Have You Tried Contra Funds Yet?

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Contra funds are essentially diversified funds that adopt a contrarian strategy by investing in stocks and sectors that are out of favour but have the potential to do well over the longer term. The fund manager of a contra fund may find these opportunities either in businesses that are in the turnaround phase or where stock multiples get re-rated. Simply put, the fund manager tries to exploit temporary market inefficiencies.

Some of the benefits of investing in contra funds are the potential for higher returns if the contrarian bets pay off, owning a diversified portfolio, and benefiting from a portfolio managed by experienced fund managers who understand market cycles and can identify under-valued stocks. There are three contra funds presently and each one of them has been able to outperform its benchmark Nifty 500 TRI over varying time periods.

As is evident, these funds have the potential to do well in different market scenarios. Even though the emerging economic scenario wherein inflation is drifting lower and there is a possibility of a rate cut in the near future would favour a growth style, cyclical or challenged businesses will also benefit from it. Therefore, contra funds can be expected to do well. Of course, there can be periods when contra funds underperform other diversified categories of funds.

However, if investors stay committed to their defined long-term time horizon, the returns can be higher than plain vanilla diversified categories like flexi-cap funds and large-cap funds. Although contra funds are diversified in nature, it may not be a great idea for first-time investors to invest in these funds. These are ideally suited for investors who have gained experience and built a decent-sized portfolio over time.

In fact, a contra fund can supplement its core portfolio and allow it to benefit from diversification due to periodic rotation between growth and value. There are a few factors that investors must keep in mind while investing in contra funds. To begin with, the time horizon should be longer than a normal diversified fund. In addition, one should look at the track record of the fund over different time periods and be well aware of the risks associated with investing in a contra fund.

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In reality, there is a fine distinction between value and contra fund. In fact, both these categories are clubbed together in SEBI's classification and hence a fund house can either launch a value fund or a contra fund. In the case of value funds, fund managers invest in companies that may be valued lower than their intrinsic value but may possess strong business characteristics or competitive advantage. On the other hand, contra funds invest in companies that are currently out of favour.

For example, the market may be of the view that certain companies are not likely to do well, but the fund manager may think otherwise and hence include them in the portfolio. If the fund manager's call turns out to be correct, investors are rewarded handsomely. As is evident, contra funds have a lot to offer over the longer term. Considering the risk profile of these funds, investors must make sure to choose them at the right stage of their investment process and own them in the right proportion.