CLASSIFICATION OF MUTUAL FUNDS AS PER SEBI REGULATIONS- UNDERSTANDING SECTORAL FUNDS & THEMATIC FUNDS

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Abstract
The Mutual Fund regulator Securities Exchange Board of India (SEBI) issued new guidelines in 2017 on classification of various categories of schemes and put restrictions on having more than one scheme in each category with some exceptions like sectoral/thematic funds and index funds. The regulations helped in restricting number of mutual fund schemes and enable investors to compare similar schemes of various mutual funds and take informed decision. Prior to this regulation, mutual funds were launching multiple schemes of similar nature under various names in the pretext of new fund offers and mobilising fresh money from gullible public. This article is about understanding various categories of mutual fund schemes under the new regulation and analyse the fund performances of some sectoral funds/thematic funds as compared to some broad-based index funds where the aforesaid regulatory restriction on number of schemes is not applicable, over a period of last 10 years.

1. Introduction

A mutual fund is a common pool which mobilizes fund from investors and channelize to capital market through investment in tradable securities. Indian Mutual Fund industry is currently managing Rs.38 trillion Assets Under Management (AUM) as on March 31, 2022 by 44 Asset Management Companies. The period 2005-2015 has seen mushrooming of schemes and launchingof New Fund Offers by Mutual Funds making it difficult for investors to compare and take informed decisions. Keeping it in view, the regulator Securities Exchange Board of India (SEBI) issued new guidelines on categorization and rationalization of schemes in October 2017 in order to bring uniformity among schemes managed by different fund houses.

2. Objectives of the study

i. To understand various categories of mutual fund schemes as per revised SEBI regulations on classification of mutual fund schemes, more specifically sectoral and thematic funds.
ii. To analyse fund performances of some sectoral funds/thematic funds as compared to broad index funds over last 10 years period.

3. Review of literature

Amita&Bodla (2012)- The analysis brought out that sectoral funds have performed better than diversified equity in those years in which the stock market performed better and vice- versa. For instance, the years 2008 and 2011 saw the global crisis and as a result the performance of the selected sectoral mutual fund schemes has been worst in these years. On the whole, such funds are good option for those who can bear moderate to high level of risk in their investments.

Maya M (2017) - The risk associated with Sector funds is very high compared to ELSS and Diversified equity funds, it is more suitable for aggressive investors having higher risk appetite.

Bhattacharjee, Animesh (2020)- The study measures the performance of 21 sector-specific mutual fund schemes by employing Sharpe ratio, Treynor ratio, Jensen alpha, M-squared measure, R-squared measure, and Information ratio. The study found that majority of the schemes are consistently providing more returns than their respective benchmarks.

4. SEBI categorisation of Mutual Fund Schemes

The objective of the regulation is to provide investors an opportunity to compare similar schemes of various mutual funds and take informed decisions

The mutual fund schemes are classified as –

1. Equity Schemes- Large cap, Midcap and Small cap stocks are defined
2. Debt Schemes
3. Hybrid Schemes - further categorized into conservative hybrid fund, balanced hybrid fund and aggressive hybrid fund
4. Solution Oriented Schemes – To meet goals for Retirement, Children education, Child Marriage etc.
5. Other Schemes – Index Funds & ETFs and Fund of Funds

The equity schemes classifications are as under:

4.1 Equity Fund Categories as per SEBI guidelines:

Multi Cap Fund*	At least 65% investment in equity & equity related instruments
Large Cap Fund	At least 80% investment in large cap stocks
Large & Mid Cap Fund	At least 35% investment in large cap stocks and 35% in mid cap stocks
Mid Cap Fund	At least 65% investment in mid cap stocks
Small cap Fund	At least 65% investment in small cap stocks

Dividend Yield Fund	Predominantly invest in dividend yielding stocks, with at least 65% in stocks
Value Fund	Value investment strategy, with at least 65% in stocks
Contra Fund	Scheme follows contrarian investment strategy with at least 65% in stocks
Focused Fund	Focused on the number of stocks (maximum 30) with at least 65% in equity & equity related instruments
Sectoral/ Thematic Fund	At least 80% investment in stocks of a particular sector/ theme
ELSS	At least 80% in stocks in accordance with Equity Linked Saving Scheme, 2005, notified by Ministry of Finance

*Also referred to as Diversified Equity Funds – as they invest across stocks of different sectors and segments of the market. Diversification minimizes the risk of high exposure to a few stocks, sectors or segment.

Usually, equity mutual funds mobilize funds from investors and invests in stocks of various companies across industry, across sector and across capitalization. Whereas sector funds invest money with a focus on one area of the market that have similar offerings of products and services.

One of the main reasons which have led to the increasing popularity of mutual funds in recent years is the opportunities and flexibility they afford to investors. Be it investment horizon, risk factors, return potential, various instruments & their characteristics, investors can find something acceptable to their needs and preferences.

A broad information of the various categories of mutual funds enables investors looking to compare various mutual funds categories and invest according to their choice and risk perception. Sector and thematic funds are somewhat opposite to the popular diversified equity fund format and Index Funds are passive funds and follow a particular index.

4.2 What are Sectoral/Thematic funds?

There are many sectors in an economy like information technology, pharma, infrastructure, energy etc. which are the building blocks of the Indian economy. A sector fund is an equity fund that allows to invest in businesses that belong to the same type of businesses or industry or same sector. The idea behind these investments is that certain sectors may perform very well in the medium to long term and investors can reap benefit on such opportunities to generate high returns as compared to diversified equity funds which deliver moderate returns over medium to long period of time. Diversified funds invest in stocks of businesses across industries and across market capitalisations making it relatively lower risky as compared to sectoral funds.

For instance, an Auto sectoral fund will have equities of Maruti, TISCO and such companies that manufacture auto or auto ancillaryequipment etc.As per SEBI's mandate, fund managers of sector funds need to invest at least 80 percent of the fund's assets in equities of a chosen sector.

Sectoral Funds are different from Thematic funds wherein investments are made in accordance with a pre-determined theme. Thematic funds have a broader scope and diversification than sector funds and the focus is on themes instead of a sector or industry. For instance, Dividend Yield funds are thematic funds in which investments are made in companies of different sectors that have a good track record in terms of giving higher and regular dividends to its investors.

4.3 Things to keep in mind before investing in sector and thematic funds

Thematic funds are more diversified than sectoral funds, but both these classes of mutual funds carry higher risks due to lack of diversification than multi-cap mutual funds which invest in companies of various sectors. The following points needs to be taken care before investing:

- Fair understanding of the fund's objectives and its suitability to our objective of investment.
- Minimum investment horizons of more than five years owing to the high volatility quotient.
- More suitable for investors having higher risk appetite and who are comfortable taking high risks.
- Timing plays a crucial role in investing in sectoral funds because the performance of these funds relates to the economic cycle.
- Before investing in sector or thematic funds, checking earnings of the sector and finding out whether the theme is sustainable.
- To give yourself an idea of where the markets are, you could also take a look at the sectoral allocation of leading funds and indices. This could act as a reference for you to evaluate the sectoral allocation of your own portfolio

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4.4 Scheme Performances of Sectoral/Thematic Funds as compared to broad based index

We have selected and analysed 62 schemes pertaining to various sectors and themes viz. pharma, banking & finance and auto sectors. Among themes, dividend yield, MNC, consumption and infrastructure schemes are chosen. All these schemes are categorised under the sector or the theme and the peer group average performances over 1 year, 2, 3, 5 and 10 years period are calculated and compared with NIFTY 50 index which is considered as the Large-cap broad based index and one of the most important benchmark index. The details of sectors/themes and their performances are as below:

Category of Funds	No. of Funds analysed	Average No. of Years of the fund	Average Fund Size (Rs. Crore)	Performance Returns in Compounded Annualised Growth Rate (CAGR) percentage as on 30/09/2022. Belowperiod in Years				
Sectoral Funds				1	2	3	5	10
Pharmaceutical Sector	9	9.76	1364	-9.85	9.23	23.75	14.19	14.24
Banking & Finance Sector	13	9.91	1639	-3.29	27.80	8.15	7.55	12.40
Auto Sector	1	18.57	1895	17.41	29.51	18.75	5.54	17.05
Thematic Funds								
Dividend Yield Theme	8	10.83	1219	-1.34	26.63	17.79	10.55	12.43
MNC Theme	2	14.24	1767	-3.13	14.00	9.88	7.69	14.40
Consumption Theme	11	10.83	1205	8.53	29.25	17.82	13.57	15.39
Infrastructure Theme	18	15.73	839	5.71	39.18	19.07	9.61	12.39
NIFTY 50 returns				-3.74	24.00	14.79	12.83	12.79

*Mutual Funds are subject to market risk, please read all scheme related documents carefully
Source: Compiled from various scheme data from value research online website

Conclusion

From the data analysis of peer group average returns with that of Nifty 50 index, it is observed that even though the Nifty 50 index has given negative returns, some of the sectors and themes have delivered positive returns viz. auto sector, consumer and infra related thematic schemes over one year period. All sectors and themes understudy have delivered positive returns in 2years and above period. Almost all sectors and thematic funds have delivered similar or above returns in 10 years period time confirming the general believe that sectoral/thematic fund deliver higher returns as compared to large-cap diversified schemes in long term. Investors need to take utmost care in understanding the scheme and risk associated with sectoral as well as thematic schemes before investment, as Asset Management Companies are at liberty to launch any sector or any theme where the regulatory restrictions of one scheme under one category is not applicable.

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