

CRISIL FUND *INSIGHTS*

Monthly funds newsletter from CRISIL Research

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Investment thoughts

The next frontier in ESG fund management

It's time to usher in ESG scoring for mutual funds

The soaring popularity of environmental, social and governance (ESG) funds in recent years presents a compelling case for adding ESG fund scoring for the fund management industry in India.

There has been a surge in sustainable assets globally, especially in the United States (US), where nearly 33%, or \$17.1 trillion of the total \$51.4 trillion assets under management (AUM) as of 2020, was in this segment.

Pension funds had the lion's share of this, with nearly \$6.2 trillion of their assets in the US as of 2020 being in the ESG space. Mutual funds incorporating ESG criteria in their investment strategy totalled up another \$3.1 trillion.

Back home, it is only recently that such funds have gained currency. The combined AUM of the 10 ESG funds currently in operation was Rs 11,818 crore as on March 31, 2022 (excluding fund of funds), having risen five-fold over the past three years. As many as seven of these were incepted in fiscal 2021.

The growth is being driven by special investment vehicles in the ESG segment and increasing preference of underlying companies for a sustainable, long-term approach to growth, which is adding to the share of sustainable assets managed by mutual funds.

Widespread adoption of ESG scoring by mutual funds at this stage will add much-needed grist to the mill by increasing transparency and trust.

After all, mitigating ESG risks is right in the lane of prudent investment management as it involves identification of companies with sustainable practices that can create a buffer for them across the three parameters, thereby improving their long-term value proposition.

These factors improve disclosures in the space among companies and also foster a stewardship code between investors and investee companies that protects shareholders.

Gauging the ESG quotient of Indian funds

A CRISIL Research analysis of mutual funds in the country, covering 354 scheme across 16 categories – 10 equity and six debt, with assets under management totalling Rs 17.69 lakh crore as on February 28, 2022 – threw up some interesting factoids.

A significant portion of money was in companies with good ESG scores, with exposure to 'Leadership', 'Strong' and 'Adequate' categories at Rs 2.29 lakh crore, Rs 5.22 lakh crore and Rs 6.46 lakh crore, respectively, while that to companies in the 'Weak' and 'Below Average' categories totalled just Rs 66,777 crore

All equity categories, except small cap and mid-cap, had higher median scores than the debt categories

Within the equity category, large caps had the highest median scores, benefitting from their mandate of selecting blue-chip companies and having exposure to sectors with high ESG scores, such as banks and computer software.

The small cap category had the lowest median ESG scores, stymied by exposure to sectors with low ESG scores, such as specialty chemicals and auto ancillaries.

On average, large cap companies had a score of 61 versus 52 for the small caps. The difference on the G parameter was narrow with the score at 69 for large cap companies versus 66 for small caps. However, small cap companies lost out on the E and S parameters with scores of 40 and 47 versus 54 and 57, respectively, for large cap ones.

Sectors that scored low on ESG parameters, on average, included transport infrastructure, construction EPC, and mining.

G parameter scores were higher than those of the E and S parameters for 97% of the schemes. Scores on the E parameter were the lowest for 86% of the schemes.

Somewhat curiously, there was a trade-off between diversification and better ESG scores. Equity schemes with more-than-average ESG scores generally exhibited lower diversification. On the other hand, funds with lower-than-average ESG score had better-than-average diversification.

Large cap, ELSS, flexi cap, focused and value/contra categories had high ESG scores but less-than-average diversification, while mid cap, multi cap and small cap categories had majority of funds with lower ESG scores but better diversification

Analysis of ESG-themed funds showed that all but one had higher ESG score than the average score across the equity categories considered, but lower diversification

ESG fund scoring can be a win-win

The Securities Exchange Board of India's rule on good governance, which kicked in from April 1 for the top 1,000 companies by market capitalisation to mandatorily include the Business Responsibility and Sustainability Report in their Annual Report, sets the stage for formal adoption of ESG for gauging corporate performance.

That, coupled with the current pace of growth, indicates ESG assets will only accelerate from here.

Adopting ESG fund scoring in investment products such as mutual funds will improve sustainability disclosures, creating a win-win for investors and the industry.

Greater awareness of ESG among companies and asset managers will be of essence here.

That said, it is important to ensure ESG is one of the components of portfolio construction and not the sole criterion, in order to avoid limitations from a developing concept, especially in a developing economy such as India.

The article was published on moneycontrol.com

Market – Overview

Indices	% Change in May 2022	% Change in Apr 2022
Nifty 50	-2.62	-2.07
S&P BSE Sensex	-3.03	-2.57

Indicators	May 31, 2022	April 29, 2022
10-year Gsec	7.42%	7.14%
Monthly CPI Inflation	7.04%	7.79%

Mutual fund - Overview

Top Stock Exposures – May 2022

1. ICICI Bank Ltd.
2. HDFC Bank Ltd.
3. Reliance Industries Ltd.
4. Infosys Ltd.
5. State Bank Of India
6. Axis Bank Ltd.
7. HDFC Ltd.
8. Bharti Airtel Ltd.
9. Larsen & Toubro Ltd.
10. Tata Consultancy Services Ltd.

Top Sector Exposures – May 2022

1. Banks
2. Computers - Software
3. Refineries/Marketing
4. Pharmaceuticals
5. NBFC
6. Engineering, Designing, Construction
7. Housing Finance
8. Passenger/Utility Vehicles
9. Cement
10. Telecom - Services

New Stocks Entries and Exits in Mutual Fund Portfolios – May 2022

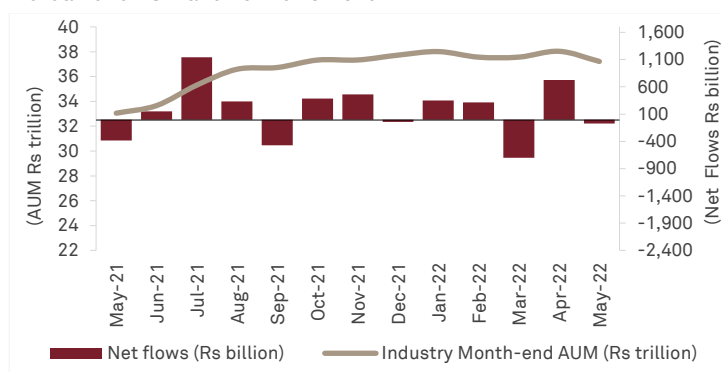
Entries	Exits
Aether Industries Ltd.	Ujjivan Financial Services Ltd.
Delhivery Ltd.	Vishwaraj Sugar Industries Ltd.
Emudhra Ltd.	
Ethos Ltd.	
Life Insurance Corporation Of India	
Paradeep Phosphates Ltd.	
Prudent Corporate Advisory Services Ltd.	
Shanthi Gears Ltd.	
Venus Pipes and Tubes Ltd.	

Category returns	Absolute monthly returns %	
	May	Apr
Large cap funds	-2.85	-2.02
Large cap and mid-cap funds	-3.76	-0.98
Multi cap equity funds	-4.29	-0.83
Flexi cap funds	-3.87	-1.92
Focused funds	-3.16	-1.77
Value – Contra funds	-3.68	-0.62
Mid-cap funds	-4.94	-0.10
Small cap funds	-6.09	0.34
Arbitrage funds	-0.04	0.26
ELSS	-3.50	-1.53
Index funds	-2.44	-1.84
Aggressive hybrid funds	-2.76	-1.31
Conservative hybrid funds	-1.12	-0.58
Gilt funds	-0.65	-0.55
Dynamic funds	-0.39	-0.51
Medium-to-long term funds	-0.24	-0.79
Medium term funds	-0.77	-0.41
Short-duration funds	-0.84	-0.12
Corporate funds	-0.67	-0.24
Banking and PSU debt fund	-0.46	-0.35
Credit risk funds	-0.55	-0.30
Low duration funds	-0.22	0.04
Money market funds	-0.20	0.09
Ultra-short duration funds	-0.50	-0.29
Liquid funds	-0.08	0.14

Category returns represented by average of CRISIL ranked funds – March 2022

- Domestic equities fell in May with benchmarks S&P BSE Sensex and Nifty 50 closing 3% down each on-month after the RBI unexpectedly hiked key rates amid weak global cues.
- Weak domestic corporate earnings of major companies for the quarter ended March 2022, coupled with an intermittent rise in global crude oil prices, also aided the downside trend in the market.
- Additionally, weak global cues, including concerns over rising inflation and a weak global economic growth outlook dented market sentiment.
- However, huge losses in the markets were prevented after the government announced a slew of reforms to tame inflationary pressure.
- Nifty sectoral indices ended mostly lower, with Nifty Metal (~16%), Nifty Energy (~10%) and Nifty Realty (~7%), falling the most.

Mutual fund AUM and net flows trend



Source: CRISIL Research

- Assets under management (AUM) of the domestic mutual fund industry's declined 2.2% on-month in May, or by Rs 81,673 crore, led by net outflows and mark-to-market (MTM) losses in debt- and equity-oriented funds, respectively.
- Assets of open-ended equity funds fell 2.5% on-month to settle at Rs 13.32 lakh crore in May due to marked to market (MTM) losses in underlying equities.
- Within the category, flexi-cap schemes recorded the highest net inflows, of ~Rs 2,939 crore, compared with ~Rs 1,709 crore in April, followed by strong inflows in sectoral/ thematic funds, equity-linked savings schemes (ELSSs) and large cap.
- Collections via SIPs came in at Rs 12,286 crore in May compared with Rs 11,863 crore in April. Meanwhile, the number of SIP accounts rose to 5.48 crore from 5.39 crore.
- Assets of hybrid funds fell to ~Rs 4.83 lakh crore, down ~0.5% on-month, or by Rs 2,244 crore, primarily weighed down by MTM losses in underlying equities.
- Among hybrid funds, balanced advantage funds (BAFs) saw inflows for the 17th consecutive month, recording net inflows of ~Rs 2,248 crore in May and Arbitrage funds saw net inflows of ~Rs 1,007 crore.
- Passive strategy continued to attract investors during the month. Exchange-traded funds (ETFs), excluding gold, and index schemes cumulatively saw ~Rs 11,779 crore in net inflows compared with ~Rs 14,725 crore net inflows in April.
- Weighed down by net outflows, the AUM of open-ended debt funds fell ~2.5% on-month to ~Rs 13.22 lakh crore.
- Within the category, liquid funds witnessed the highest net inflows of ~Rs 14,599 crore, compared with net inflows of ~Rs 16,194 crore in April, followed by overnight funds, short duration funds and corporate bond funds saw outflows.
- In the closed-ended debt category, redemption pressure continued on fixed-term plans. Net outflows totalled ~Rs 10,039 crore compared with outflows of ~Rs 20,327 crore in April.
- SEBI issued a series of measures to improve liquidity in passive funds and to make them more transparent to increase retail investor participation.

CRISIL Fund Rank 1 Schemes - Hybrid

Mutual Funds' Performance Report

Scheme Name	Point to Point Returns %					Inception Date	Average AUM (Rs.Crore)	Std. Deviation (%)	Sharpe Ratio	
	1 Month	3 Month	6 Month	1 Year	3 Years Since Inception					
Aggressive Hybrid										
Bank of India Mid & Small Cap Equity & Debt	-7.28	-3.73	-8.36	11.32	17.69	13.62	20-Jul-16	345.70	21.10	1.08
ICICI Prudential Equity & Debt Fund	-1.82	0.73	4.06	20.41	17.51	14.71	3-Nov-99	18987.66	20.84	1.08
Quant Absolute Fund	-3.82	4.15	1.78	14.30	24.87	16.96	11-Apr-01	363.86	21.69	1.47
Conservative Hybrid										
Kotak Debt Hybrid Fund	-1.71	-0.71	-1.43	5.09	10.34	8.07	2-Dec-03	1448.70	7.43	1.50
LIC MF Debt Hybrid Fund	-0.75	-1.29	-1.84	3.03	6.37	7.50	2-Jun-03	62.87	5.67	0.97
Arbitrage										
Kotak Equity Arbitrage Fund	0.36	0.88	1.91	3.96	4.38	6.90	29-Sep-05	25191.44	1.24	2.02
SBI Arbitrage Opportunities Fund	0.34	0.84	1.88	4.13	4.09	6.71	3-Nov-06	7883.73	1.35	1.54

CRISIL Mutual Fund Ranks as of March 2022
Point to Point Returns are as on May 31, 2022
Returns are annualised for periods above 1-year, other wise actualised
Risk Ratios are annualised
Period for Risk Ratios is three years
For Sharpe Ratio the risk free rate is 3.97% - the average 91-day T-Bill auction cut-off rate for three years
Average AUM is 3-months average number as disclosed by AMFI for the period April-June 2022

Average Assets under Management - A Bird's Eye View

Mutual Fund (MF) Name	Apr-Jun 2022 (Rs. Cr)	Jan-Mar 2022 (Rs. Cr)	Change (Rs.Cr)	% Change	Mutual Fund (MF) Name	Apr-Jun 2022 (Rs. Cr)	Jan-Mar 2022 (Rs. Cr)	Change (Rs.Cr)	% Change
SBI Mutual Fund	648641	648199	442	0.07%	PGIM India Mutual Fund	17206	16492	714	4.33%
ICICI Pru Mutual Fund	484873	486424	-1552	-0.32%	HSBC Mutual Fund	13532	12789	742	5.80%
HDFC Mutual Fund	418852	435537	-16685	-3.83%	Mahindra Manulife MF	9223	8805	418	4.75%
Kotak Mahindra MF	283897	286414	-2517	-0.88%	Quant Mutual Fund	8788	6506	2282	35.08%
ABSL Mutual Fund	282183	296390	-14206	-4.79%	Union Mutual Fund	8122	8147	-25	-0.30%
Nippon India MF	281440	285196	-3757	-1.32%	NJ Mutual Fund	4979	5247	-268	-5.11%
Axis Mutual Fund	246127	260335	-14209	-5.46%	IIFL Mutual Fund	4538	4264	273	6.41%
UTI Mutual Fund	224279	223842	438	0.20%	IDBI Mutual Fund	3903	4161	-258	-6.21%
IDFC Mutual Fund	117110	121230	-4119	-3.40%	JM Financial MF	3057	2318	739	31.87%
DSP Mutual Fund	106682	107911	-1229	-1.14%	Bank of India MF	2948	2750	198	7.20%
Mirae Asset MF	102384	102757	-373	-0.36%	ITI Mutual Fund	2706	2718	-13	-0.46%
Edelweiss Mutual Fund	93687	88713	4975	5.61%	Quantum Mutual Fund	1954	1978	-25	-1.25%
Tata Mutual Fund	88392	86713	1679	1.94%	IL&FS MF (IDF)	1394	1338	56	4.20%
L&T Mutual Fund	71571	75592	-4021	-5.32%	Navi Mutual Fund	1353	1039	313	30.16%
Franklin Templeton MF	60017	64123	-4107	-6.40%	Trust Mutual Fund	1034	1218	-184	-15.08%
Canara Robeco MF	49253	47956	1298	2.71%	IIFCL Mutual Fund (IDF)	625	625	0	0.06%
Invesco Mutual Fund	40218	43916	-3698	-8.42%	Samco Mutual Fund	590	367	224	61.04%
Sundaram Mutual Fund	39954	43107	-3153	-7.31%	Indiabulls Mutual Fund	524	544	-20	-3.70%
Motilal Oswal MF	32303	34948	-2645	-7.57%	Taurus Mutual Fund	498	511	-13	-2.49%
PPFAS Mutual Fund	24790	23114	1676	7.25%	Shriram Mutual Fund	208	220	-12	-5.42%
Baroda BNP Paribas MF	21896	21393	503	2.35%	WhiteOak Capital MF	127	105	22	21.09%
LIC Mutual Fund	17344	17817	-473	-2.66%	Grand Total	3823199	3883769	-60569	-1.56%

AAUM is the quarterly average number and includes domestic fund of funds

Fund Focus

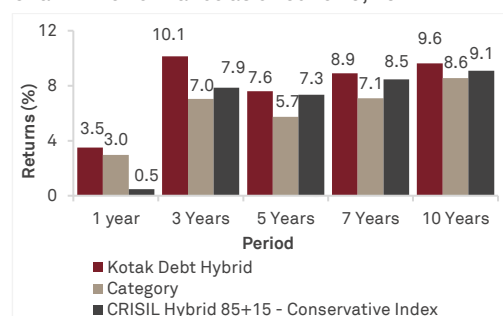
Kotak Debt Hybrid - Growth

Launched in December 2003, the Kotak Debt Hybrid - Growth fund was ranked in the top 10th percentile (CRISIL Fund Rank 1) of the conservative hybrid-fund category of CRISIL Mutual Fund Ranking (CMFR) in the quarter ended March 2022.

Performance

The fund has outdone the category benchmark (CRISIL Hybrid 85+15 - Conservative Index) and the category (represented by the funds ranked under the conservative hybrid category in CMFR - March 2022) in all the periods analysed. It has returned 8% since inception.

Chart 1: Performance as on June 10, 2022



Note: Returns above one year are annualised

Better risk-adjusted returns

The fund outperformed its category on a risk-adjusted basis, as measured by the Sharpe ratio (higher the better) over the three years to June 10, 2022. The fund's Sharpe ratio was 1.45 against 0.97 for its category and 1.39 for the benchmark during this period.

SIP returns

If an investor had set aside Rs 1,000 every month under the systematic investment plan (SIP) for the five years to June 10, 2022, the investment of Rs 60,000 would have grown to Rs 74,871 at a compound annual growth rate (CAGR) of 8.97%. Similar investments in the benchmark for the same period would have grown to Rs 71,674 at a 7.19% CAGR.

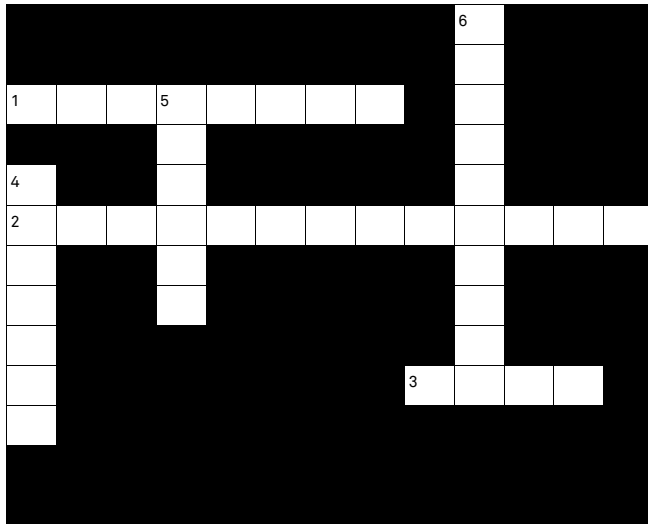
Portfolio analysis

During the three years to May 2022, the fund's debt portfolio primarily comprised non-convertible debentures (NCDs) and government securities, averaging 63% of total assets. Exposure to equities averaged 24% of total assets. The top-three sectors accounted for 28.6% of the portfolio, on average, for the past three years. The fund had the highest exposure to finance (12.7%), followed by banking (11.7%) and consumer non-durables (4.3%).

Fund managers

The fund's debt portion is managed by Vihag Mishra, an MBA in Finance with over 10 years of experience, and Abhishek Bisen, an MBA in Finance with over 16 years of experience. The equity portion is managed after by Devender Singhal, a PGDM holder in Finance, with over 19 years of experience.

Crossword Corner – boost your financial knowledge



Horizontal

- 1) A measure of a company's exposure to long-term ESG risks that are often overlooked during traditional financial analyses (1,1,1, 5)
- 2) These factors help investors determine how much a company does in limiting pollution and whether the company follows energy efficient processes (13)
- 3) Regulatory body for securities and commodity market under the ownership of Ministry of Finance (1,1,1,1)

Vertical

- 4) An asset class that is volatile over the short term and is therefore intended for risk takers (6)
- 5) These factors consider criteria such as the company's community relations, labor standards and employee / client data protection (6)
- 6) These factors consider criteria like the board composition and audit committee structure of a company (10)

Answers

Vertical: 4) Equity 5) Social 6) Governance

Horizontal: 1) ESG Score 2) Environmental 3) SEBI

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