Mutual Funds – Measuring their performance

What is the issue?

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Recently, two fund houses “DSP Black Rock and Edelweiss”, decided to use the Total Return index to measure their performance.

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What is the background?

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- For long, most equity mutual funds in India have found it quite easy to stay ahead of the index to which they are benchmarked.
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- While credit must go to skilled fund managers, a part of it must also go to the funds choosing easy benchmarks.
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- Most Indian funds measure themselves up against pure Price Indices, as opposed to Total Returns indices - TRIs.
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- While recently two new fund houses have switched to TRIs, “Quantum Mutual Fund” has been doing this for years.
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What is TRI?

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- An investor in shares makes returns from both the appreciation in the traded price of the share and the dividends received on it.
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- A **Total Return Index** is a benchmark that captures both the price

movements and the dividend payouts of its constituent stocks.
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- But in India, the default stock index used is the **Price Index**, which ignores the dividend component.
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- So, if the Nifty50 shoots up by 200 points for the day, it is the “Nifty50 Price Index” that is being referred to.
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- A sensible investor owning the Nifty50 should actually be tracking the moves of the Nifty50 Total Returns Index, which also factors in the dividends received.
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- The NSE actually disseminates both Plain Price & Total Return Indices for all the benchmarks available on the exchange.
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- The Nifty50 Total Returns Index is calculated by assuming that the dividends declared by the Nifty50 companies are reinvested in their respective stock, on the day they go ex-dividend.
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Why is it important?

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- Dividend payouts is not a source of big returns in itself.
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- But if it is reinvested over time, this can make quite a significant difference to the investor’s returns.
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- In the five-year period between 2012 & 2017, the Nifty50 Index delivered a 13.5% annual return based on price gains alone.
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- While the Total Returns for the same period, after assuming re-investment of dividends, works out to 15.2% per annum.
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Why haven’t the money managers moved to Total Returns?

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- Money managers have persisted with “Price Returns” inorder to help them

lower the bar on the returns they need to make to outperform the market.
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- The gap between “Price Returns” and “Total Returns” helps them achieve the same.
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Source: Businessline

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