Debt Mutual Fund Schemes: All kind of risks playing out?

CONTENT

- Declining Yield – Domestic and Global
- The swollen size of MF Industry and Resultant problems
- Poor performance of Debt funds due to all kind of associated risks playing out
- How to avoid such risks when the debt portfolio is built & Factors to be considered
- Construction of Model Portfolio of Debt Schemes

VALUE INVEST WEALTH MANAGEMENT (INDIA) PVT LTD
11, Y BLOCK,5TH STREET,
ANNA NAGAR,
CHENNAI - 600040.
044- 48587258,48587658

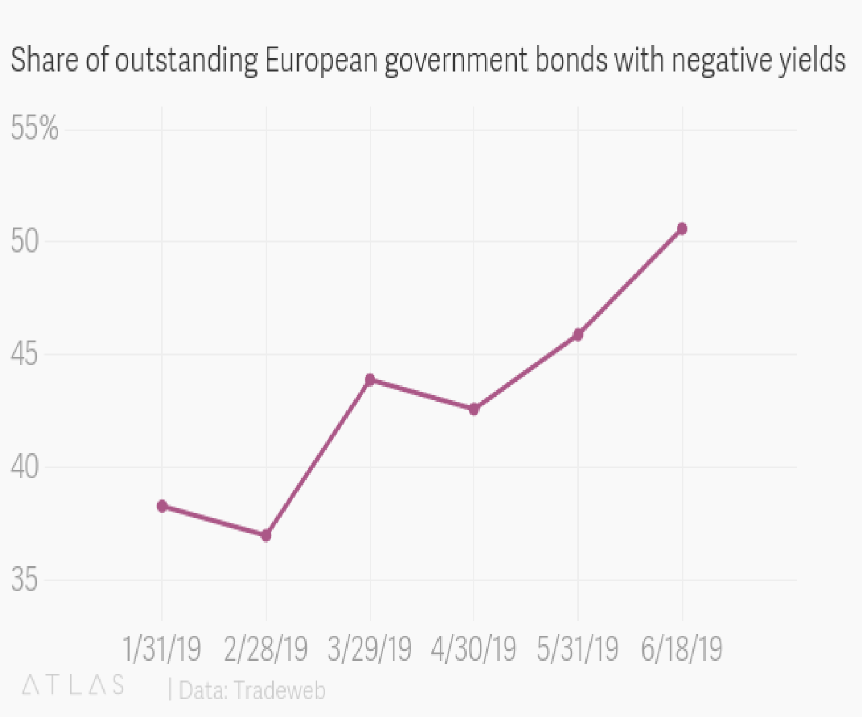
Debt Mutual Fund Schemes: All kind of risks playing out?

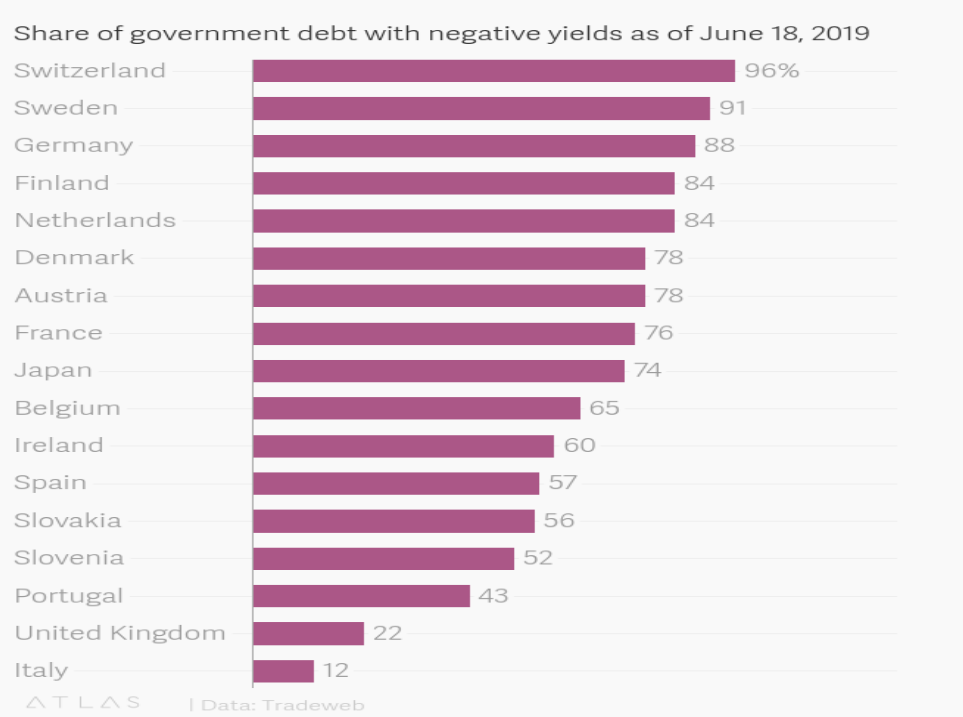
The yield on various debt instruments has come down during last one year. This should have resulted in a superior return for the debt funds. But the credit risk and rating downgrades have eroded the capital gain of the debt portfolio.

Bond Yields in % age	**As on 17th June 2019**	**1 Week**	**1 Month**	**3Months**	**6Months**	**1 Year**	**Yield difference in one yr.**
91D Tbill	6.03	5.88	6.36	6.32	6.69	6.50	-0.47
364D Tbill	6.13	6.05	6.45	6.42	7.00	7.05	-0.92
India 1 Yr G-Sec	6.12	6.15	6.52	6.54	7.01	6.91	-0.79
India 1 Yr AAA	7.36	7.42	7.86	8.02	8.27	8.55	-1.19
India 10 Yr G-Sec	6.92	6.97	7.38	7.36	7.44	7.95	-1.03
India 10 Yr AAA	8.07	8.13	8.51	8.37	8.58	8.78	-0.71
India 5 Yr AAA	7.71	7.79	8.06	8.37	8.50	8.72	-1.01
3 - Month Libor $	2.43	2.45	2.52	2.61	2.80	2.33	0.10
United States 10 Yr Govt Bond	2.08	2.08	2.41	2.63	2.89	2.94	-0.86

Global Interest rate hike cycle and monetary tightening may halt:

Almost $12 trillion of investment grade corporate and government bonds have negative yields, predominantly in Europe and Japan, according to Barclays data, the Financial Times reports. Today, half of all European government bonds have a negative yield, with the total amount outstanding at Euro 4.4 trillion ($5 trillion), compared to euro 3.3 trillion at the end of January, according to data from Tradeweb. At the end of May 2019, 20% of European investment grade corporate debt had negative yields.





FOMC (Federal Open Market Committee) in its press release dated 19th June 2019 has maintained the target range of the federal funds rate at 2-1/4 to 2-1/2 percent. The FOMC press release says The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, but uncertainties about this outlook have increased. In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective.

FOMC in its previous press release dated 19th March 2019 mentioned that " In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes". The drop of the word Patient has been taken substantive in indicating probable reversal of Fed Stance in the coming period.

The swollen size of MF Industry and Resultant problems:

The total corpus of mutual funds has increased due to large inflow from non-corporate investors after demonetisation. The absolute growth between September 2016 and March 2019 is around 50.6%. The major chunk of the growth has come from equity corpus and non-corporate (HNI & Retail) debt corpus. Both the segments registered 118% and 41% absolute growth.

Total Asset Under Management of Mutual Funds			
Category	**As of Sep, 2016**	**As of March, 2019**	**Growth in % age**
Non-Individuals-Debt	727125.56	746083.71	2.61
Individuals-Debt	297179.29	419807.21	41.26
Total Debt	**1024304.85**	**1165890.92**	**13.82**
Equity and other schemes	555771.33	1213693.52	118.38
Total Corpus	**1580076.18**	**2379584.44**	**50.60**

Source: AMFI

Poor performance of many debt funds despite declining yield:

Debt funds have been facing all kind of risks playing out at the same time. This bring forth the critical issue of Fund management Skill, Governance Issues with the Fund Houses, Scheme size management, Credit quality management and Composition of corporate/Non corporate money or Short term/Long term money.

Credit risk which is experienced across fund categories which makes the job of selecting the fund houses and schemes – more complicated and methodical.

The sudden surge in the corpus and the NBFC crisis has led to both regular risks of the investments and non-regular risks playing out. The debt funds have been sold by indicating the yield to maturity of the portfolio less the expenses. The actual return is generated, apart from interest accrual, by the capital gain or capital loss due to yield movement. Of late, the default, the rating downgrading and large-scale redemption in a particular scheme have added to steep fall in NAVs and substantially eroding the return generated in the past.

The Regular Risks: These are the usual known risks like Duration Risks, Credit Risks and Liquidity Risks. We have experienced duration risks in Gilt Funds, Income Funds, Dynamic Bond funds, Medium term funds and to some extent, Short Term Income funds.

However, more credit risk which is being experienced by the investors is new. The credit risk which has not impacted the return in a large scale is becoming a major concern for certain categories of funds. Many of the structured products taking equity as collaterals has further added to the standalone default issues.

The rating and Valuation risk also hurting the investors which was not known earlier. Rating of the instruments affects the valuation of the underlying instruments and in turn the return generated by the schemes. There will be always upgrading and down grading of debt instruments. Whenever the rating goes below investment grade, the mark down of 75% as per SEBI norm and extra mark down of 25% at the discretion of AMC reduce the NAV of the scheme depending upon the exposure to that instrument.(100% markdown means nil value for the downgraded instrument).

Large Redemption Risk: The Valuation risk further get compounded by, if the AMC does not manage its net flow into the scheme. Schemes which has large investments from corporate investors suddenly faces large redemption on the presence of likely default instrument in the portfolio. For example, assume a scheme has a corpus of Rs.10000 cr and has 2% exposure to an instrument which is perceived as a default candidate soon. The so called smart corporate investors redeem in large scale and the corpus comes down to Rs.2000 cr. Now, the probable default instrument which was constituting 2% exposure becomes 10% of the remaining corpus. In case the default probability happens and AMC mark down 100%, the fall in the NAV of the scheme is 10%. This also highlights the risk of having more of corporate investors in the scheme with nil exit load in non-liquid funds.

Mismatch of liquidity of schemes and liquidity of underlying instruments: The large inflow into the debt funds have led to investing in instruments which are not as liquid as the scheme. When the borrowers borrow short term for long term lending, any failure to roll over leads to severe liquidity crunch which in turn can lead to solvency issues. Introduction of Over Night funds by SEBI is a good move to mitigate such liquidity related risks.

How the investors should avoid such risks when the debt portfolio is built?

It is almost impossible to avoid all the risks. However, enough homework should be done before building the portfolio to minimise the impact of such risks which are going to be common in the coming period.

The following factors should be considered to avoid the above-mentioned risks:

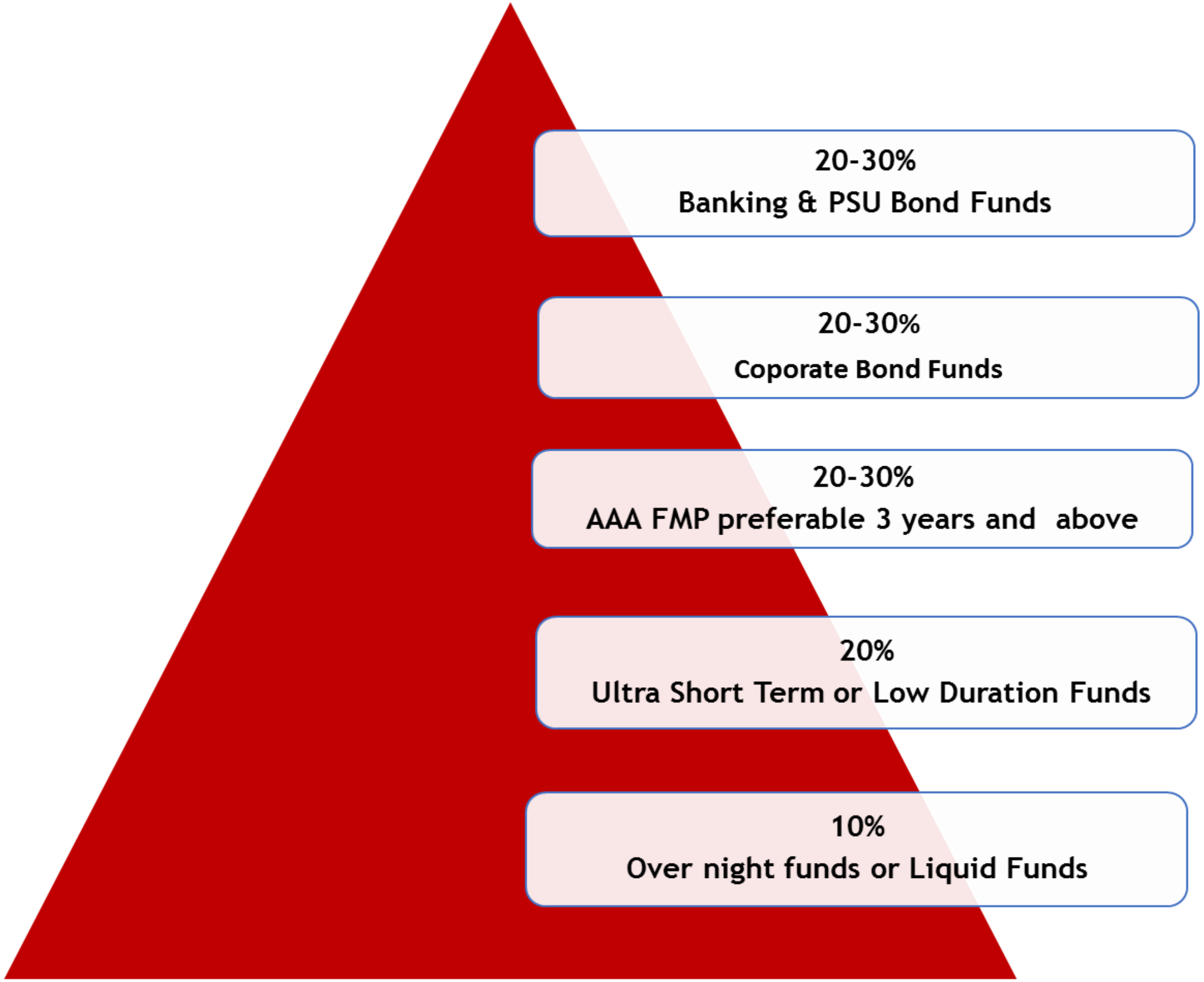
1) Select schemes which are high on credit quality like AAA and AA instruments.
2) Select schemes which has well traded instruments like Banks, PSUs which has better liquidity and rating changes are few.
3) Better to avoid LAS (Loan Against Shares) as the fall in price of the underlying equity can lead to default
4) Select fund houses which withstand sudden surge in redemption without impacting the quality of the portfolio.
5) Long term investors who wants to stay with the scheme for more than 3 years to enjoy the benefits of long-term capital gain should avoid schemes with large corporate investments. It is better to ask the fund house to provide these details before investing.
6) Reasonable part of the portfolio should be invested in FMPs with AAA portfolio which avoid duration risk and corpus related issues.
7) Build a well-diversified portfolio of low to moderate duration with high credit quality schemes with large fund houses and large schemes which manage the above risks with the non-corporate investors in focus.

Construction of Model Portfolio of Debt Schemes:

Considering credit risk, duration risk, Liquidity Risk, Dwindling corpus size risk, Expenses and Rating risk, the portfolio has to be built with lot more care with total diversification across low duration to short term duration, large fund houses with reasonable large corpus and more of non-corporate corpus. The fall in NAV of various schemes of various fund houses have also brought forth the message that direct investment is not a solution to prudent investment.

Here the major challenge is in avoiding Schemes with large share of Corporate investments. As we have seen in the past, Corporate investors who take tactical call in short duration funds make the scheme vulnerable and volatile. Hence the need to build well diversified portfolio of funds with the above characteristics.

Model Portfolio of Debt Schemes:



*Corpus movement and Performance of Various Banking & PSU Debt Fund

AMC NAME	BANKING & PSU DEBT FUND CORPUS in Rs. Cr				Scheme Performance (Report Date: 21 Jun 2019) CAGR in %age									
Fund House Name	**As on 31 May 2019**	**As on 31 Mar 2019**	**As on 31 Dec 2018**	**As on 30 Sep 2018**	**Exp. Ratio in %**	**30 Day**	**3 Mon**	**6 Mon**	**1 Yr**	**2 Yr**	**3 Yr**	**Average Maturity in Yrs.**	**Modified Duration in Yrs.**	**YTM in %age**
HDFC MF	3122.89	2994.05	2803.27	2847.14	0.8	15.22	10.3	10.19	9.49	6.75	7.8	2.68	2.12	8.24
ICICI PRU MF	5464.32	5046.28	4878.10	5116.47	0.85	19.03	12.56	10.51	8.69	6.16	8	3.24	1.98	8.45
KOTAK MF	1510.59	1205.46	913.53	1001.27	0.52	20.54	12.87	11.36	10.14	7.28	8.13	4.24	3.09	8.46
ADITYA BIRLA SL MF	6406.63	6233.78	5737.19	5128.85	0.65	21.79	12.77	10.72	9.79	7.05	8.26	3.12	2.29	8.2
FRANKLIN MF	162.74	144.20	90.75	72.76	0.53	16.57	12.05	11.94	10.98	7.54	8.08	3.68	2.85	8.67
SBI MF	1747.12	1594.48	1525.69	1296.04	0.81	18.2	11.4	9.74	9.01	7.57	7.59	2.63	1.93	7.91
AXIS MF	6450.73	4580.52	2301.82	1231.37	0.54	14.41	9	10.7	10.1	8.06	8.03	2.8	2.3	7.63
IDFC MF	6126.00	3543.00	1870.00	618.00	0.52	17.36	10.19	11.68	10.75	7.71	7.4	3.59	2.9	7.8
***Past performance may or may not repeat in the future**														

*Corpus movement and Performance of Various Corporate Bond Fund

AMC NAME	CORPORATE BOND FUND CORPUS in Rs. Cr				Scheme Performance (Report Date: 21 Jun 2019) CAGR in %age									
Fund House Name	**As on 31 May 2019**	**As on 31 Mar 2019**	**As on 31 Dec 2018**	**As on 30 Sep 2018**	**Exp. Ratio in %**	**30 Day**	**3 Mon**	**6 Mon**	**1 Yr**	**2 Yr**	**3 Yr**	**Average Maturity in Yrs.**	**Modified Duration in Yrs.**	**YTM in %age**
HDFC MF	12320.87	11796.10	10819.36	11640.78	0.45	19.79	12.33	11.63	10.23	7.36	8.26	3.89	2.86	7.86
ICICI PRU MF	6780.39	4839.00	3524.98	5498.65	0.56	13.65	10.4	10.13	8.89	6.87	7.66	2.32	1.6	8.28
KOTAK MF	1872.93	1213.92	777.76	832.40	0.58	11.01	9.7	9.78	8.96	7.61	8.15	1.04	-	-
ADITYA BIRLA SL MF	15312.53	14942.73	13372.61	13318.55	0.39	15.14	11.13	10.32	9.65	7.33	8.09	2.19	1.64	8.4
FRANKLIN MF	870.28	877.45	831.94	807.78	0.88	26.74	12.47	10.8	10.39	7.9	8.96	4.22	3.08	9.94
SBI MF	3964.10	1922.02	-	-	0.96	15.09	9.54					2.85	2.31	7.65
AXIS MF	269.96	240.98	249.30	315.79	1.03	-34.68	-6.11	1.8	5.28			3.4	2.4	8.35
IDFC MF	16068.00	15165.00	11385.00	10900.00	0.57	8.73	8.38	9.18	8.59	6.61	7.67	0.95	0.86	8
***Past performance may or may not repeat in the future**														

*Corpus movement and Performance of Various Ultra Short Term Fund

AMC NAME	**ULTRA SHORT TERM FUND CORPUS in RS. Cr**				**Scheme Performance (Report Date: 21 Jun 2019) CAGR in %age**									
Fund House Name	**As on 31 May 2019**	**As on 31 Mar 2019**	**As on 31 Dec 2018**	**As on 30 Sep 2018**	**Exp. Ratio in %**	**30 Day**	**3 Mon**	**6 Mon**	**1 Yr**	**2 Yr**	**3 Yr**	**Average Maturity in Yrs.**	**Modified Duration in Yrs.**	**YTM in %age**
HDFC MF	6196.08	3926.35	2142.99	1291.54	0.6	7.67	8.23	8.37				0.41	0.35	8.44
ICICI PRU MF	4688.18	4088.82	3198.68	2873.57	0.94	8.53	8.57	8.46	8.27	7.36	7.95	0.55	0.38	8.84
KOTAK MF	12891.71	9189.68	7078.08	7659.16	0.66	8.18	8.17	8.39	8.08	7.29	7.44	0.44	-	-
ADITYA BIRLA SL MF	15436.04	13979.63	14751.13	17834.21	0.35	8.59	8.93	8.85	8.55	7.61	7.95	0.55	0.49	8.44
FRANKLIN MF	19090.98	16595.90	15062.51	15131.48	0.42	9.4	9.52	9.8	9.68	8.66	8.92	0.55	-	-
SBI MF	8747.15	6808.24	5250.96	3824.85	0.52	8.02	8.18	8.32	8.32	7.64	7.39	0.44	0.41	7.43
AXIS MF	1548.55	1155.07	573.35	-	1.18	7.77	7.86	7.93				0.47	0.43	8.16
IDFC MF	2549.00	1648.00	664.00	648.00	0.31	8.34	8.67	8.59				0.45	0.43	7.43
***Past performance may or may not repeat in the future**														

*Corpus movement and Performance of Various Low Duration Fund

AMC NAME	LOW DURATION FUND CORPUS in Rs. Cr				Scheme Performance (Report Date: 21 Jun 2019) CAGR in %age									
Fund House Name	**As on 31 May 2019**	**As on 31 Mar 2019**	**As on 31 Dec 2018**	**As on 30 Sep 2018**	**Exp. Ratio in %**	**30 Day**	**3 Mon**	**6 Mon**	**1 Yr**	**2 Yr**	**3 Yr**	**Average Maturity in Yrs.**	**Modified Duration in Yrs.**	**YTM in %age**
HDFC MF	15996.63	12970.81	9295.27	9630.30	1.01	8.94	8.35	8.24	7.81	6.72	7.22	0.96	0.81	7.61
ICICI PRU MF	19881.81	17118.12	16134.80	17198.24	0.45	9.84	9.03	8.8	8.38	7.37	7.79			
KOTAK MF	5025.09	4609.29	4488.84	5348.52	1.07	2.78	6.26	7.54	7.7	7.14	7.64	0.79	-	-
ADITYA BIRLA SL MF	8449.06	7929.66	7321.19	8587.47	1.23	8.41	7.98	8.33	8.11	7.03	7.31	0.87	0.78	8.27
FRANKLIN MF	6920.37	6870.18	6796.52	6580.28	0.88	2.67	5.02	7.47	8.33	7.83	8.58	1.13	0.91	10.5
SBI MF	7574.60	6445.69	6304.84	7482.71	0.66	8.9	8.38	8.51	8.24	7.35	7.45	1.05	0.89	7.85
AXIS MF	1438.86	1343.52	1520.40	2708.93	0.55	9.61	8.95	9.06	8.45	7.4	7.44	0.96	0.84	8.3
IDFC MF	3571.00	3332.00	3204.00	3507.00	0.46	9.08	8.47	8.6	8.29	7.27	7.63	0.99	0.92	7.61
***Past performance may or may not repeat in the future**														

Value Invest Wealth Management (India) Pvt Ltd

New No: 11, Old No: 107, Y Block,5th Street, Annanagar, Chennai – 40

DISCLAIMER:

Investors should carefully consider the investment objectives and risks as well as charges and expenses of the mutual funds before investing. Investor should refer the offer document for complete information about the schemes. This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. Value invest does not render advise on tax and tax accounting matters. Investors should always consult their own legal or tax advisor for information concerning individual situation. Investment in securities including equities and fixed income securities involves certain risks and considerations associated generally with making investments in securities. The value of the portfolio may be affected generally by factors affecting financial markets, such as price and volume, volatility in interest rates, change in regulatory and administrative policies of the government or any other appropriate authority (including tax laws). The value of the portfolio may fluctuate and can go up or down. The investments discussed in this may not be suitable for all investors. Financial products and instruments are subject to market risks and yields may fluctuate depending upon various factors affecting capital/debt markets. Consequently, there can be no assurance that the objective of the investment would be achieved. Please note that past performance of the financial products and instruments does not necessarily indicate the future prospects and performance thereof. Such past performance may or may not be sustained in future. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means. Investors are advised to refer to the offer documents and disclosure documents of individual products before making the investments. Recipients of this information should rely on their own investigations and take their own professional advice. Neither Value Invest Wealth Management (India) Pvt Ltd., nor any of its employees shall be liable for any direct, indirect, special, incidental, consequential, punitive, or exemplary damage, including lost profits arising in any way from the information contained in this material. Source: Mutual Funds Fact Sheets and Portfolios, Excel Net Solutions, BSE Website & AMFI Site.