

MF SIP Investment Strategy

Current Scenario:

Domestic stock markets saw deep correction recently. The fear gauge of the Indian equity market has ticked up significantly amid concerns of outbreak of coronavirus. The whole world is battling a health crisis with central banks and governments across the world redrawing their priorities to tackle the economic fallout from the virus. Economies across the world are trying to flatten the curve in terms of new infections by adopting social distancing and lock-down measures. To some extent, positive developments have come from China which have reported lesser number of cases. However, there are many unknown variables; extent and outer time limit of spread of the virus in India and world-wide, effectiveness of lock-down measures to contain the virus, nature and extent of fiscal and monetary measures not just during this outbreak but after the storm withers away would also be crucial.

At the start of the month, India was relatively less impacted by the spread of the COVID-19, but things have changed rapidly. The central government has taken the unprecedented measure of 21-day lockdown in the country from the midnight of March 24, in order to tackle the spread of the virus to achieve a flattening curve in terms of new infections reported.

Existing investors in SIP schemes may be disappointed at first glance as the SIP returns may not look exciting. However, this is the result of fall in stock values over the past few weeks and once these values bounce back, the returns will look more respectable.

Investors who have been doing SIP for the last 2 year, 3 years, 5 years and in some cases even 7 years have seen negative or single digit returns now. However, investors should not judge the outcome of their SIP Investments when markets have deeply corrected. SIP returns (XIRR) are subject to end-point bias, wherein all the investments you have made during your SIP tenure is assumed to have redeemed at such dirty cheap low levels and thus the return picture would be gloomy (depressing). Taking investment action based on such returns would not be a wise decision.

Why Equities now more than ever?

These are tough times for investors at large, stock market has seen sharp correction in the last one month reflecting the pandemic crisis. Nifty 50 is now at 2016 levels; down by ~34% from its highs. Similarly, Nifty Midcap 100 is at 2016 levels (down 37%) and Nifty Smallcap 100 (down 43%) is now at 2014 levels. The big question whether the markets have bottomed out and discounted the economic and business disruption remains unanswered. Considering the uncertainty of the situation, investors might have to experience some more pain in the coming weeks and when the second and third order effects of the pandemic are witnessed, assessed and more clarity on the extent of the spread of the virus is evident.

Sharp correction in the index throws great value buying opportunity, as we know that a BEAR market is a BUYERS markets. All quantitative fundamental filters be it P/E, P/B, Dividend yield, Forward earning yield to Gsec yield, etc all come to one conclusion that equities are attractive at these levels. The fall in the index values is observed across all markets and is 3x times faster than the fall in 2008. The market cap to GDP ratio of is significantly lower to the long-term average and is very close to 2008 global financial crisis levels. The correction in the index has increased the relatively attractiveness for equities than bonds. Nifty 1-year forward earning yields to G-sec yields have spiked significantly indicating a value buy at these levels.

What are the benefits of SIP?

- Reduces Risk because of Rupee Cost Averaging, which helps in lower volatility of returns. An approach or a benefit wherein the investor can buy more units when prices are low and less when prices are high. Rupee-cost averaging can help reduce the average cost per share over time (provided the investor does not stop SIPs in bear markets) and increase your profit when the cycle turns and markets start rising.
- SIP can be started with very small amount of money. SIP does not burden your wallets, as the outflow does not happen in one go.
- Timing the market is not necessary. Investors are always in a dilemma that if it is a right time to invest or not. Investing through SIP resolves this dilemma as it is a periodic investment which occurs across market cycles. The philosophy behind starting a SIP with an equity scheme is to go on investing regardless of the market conditions. Lumpsum investment will turn out better only if the investor manages to time his entry and exit correctly.
- Long term financial goal can be aligned with SIP. SIP is a perfect tool for people who have a specific, future financial requirement. By investing an amount of your choice every month, you can plan for and meet financial goals, like funds for a child's education, a marriage in the family or a comfortable post retirement life.
- Disciplined approach towards Investment helps in controlling the emotions. Regular investment makes you disciplined in your savings and also leads to wealth accumulation.
- SIP allows to benefit from the power of compounding. When you invest over a long period, you earn returns on the returns earned by your investment.

Why not to discontinue SIP during turbulent times?

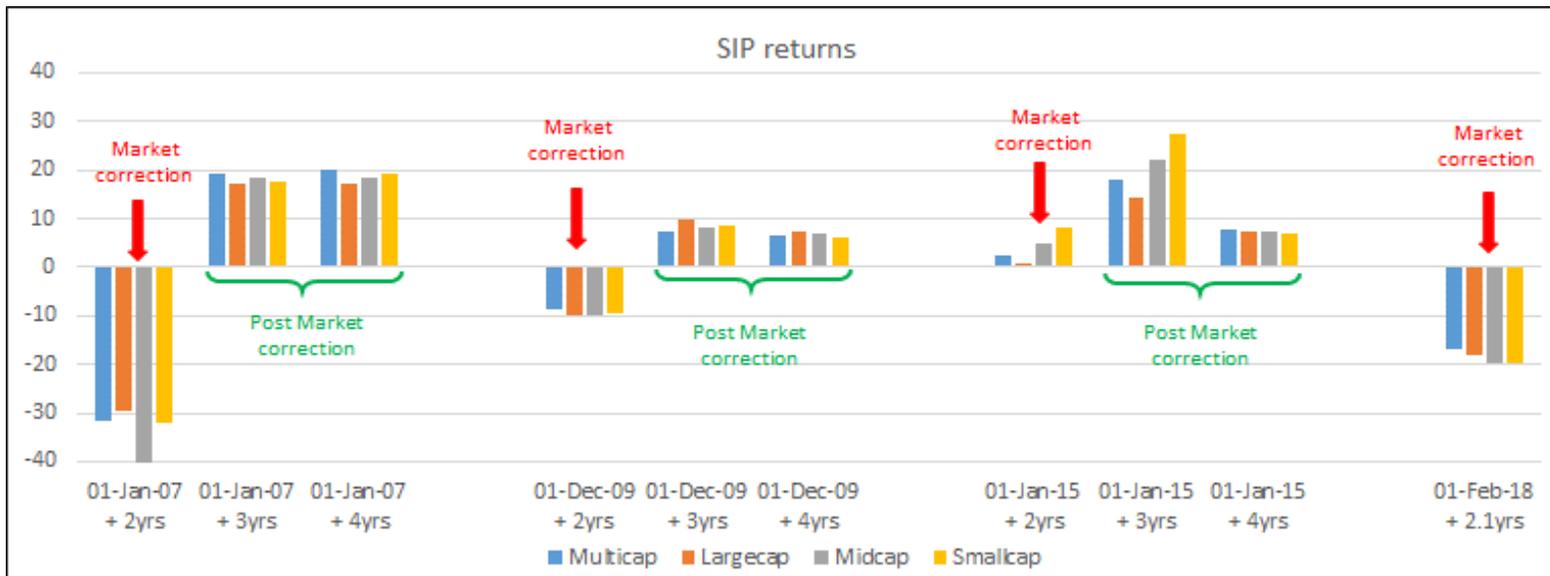
Investors who started investing in the last 2-5 years through the SIP mode, have seen their overall return enter the negative territory. In these volatile market conditions, many investors tend to stop their SIPs or redeem the invested amount even in losses in a state of panic. It is sad to note that every time there is a drop in stock markets, investors re-think on their SIP investments. They may want to take money out, fearing a longer and deeper market correction. Investors who have taken Goal-oriented investment decision should not worry about such corrections.

Stopping SIPs is totally against the reason why investor started SIPs in the first place i.e not worrying about timing the market. How will investors gain more units by investing the same amount if stock prices do not fall? In fact, SIP Investors should be happy that a correction has happened because now one can buy more MF units via SIP. In fact SIP investors would gain more in the correction is deeper and more prolonged due to rupee cost averaging. Such premature ill-timed exit could impact the portfolio returns significantly as it fails to get the benefit of lower average costs.

Investors can use the ongoing volatility as an advantage and turn this market correction into an opportunity for potential long-term wealth creation. In fact, that is the period when an investor can accumulate more units at a cheaper cost and then benefit from the eventual up move in the markets.

Investors aiming for wealth accumulation should not consider exiting, as SIP brings in a disciplined approach to that objective. Also review of schemes invested through SIP mode at regular intervals is of utmost importance so that the investor doesn't bet their stakes on underperforming schemes.

Total amount invested through SIPs in equity-oriented mutual funds have surged despite frequent bouts of market turbulence indicating this route helps investors sidestep the behavioural weakness that emerges during volatile market phases. The growing size of SIPs and the number of SIP investors showcase the mutual fund industry's efforts to inculcate the habit of disciplined investing. SIP monthly inflows have been growing and steady at more than Rs 8,000cr, but there has been an increase in the number of discontinued SIP accounts in FY 19-20 (till Feb).



Note: Two years prior to the date when markets were at bottom or near bottom has been picked as the starting date of SIP. Multicap, Largecap, Midcap & Smallcap represents average category SIP returns (XIRR%). Category average is based on the current SEBI classification. Source: ACEMF.

The above chart shows how an investor gains during market corrections. If an investor had started SIP two year before the market bottomed out, he would gain if he continued SIP for 1 more year (see +3 years return). An investor would have accumulated more units at lower NAV thus boosting his overall returns when the market recovers.

An investor who wants to exit or is in need of funds, can consider redeeming after one-year, post completion of market correction; when SIP returns are maximum. Post that some weakness and signs of new correction starts to reappear (see +4 years returns above) which again tends to reduce the overall return. So, there is a need for right exit strategy which will be discussed later in this note. In the current situation, existing SIP investors might have to continue their SIPs for more than one year to yield maximum return.

Why to Start Fresh SIPs now/ top-up SIP?

SIP as an instrument route can be started at any point of time as the whole point is to avoid timing the market. If there is a better time to start doing SIP it would be when market correct. Crisis of different magnitude has hit us in the past. Below table shows the history of crisis, SIP returns (annualized) and the Nifty levels at month ends. We can see that longer we continue doing our SIP, returns improve from deep in red to green. As time passes the SIP returns goes from deep negative to small negative or positive returns that is despite Nifty giving suboptimal returns. Also it is clear that deeper the correction and the longer the market remains in downward journey, better is the SIP returns as seen in 2008. Two years after the correction started Nifty gave -8.28% return while SIP investor gained 27.32% return in the same time.

Harshad Mehta Scam - 1992		Asian Financial Crisis - 1997		Dot com Bubble - 2000		Global Financial Crisis - 2008		Eurozone Debt crisis - 2011		Chinese Slowdown - 2015	
Nifty 50 levels before crisis	-	Nifty - 1232.4		Nifty - 1712.7		Nifty - 6144.35		Nifty - 6117.55		Nifty - 8284	
Months (after correction started)	SIP returns	Nifty	SIP Returns	Nifty	SIP Returns	Nifty	SIP Returns	Nifty	SIP Returns	Nifty	SIP Returns
3	-64.93	1,085	-29.80	1,380	-42.92	4,735	-57.53	5,506	-45.47	8,491	-12.24
6	7.38	963	-35.15	1,394	-11.93	4,041	-58.17	5,750	-7.01	8,369	-7.58
9	-35.47	1,159	15.31	1,268	-20.57	3,921	-39.18	5,482	-9.93	7,949	-13.93
12	-39.19	931	-24.86	1,351	-2.12	2,959	-50.41	5,327	-8.45	7,946	-8.43
18	7.91	966	-6.65	1,054	-22.96	4,291	15.89	5,248	-3.94	8,288	2.63
24	39.35	1,310	26.17	1,142	-5.35	5,169	27.32	5,620	4.37	8,186	-0.42
Nifty in 2 years (CAGR)	-	3.11%		-18.34%		-8.28%		-4.16%		-0.59%	

Source: ACE MF

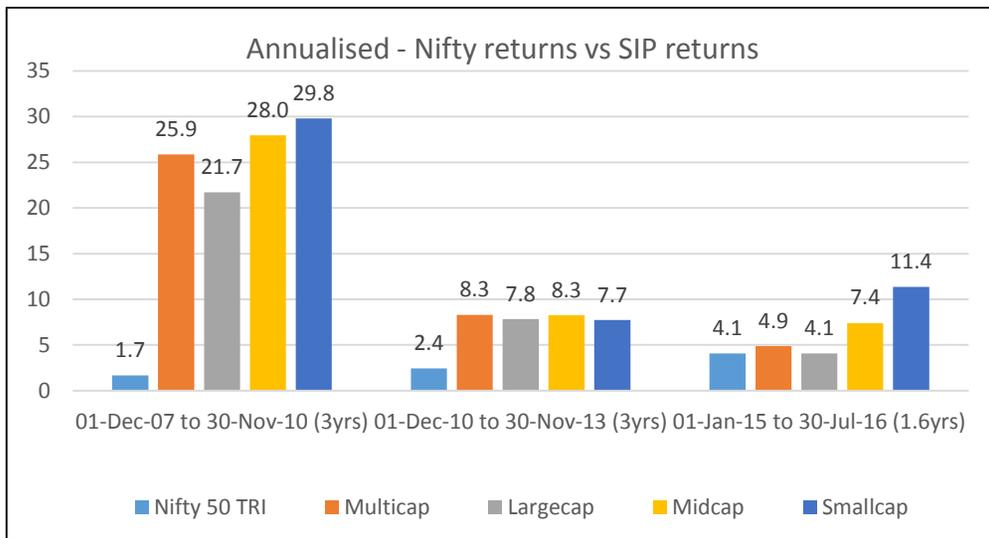


Chart alongside show, how much rupee cost averaging benefits SIP investors after market correction. Nifty having regained near about the pre-correction levels works in favour of SIP investors as shown below, where SIP annualised returns (XIRR) are more than lumpsum investment in Nifty 50 TRI (CAGR returns).

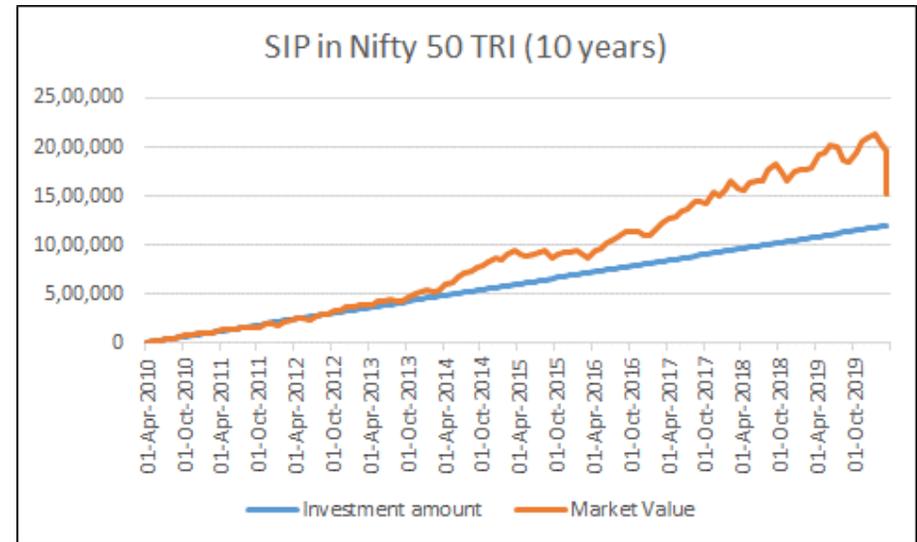
Period 01-Dec-07 to 30-Nov-10 is an exceptional situation where the markets saw big crash and quick recovery due to the Global Financial Crisis. Many market veterans are comparing the ongoing health crisis to have impact similar or worse than 2008 crisis. If things go in that directions, returns similar in those lines can be expected.

Note: Nifty 50 returns is CAGR%. Multicap, Largecap, Midcap & Smallcap represents average category SIP returns (XIRR%). Category average is based on the current SEBI classification. Source: ACEMF.

SIPs Exit Strategy:

A simple “Buy and Hold” strategy is what investors at large normally follow. It is a good strategy; as longer you are in the market, better are the chances of achieving decent returns. However, the recent crash in the market have raised doubts on this traditional strategy. Chart alongside shows, SIP investment and market value for monthly SIP amount for Rs 10,000 for 10 years in Nifty TRI (incl dividends). SIP in Nifty TRI would yield returns of meagre 3.2% annualized (as on 31st March, 2020). However, investors should not judge the outcome of their SIP Investments when markets have deeply corrected. SIP returns (XIRR) are subject to end-point bias, wherein all the investments you have made during your SIP tenure is assumed to have redeemed at such dirty cheap low levels and thus the return picture would be gloomy (depressing).

Witnessing drastic erosion of portfolio accumulated over 10 years can be disturbing; also uncertainty about the length of time to reach back at those pre-crash levels continues to haunt mutual fund investors. Life savings getting eroded can come as a big shock, which brings out the need to employ an exit strategy as well.



Source: ACE MF

Volatility is the part and parcel of equity investing. We have seen such deep corrections in the past and this would not be the last time. We have to accept the fundamental law in financial markets i.e “Reversion to the mean”.

Investors following these principles would do well:

Adhering to Asset Allocation strictly:

SIP amount accumulated over the years results in a huge lumpsum value, which is at risk from market corrections. Investing over the years, one forgets to adhere to their asset allocation set up initially. If due to run-up in markets, equity allocation is increased from initially established 70% to 80%, the investor needs to shift the excess 10% to debt or other asset class. The same should be practiced post market crashes; allocating more to equity would be beneficial at that time. It is during such times we appreciate the importance of asset allocation. A basic asset allocation formula for equity exposure: 100 – (your age) can be employed diligently henceforth. Conservative investor can use 70 instead of 100. Investors should reduce equity exposure continuously and progressively so that they can get close to their desired corpus regardless of market ups and downs. Rebalancing and strictly adhering to asset allocation should be practiced once every six months.

Fundamental Based Triggers:

Another way to reduce portfolio volatility is to reduce equity exposure when market reach higher P/E. Basic fundamental points like Nifty P/E ratio, Nifty Earning Yield to Bond yield can be used to decide on when allocate more to equities or debt. Prices are overvalued when the Nifty P/E ratio exceeds its historical levels. Part reduction in equity holding gradually can be initiated on such triggers. The earnings yield (Nifty) can be compared to the 10-yr Gsec yield to assess the relative over or under-valuation of stocks with respect to debt. Another trigger for market correction – U.S. Yield inversion (when the yields on bonds with a shorter duration are higher than the yields on bonds that have a longer duration) – can also be used by active investors. Investments in safe debt funds like money market funds, low duration can be considered when such indicators start giving signals. Arbitrage fund is also a good option for HNIs because of its taxation benefit and can also be considered for short term parking.

However, markets don't always behave in a rational way. There are beta rallies too. For all we know over-valuation of stock prices is triggered and for long periods no correction happens and investors lose potential upside due to shift from equity to debt. This is the price an investor has to pay to avoid fear of wealth erosion in such deep correction. Decent returns of 6-8% can be earned on debt funds during such times. Such irrationality may not persist for very long as eventually fundamentals will catch up and market would revert to its mean.

Targeted Returns/ Corpus Strategy:

Another way to manage high value market risk is by establishing a target return/corpus. An investor having a return expectation of 12% on his capital can monitor the funds performance on quarterly or half-yearly basis and invest or withdraw the excess amount for parking in safe shorter duration funds. This way whenever market rallies and returns are north of 12%, investor should withdraw the excess value and park it in some debt funds. Adding into equity funds from debt also needs to be carried out when market sees some correction.

A simple alternative would be to redeem equity units accumulated over 2-4 years which have yielded decent return of 12-15% p.a. and parking the redeemed amount in shorter duration funds Stopping the running SIP and starting a new SIP, thereby booking profits, raising some cash that can be tactically deployed temporarily in debt till a lumpsum investment opportunity arrives in equity space. This will help in optimizing investors' returns from SIPs and avoid investor regret of seeing high returns on unbooked SIPs which crash suddenly in bad markets.

Conclusion:

Investors can use the ongoing volatility as an advantage and turn this market correction into an opportunity for potential long-term wealth creation. Goal-driven SIP investor need not to worry about the fluctuations or ups and down that are seen in the equity market. Investors can grab better returns in the next few months/quarters period if they stay invested during market fall. SIP Investor should be patient and continue to remain invested. But investors should at regular intervals undertake due diligence and review their schemes' performance to weed out underperformers, rebalance their portfolio and adhere to their asset allocation strategy. A more cautious investment strategy (capital protection) is warranted in the short term; not only to tackle in the COVID-19 shock but also for the second/third round of effects after this storm passes.

Disclosure:

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