ETMarkets Fund Manager Talk: Current rally has bridged valuation arbitrage between large and mid/smallcaps: LIC MF

Synopsis

"The recent rally in the market has led to strong inflows into midcap and smallcap funds. However, the valuation gap between largecap and midcap/smallcap stocks has narrowed. Investors looking to invest in midcap and smallcap funds should have a longer term view and manage their return expectations accordingly. Multicap funds, with balanced exposure across market caps, have the potential to deliver good risk-adjusted returns."

*There's no doubt that the rally in the broader market has driven strong inflows into midcap and smallcap funds for the mutual fund industry in the recent months. But after such a rally, the valuation arbitrage between largecap and midcap or smallcaps has somewhat been bridged, says **Dikshit Mittal**, fund manager and senior equity research analyst, **LIC Mutual Fund**.*

Any investor coming in at this juncture into the midcap and smallcap funds needs to keep a longer term view, and keep return expectations in check, he suggests. Keeping the longer term view in mind, Mittal believes that multicap funds have the potential to deliver good risk adjusted returns given their balanced exposure across market caps. Edited excerpts from an interview with ETMarkets:

After the recent rally in the market, many money managers believe that valuations are stretched across the market cap. Do you also believe the same or contradict?
Markets, especially midcap and smallcap indices have done very well recently, delivering robust returns in the last 2-3 years. However, if one stretches the horizon a little bit more, say 5 years, the returns have been decent, but not as spectacular.

On a 5-year horizon, NSE 100 index has delivered 12% CAGR, while NSE Midcap and NSE Small Cap indices have delivered 15% and 9% CAGR returns, respectively, which is more or less in line with the earnings growth.

Going forward, it's difficult to call out short term movements, but over a 3-5 year horizon, one can expect returns in line with the earnings growth. Midcap and smallcap funds continue to see strong inflows. Do you see this trend continuing?
Normally, in all asset classes, good performance attracts more money, and the same thing seems to have happened with small cap and midcap funds.

At the current point, valuation arbitrage between largecap and midcap/smallcap seems to be bridged, so any investor coming in at this juncture into these funds needs to keep a longer term view, and keep return expectations in check, as one cannot extrapolate last 3 years returns into the future.

We are seeing a lot of multicap fund launches recently. What do you think is triggering this at the current juncture?
Multicap funds are much more balanced in terms of exposure to large/mid and smallcap stocks. By definition, multicap funds have minimum 25% allocation each to largecap, midcap and smallcap stocks, which gives investors an opportunity to participate across market caps in a single fund.

Over the long term, multicap funds have potential to deliver good risk adjusted returns, and investors may consider to add these funds in their portfolio to achieve their long term financial goals.

Which sectors are you currently overweight and underweight, and why?
We are overweight on consumer discretionary, autos, capital goods and underweight on the oil and gas sector. We expect the India consumption story to come back strongly as the festive season picks up, and this reflects in our overweight position in the sector. Oil and Gas is a regulated sector, so we have limited our investment at this point in time.

Until general elections next year, how do you see equity markets performing?
General elections are less than an year away, and it's difficult to call out short term movement of stock markets. So I'll refrain from taking a guess on market movement for the next 6-9 months.

What are the new emerging themes in the market today that look interesting from an investment perspective?
Discretionary consumption is an evergreen theme, considering the rising per capita, demographics and low penetration across categories. With the government's focus on Make in India, manufacturing as a theme seems to have a long runway for growth in India. In addition, with focus on renewables and new power capacity addition, I expect large investments in transmission and distribution space, and companies operating in this value chain can do well.

Despite good earnings, banking stocks have largely underperformed in the current rally. Do you see them leading the next bull run in the market?
On banking stocks, long trade on expected peak in NPA cycle and rising NIMs seems over, and now the focus is back on growth, NIMs and asset quality from here on.

Market seems to be worried on expected contraction in NIMs in the next 2-3 quarters on the back of rising cost of funds. Though NIMs can contract somewhat going forward, the impact on RoAs is expected to be minimal as credit costs are expected to remain low at least in the short to medium term. Credit growth in economy is still strong (in mid teens), and I expect banking sector earning growth to be in double digits, going forward. Overall, I am positive on the banking sector.

New age technology stocks have started finding favour among the institutional investor

community. What’s your fund house’s view on this pack?
Many of the leading new-age stocks have seen correction in valuations from peak and improvement in financials, with focus of the management to improve profitability.

Some of these businesses are unique and have high entry barriers. Companies which have a clear path to profitability and have unique business models, may find a place in portfolios.

(Disclaimer: Recommendations, suggestions, views and opinions given by the experts are their own. These do not represent the views of Economic Times)