'THE MARKET'S SOUL IS THE SAME'

In this special interaction with *Mutual Fund Insight*, **Prashant Jain,** Executive Director & Chief Investment Officer, HDFC Asset Management Company, talks about his early days as a fund manager, the changes in the market over the past two decades, performance of his funds and why he does not get bored managing funds

You have been a fund manager for many years and have been managing HDFC Prudence and HDFC Equity from 1994 and HDFC Top 200 from 1996. What has changed between then and now with the markets?

When I look back, it feels on one hand a lot has changed, but on the other nothing has actually changed. Way back in 1991 when I started my career, there was no screen based trading. To get a quote could take a few minutes and one would buy a 'bhav' copy on the way back to check the day's prices. There were no mobiles. When travelling, we would stop at a PCO to check on the markets. Sell side research was less and information gathering itself was a major activity.

I remember we had tied up with a few scrap paper dealers to sell annual reports to us by the kilos. No companies visited us in

our office except at the time of public issues. There was no investor relations role in companies, or for that matter investor conferences. Most funds were close-ended, daily NAVs were calculated, but published generally at weekly intervals. There were no CNBC-type channels and there were no mutual fund rating agencies. Air fares were less affordable and we were advised to keep travel to a minimum unlike today when people have to be prodded to travel more. Also, SIP meant having tea. Thus, a lot has changed!

Despite the explosion in information availability and other changes, the nature and character of the markets and its participants remain unchanged. Markets continue to be imperfect and driven by sentiments in the short-run. And, are close to perfect and driven by fundamentals in the long-run. Investor behaviour continues to be as much driven by fear and greed today as it was then. Even then, bulk of the money in mutual funds used to come after the best returns were over – UTI Mastergain collected ₹4,000 crore in 1992 after the Sensex had moved from 400 levels to 4,000 levels between 1988 to 1992; at today's prices it is about ₹20,000-30,000 crore. Even today, the bulk of money in mutual funds comes after the best returns in the markets are over. In FY08, mutual funds received over ₹50,000 crore at 20-25 PE when the Sensex levels were close to 20,000 compared to just ₹120 crore in FY03 when Sensex was near 3,000 levels with the PE at 10. Thus, not much has changed. To summarise, the soul of the markets is the same, though the body has changed beyond recognition.

For most active fund managers great long-term performance can be attributed to a few key events or actions like big bets or avoidance. Can you recount any such key events in your career spanning two decades?

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It is true that certain key actions have played an important role in my career. Buying IT in a major way in the mid 1990s and selling IT in 1999 or buying old economy stocks in sectors such as steel, auto, capital goods, banks, etc, during 1999-2000. Also, not buying real estate, NBFCs, power utilities in 2007 and instead buying FMCG, pharma, auto, etc, have all played an important role.

While these moves have played a significant role, meaningful value has also been created by a large number of companies that may not fit into these themes. Finally, when I look back, after 1995, barring one idea, in my opinion we have not lost serious money on an investment. Over the long-run, not losing money is as important, if not more, than identifying the winners.

Why are there so many equity funds from HDFC? Which of these would you like to close down?

This question would be better addressed to the MD. In my opinion, compared to our peers and to our size, we do not have too many funds. The number of NFOs that have been done by us is modest. What is more important in my opinion than the number of funds is how the funds have done. Generally, all our funds have added value over the benchmarks over the medium- to long-term period.

In the case of HDFC Prudence; investors were scared with the aggressive stance on equity allocation. What was the rationale for this? Have you done anything to address the concern?

In 2008, the markets went from one extreme in valuations to other in a very short time period. In my opinion, a 60 per cent fall in about a year was the fastest ever in the Indian markets. It was once in a lifetime kind of a situation and was a result of large institutions going bankrupt

in the US and globally. My approach to investments has been to invest with a long-term view and to keep a balanced view of the markets. It is not based on extreme views of the markets or on very short-term views.

The fall in 2008 was so severe and fast that even the good quality stocks dropped substantially. While this did lead to high volatility in the short-run, we did not panic; we instead further improved the quality of the portfolio with a long-term view. This approach paid off handsomely as it has in the past. As of June 29, 2012, the HDFC Prudence has delivered a CAGR of nearly 20 per cent since its inception in 1994. Now, the NAV is around 30 per cent higher over the peak NAV of 2007, though the markets are down nearly 10 per cent in the same period.

HDFC Top 200 has slipped on our ratings. What went wrong?

The *Value Research* ratings mean a lot to me. I have always held you and your processes in high esteem, which are focused on the long-term with investor interest at its core. At the same time, in my opinion, ratings based on peer group performance alone have some deficiencies. If for a moment, all funds in the universe under-perform the benchmarks, the fund that underperforms the least would get the highest ratings. Excessive focus on peer group-based measurement of performance also leads to excessive risk-taking by funds as had happened in 1999 and 2007 which is detrimental to their long-term performance.

I feel that the primary objective of an active fund manger is to do better than the benchmark. Any fund that per annum delivers 2, 3 or 5 per cent better returns than the benchmark over medium- to long-term of say 3 or 5 years or longer periods is doing a good job and vice versa. This is particularly relevant to the Indian markets. Indian markets have been delivering nearly 15 per cent CAGR returns over long periods. While this in itself is an attractive return; funds that can better this by a reasonable margin make for compelling investments.

Coming back to the ratings of HDFC TOP 200, while the ratings may have slipped a little, but as long as we continue to do better than the benchmarks over 3 and 5 years timeframes, I would not be unduly worried. HDFC TOP 200 is also a Fund whose universe is limited to the BSE 200 stocks and there are limits on the divergence between the Fund and the benchmark. Thus, even though it may not be 100 per cent appropriate to compare this Fund with less constrained ones, we will endeavour to perform better over time as has indeed happened on quite a few occasions in the past.

Over the next 5-10 years what should one expect from HDFC Equity?

Let me start from the economy and the markets, as a significant portion of the total returns over long periods come from market performance. Despite the current pessimism in the markets and the challenges in the economy, in my opinion, unless we really mismanage, the economy in the current decade should grow faster than the last one. And, the markets should perform, in view of the prevailing below average PE multiples and prevailing peak interest rates.

Coming to HDFC Equity Fund, its positioning and investment strategy has remained unchanged for a long time. This is because the strategy of building a diversified portfolio of good quality with reasonably valued businesses to create wealth is as relevant today as it was in the past. Hopefully, following the same approach and discipline should lead to this Fund doing better than the benchmark as has been the case so far over medium- to long-term periods.

Your funds are among the largest in their respective categories — is it not a barrier to performance?
This debate of size and performance has been there for few years now. Please bear in mind that the size of mutual funds put together is miniscule compared to the markets and the economy. Even the largest fund is about 0.20 per cent of the overall market cap. Thus, there is no risk of being crowded in my opinion. If you classify all funds in order of performance, in my opinion, the larger funds have done better than the smaller funds consistently over medium to long periods. While large size is not an asset, sizes are not close to a point where they can start impacting performance, particularly against benchmarks, in my opinion.

How do you balance bottom-up stock picking and diversity of your portfolios?
Diversification is good, but over diversification dilutes long-term performance. We take care to remain diversified across key economic variables and sectors. But, at the same time we do not shy away from committing reasonably large amounts of capital behind good quality high conviction ideas.

When looking at the portfolio of HDFC Top 200 and HDFC Equity, there are several overlaps. Why is it so?
In large-cap funds, some portfolio overlap is inevitable. After all, there are only 50 or so large-cap companies. However, what people typically do is glance though the top 10 holdings of different funds, see very familiar and quite a few common names in them and conclude that the portfolios are similar. Some of the top holdings are indeed common and will remain so. The allocations could however be different and the non top-10 holdings may be different. A 20-40 per cent difference in portfolio composition is sufficient to make a reasonable difference to performance, particularly over long periods. For instance, an annual 2 per cent difference over 10 years will make a big difference to wealth.

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What is your view on gold as an investment?
I am not an expert on gold. And, even expert opinion is very divided on gold. I have few observations though; gold prices in real USD terms are close to all time high levels and gold is not supposed to create real wealth, it is only a reservoir of wealth. Investments by Indians in gold have multiplied almost 10 times in the past four years. It is never easy for the majority to make money in gold and in my view, a more cautious approach is warranted for investments in gold at current prices.

Where do you put your money?
Nearly all my savings are in equity funds of HDFC Mutual Fund. It should however be noted that investments should be tailored to one's specific needs and that there is no single approach that is suitable for all.

You have been a fund manager for two decades. Don't you get bored?
Not yet. There are a few downsides to my job, but the good thing is that one learns everyday. Over time, as you keep learning, you experience more market cycles, which makes you better equipped to deal with the future. ■