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Diversify your portfolio by investing a portion in US-focused mutual funds

Domestic equity mutual fund investors have had a rather rough ride over the past couple of years. For many, investments made even through the SIP (systematic investment plan) route have declined in value significantly across categories. Debt markets too have been rather volatile over the past one year.

Be that as it may, US-focused mutual funds are one category whose solid performance year-to-date and even over the past three years has gone relatively unnoticed.

Not only have US-focused fund-of-funds and ETFs outperformed key categories of domestic equity funds—large-, mid- and small-cap—over one- and three-year timeframes, they have also done better than domestic indices over these periods. There are five FoFs – domestic funds investing in their respective parent's/others' mutual fund units in the US – and one ETF focussed on the US that have delivered substantial outperformance.

US-Focused schemes trump domestic mutual funds

Fund	Returns (%)		
	Year-to-date	1 Year	3 Years
Franklin India Feeder - Franklin US Opportunities	26.5	9.3	17.4
Motilal Oswal NASDAQ 100 ETF	24.4	6.4	18.8
Reliance US Equity Opportunities	21.5	13.1	16.1
ICICI Pru US Bluechip Equity	17.3	8.5	13.1
Kotak US Equity - Standard Plan	14.2	2.6	11.1
DSP US Flexible Equity	14.1	-0.3	12.6
S&P 500 (US)	14.8	2.2	9.7
Sensex TRI	4.5	-0.1	11.2
Nasdaq 100 TRI	20.1	4.5	19.5
Category average of domestic funds			
Large-cap	1.9	-3.5	8.7
Multi-cap	0.9	-5.0	8.1
Mid-cap	-5.0	-10.5	5.5

Source: Valueresearch; only direct plans considered

Returns as of Aug 12; 3-year returns are compunded annually

In the current year so far, these US-focussed funds delivered 14-26 per cent returns, while domestic diversified equity schemes managed, on average, -5 per cent to 1.9 per cent growth in their NAVs depending on the category to which they belonged. Over a three-year period, US-focussed FoFs have delivered 11-19 per cent compounded annual returns, while domestic funds managed just 5-9 per cent. Hearteningly, the returns aren't because of a weak rupee. The rupee has depreciated by just 6 per cent in absolute terms in the last three years (66.9 to 71.14). Since foreign investments are dollar-denominated, a weak rupee adds to the returns of investors in global funds.

The upswing in the US economy in recent years helped US-focussed funds beat domestic equity schemes in terms of returns. US markets have been rallying for the past several years, backed by healthy GDP growth, record-low unemployment figures, a large number of buybacks, and higher corporate earnings. Of course, past returns may not be repeated in the future. But indices such as the tech, FMCG and pharma heavy NASDAQ have been making new highs on the back of sound earnings growth of the underlying companies. The fact that the US Federal Reserve hasn't indicated further rate cuts has also meant that the dollar has strengthened and will continue to gain against most currencies.

There are three distinct advantages in considering US-focused funds. These are: low correlation between the movement of Indian and US markets; opportunity to invest in sectors (semiconductors, electronics, technology etc.) that have limited presence in India; and the structural decline in the rupee over the past decade against the dollar.

One another reason given by market experts is to invest in US-focused funds if they have future goals related to the dollar – sending children to study in the US, for example.

Portfolio diversification and limited correlation:

Despite the advantages of investing in funds focused on the US, investors have generally been lukewarm to the idea.

"Indian investors have predominantly been biased towards taking much higher exposure to domestic markets vis-à-vis offshore," says Ankur Maheshwari, CEO, Equirus Wealth Management

Kaustubh Belapurkar, Director, Fund Research, *Morningstar* Investment Adviser India, elaborates, "Indian investors typically have a huge home bias, due to the fact they have witnessed solid equity returns over a long term. What they tend to ignore is that developed markets such as US have delivered significant returns over market cycles."

Manish Gunwani, CIO - Equity Investments, Reliance Nippon Life Asset Management outlines the reason for the US market's outperformance: " The US Government's fiscal stimulus, along with record Corporate buybacks has led to the US market outperforming most global markets including India."

In a connected world, there are times when all markets fall or rise in tandem. But, by and large, the Indian and US markets haven't moved in the same direction over the long term of five to 10 years. This means an investor's portfolio remains relatively immune to volatility if it is well diversified across geographies.

Says, *Deepak Jasani*, Head of Retail Research, HDFC securities, "Low correlation between Indian & US markets can be seen in quite a few instances in the past, especially after Aug 2018."

"Adding global equity exposure is a great way to diversify your portfolio. More importantly, these markets do not necessarily move in sync; thus, adding global diversification can lower volatility," says Kaustubh.

A chance to invest in global majors

The US has a massive number of companies that are market leaders across several countries. Google, Apple, Microsoft, Facebook, Netflix, Intel and GE are some examples of global majors.

Investing in US indices means exposure to segments such as semiconductors, technology, pharma, fast-moving consumer goods (FMCG) and even consumer durables. In India, there are limited avenues to invest in these segments.

Says Kaustubh from Morningstar, "Fundamentally, US and European stocks give Indian investors exposure to global companies that have great globally recognized brands, products and are growing at a healthy clip."

Adds Manish of Reliance Nippon Life, "Some of the growing businesses such as new tech have limited presence in the Indian market."

Currency and taxation

Though the rupee has not depreciated much in the last 18 months, on a structural basis, the currency's decline against the dollar has been steady over the last 10 years – from 48 levels to over 71 currently. So, even over the longer term, the rupee's depreciation may provide a kicker to returns.

Says Deepak of HDFC Securities, "Returns from these funds gets accentuated or offset by currency changes in a period. Rupee depreciating further would provide a cushion to the investors in such schemes by and large. A sharp change in the direction of the Rupee from depreciation to appreciation is unlikely considering that the global sentiments towards emerging markets are not strong."

He has an interesting analysis on the prospects of the two markets, US and India: "Historically, the Nifty 500 index has outperformed the S&P 500 by a margin over a shorter period. But if we look at returns over the last 6 years, then the outperformance has been minimal. The main investment consideration will still be based on relative economic prospects."

Long-term capital gains (holding period of more than three years) made in international FoFs are taxable at 20

How much to invest?

While there is a case for investing in US-focused funds, you should not go overboard in parking money in such FoFs or ETFs. Investment should be in keeping with your overall asset allocation policy as advised by a financial planner or an expert.

Says Ankur of Equirus Wealth, "Investors should look at US-focused funds and make it a regular allocation to the portfolio, to the tune of 10-15% of overall portfolio."

Kaustubh suggests making a 15-20 per cent allocation to global equity funds.

There are other uses to investing in US-focused funds. If you want to send your child to the US for higher education after 10 years, you may find that the rupee-dollar rate may become, say, Rs 85. This decline means you will need to cough up more money to fund your child's education. An investment in the US can cover this risk for you.

Says Deepak, "Investors who have future dollar expenses (for example, parents planning to send their children to US for higher education, importers having dollar commitments, etc.) can hedge against any future depreciation in the rupee vis-à-vis the US dollar by investing in these schemes."

Manish adds a note of caution: "Given the fact that the Indian market has underperformed already it may not be wise to increase allocation to the US market just owing to its recent performance. However, if someone doesn't have any global equities in the overall portfolio then there is case to diversify into global equities."

Moneycontrol's take:

US-focused funds have had a great run over the past five years. There are, of course, tensions related to the trade war with China and concerns on interest rates and yields. But the underlying fundamentals have been pretty strong for the US for the past several years.

Investors would also get to invest in global leaders and a diversified basket. With a horizon of at least five years, investors can park at least 10 per cent of their portfolio in ETFs or direct plans of FoFs.