Nippon india Mutual Fund

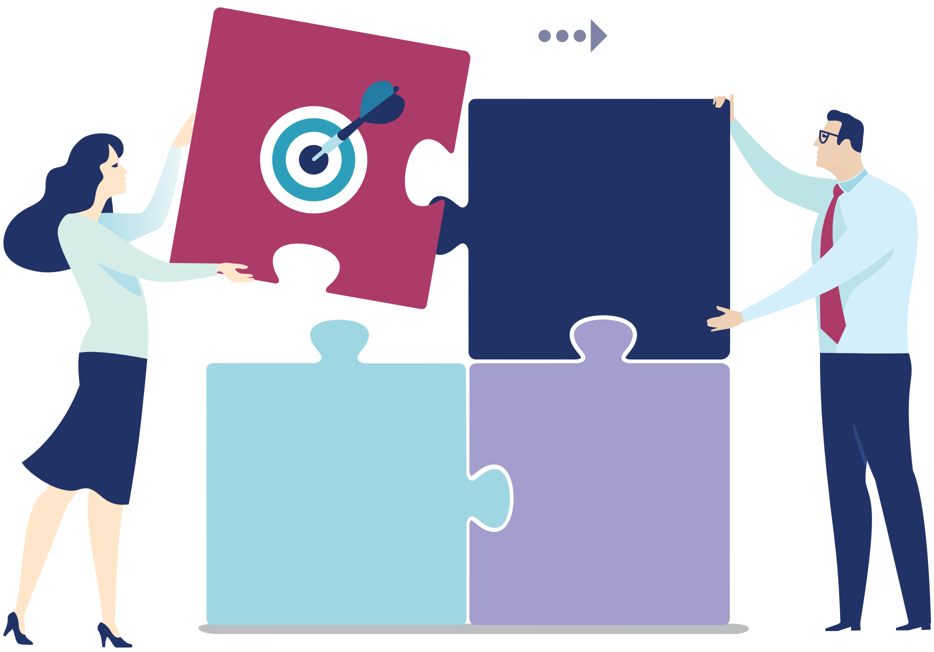
Wealth sets you free

THE NIPPON WAY

Good gets *better*

Investment Process – the Nippon Way

In the last two editions of the Nippon Way, we explained to you the importance of having Sector Limits and Active Share thresholds possibly to achieve relatively consistent returns. In Part 3 of the Nippon Way, we are bringing to you the concept of 'Style Diversification' and its relevance in portfolio construction.



Part 3: Investment Process

STYLE DIVERSIFICATION

Different Factors or ‘Styles’ would work at various points in time in the market. For example, there may be times when ‘Growth’ style of investing may be in favor. There may be other times where ‘Value’ investing may be a popular theme, which may be working in the market. Similarly, within the equity markets, there have been times when large caps fare relatively better than the broader markets – mid cap and small caps, and vice versa.

If the Fund Manager is spot on, and rides the bandwagon by being in the right ‘styles’ ahead of the markets, he may create reasonable alpha. On the other hand, if the Manager may get it wrong, the portfolio returns may suffer. Factor contributions tend to rotate – a particular factor working well at sometimes, may get replaced by another – both in the short term and long term. It would be difficult for a Fund Manager to get the trends right all the time, or even most of the times.

Hence, a prudent approach may be to strike a balance in Factor or Style exposures.

Morgan Stanley Capital International (MSCI), a global leader in providing tools to help clients build and manage better portfolios, implement strategies and measure performance invented a common language to explain risk and return through the lens of factors. MSCI has developed Factor Models in consultation with the world’s largest investors and has research backed by four decades of factor data. MSCI, through their tool MSCI Barra, provides stock-level factor exposure details on different parameters for the Indian markets, on factors / styles such as Growth, Momentum, Size, Profitability, Leverage, etc.

THE NIPPON WAY

At Nippon India Mutual Fund, we have opted for having balanced factor / style exposure for the diversified equity funds. We check for the factor exposures of funds on a monthly basis in our PDCA meetings (acronym for Plan, Do, Check and Act – a formal review mechanism to evaluate the portfolios in detail), through data from MSCI Barra. Any excessive tilts on any factor is encouraged to be corrected by carrying out necessary changes to the portfolio.

By doing so, extreme exposures, and consequently volatile fund performance may be avoided. Risk mitigationby striking the right balance, the Nippon Way!