A DURATION DECISION TO STAY WITH PRIVATE BANKS

PANELISTS AT THE HUBBIS INDIAN PRIVATE BANKING FORUM 2014 IN MUMBAI IN LATE AUGUST DISCUSSED TRENDS IN FIXED INCOME IN THE DOMESTIC MARKET, AND THE IMPACT ON PERFORMANCE.

The Indian mutual fund industry has even more product categories in fixed interest than some other developed markets, despite not having the same breadth or depth.

However, this is likely to stay as private bankers prefer to make the duration calls on behalf of clients.

This was one of the conclusions of speakers on the panel discussion on fixed interest at the Hubbis Indian Private Banking Forum 2014, held in Mumbai in late August.

Another area of discussion was the quality of credit being invested by the asset and wealth management industry.

PRODUCT CATEGORISATION BASED ON FIXED DEPOSITS

The discussion started by focusing on the number and categorisation of fixed interest products.

Suyash Choudhary, head of fixed income at IDFC Asset Management, shared a framework for classifying debt funds, dividing them into categories equivalent to cash, fixed deposits and fixed deposits-plus (FD+).

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"There are two things that manufacturers and the industry need to work on," explained Choudhary. "First, the tendency to over-allocate to FD+ and profile based on market noise; and secondly, to consider whether credit funds should be FD+ profile."

Rahul Goswami, head of fixed income at ICICI Prudential Asset Management,

summed up the views of the panel on the number of products.

"The role of the manufacturer is to provide risk-return product in every risk-return bucket. It's the asset allocation which is more important across the funds as far as the risk-adjusted return is concerned."

Yet Dhawal Dalal, Head of Fixed Income at DSP BlackRock Investment Managers, had a different view: "I would disagree with the number and categories of funds available. While there are broad categories of liquid, liquid-plus, short, income and guilds, there are many funds out there just because of seasonal requirements."

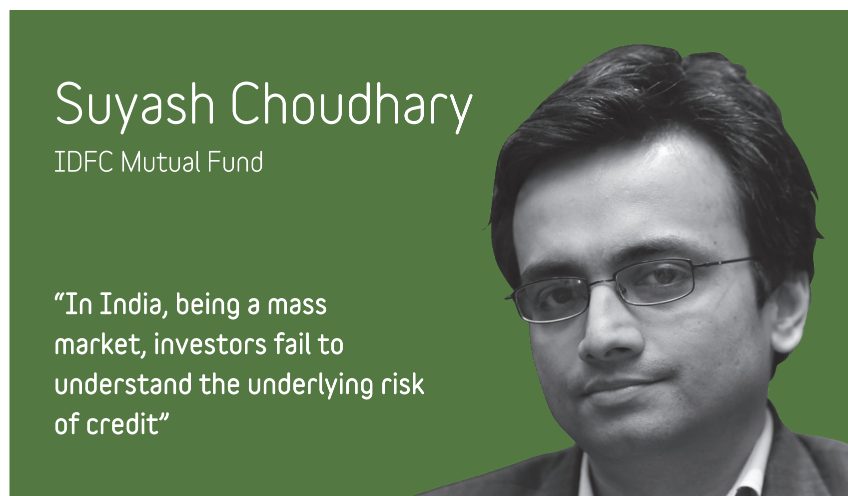
Dalal said that funds tend to get launched, but when the requirement passes, the assets flow out, leaving too many funds with small fund sizes. "As a manufacturer, while launching, we have to ask ourselves is this a sustainable plan."

IS CREDIT RISKIER THAN FIXED DEPOSITS?

When it comes to assessing credit, Choudhary said: "If you take a credit fund, and their average credit exposure around the globe, and compare it with what is getting manufactured in India, you may find that India relatively is blue-chip. However, that's not the point. In India, being a mass market, investors fail to understand the underlying risk of credit."

His point was that credit was being mis-classified.

"So we, the industry, have to match risk profile with the investments made. And FD risk cannot be merged with an FD+ kind of bucket."



Munish Randev, chief investment officer at Waterfield Advisors, said his clients would like to invest in investment grade, but with an A rating.

However, it's not available in the mutual fund space, hence he would look at AIF structures.

Compared with developed markets where regulators are considering designating certain asset management companies (AMCs) as "systemically important financial institutions", the panel believed this was not likely, nor needed in India.

Neither is it likely for money market funds being allowed to limit withdrawals or impose redemption penalties.

However, Choudhary pointed out that the Indian corporate bond market is pretty shallow, and there is scope for panic withdrawals because investors don't really understand credit risk.

Dalal said the proportion of assets in less AA- rated paper is miniscule, and the scope to add value is in credit funds.

However, he stressed that asset managers have to do their research as most of the deals are being priced differently by the banks.

Munish Randev

Waterfield Advisors

"It's the job of the adviser to choose where he wants to place himself for the client"

Goswami agreed that people have different views on credit pricing, and that asset managers' holdings are miniscule compared with bank loans.

However, asset managers' holdings are more susceptible to risk as banks have more diversified sources of funding to absorb risks. He said he believed that any risk is more likely to have on the liquidity side rather than the credit side.

Dalal warned: "There is some kind of risk in this category of credit because a large amount of money comes in and goes out on daily basis and that is the huge amount of risk is what we are basically running…. If money didn't come there is systematic risk…. The regulators are still watching." The liquid funds market is basically an intra-mutual fund market, with very little corporate money.

On the issue of credit ratings, the panel confirmed that they look at ratings as a first filter but do their own homework.

Dalal said that while credit ratings are a thriving business, judging by the stock price of credit rating agencies, the risk lay with the asset managers and therefore they do their own research.

Choudhary pointed out there were examples in the market of two different bonds being rated AAA and trading 200 basis points apart, showing the extent to which the market perceives risk differently to the credit ratings agencies.

He added that he has been impressed with the quality of credit research by some of the larger AMCs.

"So much money bled out of the bond market because of the impression of the high interest rate risk."

WHO SHOULD MAKE DURATION CALLS?

Choudhary said that while he can understand private bankers preference for making selections based on duration needs of the clients, he believed that some advisers tend to "over allocate" by moving around too much and not letting the fund manager make the call. "So much money bled out of the bond market because of the impression of the high interest rate risk," he said. "Tax-free bonds were a 'hold' and people held all those bonds because they were giving 7.5% return."

Added Randev: "From the family office perspective, they are professional investors, not the normal HNW or retail category. It's the job of the adviser to choose where he wants to place himself for the client."

Randev added that family offices appreciate the lower risk of dynamic bond funds.

But they still prefer to allocate themselves, he explained.

Dynamic bond funds are considered the best indicator of a fund house's capabilities, said the panel, as they have the widest mandate of duration calls and also ability to invest in fixed interest.

But Choudhary pointed out on the panel that dynamic bonds funds are not the same – AMCs tend to manage them very differently.

Some private banks evaluate the value-add by plotting the weighted duration of the portfolio against the bond yield of the 10-year GSec.

Some of the examples put up showed that some funds had changed duration calls significantly when bond yields hadn't moved that significantly.

Said Dalal: "Asset managers have not done well in this category and we do have to introspect." ■