

# **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.  $\n$
- While credit must go to skilled fund managers, a part of it must also go to the funds choosing easy benchmarks.  $\gamman$
- Most Indian funds measure themselves up against pure Price Indices, as opposed to Total Returns indices TRIs.  $\n$
- 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.  $\$
- A **Total Return Index** is a benchmark that captures both the price movements and the dividend payouts of its constituent stocks.
- 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.  $\n$
- 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.  $\nline{\nline{1.5}}$
- 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.  $\$
- In the five-year period between 2012 & 2017, the Nifty50 Index delivered a 13.5% annual return based on price gains alone.
- 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.  $\n$
- $\bullet$  The gap between "Price Returns" and "Total Returns" helps them achieve

the same. n

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#### Source: Businessline

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