Fund Focus: Canara Robeco Emerging Equities Fund

18.18% 10 yr CAGR from this midcap champion fund

Ravi Gopalakrishnan, Head - Equities, Canara Robeco MF

25th May 2017

In a nutshell

10 years of strong alpha and peer group performance result in an impressive 18.18% 10 yr CAGR return for the Canara Robeco Emerging Equities Fund vs 13.27% for the midcap index and 7.95% for the broad market

Midcaps trade at a premium to broad markets in a bull market. Strong earnings growth prospects over the next 2-3 years make current valuations appear reasonable, though not cheap

he best way to participate meaningfully in the midcap story is to remain invested for the long term, rather than attempting to time bouts of volatility.

Canara Robeco Emerging Equities Fund	2009	2010	2011	2012	2013	2014	2015	2016	2017 (YTD)
Fund Return %	112.37	28.32	-22.28	48.89	3.16	96.02	13.06	2.56	31.20
Benchmark Return %	98.97	19.16	-31.00	39.16	-5.10	55.91	6.46	7.13	28.25
Sensex Return %	81.03	17.43	-24.64	25.70	8.98	29.89	-5.03	1.95	13.88
Fund rank in category	7/32	4/33	13/32	7/30	21/28	1/32	6/43	33/55	5/61
Percentile	81	91	63	80	29	100	88	42	93
Alpha over benchmark	13.40	9.15	8.72	9.73	8.26	40.11	6.60	-4.57	2.95
Fund Size - (Rs.Crs)	21	37	38	43	40	230	911	1298	1824

Benchmark: Nifty FreeFloat Midcap 100. Fund category: Equity - Midcap. YTD 2017 data upto 15-May-17. Data: ACE MF

Click here to know more about percentiles and the colour codes

WF: The fund has a stellar long term track record in terms of alpha generation as well as peer group performance. CY16 was a tough year, though the fund has bounced back well in CY17 YTD. What caused the speed-bump in CY16 and what steps have you taken to bring the fund back to its high performance ways?

Ravi Gopalakrishnan: The fund's superior performance could be attributed to its portfolio construction process which incorporates the Business-Management-Valuation approach to stock selection and also to the adequate diversification, which has helped the fund avoid taking excessive risks. Considering the economic environment in recent years, the focus has been to invest in good businesses with a clean balance sheet. Good businesses offer economy led growth and operating leverage benefits while clean balance sheets avoid the issues associated with financial leverage. The volatility in equity markets last year had impacted both large cap and mid cap segments of the market. Since the fund primarily operates in a space which is very much aligned to the domestic economy, every event that causes some turbulence in the domestic space definitely impacts the fund to some extent.

In 2016, it was first the Fed lift-off and then the demonetisation which acted as speed-bumps but thankfully, the impact of these events was short lived and the markets came back even stronger than before. We did make some changes to the portfolio to limit downside, but since consumer facing sectors were the most impacted we took some pain before things were fine again. While calendar year may be one way of looking at performance, the overall long term returns for investors invested in the fund has been good. Inspite of the very short term underperformance vis-a-vis the benchmark the longer term performance of the fund continues to remain very robust.

WF: Which are the sectors and stocks that are driving outperformance in CY17 YTD?

Ravi Gopalakrishnan: Generally, any economy stands on three important pillars i.e Investment, consumption and exports. Investment is comprised of Cement, metal, capital goods, infrastructure, banks dealing with corporate lending, commercial vehicles etc. Consumption is comprised of FMCG, paints, Auto, media and banks & NBFC dealing into retail finance. Lastly export is comprised of IT,

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Pharma, selective auto ancillaries, engineering and specialty chemicals. Our portfolio too has essence of all the three pillars. Within that pockets such as auto Ancillaries, urban consumption, building material and specialty chemical have contributed positively to our performance YTD.

WF: Midcaps are in the eye of the storm around "bubble valuations" with many experts suggesting extreme caution even as fund managers continue to believe that there exist good bottom-up opportunities. This assertion is being viewed with some circumspection as fund managers rarely ask investors to redeem and take profits. How do you view this debate and how can you give comfort to advisors who are worried about the perils of remaining invested and watching paper profits vanish if this "bubble" bursts?

Ravi Gopalakrishnan: The Indian markets at present is undergoing a fair bit of rerating on the back of a structural improvement in the economy. The markets have gone up a lot and are currently trading at all-time highs. Based on FY19 valuations, the broad market is trading at about 18x FY19 estimated earnings. This is definitely not cheap valuation, but by no means it is expensive. This is because historically markets have traded at P/E mutliples between 10x and 24x 1-year forward earnings. Coming to mid-caps, typically they trade at premiums relative to the broad markets during bull markets and at discounts during a bear phase. Currently, we believe markets are in a structural bull markets and hence premiums appear to be inflated.

One of the main reasons for this anomaly is because earnings in general of the broader market and of mid cap companies are at a trough and are expected to recover over the next 2 to 3 years. Moreover, the operating and financial leverage of many of the mid cap companies is usually very high resulting in disproportionate earnings growth compared to large caps during an economic up cycle. As a results, markets tend to ascribe a higher premium to mid-cap companies especially to the ones with unique business models, companies with competitive edge globally, and also strong brand among other things. While valuations of mid cap companies may appear to be high based on current earnings, if one were to look future earnings, valuations in general are reasonable.

Stock market investing is all about remaining disciplined and staying invested through various economic and business cycles over the long term especially for midcaps. While near term volatility will impact performance every now and then, disciplined investing and staying invested for long term usually smoothens out the volatility. For example, as on 28th April, 2017, CREE 10 year returns have compounded at 18.18% compared to broad market returns of 7.95% and mid cap index return of 13.27%.

WF: In what ways (if any) are you trying to protect the portfolio in the event of a mean reverting correction that many experts seem to be predicting may be around the corner in mid and small caps?

Ravi Gopalakrishnan: Stock market volatility and near term trends are very difficult to predict. During periods of high volatility individual stocks can correct 25 to 30% within a matter of days. The only way to limit the downside particularly for midcaps is by having a portfolio approach which will have a combination of both high and low beta stock and by avoiding concentration risk in the portfolio. This can be achieved by spreading the investments across multiple sectors and by ensuring limits of single stock exposures within the portfolios.

Given the high volatility in the earnings stream of mid cap companies, stock price movements can be quite volatile. Hence staying invested over the long term is perhaps the only way to smoothen out the volatility as opposed to trying to time the markets and trying to capture every single volatility in the markets.

WF: Do you see any cyclical or structural risks to the Indian midcap story over the next couple of years?

Ravi Gopalakrishnan: While there are structural and cyclical risks to equity investments at any given point in time, it is applicable to both large cap and mid cap investing. Midcaps do have greater downside during cyclical and structural down turns as compared to large caps.

From a risk perspective, there are quite a few challenges global and local which can impact markets. The disruptions during implementation of GST, recovery in earnings and the monsoon situation in India can all be near term risks. Similarly, US interest rates going up, China slowdown and uncertainty surrounding the Eurozone due to Brexit can cause volatility in global markets. This can have impact on flows coming into emerging markets and can also impact the Indian markets.

WF: What would you say is the key investment argument for this fund, for an investor coming in today?

Ravi Gopalakrishnan: For the past two years, the Indian equity markets have risen on hopes of a recovery in the economy. Being considered as one of the best investment destinations in comparison with other economies worldwide, Indian equities benefited from the fillip received from the investors worldwide. The economy too showed signs of recovery. In such an environment, it is usually the Midcap companies that benefit the most. These are companies that are midsized and as the economy grows, these companies could grow into larger companies.

As the name of the fund indicates, our endeavor is to identify tomorrow's emerging leaders. In emerging India, there are many sectors which are at a nascent stage where there are very limited large cap opportunities to invest. For example movie exhibition, specialty chemical, healthcare and diagnostic, auto ancillaries, niche financial pockets such as insurance, exchanges and micro finance, agro chemical etc. All of these pockets are captured by the emerging equities fund.

We continue to believe that investors should certainly expand their asset allocation to the small and midcap space if their risk appetite allows them from a longer term perspective.

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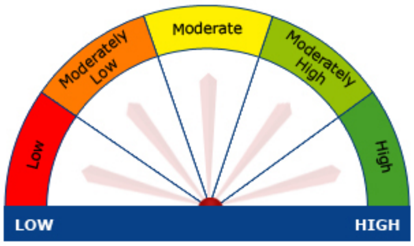

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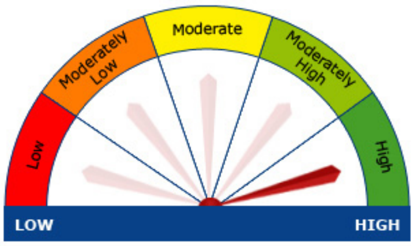

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Name : A Gupta	City : Lucknow
ARN NO : AG Wealth Circle	Date : 26 May 2017

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Problem with this fund is that it doesnt stick to its midcap profile properly. It takes much higher exposure to smallcaps to come out as a winner in midcap category. Compared to midcap category its returns are much more volatile. It is neither a midcap fund nor a smallcap fund.

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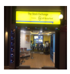
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