April 30, 2020

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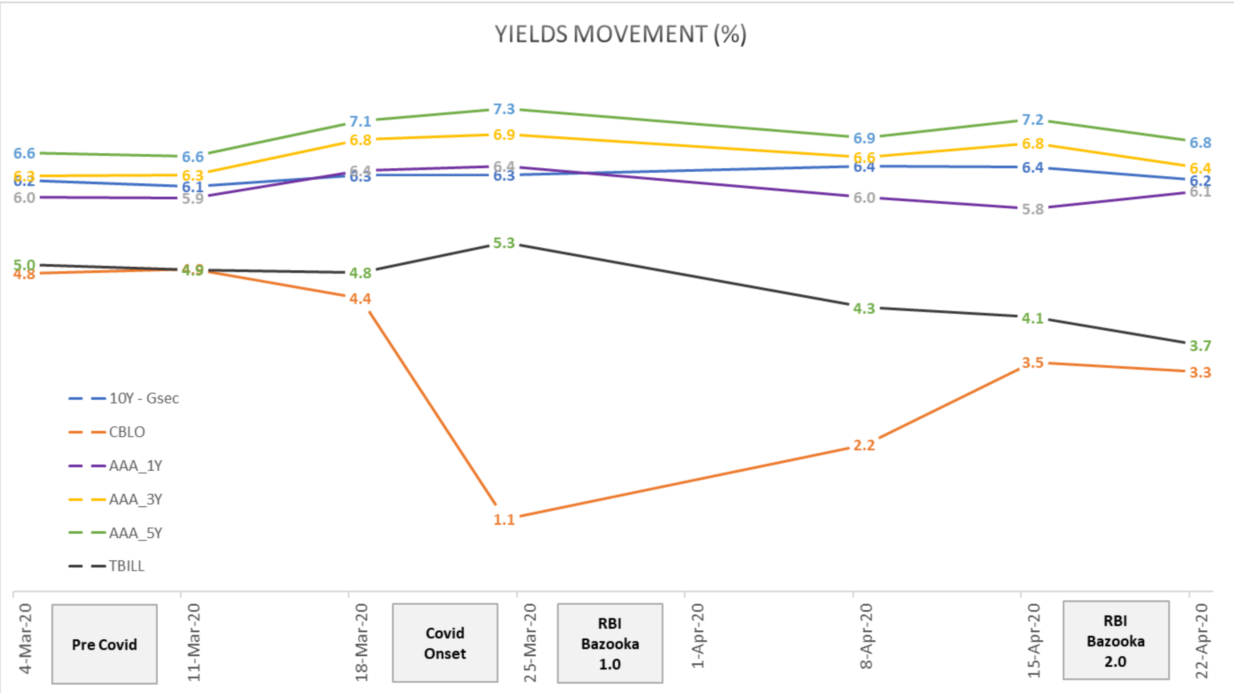
Product Update April'20

Market Outlook:

The Indian economy has been facing cyclical and structural issues for some time which has got aggravated due to the COVID pandemic. RBI measures like repo rate cut, long term repo operations (LTRO), and removal of FPI ownership limits in certain G-secs are aimed at soothing long-term interest rates. RBI has announced couple of liquidity measures addressing the concerns of NBFCs, / MFIs and liquidity to RRBs / Co-Op Banks and Housing Sector through NABARD / SIDBI and NHB. As a result of these measures, there is adequate liquidity in the system, however, due to the lockdown, trading volumes being witnessed is at the lower end which is resulting in volatility at the shorter end. While the government is employing fiscal and monetary measures to address the economic situation, concerns like Govt. borrowings, inflation and FPI outflows are expected to create upward pressure on interest rates on the longer end of the curve. The next six months are very crucial for the economy and will need regular intervention from the RBI and Indian government to keep liquidity flowing, especially to sectors with huge liquidity lined up. Until then bond yields may remain very volatile. The scare of the risks in the debt segment due to COVID-19 is temporary but these risks can get quite real till the COVID-19 situation starts to subside.



(Source : Bloomberg)

As seen in the above table, corporate bond spreads in 1 - 3 Y AAA segment rose & are offering attractive value. In the Pre-Covid stage, the differential in the 1- 3Y AAA bucket v/s T-bill was about 100-130 bps. The spreads have widened further with the RBI Bazooka 2.0 announcement, & are now offering attractive spreads of around 230-270 bps (as on 22nd April'20), which would prove beneficial for funds which have AAA papers maturing within 3 years in their portfolio.

Why Short Term funds?

Debt funds are a better option, especially in a period when interest rates are low and traditional fixed-income options such as bank fixed deposits and small savings schemes are seeing lower interest income.

These funds offer potentially higher gross returns compared to traditional avenues for investment tenure above 1 year and are tax efficient when investments are made for 3 years & above.

- Short term bond funds have a shorter maturity, so they generally offer safe and stable returns.
- The fluctuations in interest rates of the debt market have marginal impact on the returns of short-term debt funds & they usually perform better than longer term bond funds which are impacted by market fluctuations.
- In case of emergencies, the investors can easily withdraw their investments with minimal exit load or no load .
- Short term debt funds provide better tax adjusted returns viz bank Fixed Deposits. Unlike bank deposits, where TDS is deducted, in debt funds, the tax is payable on redemption which makes compounding gains more efficient.
- SWP is an efficient way to generate regular income (if holding is for more that 3 years) as compared to Fixed Deposit where partial withdrawal is not available.

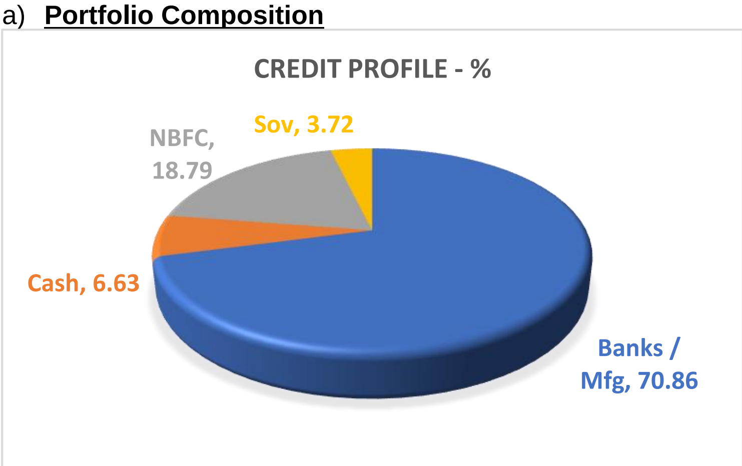
Suitability:

Short Term Bond Fund are typically considered to be the next step up in the Risk spectrum from Money Market / Liquid funds. Hence, such funds can be an option for those with a slightly longer time investment horizon, greater than 1 year. As a result, this helps them to take on a modest degree of risk in exchange for a higher yield. They are less sensitive to rising inflation than intermediate & long-term bonds. Investors who don't prefer interest rate volatility and have a medium-term horizon should build a portfolio using short-term funds which carry high credit quality instruments. Clients with moderately low risk appetite & those looking seeking to capture short term yield movements with the cushion of accrual income should consider Short term bond funds. Funds which blend low volatility with high credit quality are better suited & add stability to the portfolio.

Why Baroda Short Term Bond Fund?

The fund was launched in June'10 & is managed by Alok Sahoo & Hetal Shah. It has an AUM of 282 crs as on 31st March '20. The fund's objective is to generate income from a portfolio constituted of short-term debt and money market securities. However, in order to evaluate short term bond funds, highest returns is not the only factor that needs to be considered, deeper evaluation of other factors like consistency of returns, portfolio credit quality & portfolio composition. Baroda Short Term Bond fund has been able to outperform due to its stringent fixed income process followed by in depth analysis of the instruments & maintaining a fair balance between duration & yield.

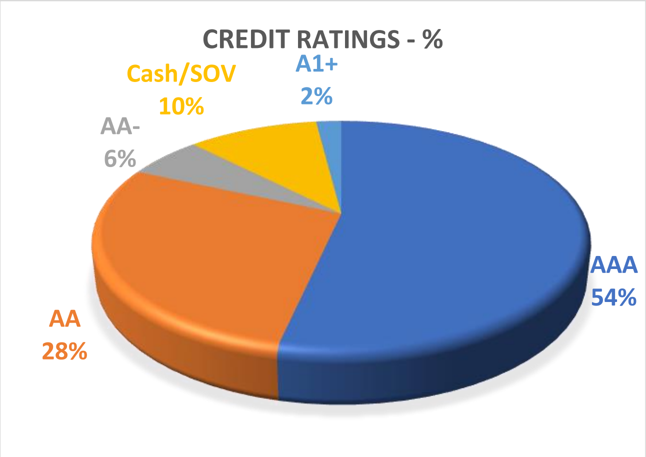
a) **Portfolio Composition**



(Source: Factsheet, March'20)

The fund has majority of its exposure in Banks / Manufacturing instruments which are liquid & easily tradable. The NBFC exposure is at 18% which are primarily short term in nature. (10.38% will be maturing by end of Sept'20). A breakup of the portfolio maturity shows that: 18 % of the portfolio is liquid & is maturing in < 1 year; 57% is in high quality NCDs with 1-3 yr maturity ; 25% is in GSec / PSU / Mfg instruments with > 5 yr maturity.

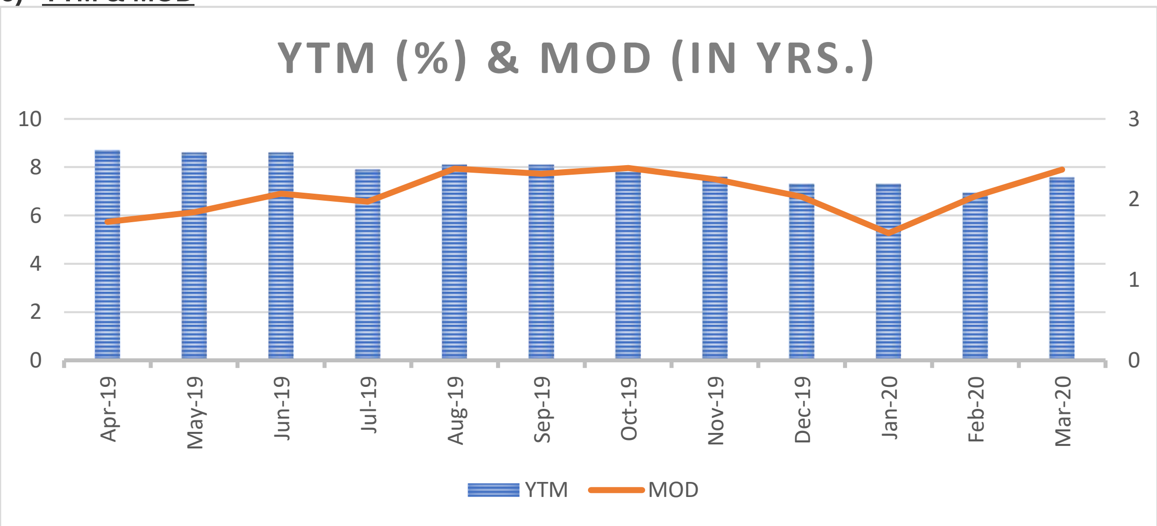
b) <u>Credit Ratings</u>



(Source: Factsheet, March'20)

The fund has maintained a conservative view & is currently 64% invested across Cash & AAA papers. It has 34% exposure to AA category & NIL exposure to A or below rated instruments thereby generating better returns without comprising on the credit risk in the portfolio. Currently, the fund has 26% of its portfolio in AAA segment with 1-3 year maturity, which offers best values & the fund is poised to take advantage of the same.

c) <u>YTM & MOD</u>



(Source: Factsheet, March'20)

<u>Recommendation:</u>

Short term debt funds are a tax-efficient alternative to traditional fixed-income products & provide liquidity, better risk adjusted returns & investors need to consider them during such times. In an environment wherein the economy is facing headwinds, investors need to invest in funds which have an established track record, good quality portfolio, follow robust investment process and have risk management strategy in place & offer better risk adjusted returns.

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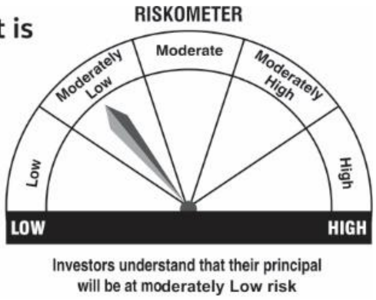
Baroda Short Term Bond Fund: This product is suitable for investors who are seeking~-

- Regular Income over short term.
- Investment predominantly in Money Market Instruments (i.e. CP/ CD) and Short Term Debt Market Instruments.

~ Investors should consult their financial advisors if in doubt about whether the product is suitable for them.



Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.