Sakthi Financial Services

Weekly Update

21st June 2022 Vol: - 22.23.11

SENSEX	NIFTY	USD	GOLD	CRUDEOIL
51597.84	15350.15	78.52	51005.00	8504.00

Should equity mutual fund investors worry about Sensex fall, volatility?

The stock market is going through a rough phase. Rate hikes and inflation are monopolising the conversations. If you dig deeper, you will find that everyone is worried about an impending recession in developed countries. And what kind of impact all these will have on the Indian stock market is on everyone's mind. Most of the equity mutual fund categories offered negative returns in one day due to the fall in the market.

Market analysts believe that domestic stock markets and the rupee are facing problems due to the sharp rise in US inflation and hence the concerns over more aggressive rate hikes and stronger capital outflows. May consumer inflation hit a fresh 40-year high of 8.6% in the US, while India CPI inflation in May is expected to stay above 7%.

Equity mutual funds have been offering negative returns in the short term because of the frequent falls in the market owing to several factors. Most of the equity categories are posting negative double-digit returns so far in this year.

It was totally led by uncertainty and multiple news coming from various parts of the world. Market is trying to fathom the global inflation rise, expectations of rate hikes and the war.

However, mutual fund managers believe that the correction we have seen so far is only averaging the gains in the market. They believe that the falls can help investors buy at better valuations.

"The markets, when measured by the Nifty Index, are now approaching average valuations. The trend of contracting valuations multiple and improving earnings is likely to continue. This is the time to gradually increase equity allocations. Using volatility to our advantage will require one to stick to a disciplined approach to investing," says Sahil Kapoor, Head- Products & Market Strategist, DSP Mutual Fund.

These mutual fund managers believe that investors should not focus on short term returns and volatility. They also believe that investors who are new and feel that they can't stomach this kind of volatility should look at other, less risky asset classes. "Return expectations should always be based on your goals and your risk appetite and not on what markets have to offer in the short term. Indian markets are likely to do well over the long term and investors should remain focused on long term wealth creation," says Sahil Kapoor.

Despite volatility, mutual fund equity schemes registered net inflows of Rs 18,529 crore in May, up from Rs 15,890 crore in April, data released by Association of Mutual Funds in India showed.

Overall assets under management for the mutual fund industry stood at Rs 37.22 trillion (lakh crore) as on May 31 compared to Rs 38.03 trillion a month ago. None of the equity scheme categories saw net outflows in May despite correction in the stock market. Systematic investment plans (SIP) have emerged as a preferred mode of investment in equity funds. SIP contribution for May stood at Rs 12,286 crore compared to Rs 11, 863 crores in previous month. Number of SIP accounts went up to 5.48 crore as on May 31 compared to 5.39 crore as on April 30. All categories of hybrid schemes- mutual fund schemes investing in varying mix of stocks, bonds and gold - registered net inflows in May. Hybrid funds as a whole registered net inflows of Rs 5,123 crore which were lower than Rs 7,240 crore in previous month. Balanced advantage funds (BAFs) got the highest net inflows in hybrid funds worth Rs 2,247 crore. Investors keen to take advantage of volatility in the stock market tend to invest in BAF.

Mutual funds can again accept money in international schemes

The Securities and Exchange Board of India (Sebi) has allowed mutual funds to accept fresh money in international schemes to the extent of the overall industry limit of $7 billion. In a letter to industry body Association of Mutual Funds of India (AMFI) last week, the capital markets regulator said asset managers may resume subscriptions and make investments in overseas funds or securities 'up to the headroom available without breaching the overseas investment utilization limit'.

Some mutual funds may however not accept investor flows in these products due to lack of clarity over the limits available.

While there is no estimate of the redemptions in international schemes, mutual fund officials and distributors speculate the headroom to accept fresh flows could be low. This is because international schemes did not witness sharp outflows amid the correction.

"We estimate that the total headroom for the industry will be just 2-3% of the $7 billion limit," said the CEO of a domestic fund house. This means the industry will be able to add just ₹800-1200 crore of international assets.

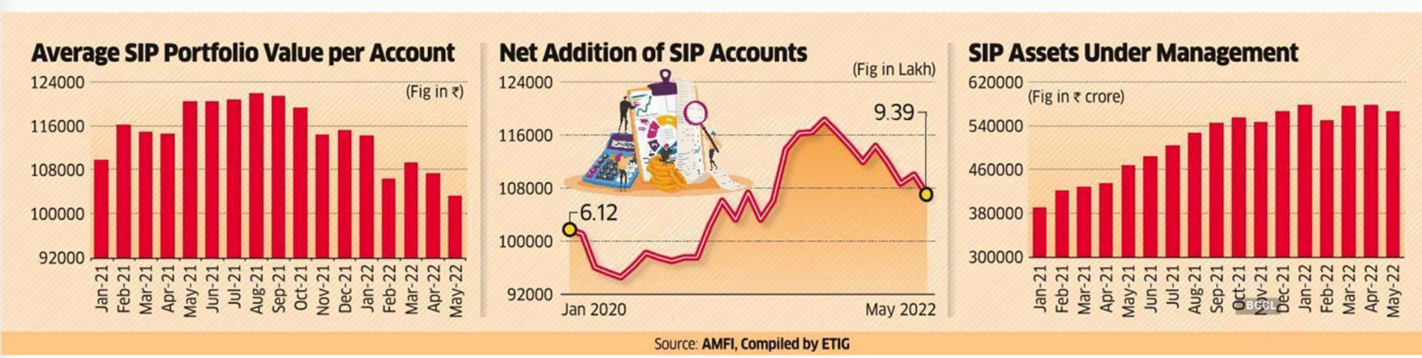
Emails sent to Sebi and AMFI went unanswered till the time of going to print.

AMFI, as advised by Sebi, had asked all fund houses to suspend fresh investments in schemes that intend to invest in overseas securities beginning February 2. The regulator has a cap of $7 billion on the mutual fund industry's investment in overseas stocks. It was believed that mutual funds had crossed the 95% mark. The RBI, which decides on overseas investment rules by domestic individuals and entities, has not allowed a higher ceiling.

ET spoke to top officials of four fund houses who were unsure about how to open up schemes for subscription. Fund officials said mutual funds will have to estimate their limits individually. While some fund houses are waiting for further guidance from AMFI, others have decided against accepting fresh flows.

"There is very little headroom available to us as we have already reached our overall fund house limit of $1 billion. We are getting more information," said a top official with a domestic mutual fund, which runs a large international product.

SIP account addition moderates in May as average portfolio value falls amid choppy market



(Cont.)

Even though inflows via Systematic Investment Plans (SIP) of mutual funds remains firm, account additions show signs of moderation amid falling SIP portfolio value due to the market volatility. The net SIP accounts addition was at 9.4 lakhs in May 2022, the lowest in 12 months, taking the number of total accounts to 548 lakhs.

The average portfolio value of SIP investors shrunk 15% to Rs 1 lakh in May 2022, compared with the peak of around Rs 1.2 lakh reached in August 2021, the data from the Association of Mutual Funds in India (AMFI) show. The portfolio value in May was the lowest in twenty months.

The moderating account addition weighed on the SIP opening-to-closure ratio, which dropped to 1.9 in May 2022 compared with the one-year average of 2.4. Similar to the net addition, the gross new SIP account addition in May was also at a 12-month low of 19.7 lakhs.

The average SIP portfolio value dropped in eight out of the past ten months. However, the total assets under management of the SIP linked funds rose by 21% year-on-year to Rs 5.6 lakh crore in May, faster than the 12% growth in the total AUM of the mutual fund industry in India at Rs 37.2 lakh crore. A prime driver of the SIP AUM growth is the consistent monthly inflow. These schemes reported an inflow of Rs 1.1 lakh crore in the past 12 months. The monthly SIP inflow was above Rs 10,000 crore for ninth months in a row up to May.

Mutual funds unlikely to get a raise in overseas investment cap

Indian regulators are unlikely to permit any increase in the limit on mutual fund investments in overseas assets, in part because it could further pressure the rupee which is already at historic lows, said two people familiar with the matter.

There is a cap of $7 billion on total investments by Indian mutual fund schemes in foreign funds which actually hold the assets. There is a separate limit of $1 billion for local funds that invest in foreign exchange-traded funds (ETFs). A collapse in the value of some of those schemes has led to a demand for higher limits to help investors bring down their average investment cost.

"While Sebi (Securities and Exchange Board of India) has been in favour of an increase in the limit to help mutual funds to garner more funds, the central bank is reluctant to raise the limit," said one of the people.

Fund houses put extra checks in place to curb insider trading

A leading mutual fund has asked top executives to stop using encrypted messaging platforms such as WhatsApp on their work phones. Some brokerages are installing monitoring applications on the terminals and phones of key employees, while another firm wants to track investments by family members of staff. These are some of the actions that various domestic asset management companies and broking firms are taking or considering in the wake of front-running and insider-trading cases surfacing in recent times. Many of these financial services firms are looking to add such conditions to employee contracts, despite grumbling that this would infringe privacy.

The increased surveillance is to monitor who the employees are in touch with during work hours, to track any leaks of price-sensitive information. Such tools would serve as a deterrent against unethical practices, said market participants.

Some finance firms are employing analytical tools to look for patterns in all the data recorded, akin to how the market regulator and stock exchanges keep tabs on insider trading. In the past few months, at least three cases involving insider trading have come under regulatory scrutiny, said people with direct knowledge of the matter. In such instances, the institution itself could be exposed to regulatory action.

Axis Mutual Fund recently asked two fund managers to leave after a probe into allegations of wrongdoing, which included front-running and taking kickbacks from stock brokers.

Firms are increasingly concerned that transgressions by a few employees will invite regulatory action and bad press.

To be sure, these enhanced surveillance measures are only for key persons dealing with price-sensitive information on a regular basis. Also, job contracts are designed to cover such special measures and, hence, such staff give their consent to be tracked during work hours, said legal experts.

"While one could say this impacts the privacy of the employees, such surveillance measures may be a necessity given the position and access certain roles provide," said Moni Ladha, partner, Khaitan & Co. "We should keep in mind that regulated entities are also exposed to higher risk should an employee misuse any confidential information and access rights."

Currently, all calls and messages of important employees of mutual funds and brokerages are recorded and monitored. However, communication on encrypted platforms such as WhatsApp or Telegram may not be captured. If the curb on these is implemented, employees will have to stick to phone calls and SMSs to communicate.

Mutual funds and leading brokers don't allow a second phone for personal purposes during work, said legal experts. A leading domestic brokerage is learnt to have asked all dealing room employees to submit an undertaking saying they do not own any additional phones, apart from what has been disclosed.

MF industry adds over 6 lakh new investors in May 2022

The MF industry sees addition of more than 20 lakh folios in one month.

Investor count increased by 2% or 6.08 lakh, taking the total number to 3.49 crore. This includes 3.44 crore unique PANs and close to 5 lakh unique PEKRNs (PAN-exempt KYC reference numbers). The folio count increased by 2% from 13.13 crore as on Apr 2022 to 13.33 crore as on May 2022.

Now, you need nominations for MF investments

The Securities and Exchange Board of India (Sebi) has mandated investors to either specify a nominee or explicitly opt-out of nomination for all mutual fund (MF) investments.

What's changed?

As per a recent Sebi circular, any new investor subscribing to an MF scheme from 1 August will either have to specify a nominee or submit a signed declaration to opt out of nomination. Existing MF investors will also have to either specify a nominee or opt out of nomination. The deadline for this is 31 March 2023. Failure to do so will result in the MF folio getting frozen, implying that investments cannot be redeemed.

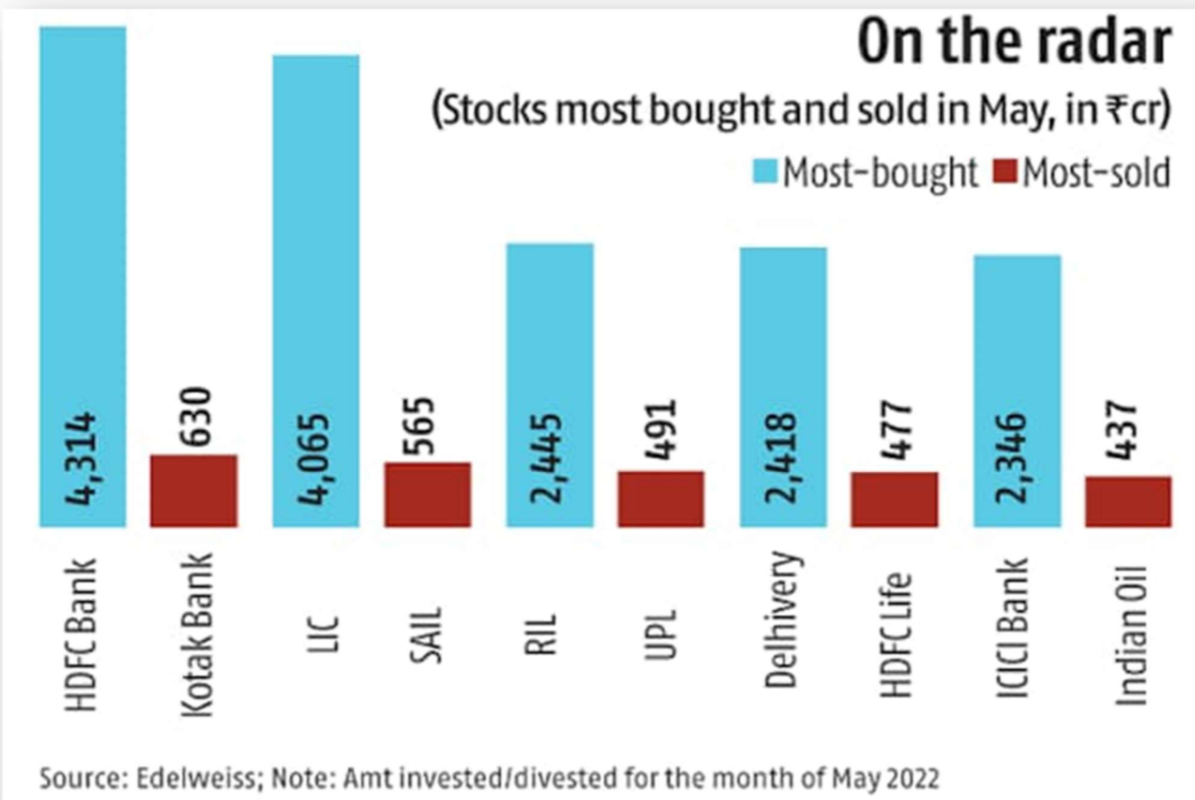
AMCs will have to provide investors the option of submitting either the nomination form or the declaration form to opt out of nomination. They may do so either physically or online.

IPOs suck mutual fund liquidity in May, shows data

Mutual fund (MF) investors' ability to invest in listed stocks was crippled by large public floats in May.

As per an analysis done by Edelweiss Alternative Research, state-owned insurance major LIC and Softbank-backed logistics major Delhivery attracted MF investments worth Rs 4,065 crore and Rs 2,418 crore in May. Overall, MFs invested Rs 29,400 crore last month even as overseas investors sold shares worth Rs 42,900 crore. HDFC Bank, Reliance Industries and ICICI Bank were the other counters that saw substantial MF investments.

On the other hand, Kotak Mahindra Bank, SAIL and UPL saw new outflows from domestic funds.



Mutual funds barred from bundling schemes with insurance or any other products

Securities and Exchange Board of India (SEBI) has advised Association of Mutual Funds in India to inform all members that no existing or new mutual fund schemes shall have bundled insurance products. Put simply, the fund houses cannot launch new products offering any additional benefits along with their mutual fund schemes.

Mutual funds have been bundling insurance with schemes as one of the ways to attract investors for the long term.

For more than a decade mutual fund houses have been offering bundled insurance along with systematic investment plans (SIP). The sum assured is typically linked with the SIP amount and tenure of the SIP. Fund houses would stipulate the minimum tenure of the SIP to be eligible for this benefit, typically around three years and the sum assured would range between 100 and 120 times of the SIP amount.

Some fund houses used to offer target sum assured which would reduce the death benefit as SIP instalments come in. Target sum assured at the beginning of the SIP would be equal to SIP amount and the number of instalments one wants to invest. In most cases, SIP in equity and hybrid schemes were eligible for insurance benefits.

The cover would cease by the age of 55 years of the investor, or as SIP matures or if the SIP gets cancelled for any reason by the investor, whichever is earlier. In most cases, the insurance would kick in immediately after signing up for an SIP. And the only exclusion was suicide in the first year of SIP. The costs towards providing the life insurance were born by the asset management companies.

Fund houses such as Nippon India, Axis, DSP, ICICI Prudential, Aditya Birla Sunlife, PGIM had offered SIP with insurance facility to their investors in the past. While Nippon India continues to offer the product, ICICI Prudential has stopped offering it to new investors, but continued to offer it to existing SIP enrolments. Aditya Birla Sun Life AMC recently relaunched this facility for investors, after suspending it for some time last year.

This benefit has been optional. The insurance feature is targeted at investors looking for goal-based investments. The death benefit in these products would ensure that the investors get an assurance that there will be money as per their investment plans even in case of a **death of the investors** committing SIP. Mutual fund houses used this product to attract long term money in their schemes.

Clarity is awaited if the fund houses have to stop offering this facility to existing SIP enrolments done before June 17, 2022, the date on which the circular was issued by the regulator.

MINT 20 MUTUAL FUND SCHEMES TO INVEST IN

mint 20 BEST FUNDS

We have hand-picked 20 mutual funds for your portfolio that have jumped through hoops of good returns, low risk, good portfolio hygiene and our own qualitative research. We have restricted the choice universe to 10 categories out of the total 37 and given you at least two options to pick from each.

EQUITY	3-years return (%)	5-years return (%)	Corpus (₹ cr)
LARGE-CAP			
UTI Nifty Index Fund - Growth	10.73	11.45	7,095
HDFC Index Fund - Nifty 50 Plan	10.47	11.25	5,919
Category average	10.28	10.89	
EQUITY FLEXICAP			
Canara Robeco Flexi Cap	13.00	12.05	7,263
Parag Parikh Flexi Cap	20.57	16.52	22,647
Category average	11.77	9.93	
EQUITY SMALL AND MIDCAP			
Axis Midcap	17.45	15.19	17,165
SBI Small Cap	23.61	17.43	11,831
Category average Midcap	16.79	10.69	
Category average Smallcap	20.15	12.36	
EQUITY (TAXSAVER)			
Canara Robeco Equity Tax Saver	14.76	13.27	3,602
Mirae Asset Tax Saver	15.37	13.65	11,805
Category average	11.23	9.33	
HYBRID			
BALANCED ADVANTAGE			
Edelweiss Balanced Advantage	11.92	9.83	8,046
ICICI Prudential Balanced Advantage	10.37	9.34	40,146
Category average	8.26	7.63	
ARBITRAGE			
Kotak Equity Arbitrage	4.38	5.16	26,010
Tata Arbitrage	4.43	NA	9,887
Category average	4.13	4.91	

(Equity and Hybrid Schemes only)

(Source:- Economictimes, Moneycontrol, Livemint, Cafemutual, IBJArates, AMFI Etc.)