods. A returns distribution (chart 2) of CRISIL-ranked large-cap funds shows that the probability of incurring negative returns is nil for investment periods of more than three years. Also, the probability of getting returns between 10% and 20% CAGR (compound annual growth rate) consistently increases over longer holding periods.

Chart 2 : Returns distribution (For illustration purpose only)

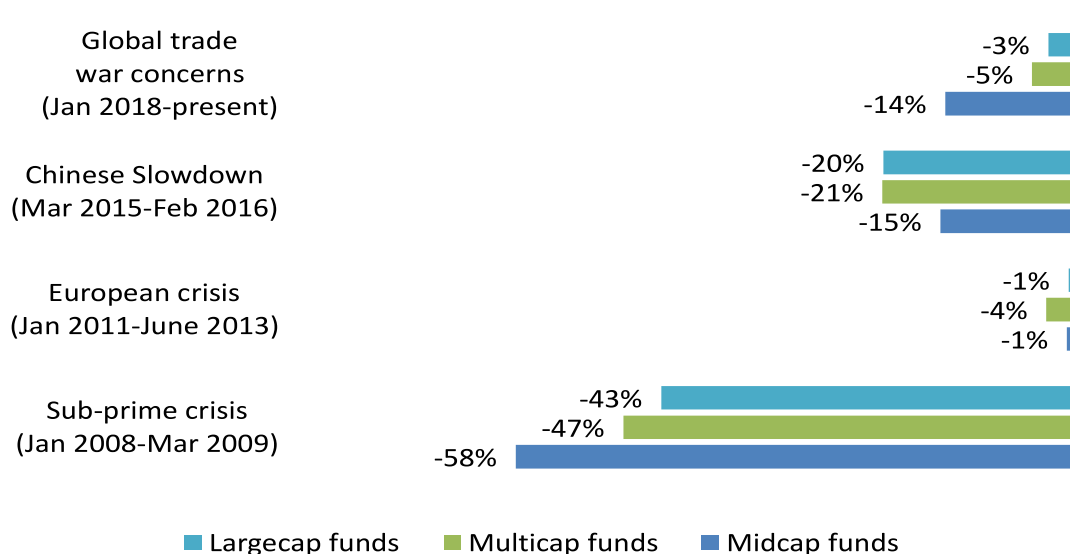


Returns distribution based on daily rolling returns (CAGR) of various holding periods. Period considered: April 2000 – February 2019
Large-cap funds represented by CRISIL-ranked large-cap funds.

Seeks Limited downside risk

Wealth creation is not only about capital appreciation, but also about preserving it by avoiding erosion. Large cap stocks may be inferred to be more resilient to market downturns. Hence, one can infer that they typically have lower drawdowns during market downtrends and have more downside protection than the midcap and the multi cap funds.

Chart 3: Lower drawdowns during downtrends (For illustration purpose only)



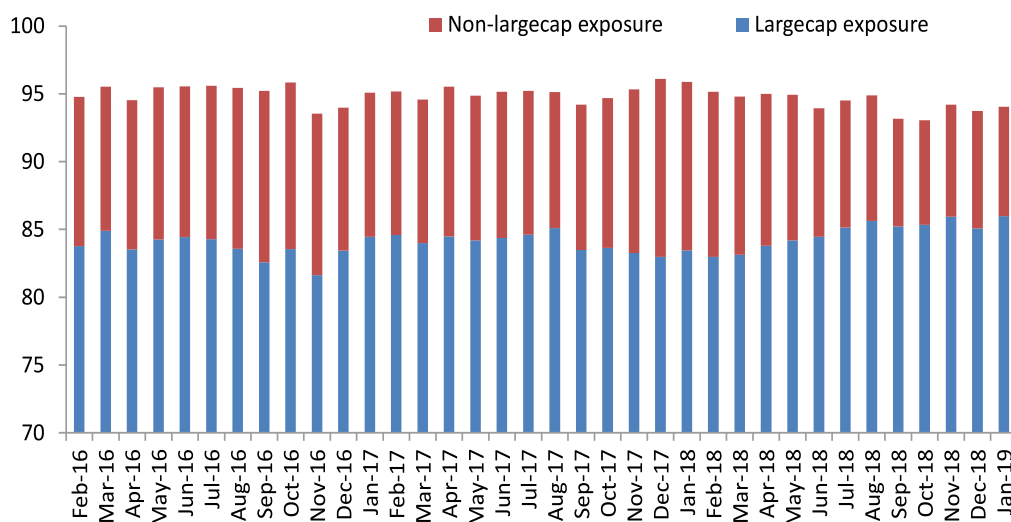
Category performance represented by CRISIL ranked funds

Tactical allocation to stocks outside the large cap universe

As per the new regulations, a fund should invest a minimum of 80% of its total assets in large cap stocks to qualify as a large-cap fund. Hence, the fund manager has some leeway to tactically invest in mid and small cap stocks to provide a kicker to the overall potential returns profile and generate alpha.

As you can observe in Chart 4, the large cap funds have reduced mid and small cap exposure during 2018, when the mid and small caps corrected, as compared to higher exposure towards them during 2016 & 2017.

Chart 4: Tactical allocation to stocks outside the large cap universe
(For illustration purpose only)



Based on portfolio of CRISIL ranked large cap funds as of December 2018 ranking

Data as on Feb 28, 2019 unless mentioned otherwise

Summary

Investors aiming for potential returns with relatively limited downside risk can consider investing in large cap funds. While they are comparatively one of the better options to invest than multi-cap and mid cap funds, investor should also understand that the upside potential is also relatively limited. Hence, investors should first define their goals and carefully assess their risk-taking ability before investing in these funds. Investors are advisable to consult their financial advisors to know in detail about the funds before investing.

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