



## Aim to get more out of large cap investments by investing in Nifty Next 50

Equity, as an asset class, is an attractive investment avenue for investors with high-risk appetite and a long-term investment horizon. Within the equity universe, the safety quotient draws investors to large cap companies and often away from higher returns promised by small and mid-caps.

But what if investors can get a blend of both – relative safety (large caps) along with opportunity to generate higher returns? The answer to this convergence is Nifty Next 50 ETF (Exchange-Traded Fund).

### Understanding Nifty Next 50

Nifty Next 50 consists of 50 large cap stocks that come after the top 50 (Nifty 50), in order of free float market capitalisation (cap) in Nifty 100. The index was introduced on December 24, 1996, with a base date of November 4, 1996<sup>1</sup>. It predominately captures the performance of bluechip companies in the large cap universe along with a few mid-caps. Thus, the index enables investors to enjoy the twin benefits of relative safety (from large caps) and returns potential (from mid-caps).

### What's in it for investors?

Let's take a look at the qualitative and quantitative benefits for investors.

#### Qualitative: Safety of large companies

By investing in Nifty Next 50 ETFs, investors can find comfort in the fact that the stocks in the portfolio are that of fundamentally sound large cap companies. Further, the index provides an opportunity for investors to invest in companies that are potential candidates for inclusion in the Nifty 50 in the future. To be sure, over the past 18 years, 41 stocks have been upgraded to Nifty 50, out of which 27 currently form part of Nifty 50.

Large companies with well-established businesses, strong cash flows and stable earnings growth.

Established track record and steady dividend payout.

Benefits of investing in large cap

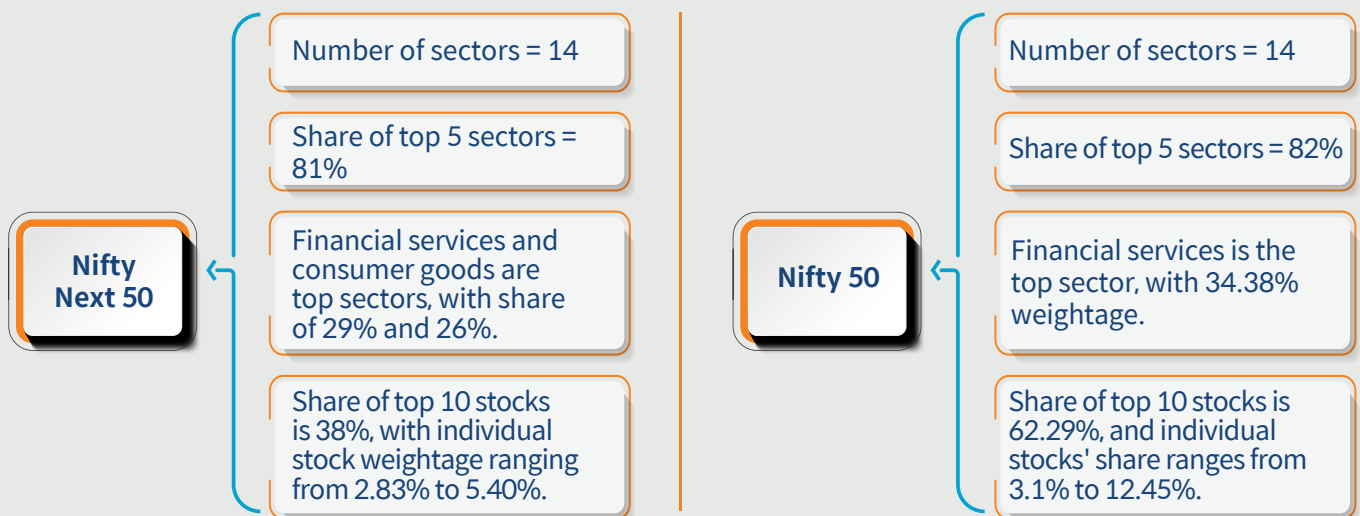
High quality of management and business.

Well-researched and defined business for analysis.

## Diversified portfolio

Also, Nifty Next 50 is a well-diversified index as compared to Nifty 50.

## Index composition of Nifty Next 50 and Nifty 50



Source: Nifty Next 50 and Nifty factsheet

In fact, the sectoral composition of the Nifty Next 50 is less skewed and the top sectors include consumer goods and pharmaceuticals, which are more defensive in nature - a key consideration in these volatile times, owing to the Covid-19 pandemic. In comparison, sector weightages of the large cap funds are in line with the Nifty 50, and, hence, the portfolio is skewed towards sectors such as financial services, information technology (IT) and energy, which have registered sharp volatility because of the demand destruction brought on by the pandemic.

## Sector weightage

Chart 3: Nifty next 50

Nifty Next 50	Sector Weightage
Financial services	28.50%
Consumer goods	25.58%
Pharma	16.09%
Oil and gas	6.90%
IT	3.51%
Cement and cement products	3.45%
Automobile	2.86%
Services	2.84%
Chemicals	2.83%
Metals	1.68%
Power	1.65%
Textiles	1.56%
Industrial manufacturing	1.32%
Construction	1.24%
<b>Total</b>	<b>100%</b>

Chart 4: Nifty 50

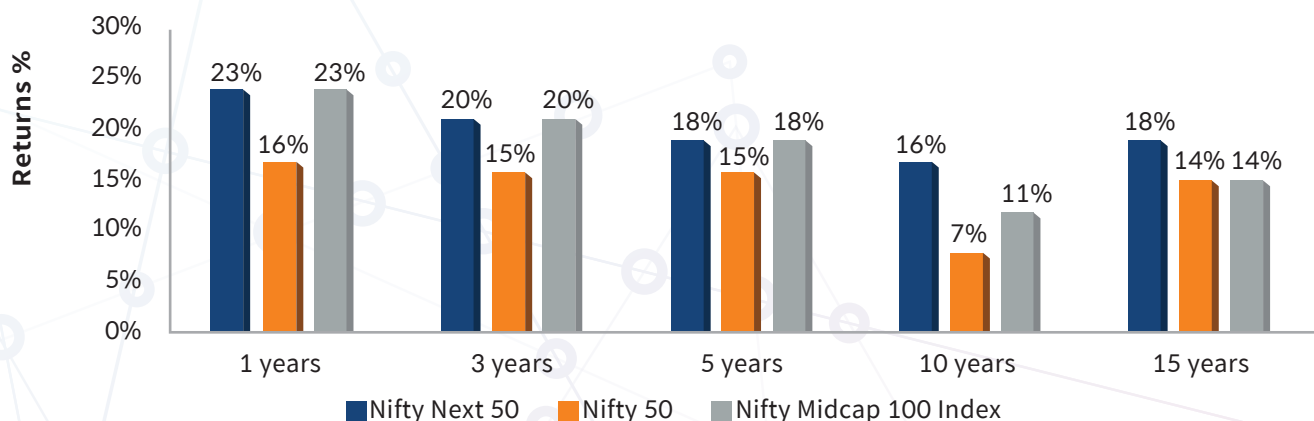
Nifty 50	Sector Weightage
Financial services	34.38%
Oil and gas	14.76%
IT	14.17%
Consumer goods	13.46%
Automobile	5.52%
Telecom	3.53%
Pharma	3.03%
Construction	2.66%
Metals	2.58%
Cement and cement products	2.31%
Power	2.10%
Services	0.60%
Fertilisers and pesticides	0.54%
Media and entertainment	0.36%
<b>Total</b>	<b>100%</b>

Source: NSE, Nifty Next 50 and Nifty 50 June 2020 factsheet.  
 Industry wise classification as recommended by AMFI.

## Quantitative: Appealing performance

Here's a look at some numbers: CRISIL analysed and compared the returns of Nifty Next 50 with Nifty 50 and Nifty Midcap 100 to showcase its performance compared with both benchmarks. To corroborate, we also did a rolling returns analysis compared with point-to-point returns to showcase the performance at any point in time since the turn of the millennium. And, the numbers don't lie. The Nifty Next 50 has outperformed the Nifty 50 across all time frames analysed, as per the rolling returns analysis. Nifty Next 50 has also outperformed Nifty Midcap 100 over the long term - 10 and 15 years - while maintaining its performance in line with Nifty Midcap 100 index over one, three and five years.

Chart 1: Rolling returns analysis of Nifty Next 50 vis-à-vis Nifty 50 and Nifty Midcap 100



### Notes:

- 1) Daily average rolling return period of analysis - January 1, 2001 to June 30, 2020.
- 2) Returns above one year are annualised, otherwise absolute.

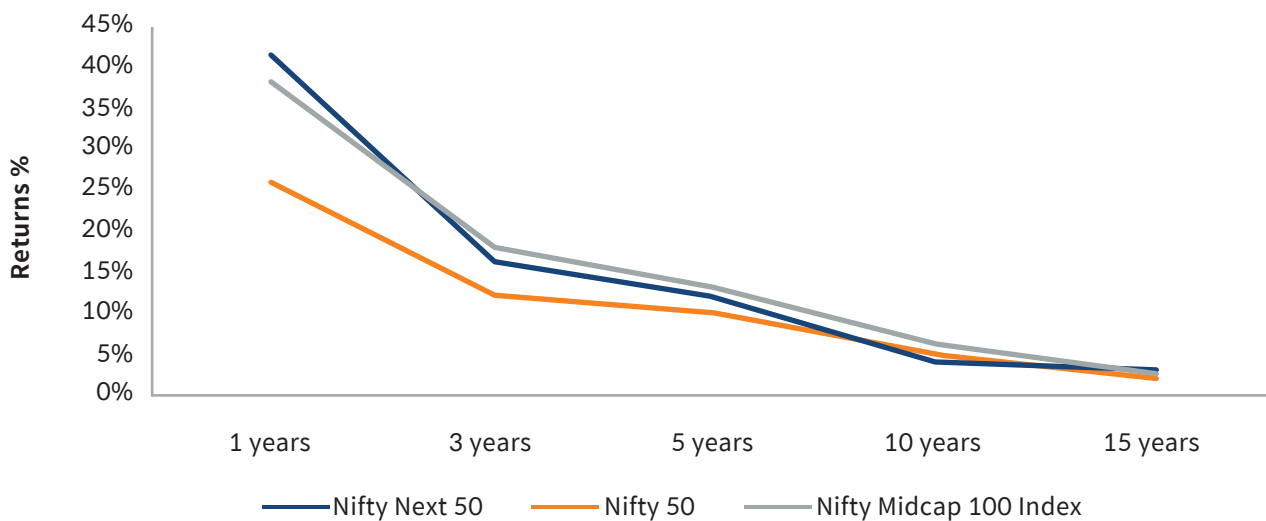
Source: CRISIL Research

Past performance may or may not be sustained in future.

## Market phase and volatility put Nifty Next 50 between Nifty 50 and mid-caps

As stocks in the underlying Nifty Next 50 fall between Nifty 50 and mid-caps, volatility associated with the index also lies between these two indices. Analysis shows that in terms of volatility (measured by standard deviation), Nifty Next 50 is more volatile than Nifty 50 but less than Nifty Midcap 100 across three, five and ten years and slightly more volatile over one year and fifteen years. However, investment over the long term tends to reduce volatility.

**Chart 2: Volatility of Nifty Next 50 vis-à-vis Nifty 50 and Nifty Midcap 100**



**Notes:**

- 1) Volatility is represented by standard deviation.
  - 2) Time period of analysis is January 1, 2001 to June 30, 2020.
- Source: CRISIL Research

Further, market phase analysis reveals that Nifty Next 50 (-9%) has fallen less than the Nifty 50 (-15%) and Nifty Midcap 100 (-14%) in the recent Covid-19-induced market volatility. Historically, though, the Nifty Next 50 has fallen more than the Nifty 50 in bear phases (2008 subprime and 2011 eurozone crises). But, during bull phases, the Nifty Next 50 has performed better vis-à-vis Nifty 50, as evident during the post subprime and eurozone crises. Meanwhile, its performance vis-à-vis Nifty Midcap 100 has been mixed during bull and bear phases.

**Table 1: Market phase analysis**

Period	Nifty Next 50	Nifty 50	Nifty Midcap 100 Index
Subprime crisis (Jan 2008-Mar 2009)	-57.60	-43.42	-55.67
Sharp bounce-back post subprime crisis (April 2009-December 2010)	79.60	48.77	71.87
European crisis (January 2011-June 2013)	-2.29	-1.94	-7.25
Post European crisis (July 2013-February 2015)	35.48	28.07	39.83
Chinese slowdown (March 2015-February 2016)	-13.35	-21.03	-12.19
Global liquidity and domestic reforms (March 2016-December 2017)	35.87	22.88	37.14
Mixed domestic and global scenario (January 2018-December 2019)	-4.29	8.00	-10.00
Covid-19 pandemic (January 2020 till June 30, 2020)	-9.01	-15.44	-14.23

Note: Returns above one year are annualised, otherwise absolute.

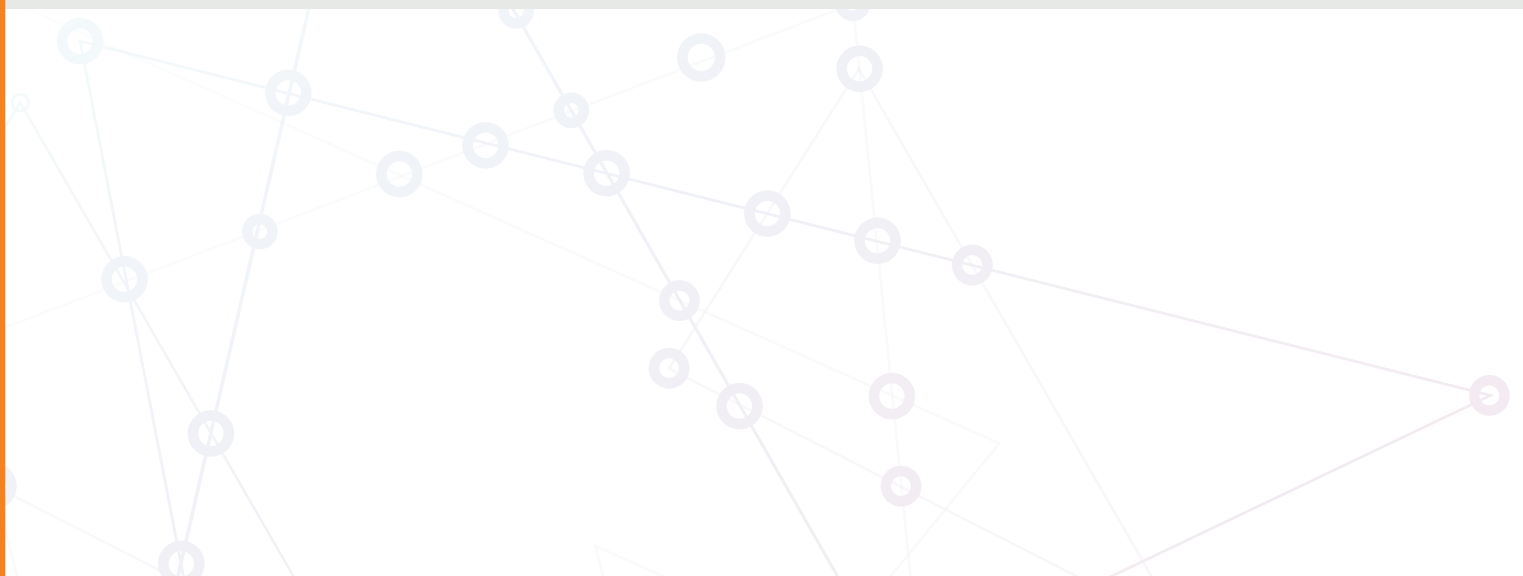
Source: CRISIL Research

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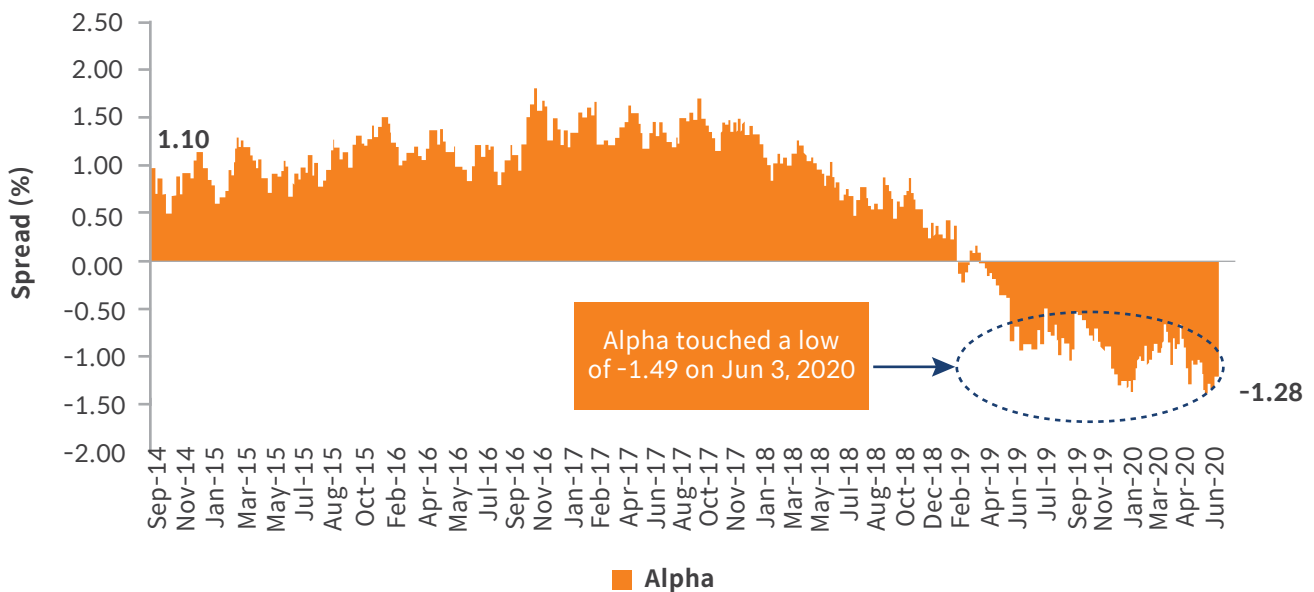
## Dip in alpha makes investing through ETFs a better option

Having built a case for Nifty Next 50 as an attractive investment option, let's see how a dip in alpha from actively managed funds over benchmarks makes a case for investing in the index through ETFs.

For analysis of the alpha spread, CRISIL analysed the alpha spread by taking the five-year daily rolling returns of large cap funds versus Nifty 50. The alpha declined sharply since December 2019 and touched a low of -1.49 on June 3, 2020. The fall in alpha makes investing through ETFs in the index a better option for investors.



## Dip in alpha returns of actively managed funds versus benchmark



### Notes:

Alpha is the difference between the daily five-year annualised rolling returns of a weighted large cap fund performance index based on CRISIL-ranked large cap funds and Nifty 50 TRI as on June 30, 2020.

Source: CRISIL Research

Past performance may or may not be sustained in future.

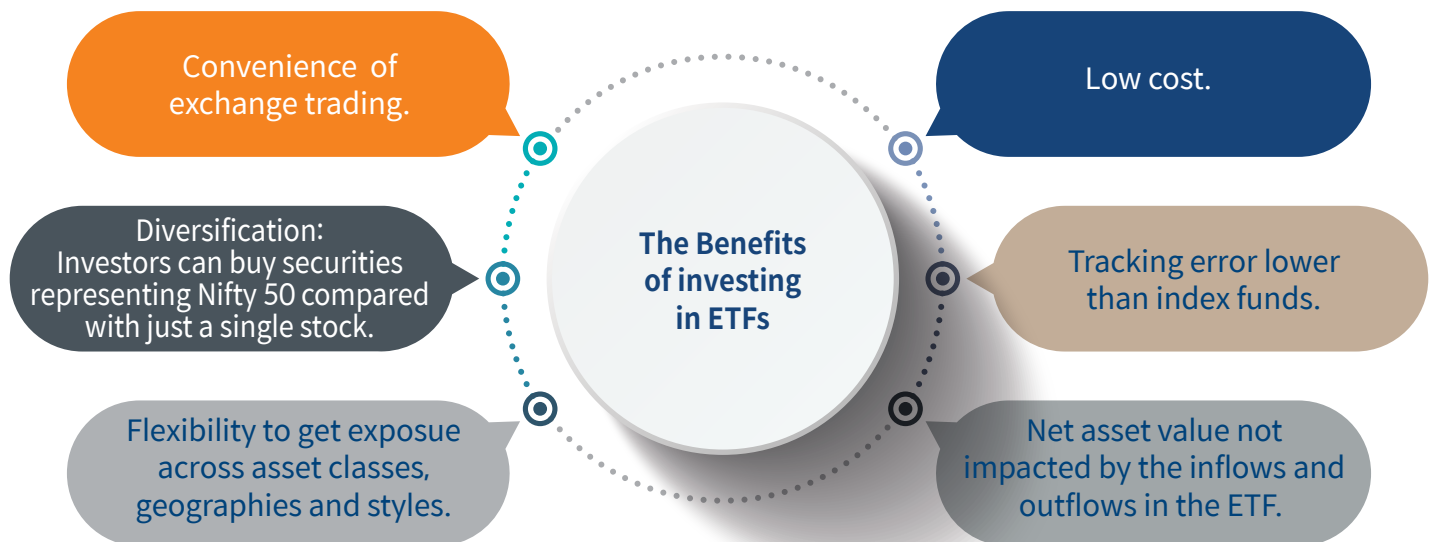
## Passive versus active

Passive investing assumes that alpha generation is extremely difficult under the premise that all securities in the market are priced correctly. Therefore, the passive strategy abandons the attempt to outperform the market benchmarks (generate alpha) and instead tracks a market index/portfolio of stocks. As a result, the investor is exposed only to the broad market risk. When equities fare poorly, the fund's losses are restricted to roughly the designated benchmark. On the flipside, when sentiment for stocks is buoyant, the upside appreciation of the fund is capped to as much as the benchmark's gains.

In contrast, the active approach focuses on trying to beat the market, assuming that asset mispricing exists. This is achieved by the fund manager tactically managing exposure of the scheme's constituents at the sector and stock level, thereby positioning the portfolio for optimal returns in response to changing micro and macro developments. It is not uncommon for an active fund's returns to rise significantly above its benchmark, signifying that the right calls were made with respect to stock selection. Misjudgement in this regard, however, as has been seen historically, results in adverse consequences.

The passive investing philosophy looks to keep the stock selection risk in check.

## The benefits of investing in ETFs



## Why consider Nifty Next 50 at this juncture?

In the backdrop of recent volatility in equities and not forgetting the quintessential, unpredictable nature of the asset class, a more diversified, low-cost passive investment approach can supplement the existing active investment portfolios. Hence, instead of a conventional market index like Nifty 50, an investor can consider investing in Nifty Next 50 ETFs. However, before investing, it is important to examine risk appetite and returns expectations, conduct due diligence of the cost involved in terms of expense ratio, tracking error (a measure of how closely the index fund's returns match its benchmark's returns) and the fund house's track record.

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