PGIM
India Mutual Fund

Financial Airbags

Ajit Menon
CEO

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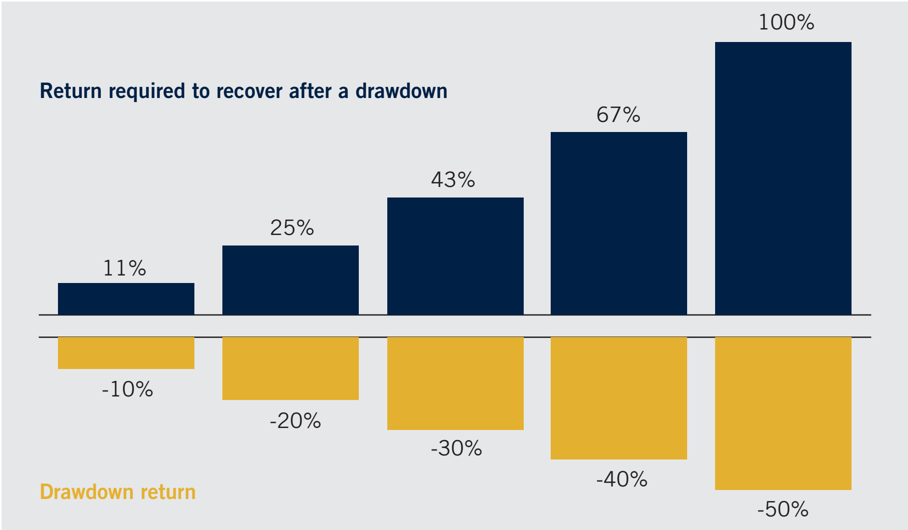
Dear Investors and Partners,

Investing in equity mutual funds can be a great way to beat inflation and grow your money over time. However, equity markets have historically gone through cycles of great positive runs and also some sharp corrections.

Many factors beyond ones control, that include demand and supply dynamics, politics and policy, regulation, earnings, competition, profitability and sentiment, among many more, contribute to volatility in the prices of equity stocks. This is why your equity mutual funds go through the same volatility. A simple way to gauge the volatility of your fund/s is through its standard deviation. Standard deviation measures how much the returns of a mutual fund vary over a period of time. Comparing this number for the funds you are invested in can give you a sense of risk that each fund is exposed to while generating its return.

You will find this metric in the mutual fund factsheet published every month. For instance, as of the end of June, 2024, the three year standard deviation (annualised) of PGIM India Midcap Opportunities Fund is 14.62% versus 16.51% for its benchmark - NIFTY Midcap 150 TRI.

A higher standard deviation means potential for bigger swings in investment value and vice versa. That said, some may argue that a high standard deviation may not be necessarily bad as long as returns are positive. But what investors need to also focus on is how much your fund is able to protect the downside when markets fall. Let us understand why protecting the downside becomes crucial in your investment journey with an example. Given below is a hypothetical example of drawdowns and the return required to recover from the drawdown.



The lower bars show the fall in portfolio and the corresponding upper bars show the return required to recover to the initial level. For instance, if your portfolio witnesses 50% drop/drawdown, it has to earn 100% to come back to its initial value but if your portfolio witnesses 20% drop/drawdown, it has to earn just 25% to come back to its initial value. Thus, implying that losing less gives you not only an opportunity to bounce back easily but also for compounding to work much more in your favour in creating wealth.

In the recent past, investors have mostly had a good experience with markets. The market seems to be in a bull run. However, markets can never be in a perpetual bull run and it shall have its share of corrections too.

Let me try to explain the relevance of paying attention to downside protection with an analogy. Let us say you are planning a trip with your wife and one kid. You have three options: travelling by bike, car, or public transport.

Here are the benefits & concerns of each mode of transport:

Bike: By travelling on a bike you might reach your destination faster with less cost, but the journey is risky. You have no protection from soaring sun, pollution or rains, limited scope to carry luggage and a higher risk of injuries if you meet with an accident.

Car: If you travel by your car, most of these risk are avoided and you have more flexibility. You have seatbelts and airbags to protect your family and enjoy your favourite music on the way and stop at a scenic spot to click some pictures.

Public transport: You can also choose a public transport which can come with reasonable safety. But you also desire some comfort, luxury and freedom to enjoy the road trip.

To infer, you may like to create some balance of risk and benefit to reach your destination not only in a safe environment but also in time.

Now imagine your investment journey in the above case starting at A and going to B with, not your family, but a suitcase that contains your wealth. When it's a money destination, ignoring downsides and adding too much risk can make a huge difference between reaching your financial goals or missing them.

The recent market run should not be assumed to be continuing perpetually and may see some bouts of market corrections (as history tells us) periodically. How you navigate those corrections shall play a crucial part in your long-term financial planning. It is important to assess your risk appetite, protect your downside which are like your financial airbags, and stick to asset allocation which shall help you navigate uncertainties, both in the markets as well as in life.

Whether you are going for a holiday with family or planning for your financial goals, it is always advisable to do some homework and if you feel overwhelmed with choices, taking the help of a travel guide/financial advisor will help you plan your journey better.

Happy Investing!