Mirae Asset Mutual Fund

De:CODE

PORTFOLIO TURNOVER RATIO (PTR)

Portfolio Turnover Ratio (PTR) is one of the key metric in evaluating mutual funds and understanding a fund manager's strategy.

Portfolio Turnover Ratio reflects the percentage change with which the fund's holdings have changed over the past one year.

$$\text{Portfolio Turnover Ratio (PTR)} = \frac{\text{Min. Securities either sold or bought (whichever is lesser)}}{\text{Average Assets Under Management (AAUM)}}$$

For example, if a portfolio sold assets worth 200 crores and bought assets about 220 crores in a year and average AUM of the portfolio is 800 crores, the portfolio turnover ratio would be 200/800 = 25%.

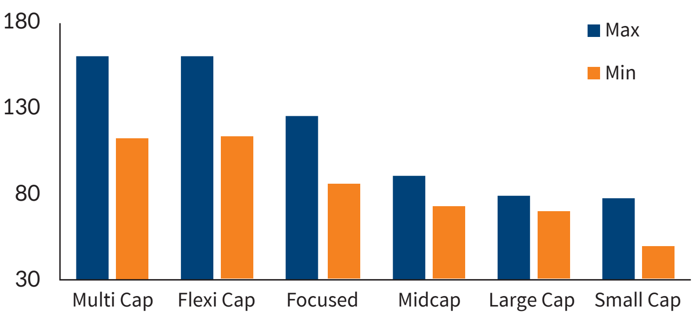
Is high PTR or a low PTR better?

- High turnover ratio may indicate a lack of conviction from the portfolio managers, however that should not be the core principle.
- Low turnover ratio usually indicates a buy and hold strategy and may suggest strong conviction by the fund managers.

In mutual funds, certain funds such as growth funds or funds with more aggressive investment style may have a high PTR than a value-oriented fund or passive funds.

For example, we've considered the year 2020 for portfolio turnover ratios of different equity categories as shown below -

TURNOVER RATIO (%) FOR FEW MAJOR EQUITY CATEGORIES



Source: MFI Explorer, Data is for the year 2020. Maximum and minimum from all the months in 2020 have been taken for all the mutual fund that falls under the mentioned category. Past performance may or may not sustain in the future.

It is quite evident from the chart above that small cap funds have relatively lower portfolio turnover ratio compared to other equity categories considered, suggesting that the fund could have followed a buy-and-hold strategy.

Frequent churning of Portfolio

⇩

Contributing to the expense ratio (transaction costs)

⇩

The frequent churning should be compensated by higher-risk adjusted returns for the fund.

One cannot state that a low turnover ratio is better than a high turnover ratio.

- ✓ Check the risk-adjusted returns of the fund (which is nothing but Sharpe ratio...)

For example, a portfolio has a portfolio turnover ratio of about 110% and a Sharpe Ratio of 1.1 while the Sharpe ratio of the category is about 0.65, indicating that return generated per unit risk taken is greater than the category and thus, the higher expense ratio that you're paying could make much more sense.

- ✓ There are other factors to consider as well, such as the age of the fund, average AUM of the fund and market timing.

For example, funds with lower AUM provide fund managers with more freedom to churn portfolio. If the frequent churning may lead to relatively higher risk-adjusted return then fund may get more money as a result, thus reduction in frequent churning in the long term.

The portfolio turnover ratio, ideally, should be used to compare any two funds in the same peer category and along with the other ratios that we have covered earlier.