PGIM
India Mutual Fund

Return is only one side of the coin. Risk is the other side. Whether it be your health or investments.

August, 2021

Ajit Menon
CEO

Dear Investors and Partners,

As life returns to normalcy, our collective behavior undoubtedly will be the key in defining whether the pandemic will rear its ugly head again or whether it will be relegated to history. So, I hope that all of us continue practicing the health protocols adopted during COVID.

Through the period of the pandemic, the market sentiments alternated between focus on risk and focus on returns. Last year's focus was on managing risk, now it is about maximizing returns. Investors quite often focus on the last one-year return on a particular date to choose a scheme for investment. There is a big fallacy in doing so. I would like to explain it by way of an example related to the lives of individuals. Idea is to create awareness about the other aspects of evaluating a funds performance.

Let's say that the head of the family Mr. M wants two of his family members, A & B of similar age and built to embrace healthy living, inculcate regular exercise and nutrition in their day-to-day routine. He knows that both are overweight for their height and gives them a challenge of losing weight over the next three years with a promise of handsome reward for the achievement. At the end of three years, A loses 21 kgs and B loses 19 kgs. These are point-to-point numbers arrived at by taking the difference in weights at the beginning and end of the period. If the yardstick was only about weight, then A is the winner, but the question is, do the numbers tell you the whole story. What if the journey to weight loss for A was - lost 6 kgs in year 1, gained 3 kgs in year 2, and lost 18 kgs in the last year. The corresponding numbers for B are lost 5 kgs in year 1, 6 kgs in year 2, and 8kgs in year 3. Who is more likely to have embraced a healthy regime of diet and exercise? If the objective was to have a healthy individual, then does the number 21 give the entire picture? This is the fallacy of taking point-to-point numbers. Much like weight loss data in our example, point-to-point returns for a fund do not give you the entire picture about the robustness and consistency of the fund.

Assuming that Mr. M is aware of the fallacy of just measuring the weight at the start and the end of the period, he decides to record the weight for both the individuals at the beginning of every quarter and compare it with the weight at the end of the quarter. He records weights at the beginning of Jan and the end of March, the beginning of April end of June, and so on. He now has data for twelve quarters, and an average of it gives the idea of a more consistent person in the race. Intuitively we know that B will stand out. This method when adopted for the fund returns is what is called rolling returns. Since the conclusion is not relying only on one data point like point-to-point returns, this gives you a better picture of consistency.

Now another aspect that Mr.M could bring in to evaluate the true winner with a sustainable lifestyle could be the risk taken by an individual to achieve the objective. What are the typical risks in attempting a weight loss? Adopting an extreme diet, an exercise that may not be sustainable in the long term and could cause the body harm. In our example, if A has adopted some extreme form of diet and had worked out way beyond limits especially in the last year, while B has consistently followed a moderate diet and workout routine, then A has taken more risk to achieve the objective. The risk taken per unit of weight loss would be higher for A over B. From the lens of risk taken for achieving objective, B is the winner. Though the risk taken to deliver returns is difficult to quantify in the case of the healthy regime, fortunately for us as investors it is easily quantifiable in the case of MF schemes. There are various ratios that give you insights into the risk taken by the fund manager in delivering the returns.

As you can see a single number that takes into account only two data points cannot be a true yardstick of measuring who is the real winner in achieving the long-term objectives. A consistent and disciplined process is the key to achieve goals over the long term, be it a health goal for an individual or an investment objective for a scheme. To identify the true winners in the investment world the focus should be on measuring aspects like consistency, risk rather than just a number that does not reveal the entire picture. Looking for these aspects or asking the right questions to your advisor will help you get better at making the right choices.

Stay safe and happy investing.

Connect with us on: www.pgimindiamf.com 1800 2667 446