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'Short Term Funds, Income Opportunity Funds can deliver higher returns than bank FDs in 2017'

Amandeep Chopra, Head - Fixed Income, UTI AMC talks about the global and local interest rate scenario, his portfolio strategy and debt fund performance

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With many new investors trying out debt funds, Amandeep Chopra, Head - Fixed Income, UTI AMC feels that they need to be engaged actively right from the first stage of buying into a fund, by seeking sufficient information and understanding from the financial advisors. In an interview with Kumar Shankar Roy, Chopra says when to sell an under-performing debt fund, the global and local interest rate scenario and his portfolio strategy.

Edited excerpts

Can you tell us about your fixed income investment framework and how it works in the current scenario?

Our fixed income framework is geared towards the objective of achieving consistent and stable returns with lower level of volatility through an appropriate combination of investment philosophy and strategy.
Our portfolio strategy consists of maintaining a high quality diversified debt portfolio, low credit risk strategy, active duration management and actively employing trading opportunities.
This combination for us has been agnostic to business and market cycles and having stayed true to them has helped us manage our funds even in the current scenario.

How does a retail investor know when to sell an under-performing debt fund?
Investors need to be actively engaged right from the first stage of buying into a fund by seeking sufficient information and understanding from the financial advisors. Having chosen the appropriate products, these then need to be monitored at a reasonable frequency commensurate with the nature and tenor of the fund. Say a short term fund could be reviewed on a 6 monthly basis and not monthly and so on. The monitoring in my view is wrt (1) the positioning and mandate of the fund, (2) its benchmark and (3) the right peer set.
In the fixed income funds, I find that there is ample confusion in creating an appropriate peer sets, including with some popular websites. A deviation from (1) and/or sustained underperformance with respect to (2) and (3) in my view should warrant a deeper analysis and action from investors.

How do you validate the management quality of companies who do not have a long track record in fixed-income securities?
The management quality validation is a result of our review of the business model, promoter philosophy, corporate governance structure & policies, disclosure levels, related party transactions and track record. We actively engage the promoter(s) and senior management through meetings.
At UTI MF, there is a strong support between the fixed income and equity research teams. Through active discussions, feedback and exchange of ideas, it helps us obtain additional inputs for our decisions for investing in fixed income securities of new (and even existing) issuers.

As an active debt fund managers, today which is the biggest risk among credit, duration, interest rate, and liquidity?
We are again in a period of high uncertainty with the Fed & Trump future policies in the

US, elections in Europe and RBI's change of stance. All these in our view will manifest in increased risk to duration and interest rates.

Credit is a very bottom-up story and will always remain some source of risk but its not as high in the hierarchy as the future direction of interest rates.

Is the RBI indicating that we are at end of rate cut cycle? What does the situation mean for debt fund investors?
We do read the neutral stance of RBI as an end to the easing that began in Jan 2015. The second half of FY18 will be challenging. The Fed would have likely hiked 1-2 times by Sep 2017, with indications of more to follow into 2018.
Furthermore, with expected CPI trajectory moving up (with upside risks) would feed into concern for rupee and local rates thus putting pressure on the RBI.
I think debt investors need to be aware but not worry and rejig their fixed income portfolios. Investors who have followed an asset allocation approach in the debt funds should maintain that discipline. Those who increased duration thematically and hence moved up one ladder of duration funds could consider de-risking should the scenario narrated earlier play out in 2017.

Given that lending and deposit rates in banks are quite low, does this mean going forward the returns from fixed income mutual fund schemes will also tend lower? Since the general level of interest rates have declined over 2016, the returns from debt funds will tend lower. However, the Short Term Funds and Income Opportunity Funds can deliver higher returns than the bank deposits in 2017. These funds have achieved this even in the earlier years.

In the backdrop of the Budget 2017, what are the hits and misses in terms for fixed income investors?
The budget 2017 was net positive for the fixed income markets with the Government exercising fiscal restraint as it targeted a lower deficit and kept receipts fairly realistic. Furthermore, it continued with increased push to the agri sector, rural development, housing and employment, some growth in capital spending and partial redistribution of wealth as with the previous years budget. This should be supportive for growth at the margins.
The miss for the mutual fund fixed income investors was possibly the extension of the 3 year long term capital gains tax rule (currently applicable to the debt funds) for direct purchase of bonds.

Have you seen any major change in retail investor behavior with respect to debt funds post-demonetization?
No, not really.

In terms of the growth, one of the engines obviously would be the transmission of the rates actually coming through to the economy. How do you see this playing out?
While the degree may differ, there already has been a fair amount of transmission of interest rates by both the banking industry and the capital markets.
I think there are challenges for banks to reduce the lending rates meaningfully from here on and hence the deepening of the bond markets is important.
While it will take some time, the gradual shift in higher household savings moving into the mutual fund products will not only offer investors a good alternative but also provide a steady demand for corporate bond issuances. There is a need to reduce the crowding out due to the GOI+State supply and provide some flexibility to the domestic long-term institutional investors and foreign investors to participate in adding to the existing demand.