IDFC MUTUAL FUND

# EQUITY - TIMES


## IDFC Core Equity Fund: Performance Review

(Large & Mid Cap Fund - An open ended equity scheme investing in both large cap and mid cap stocks)

### Market Roundup - 6 month returns across sectors and market cap

Over the last 6 months, NIFTY, NSE Mid Cap and NSE Small Cap returns have been 0.39%, -7.39% and -10.81% respectively. But the stock returns for the SEBI defined Large, Mid and Small Cap segments have been quite different. As can be seen from the below table the SEBI defined Mid-Cap stocks with market cap rank between 101-250 have been the best performer (in terms of average stock returns) in the last 6 months across sectors. Mid Cap segment has surprisingly outperformed Large and Small cap segments in 8 out of the 12 sectors over the last six months. Small cap segment has reported positive returns in just 3 out of the 12 segments during the same period. Similarly, while there has been a popular perception of large caps being a "safer" alternative during this period, in only 3 sectors have large cap stocks outperformed mid and small caps (Consumer Staples; Utilities and Consumer Discretionary)!

| Sector Wise - 6 month returns | 100 | 101-250 | 250-500 |
|---|---|---|---|
| Financials | -5.44 | -5.89 | -25.09 |
| Consumer Staples | 14.21 | 0.91 | -3.40 |
| Consumer Discretionary | 7.38 | -3.64 | -1.93 |
| Auto | -6.45 | 2.41 | -6.18 |
| Information Technology | 0.99 | 33.53 | 26.37 |
| Health Care | -15.07 | 3.97 | -7.34 |
| Cement / Building Mat | -11.85 | -0.93 | -15.70 |
| Industrials | -9.17 | -6.37 | -7.30 |
| Energy | -17.55 | -12.87 | -27.77 |
| Commodities | -6.59 | -4.34 | -15.28 |
| Utilities | -2.72 | -20.26 | -26.74 |
| Telecommunication Services | -28.72 | -10.77 | 0.06 |
| **Index** | **NIFTY Index** | **NSEMCAP Index** | **NSESMCP Index** |
| Returns | 0.39 | -7.39 | -10.81 |

The key observation which one could surmise from the above is a shift in investor's preference from "Greed" to "Fear", which is a complete reversal from the previous year. In this flight to safety, IT services and "high quality" domestic franchises across – consumer staples; consumer discretionary and retail focused banks has played out strongly. Optimism on corporate focused banks evident during the November-December'2017 was completely overturned due to the surfacing of financial scams as well as the sharp rise in yields, though the imminent resolution of larger NPA accounts was closer than ever before (the original rationale for these stocks to shoot up!). The emergence of another dark cloud in the form of crude oil prices has added to the "Fear" factor, amplifying this flight to safety.

Valuations, have been touted as one of the key driver for small cap segment's severe underperformance during the last six months. However, when the burden of valuation leads to a crack in stock prices, it is generally difficult to forecast with accurate timing; though very generic comments on overvaluation of the segment can be turned into prophetic utterances through savvy media connect, especially in a media overkill environment of today! The note later will discuss our action on this front.

## IDFC Core Equity Fund: Performance Review

After CY 16 and CY 17, the performance appears to have hit an air pocket during the last six months. With the new SEBI mandated classification, the last six months' period has been used as a transition of the portfolio to meet the new regulatory requirement. A deep dive of the portfolio across the Large; Mid and Small cap segments is shown in the table below. A read of the table reveals a healthy outperformance in 7 out of the 12 sectors in the large cap space; 8 out of 12 in the Mid Cap space. *For example, across the Financial sector exposure - in the top 100 segment, the average return is -5.4% as compared to IDFC Core Equity Funds average Top 100 Financials return of -1.2% and we had no exposure to the 250-1000 segment of the Financials sectors where the return was -25.1%.*

| IDFC CEF - 6 month returns | 1-100 | | 101-250 | | 250-1000 | |
|---|---|---|---|---|---|---|
| | IDFC Core | Segment | IDFC Core | Segment | IDFC Core | Segment |
| Financials | -1.2 | -5.4 | -5.1 | -5.9 | - | -25.1 |
| Consumer Staples | 17.1 | 14.2 | 10.5 | 0.9 | - | -3.4 |
| Consumer Discretionary | -1.4 | 7.4 | -7.8 | -3.6 | -1.1 | -1.9 |
| Auto | -1.7 | -6.4 | 7.0 | 2.4 | -8.3 | -6.2 |
| Information Technology | 19.6 | 1.0 | - | 33.5 | 48.2 | 26.4 |
| Health Care | -18.3 | -15.1 | -13.4 | 4.0 | -38.0 | -7.3 |
| Cement / Building Mat | -22.1 | -11.8 | 12.8 | -0.9 | -16.8 | -15.7 |
| Industrials | -12.7 | -9.2 | 8.3 | -6.4 | 2.6 | -7.3 |
| Energy | -17.5 | -17.5 | - | -12.9 | - | -27.8 |
| Commodities | -6.3 | -6.6 | -0.5 | -4.3 | - | -15.3 |
| Utilities | -7.4 | -2.7 | -21.0 | -20.3 | - | -26.7 |
| Telecommunication Services | - | -28.7 | - | -10.8 | - | 0.1 |

Though the small cap stocks in IDFC Core Equity Fund have fallen lesser than the small cap segment, the higher weight of small caps as compared to the benchmark/peers has impacted the near-term relative performance of the fund. In CY16 & 17, similar exposure to Small Cap segment resulted in outperformance with respect to the peers/benchmark.

A case in example is our exposure to small caps in IT sector like Mastek and KPIT Technologies. Both the stocks, over the duration of their holding, have been the best performing stocks in the segment. But by being small caps, the fall in these stocks on days of market fall is higher than other IT stocks in the Mid & Large Cap space. Due to this small-cap 'nature' of these stocks, they are unable to insulate the performance of the fund on bad days, unlike most large cap IT stocks, which would be held by our peers.

| | IDFC CEF | BSE200 |
|---|---|---|
| Large Cap | 46.6% | 85.5% |
| Mid Cap | 35.1% | 12.8% |
| Small Cap | 11.9% | 1.6% |

*For Large and Mid Cap Funds, SEBI defined large cap allocation should be minimum 35% and mid cap allocation should be minimum 35% (large cap, mid cap and small cap as defined by SEBI). This scheme has been repositioned as Large & Mid Cap Fund effective May 28, 2018.*

At the start of this note we had alluded to valuations, rather the burden of valuations, which could have impacted small caps, especially over the last six months. Our strategy to counter this has been to identify and build a portfolio of small caps which should deliver stronger growth while having moderate valuations. The superior earnings growth potential along with moderate valuation is reflected in the PEG (Price/Earnings to Growth) ratio of below 1 for the fund. The table below highlights the earnings growth for each of the segments for IDFC Core Equity Fund over the next 2 years based on internal and Bloomberg consensus estimates. Just to highlight, as per our forecasts the small cap exposure is expected to deliver an earnings growth of 50% led by stocks like Graphite India, Nav Bharat Ventures, Deepak Nitrite, Future Lifestyle Fashions etc.

| | PE Ratio | | | FY 18-20 | |
|---|---|---|---|---|---|
| | FY 18 | FY 19 | FY 20 | Gr | PEG Ratio |
| Overall | 24.4 | 17.8 | 14.6 | 27% | 0.89 |
| Large Cap | 20.5 | 16.8 | 14.1 | 20% | 1.01 |
| Mid Cap | 31.6 | 20.4 | 16.3 | 30% | 1.04 |
| Small Cap | 26.8 | 16.1 | 11.9 | 50% | 0.54 |

## Final Word

The flight to safety, which has come to the fore over the last few months is a reflection of the increasing uncertainty investors perceive currently – deteriorating macro; rising crude oil prices; sliding INR and the increasing din over the outcome of the next general elections. All these fears are real and should not be disregarded by investors. In such a scenario, the easiest path is the flight to safety. Clearly, we misread the initial part of this move, did not reduce weight in PSU banks, after the emergence of news of Nirav Modi/Gitanjali Gems saga. This clearly impacted our performance during this phase – profitable PSU bank investment remains even more elusive than the magical waterhole in the desert! Another area which we left uncovered (which negatively impacted performance) was the mid cap IT space – reasonably well managed companies – Mindtree; Hexaware; Mphasis, non-representation in this segment impacted performance relative to peers. However, the move into crowded and highly valued "quality" domestic focused companies is an area where we would have been as restrained even if we had the benefit of accurate forecasting. This would be running contrary to our core philosophy to focus on stable growth at moderate valuations. While tactically, we could have raised our exposure in this segment, the fund should not be expected to hold a large weight in such stocks on a consistent and sustained basis. On small caps, our belief remains unwavering, to achieve superior alpha generation over the medium to long term, the fund will continue to remain invested in this space. Air pockets which impact near term performance will be taken on the chin with the same sagacity as applause during CY 16 and CY 17.

To our stakeholders, investors and distributors, the current portfolio is based on our premise that the benefit of a "normal" year - without any one-off financial announcement (De-monetization; GST implementation); a monsoon forecast which plays out and no significant global upheaval - would be well placed to recover some of the lost ground during the last few months. On the other hand, if the forecast of a "normal" year does not play out, our size and willingness to accept our missteps should help in re-orienting the portfolio if required. Returns to our investors rather than our doggedness to prove a point should be at the heart of any investment philosophy.

*All data given above are as on 22nd May 2018*

Performance of IDFC Core Equity Fund (earlier known as IDFC Classic Equity Fund) as on 30th April 2018:

**Performance Table**

| Scheme Name | CAGR Returns (%) | | | | Current Value of Investment of ₹ 10,000 | | | |
|---|---|---|---|---|---|---|---|---|
| | 1 Year | 3 Years | 5 Years | Since Inception Aug 09, 2005 | 1 Year | 3 Years | 5 Years | Since Inception Aug 09, 2005 |
| IDFC Classic Equity Fund | 14.19% | 13.72% | 16.33% | 12.81% | 11,419 | 14,710 | 21,310 | 46,398 |
| S&P BSE 200# | 17.04% | 12.83% | 16.24% | 14.39% | 11,704 | 14,367 | 21,230 | 55,388 |
| Nifty 50## | 16.91% | 10.89% | 14.03% | 14.18% | 11,691 | 13,640 | 19,286 | 54,106 |

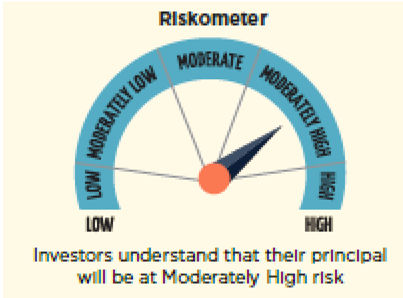
#Benchmark Returns. ##Alternate Benchmark Returns.

Performance of other funds managed by the fund manager:

| Period | | | 1 Year | | 3 Years | | 5 Years | |
|---|---|---|---|---|---|---|---|---|
| | Managing Since | Benchmark Index | Scheme Return (%) | Benchmark Return (%) | Scheme Return (%) | Benchmark Return (%) | Scheme Return (%) | Benchmark Return (%) |
| **Fund Manager Name: Mr. Anoop Bhaskar** | | | | | | | | |
| IDFC Classic Equity Fund | 30-04-2016 | S&P BSE 200 | 14.19% | 17.04% | 13.72% | 12.83% | 16.33% | 16.24% |
| IDFC Multi Cap Fund | 30-04-2016 | S&P BSE 500 | 11.63% | 17.22% | 10.30% | 13.51% | 20.51% | 16.90% |
| IDFC Sterling Equity Fund | 30-04-2016 | Nifty Midcap 100 | 23.51% | 13.28% | 17.69% | 18.34% | 23.34% | 22.54% |
| IDFC Hybrid Equity Fund | 30-12-2016 | CRISIL Hybrid 35+65 - Aggressive Index | 7.96% | 12.39% | NA | NA | NA | NA |
| Mr. Anoop Bhaskar manages 5 schemes of IDFC Mutual Fund. | | | | | | | | |

Performance based on NAV as on 30/4/2018. Past performance may or may not be sustained in future.
The performances given are of regular plan growth option.
Regular and Direct Plans have different expense structure. Direct Plan shall have a lower expense ratio excluding distribution expenses, commission expenses etc.

With effect from 1st February 2018, we are comparing the performances of the funds with the total return variant of the benchmark instead of the price return variant. Current Index performance adjusted for the period from since inception to June 28, 2007 with the performance of S&P BSE 200 price return index (Benchmark)




**This product is suitable for investors who are seeking*:**

• To create wealth over long term.

• Investment predominantly in equity and equity related instruments in large and mid-cap companies.

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

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**MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.**

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