Mutual Fund Research
India

Fund Update

# Morgan Stanley Growth Fund

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## *Stay long for long term*

**Structure of the Fund**

Morgan Stanley Growth Fund is a close ended diversified equity scheme launched in 1994. The scheme is listed on both National and Bombay stock Exchange including some other regional exchanges. The scheme has a tenure of 15 years (ending on Feb 2009) and will redeemed or become open ended as decided by the Fund House. The MSGF units are placed as eligible securities with NSDL & CSDL making it possible to hold them in demat form. The NAV of the scheme is declared on a daily basis, which is generally higher to the trading price of the scheme on the exchanges .i.e. the scheme usually trades at a discount to the underlying value of the portfolio.

**Objective of the scheme**

The investment objective of the Scheme is to provide investors a vehicle for long-term capital appreciation. The Scheme will seek to achieve this objective through investment, primarily in equity and equity-related securities of Indian companies. The fund will maintain atleast 70% exposure to equity & equity related securities at all points of time.

**Declaration of the portfolio**

Detailed portfolio of the schemes is declared on a quarterly basis and also published on a half yearly basis. The top 25 holdings of the fund are updated on a monthly basis.

**Why do close ended fund traded at a discount?**

Close ended fund historically across the world have traded at a discount. Some of the reasons that can be sighted for such discount gaps are:

- High supply and low demand for the fund on the exchanges
- Market expectations from the underlying portfolio
- Investors desire to hold investments which are worth more than the price
- Management fees (to some extent)
- Low liquidity of the fund or the securities they hold, etc.

**Changes and Events in the Morgan Stanley Growth Fund's history**

January '1994--------------Launched
July' 1999------------------First Dividend @ Re 0.75 per unit
During 1999---------------Buy Back of Units (approximately 1/3 of outstanding)
Apr' 2000------------------Second Dividend @ Re 0.75 per unit
June '2001-----------------Third Dividend @ Re 1 per unit
June '2004-----------------Change in Portfolio Managers
May' 2004-----------------Forth Dividend @ Rs 1.5 per unit
October' 2006-------------Fifth Dividend @ Rs 2 per unit

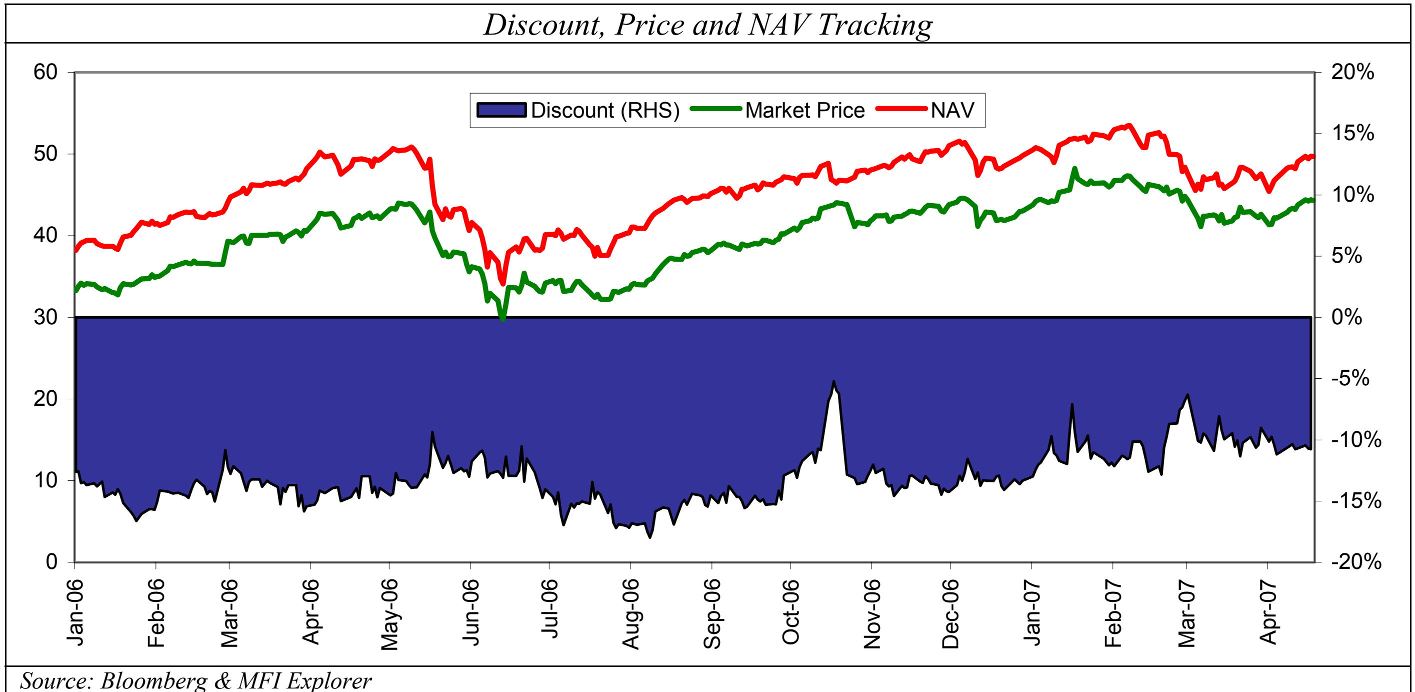
Apart from the above changes the fund witnessed changes in style of managing funds. In the initial life of the fund it used to hold extensively massive portfolio of over 350 stocks. According to the portfolio managers, with the liquidity in the Indian equity markets improving, the portfolio became more concentrated and now holds less than 50 stocks. The fund in the year 1999 bought back approximately a third of its unit from the market, which inflated its NAV substantially. A buy back causes the discount benefit that is sacrificed by the seller getting distributed in the existing unit holders and further appreciation of NAV.

**Please see additional important disclosures at the end of this report.**

**Discount Tracking & Volumes**

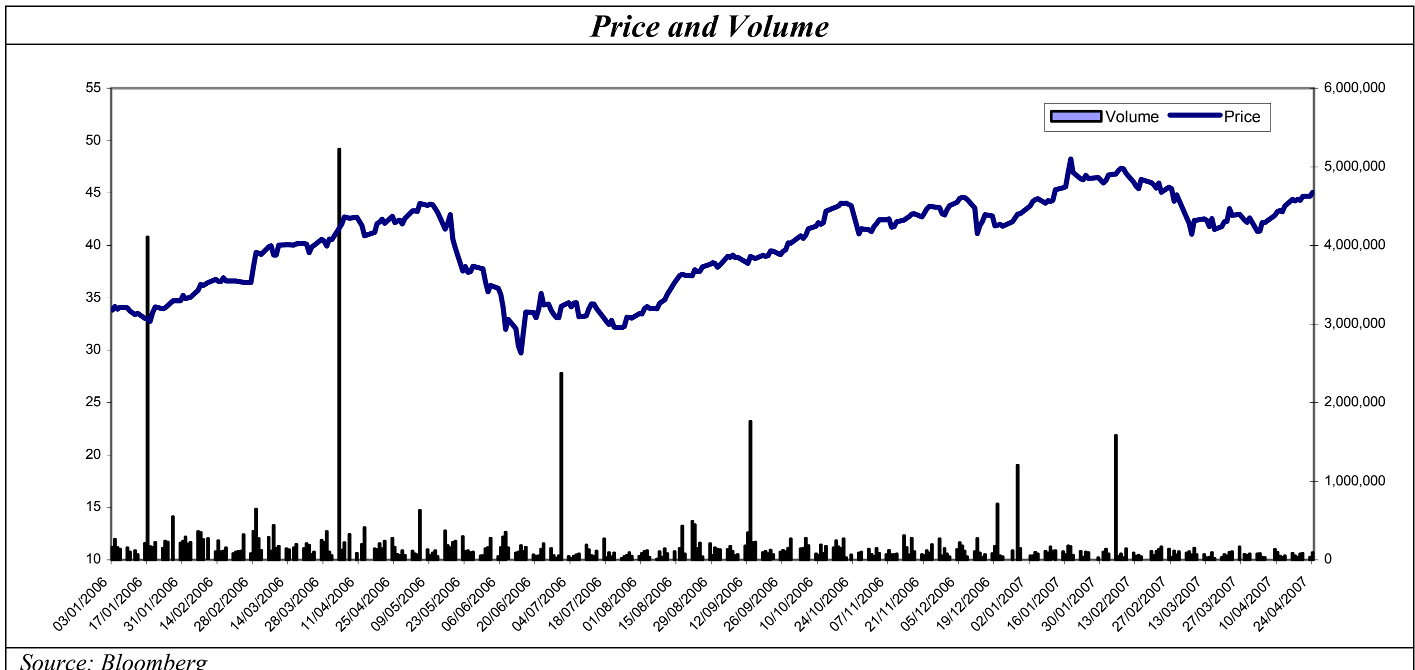
The fund is currently trading at a price of Rs 44.32 (as on Apr 19, 2007) carrying a net asset value of Rs 49.67 thereby reflecting a discount of 10.77% till the maturity. The fund as mentioned above, is expected to mature in February 2009 completing its 15 years and hence it translates in a discount of 6.34% p.a. (CAGR discount). This gap will extinguish and benefits will be realized only at the maturity of the fund. The open market volumes/trades ranges from 30,000 units to 1,50,000units and sometimes even soars upto 4-5 lakh units on particular days. The large trading volumes help in reducing the bid ask spreads in the price of the fund and thereby reducing the impact cost of selling the fund.

*Discount, Price and NAV Tracking*




*Source: Bloomberg & MFI Explorer*

***Price and Volume***




*Source: Bloomberg*



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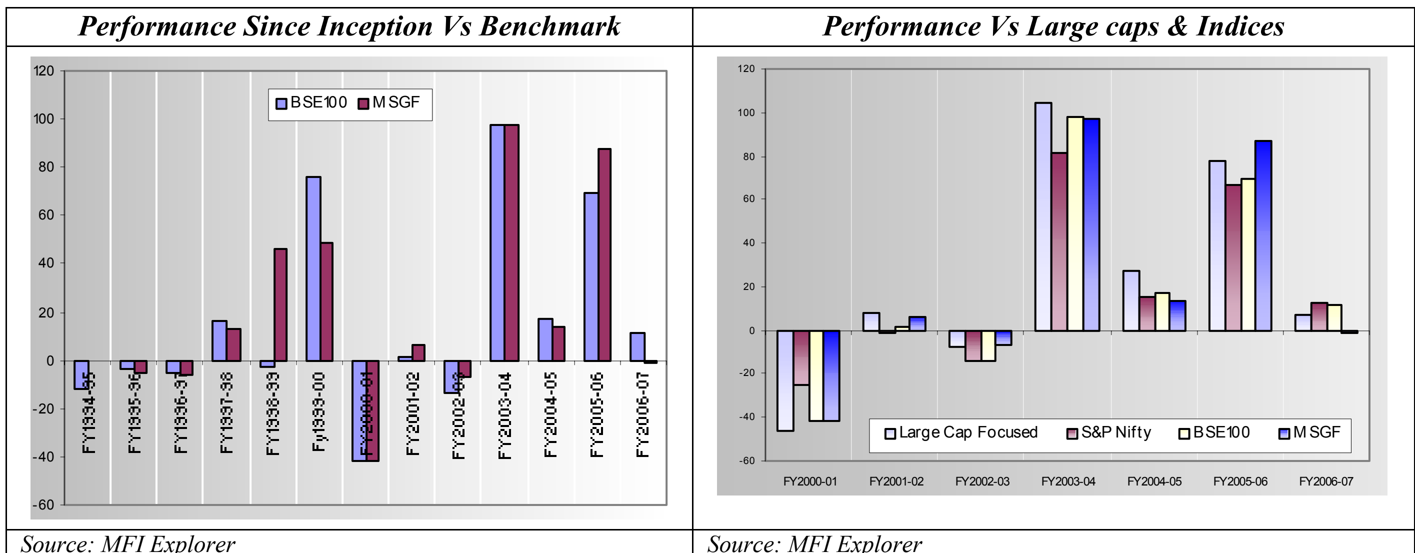
**Performance Overview**

The fund commenced its operations in 1994. Since its inception the fund has given a compounded annual return of 14% as compared to 10.8% returned by its benchmark, the BSE 100. The fund in its long history of existence has seen many bull and bear cycles and has managed to outpace its benchmark on a collective 13 year basis. (NAV Return).
However, an analysis of yearly performance brings out certain pockets of underperformance hidden in the long history of the fund. It witnessed some bad years in its 13 years, namely FY 1995, 1997, 1999 & the most recently concluded year 2006. The year 2006-07 has turned out to be the second worst period of its performance after its steep underperformance to BSE 100 in 1999-00. Lets try to break the 13 years of existence in to outperformance and underperformance to the benchmark. Six out of 13 years (46%) its has outperformed while for the 5 years (i.e. 31%) it underperformed. The rest of the years (3yrs) the fund displayed a neutral performance, being very close to the benchmark return.




*Source: MFI Explorer* | *Source: MFI Explorer*

The fund's last one year performance when compared to the active open-ended diversified funds has not been enthusiastic. The closest large cap diversified open ended fund with more than 10 year existence are Franklin India Bluechip Fund (launched in 1993) and HDFC Equity Fund (launched in Dec 1994). Franklin Bluechip generated a return of 18.7% (since Apr 1994 till 19 Apr 2007) as compared to 14% from MSGF. HDFC Equity on the other hand outperformed massively for the past 12 year period by generating a return of 26% vis-à-vis 15.2% from MSGF. Prudential ICICI Power launched in Aug 1994 has an 11 year return of 22.35% as compared to 17.36% of MSGF.

It is this massive underperformance to the open ended class of funds which has led to wide spread disapproval. However, we believe barring the last one year underperformance, the fund has done decently well with respect to both its benchmark and its peers. The funds very old performance (post 2000) will not be comparable, as the portfolio has undergone a complete shift in terms of its holdings, concentration and portfolio managers.

On the recommendation part, we would categorize the investors in two baskets, I) Investors in the NFO and II) investor at the market price. Investors who have invested in the beginning at the launch of the fund in 1994 have generated a return of 14%. An exit at this point of time which is possible through selling at the market price will lead to the price discount eating in to the returns on the underlying portfolio. Hence making it unattractive for these investors to exit at this time. Best time for them would be, when the discount gap is the lowest and the NAV performance has improved. However we would advise to stick to the portfolio till the maturity to make optimum benefit of the price NAV deviation.

For the Type II investors (at market price) the advice would depend on the case-to-case basis. The timing of the investment would drive the judgment as the discount gap locked in at that point of time and the underlying NAV performance collectively would define the holding returns. For e.g. the investment was done when the discount gap was 20% and



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assuming if currently the fund trades at 5% discount, the narrowing of the discount gap has led to enhancement of the return by 15% over the NAV return.

We believe investor with a horizon of minimum 2 years may consider fresh investments in the fund keeping in view the quality of the underlying portfolio. Investor would also start benefiting from the discount gap 2-3 months before the maturity of the fund in Feb '09. The price performance of the fund has been in line with the NAV performance of fund signifying close relation to the underlying fundamentals of the portfolio rather than being entirely dependent on the demand supply in the open market.

**Performance Vis-à-vis peer funds**

The performance of the fund can be seen from two angles I) from the NAV perspective and II) from the price perspective. Both the NAV and the price returns have been similar with the investors attaching greater significance to the fundamental factors driving the price of the units. The speculation activity, which generally leads to high disparity and volatility in the NAV and price, has been low. On the 3 year and 5 year & 10 year time periods the fund has been able to outperform its benchmark returns however as compared to other bluechip funds the performance stands near the average of the category. The last one year has been one of the worst periods in its history. It underperformed the top funds by a wide margin. The funds past one year performance can be taken as one off performance considering the fund aversion towards certain risky bets, which have been the driver in the rally. Having a diversified portfolio would anyway be beneficial in a volatile market like the current times.

**Report as on April 23, 2007**

| | Compounded Annualised % (Point to Point) | | | |
|---|---|---|---|---|
| **Scheme Name** | **1 Year** | **3 Years** | **5 Years** | **10 Years** |
| Franklin India Bluechip - Growth | 10.40 | 31.70 | 42.21 | 39.31 |
| HDFC Equity Fund - Growth | 14.09 | 38.64 | 46.33 | 37.85 |
| Franklin India Prima Plus - Growth | 17.50 | 37.24 | 42.55 | 35.04 |
| Reliance Vision - Growth | 9.22 | 38.24 | 53.41 | 31.86 |
| DSP ML Equity Fund | 13.18 | 40.33 | 46.35 | 27.86 |
| ICICI Prudential Power - Growth | 12.22 | 39.59 | 46.31 | 26.88 |
| Sundaram BNP Paribas Growth Fund - Growth | 1.38 | 31.36 | 39.54 | 25.24 |
| Morgan Stanley Growth Fund (NAV Performance) | 6.75 | 32.35 | 35.31 | 22.59 |
| MSGF (Price Performance) | 6.13 | 33.68 | 37.18 | 21.94 |
| SBI Magnum Equity Fund - Dividend | 15.23 | 35.05 | 37.57 | 20.21 |
| UTI Masterplus Unit Scheme 91 - Growth | 8.92 | 30.85 | 36.48 | 14.86 |
| **Indices** | | | | |
| S&P Nifty | 15.15 | 29.24 | 29.85 | 14.32 |
| BSE Sensex | 16.95 | 32.96 | 32.53 | 13.78 |
| BSE100 | 13.44 | 30.10 | 32.83 | 15.62 |

*Source: MFI Explorer*

**Portfolio Overview:**

The portfolio is currently overweight on Technology stocks, banking and industrial goods. Technology stocks compose nearly 15% of the portfolio largely skewed to the large cap stocks like Infosys, Wipro, HCL and marginal allocation to mid caps like Geodesic & SSI (2% combined). In the banking segment, private sector bank namely ICICI Bank and HDFC Bank fill up the maximum space with 10% and rest in public sector banks. The fund is one of the large cap focussed funds in the industry having the highest exposure to banking stock. Industrial Goods and Electrical Equipment sector has a weightage of 14.7% in the portfolio through companies like ABB, BHEL, NTPC, Jyoti Structures & EMCO. The fund manager over the past 6-7 months has reduced it exposure to Industrial Goods and Construction stock as a rescue effort to save from a further underperformance. The funds portfolio orientation is maintained as per the mandate and has kept a major portion of the portfolio in large cap bluechip stocks. Currently fund has 15-20% exposure to mid cap stocks and rest is concentrated in large cap bets. The portfolio had a turnover ratio of 40% for the year ended Mar 2007.



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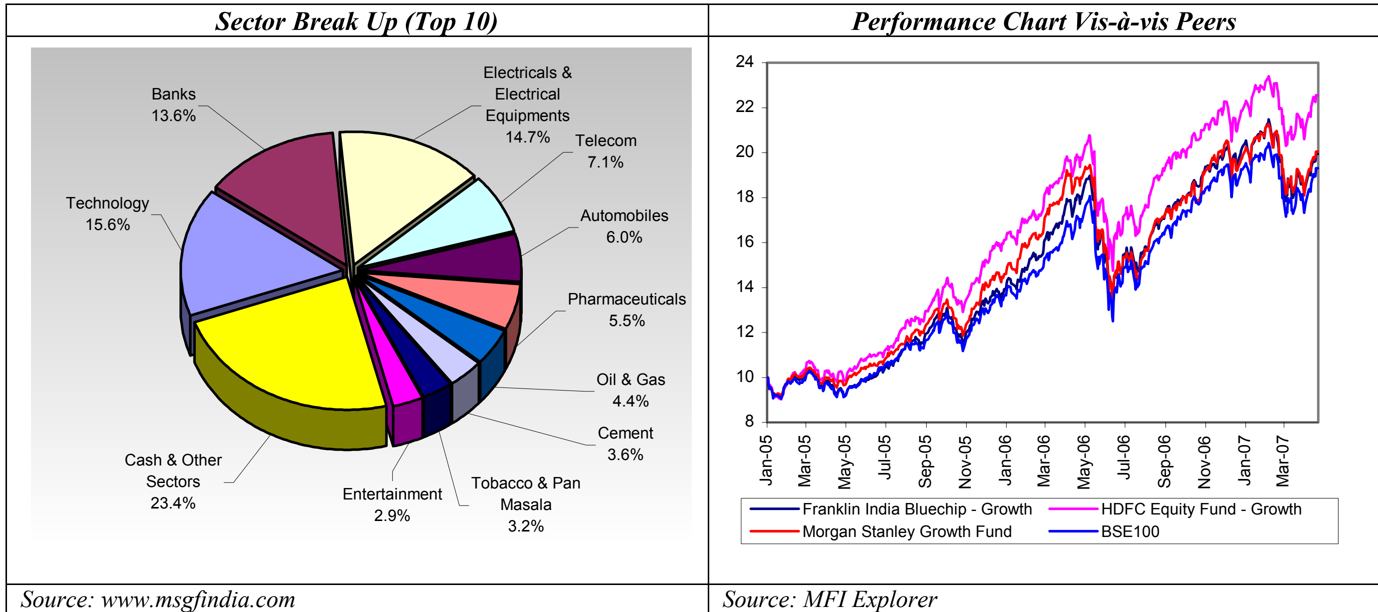
***Comment:***
The portfolio is fairly diversified and amongst 45-50 stocks with adequate amount of diversification. The quality of the stock holding also gives confidence on the long view of the fund. The fund is being maintained in a large cap format and sticks to the leaders in the industry. To achieve alpha returns in the market the fund manager does take some calls in quality mid cap stocks in a limited way by maintaining adequate mix of mid and small cap stocks in that segment. We believe the portfolio would gradually catch up in performance.




*Source: www.msgfindia.com* | *Source: MFI Explorer*

**Portfolio Managers**
Sridhar Sivaram and Amay Hattangadi

**Head Global Emerging Markets**
Ruchir Sharma

**Portfolio managers Comments:**
As per our understanding and discussion with the portfolio mangers', the recent underperformance of the fund to the diversified large cap categories and the benchmark index can be attributed to a few factors such as being overweight on sectors such as industrials goods, construction, etc & also fund's avoidance of taking exposure to Reliance Industries because of having a contrary view on it. The fund has displayed a portfolio turnover ratio of nearly 40% depicting an active style of management, which is also depicted in its exposure outside BSE 100 stocks and also holding varying proportions in index stock.

**Conclusion:**
On the recommendation part, we would categorize the investors in two baskets, I) Investors in the NFO and II) investor at the market price. Investors who have invested in the beginning at the launch of the fund in 1994 have generated a return of 14%. An exit at this point of time which is possible through selling at the market price will lead to the price discount eating in to the returns on the underlying portfolio. Hence making it unattractive for these investors to exit at this time. Best time for them would be when the discount gap is the lowest and the NAV performance has improved. However we would advise to stick to the portfolio till the maturity to make optimum benefit of the price NAV deviation.

For the Type II investors (at market price) the advice would depend on the case-to-case basis. The timing of the investment would drive the judgment as the discount gap locked in at that point of time and the underlying NAV performance



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collectively would define the holding returns. However, our advice would be to stay invested in the fund considering the quality of the portfolio and reasonably decent performance barring the one-year performance.

We believe investor with a horizon of minimum 2 years may consider fresh investments in the fund keeping in view the quality of the underlying portfolio. Investor would also start benefiting from the discount gap 2-3 months before the maturity of the fund in Feb '09. The price performance of the fund has been in line with the NAV performance of fund signifying close relation to the underlying fundamentals of the portfolio rather than being entirely dependent on the demand supply in the open market.



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