

Cash Holdings and Equity Mutual Fund Performance

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Cash is a very important constituent of actively managed mutual funds. At the end of 2017, the total assets invested worldwide in actively managed open-ended mutual funds is in excess of USD 49 trillion. This is more than double of their 2008 levels. More importantly, in 2017 alone, the total net assets (TNAs) of these funds soared by about USD 9 trillion. Of this, more than USD 22.1 trillion is invested in funds operating in the United States, more than USD 17.7 trillion is invested in European Union domiciled funds and the Asia-pacific region has USD 6.5 trillion in TNAs.¹ More importantly, from March 2008 to June 2018 TNAs in Indian mutual funds have grown from INR 5.21 lakh crore to INR 23.45 lakh crore.² At the same time, Indian mutual funds hold 6.71 % of TNAs in cash on an average, whereas that of their US and European counterparts hold cash in the range of 3% to 3.5%. The average cash holding of top five Indian fund houses on the basis of market share is shown in Table 1. Except for ICICI Prudential AMC with a cash holding of 14.82%, all other funds have a cash holding less than 5%.

Table 1: Top 5 Indian Mutual Fund Houses and their Cash Holdings as on Dec-2018

AMC	Market Share	Equity(Cr)	Cash(Cr)	Cash Holding (%)
ICICI Prudential AMC	13.25%	61482	9110	14.82
HDFC AMC	13.10%	80744	3579	4.43
Aditya Birla Sun Life AMC	10.64%	65353	3185	4.87
Reliance Nippon Life AMC	10.28%	64327	2538	3.95
SBI Funds Management	9.96%	110003	3482	3.17

Data Source: ACE Mutual Funds, Author's own computations

¹ 2018 Investment Company Fact Book retrieved from https://www.ici.org/pdf/2018_factbook.pdf

² Authors own computations. Data source – ACE Mutual Funds.

However, there are some funds such as ICICI Prudential Value Fund, IDBI Focused 30 Equity fund, Tata Value Fund, etc. as shown in Table 2 have a very high cash holdings. These values are surprising as we expect that the funds in which we buy mutual fund units to invest all our money optimally in well-diversified instruments as per the investment objectives of the fund. Cash holdings differ significantly even among the funds which are similar and compete with each other.

Table 2: 10 Mutual Fund Schemes with High Cash Holding

Scheme Name	Average Cash (INR Crore)	Average Equity (INR Crore)	Average Cash Holdings (%)
L&T Emerging Opp Fund-I-Reg(D)	54	336	17
Quant Small Cap Fund(G)	0.04	0.43	18.54
Sundaram LT Tax Adv Fund-Sr IV- Reg(G)	5	24	19
Quantum Long Term Equity Value Fund(G)	97	525	21
Tata Value Fund-Sr-2-Reg(G)	44	212	21
L&T Emerging Opp Fund-II-Reg(D)	34	172	21
Tata Multicap Fund-Reg(G)	296	1155	26
L&T Focused Equity Fund-Reg(G)	105	402	27
IDFC Equity Opportunity-5-Reg(G)	121	455	28
ICICI Pru Value Fund-19(G)	464	1490	32

Data Source: ACE Mutual Funds, Author's own computations

Mutual funds need to hold cash for various purposes. Mutual funds in the course of their investment business incur significant costs in the way of transaction costs, commissions and any other expenses in the day to day operations. Mutual funds generally have to meet the expected redemptions from investors as their one of the important motivations to put their money in mutual funds is due to the liquidity factor. Hence, holding cash helps the fund managers to overcome

redemption pressure. Mutual fund managers are paid very high to manage the fund portfolio and extract maximum returns. In this process, they always look for the best deals. These deals in the stock market do last long or are not available every time. The managers have to act swiftly when there is an opportunity available and that is when cash holdings come in handy. In the times of high inflation, cash is not very attractive. However, when the markets are bearish, cash looks exciting as the mutual fund managers have the option to convert the fund securities into cash or risk-free assets such as government bonds as a precautionary measure and wish to use them to make attractive deals when the market turns bullish.

As discussed above, on the one hand cash holdings are important for mutual funds but they are extremely costly on the other hand. Lower realized returns from cash will impact the mutual fund performance. Holding excess cash to make good deals in the event of market downturn may have adverse effects. It has been documented in the academic research that managers have poor market timing skills and hence their attempts to use cash for market timing do not produce the desired profits.³ Given the different levels of cash holdings by various equity mutual funds in India, we examine if the level of cash holding impacts their performance. In Table 3, we report the top 5 and bottom 5 mutual funds based on performance along with their average cash holdings for the period 2014 to 2018. As seen from the table there is no clear relationship between cash holdings and performance⁴. There are funds with very high performance and less cash holdings and also low performance with high cash holdings and vice-versa.⁵ Hence, from this we can understand that cash holdings may not be the only reason for a fund to perform poorly and vice-versa.

³ Mikhail Simutin; Cash Holdings and Mutual Fund Performance, *Review of Finance*, Volume 18, Issue 4, 1 July 2014, Pages 1425–1464

⁴ These results may show a different picture if tested statistically and hence should be read with caution.

⁵ For lack of space, we do not report those details.

Table 3: Cash holding vs Performance of Top 5 and Bottom 5 Mutual Funds

Scheme Name	Average Cash Holding (%)	Average Return (%)
Sundaram Small Cap Fund(G)	1.78	32.17
Mirae Asset Emerging Bluechip-Reg(G)	2.95	32.37
Canara Rob Emerg Equities Fund-Reg(G)	3.12	33.82
Reliance Small Cap Fund(G)	4.88	34.37
SBI Small Cap Fund-Reg(G)	6.14	37.98
ICICI Pru Value Fund	27.09	-6.92
Union Largecap Fund-Reg(G)	4.14	-5.56
Axis Emerging Opp Fund-2-Reg(G)	5.34	-5.21
Tata India Pharma & Healthcare Fund-Reg(G)	6.41	-4.16
Sundaram TOP 100-Sr VII-Reg(G)	2.80	-3.94

Data Source: ACE Mutual Funds, Author's own computations

Based on my earlier discussion and also the numbers in the tables, we should not invest in mutual funds with more cash in bearish markets in the hope that they will show abnormal performance. On the other hand, if we don't have any view on the current as well as future stock market states, and hence invest in funds with higher cash holdings may still make the mistake of making losses. This is because we should understand that no manager can time the market consistently and if any manager or mutual fund thinks otherwise, they are miscalculating their abilities.