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BEST NPS FUNDS

You can now spread your NPS corpus across three different pension fund managers. Find out which pension fund deserves your money.

By **Babar Zaidi**

One of the reasons investors stay away from the National Pension System (NPS) is that it is very rigid. Your money gets locked till you are 60, and even then only 60% of the corpus can be withdrawn. The remaining 40% goes into an annuity to earn a monthly pension. "I am better off investing in equity mutual funds, where I can earn higher returns and retain liquidity," says Delhi-based Rishi Ahuja.

This is only partially true because the NPS also offers a lot of flexibility. Investors can choose their asset mix by dividing the corpus among four different types of funds. They can also change this asset mix up to four times a year. The choice of pension fund managers has also broadened. Now, there are 10 pension fund managers to choose from. Investors are also allowed to switch their pension fund once in a year.

From this year onwards, the Pension Fund Development and Regulatory Authority (PFRDA) has allowed investors to spread their investments across different fund managers. You can invest in the equity fund of pension fund A, the gilt fund of pension fund B, and the corporate bond fund of pension fund C. The only restriction is that the alternative investment fund (allocation is capped at 5%) has to be from any of the pension funds selected by the investor. PFRDA Chairman Deepak Mohanty says this new feature adds to the flexibility of the NPS and will make the pension scheme more attractive for investors.

Our cover story identifies the best performing NPS funds to help investors decide which pension fund manager they should go with. Investors should not look at annualised returns in isolation. These are point-to-point returns and may not give the correct picture. The SIP returns, which are calculated using the internal rate of return formula, will be a better indicator, especially if you intend to invest through monthly SIPs.

The equity fund of Kotak Pension Fund, for instance, has done consistently well, while the gilt fund of LIC Pension Fund has been a long-term outperformer. The corporate bond fund of HDFC Pension Fund has been the top performer throughout. The best performing funds in different time frames have been marked in the tables to help you zero in on the top schemes. We have looked at the long-term performance (three, five and 10 years), so the three new pension funds (Axis Pension Fund, Max Life Pension Fund and Tata Pension Fund) don't figure in the tables. We hope to include these in the future when they acquire a longer track record.

> The asset allocation can be changed four time a year, while the pension fund manager can be changed once a year.

Apart from the flexibility of changing fund managers and spreading their investments across different pension fund managers, the NPS also offers tax advantage to investors. There are no tax implications of switching from one fund to another, or changing the asset mix. In mutual funds, any switch is deemed as a sale and has a tax implication. Though long-term capital gains of up to ₹1 lakh from equity schemes and equity-oriented hybrid funds are tax-free, gains from non-equity schemes are taxable. This year's Budget has also removed the indexation benefit that non-equity mutual funds had enjoyed till now. So, all gains from investments made after 1 April 2023 will now be taxed at the slab rate applicable to the individual.

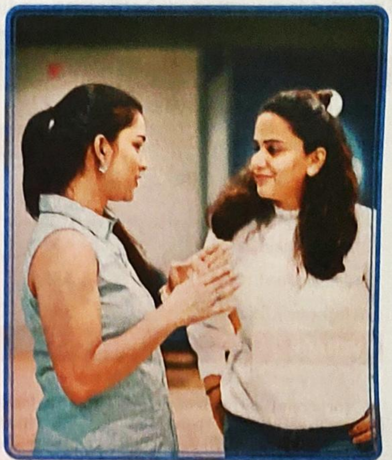
We hope our cover story will help you make the right decision regarding your retirement savings

EQUITY FUNDS ▶ Handsome gains for aggressive investors

Raising of the limit on equity exposure to 75% has proved to be a boon.

PENSION FUND MANAGER	Annualised returns (%)			SIP returns (%)		
	3-YEAR	5-YEAR	10-YEAR	3-YEAR	5-YEAR	10-YEAR
Aditya Birla Sun Life Pension Scheme	20.47	11.71	NA	11.00	12.17	NA
HDFC Pension Fund	21.59	12.50	**15.09**	10.95	12.52	**10.73**
ICICI Prudential Pension Fund	22.64	12.45	14.89	11.80	12.92	10.54
Kotak Pension Fund	22.47	**12.78**	14.96	**12.01**	**12.93**	10.64
LIC Pension Fund	**22.90**	11.91	13.02	11.67	12.73	10.03
SBI Pension Fund	21.07	11.52	14.41	10.96	12.02	10.10
UTI Retirement Solutions	21.97	11.75	14.76	11.10	12.35	10.34
AVERAGE	**21.87**	**12.09**	**14.52**	**11.35**	**12.52**	**10.40**

DATA AS ON 5 SEP 2023. **SOURCE:** VALUE RESEARCH.



Young investors should allocate the maximum 75% to equity funds. In the long term, equities can outperform.

With the markets hitting all-time high levels in 2023, equity funds have given terrific returns to investors. The raising of cap on equity allocation to 75% has proved to be a boon for aggressive investors. LIC Pension Fund has been the best performer in the past three years, with almost 23% returns. But, as mentioned earlier, investors should not be misled by annualised returns in the past three years. These are point-to-point returns and the numbers are distorted by the Covid-induced crash in 2020. The SIP returns are a better indicator of how much investors actually made. It is here that Kotak Pension Fund has been more consistent, while HDFC Pension Fund is the long-term outperformer.

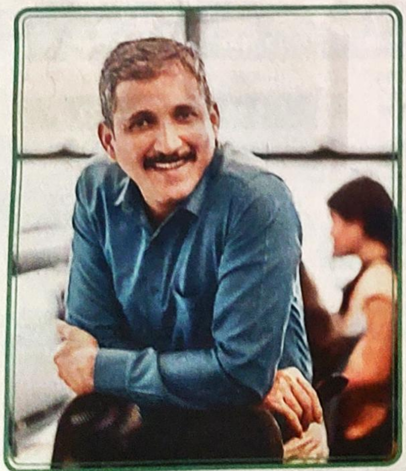
It is worth noting that the variation in returns earned by the seven pension funds in the past 10 years is not huge, but three-year returns have a greater divergence. This is because the investment norms for pension fund managers were relaxed a few years ago, allowing them to look beyond the index and invest in stocks in the F&O basket.

All NPS equity funds have nearly 90% allocation to the large-cap segment, but fund managers also invest in mid-cap scrips, where there is a greater potential for growth. Though mid-cap stocks can deliver alpha, they are also more volatile and prone to higher drawdown during downturns. This is why the PFRDA has laid down that NPS equity funds can invest only in stocks with a market cap of at least ₹5,000 crore.

While the cap on equity exposure has been removed for younger investors, the maximum equity exposure starts reducing by 2.5% every year after the investor turns 50. When the subscriber is 60, the exposure to equity funds is only 50%.

GILT FUNDS ▶ Rising interest rates hit long-term bonds

All gilt funds of the NPS have a sizeable exposure to long-term bonds.



Government bond yields are expected to fall when the rate cycle turns. Gilt funds will then outperform.

PENSION FUND MANAGER	Annualised returns (%)			SIP returns (%)		
	3-YEAR	5-YEAR	10-YEAR	3-YEAR	5-YEAR	10-YEAR
Aditya Birla Sun Life Pension Scheme	**4.96**	9.21	NA	**4.65**	5.36	NA
HDFC Pension Fund	4.63	9.27	9.13	4.42	5.25	6.45
ICICI Prudential Pension Fund	4.65	9.00	9.13	4.44	5.16	6.37
Kotak Pension Fund	4.75	9.22	9.18	4.52	5.26	6.45
LIC Pension Fund	4.80	**9.76**	**9.93**	4.57	**5.38**	**6.86**
SBI Pension Fund	4.65	9.10	9.32	4.50	5.22	6.44
UTI Retirement Solutions	4.61	8.94	8.97	4.59	5.19	6.23
AVERAGE	**4.72**	**9.21**	**9.28**	**4.53**	**5.26**	**6.47**

DATA AS ON 5 SEP 2023. **SOURCE:** VALUE RESEARCH.

Gilts funds have not done too well in recent years. The 5-10 year annualised returns are close to 10%, but this does not reflect the true picture. The flurry of interest rate hikes in 2022 saw a fall in bond prices. The average 3-year SIP returns are below 5%, while 5-year and 10-year SIP returns are not very attractive. This is the price that investors must pay for their obsession with safety.

However, this could change when the interest rate cycle turns. The RBI kept the repo rate (key interest rate at which the central bank lends money to commercial banks) unchanged at 6.5% last month. However, analysts don't expect a rate cut till March 2024.

Given the parent's expertise in investing in debt instruments, the gilt fund of LIC Pension Fund has been the best performing scheme. There is, however, a new star on the firmament in the shorter term. Aditya Birla Sun Life Pension Fund has emerged at the top in the past three years. The average yield to maturity of NPS gilt funds has risen to 7.21%, which roughly mirrors the prevailing 10-year government bond yield of 7.19%. The NPS schemes usually have a very long average maturity of 12-14 years. The longer the maturity of a debt paper, the higher is its sensitivity to interest rate changes. Given their long maturity profiles, gilt funds are a play on the interest rate cycle.

Keep in mind that the NPS is a long-term investment and funds usually hold bonds till maturity because there is no redemption pressure. The prevailing high yield to maturity would translate into good gains from gilt funds when interest rates recede. Investors can expect returns of 7-7.5% over the next few quarters.

CORPORATE BOND FUNDS ▶ Cushioned by short-term bonds

These funds did marginally better than gilt funds due to the shorter average maturity of the portfolio.

PENSION FUND MANAGER	Annualised returns (%) 3-YEAR	5-YEAR	10-YEAR	SIP returns (%) 3-YEAR	5-YEAR	10-YEAR
Aditya Birla Sun Life Pension Scheme	5.54	8.67	NA	4.52	5.54	NA
HDFC Pension Fund	5.95	8.88	9.33	4.64	5.73	6.63
ICICI Prudential Pension Fund	5.68	8.46	9.27	4.53	5.47	6.47
Kotak Pension Fund	5.37	7.69	8.81	4.35	5.11	6.04
LIC Pension Fund	5.39	8.61	9.06	4.39	5.48	6.37
SBI Pension Fund	5.61	8.53	9.15	4.41	5.43	6.41
UTI Retirement Solutions	5.24	8.12	8.84	4.40	5.30	6.17
AVERAGE	5.54	8.42	9.08	4.46	5.44	6.35

DATA AS ON 5 SEP 2023. SOURCE: VALUE RESEARCH.

Corporate bond funds are not for young investors, but those retiring soon can park their corpus in these.

Corporate bond funds have not been as badly hit by the rising rates because they hold bonds of shorter maturities compared to gilt funds. The average maturity of bonds in gilt funds is more than 12 years, compared to 6.5 years for corporate bond funds. So they are not as sensitive to rate changes. A rate cut will not lead to a big rally in these funds.

At the same time, corporate bond funds have lower yields to maturity than gilt funds. So, while their short-term returns are better than those of gilt funds, they have not managed to beat them in the long term.

Till a few years ago, the NPS funds were allowed to invest in corporate bonds rated AA and above. In 2018, the PFRDA changed the rules and allowed these funds to invest in bonds with an A rating, as long as this exposure was not more than 10% of the portfolio. This exposure to high-yield paper may help boost returns, but the low rated bonds also enhance the risk of the portfolio. One bad call can drag down the returns of the fund. In 2019, many corporate bond funds of the NPS were caught on the wrong foot when the IL&FS bonds in their portfolios turned toxic.

HDFC Pension Fund has consistently remained at the top of the heap in this segment. Readers will note that there is no big variation in the returns of the seven players. This means that investors need not go by returns when it comes to corporate bond funds, but should look deeper into the risk profile of the portfolio. Corporate bond funds are appropriate for investors who are looking for low, but stable, returns. Though this might not be the best option for long-term investors, individuals set to retire in 3-4 years can park their money in these funds.

ALTERNATIVE INVESTMENTS ▶ Cap on exposure helped contain risk

Alternative investments did not do very well but investors benefitted from the 5% cap .

If unsure about the allocation to equities, go for lifecycle funds that change asset mix as you get older.

PENSION FUND MANAGER	Annualised returns (%) 3-YEAR	5-YEAR	SIP returns (%) 3-YEAR	5-YEAR
Aditya Birla Sun Life Pension Scheme	5.89	5.84	4.26	4.40
HDFC Pension Fund	7.83	8.76	5.46	6.22
ICICI Prudential Pension Fund	6.18	6.96	3.59	4.53
Kotak Pension Fund	4.41	7.19	2.73	4.00
LIC Pension Fund	7.00	7.69	4.79	5.49
SBI Pension Fund	6.33	8.91	3.76	5.76
UTI Retirement Solutions	5.55	5.81	3.94	4.25
AVERAGE	6.17	7.31	4.08	4.95

DATA AS ON 5 SEP 2023. SOURCE: VALUE RESEARCH.

Introduced a few years ago, alternative investment funds invest in real estate investment trusts (REITs) and infrastructure investment trusts (InvITs). REITs invest in completed and under-construction real estate projects, and should have at least 80% of the assets in completed and income-generating properties. InvITs invest in infrastructure projects, such as roads, power plants, highways and warehouses. At least 80% of the corpus has to be invested in completed and revenue-generating infrastructure projects. They also invest in certain bonds and securitised papers from private alternative investment funds.

The new asset class was meant to diversify the investment portfolio of retail investors. The PFRDA has placed a cap of 5% on the exposure to alternative investment funds. After a good start in the initial years, alternative investment funds have not managed to impress the investors. Returns have been hit due to the downturn in REITs, following changes in tax rules.

NPS investors should ideally decide an asset allocation that suits their age and risk profile. The investors who are not very sure of how and where to allocate their NPS corpus should opt for the lifecycle funds.

There are three lifecycle funds to choose from. The Aggressive Life Cycle Fund is for those willing to take higher risk. It starts by putting 75% of the corpus in equities till 35 years of age, and gradually reduces it every year. The Moderate Life Cycle Fund starts with an equity exposure of 50% and starts reducing it after the investor turns 35. The Conservative Life Cycle Fund caps the equity exposure at 25% and starts reducing after the person is 35.