Mutual Fund Category Analysis July 06, 2012

MF Category Analysis: Hybrid - Equity Oriented

Key Takeaways:

- The Hybrid – Equity Oriented schemes that have the elements of both –Equity and Debt asset classes witnessed either outperforming or in-line returns compared to Equity Diversified and other equity oriented categories over the long run.
- The hybrid strategy of investing together in equity and debt exposure helps out to achieve asset class diversification. While the equity component of the portfolio appreciates the NAV value with higher growth potential and the debt component makes the funds less volatile providing better downside protection.
- Though the schemes cushion better during market fall, they end up with middling returns during equity market rises as compared to other equity oriented schemes given the considerable allocation to debt.
- Investments made in Hybrid – Equity oriented schemes is tax efficient as they are treated as pure equity funds, allocating to domestic companies to the extent of more then 65% of the total assets.
- Medium risk profile investors who want allocation into equity as well as debt in their portfolio can consider investing in the top performing schemes from the category such as Canara Robeco Balance, HDFC Balanced, HDFC Prudence and Reliance Regular Savings Fund – Balanced and hold for at least 2 years.

Prologue: Hybrid – Equity Oriented mutual fund schemes invest in equity and fixed-income components to seek better returns while minimizing risk. This hybrid diversification strategy provide investors an opportunity to combine both growth and income by investing in equity and debt. The debt portion in the fund performs the task of protecting the downside whereas the equity portion works towards attaining growth.

Benefit of hybrid investing strategy: In general, different asset classes tend to perform differently under the same market conditions. In normal conditions when bonds go up, equities tend to go down and vice versa. Long-term studies have shown a portfolio of a mix of asset classes can help deliver better returns in the long term. That's because the asset class that outperforms in a period can offset the poor returns of the underperforming asset class. In the years 2001, 2008 and 2011, the portion of debt compensated the return of the portfolio when the equity market posted negative returns (see the table below).

Mutual Fund Category Analysis contd…

The below table underline the benefit of investing in equity and debt together.

Achieving positive returns: The outperforming asset offsets the poor returns of the underperforming asset :

Year	Stock (Nifty)	Bonds (I Sec Sovereign Bond Index)	Simple Average Return (%)
2001	-16%	25%	5%
2002	3%	23%	13%
2003	72%	12%	42%
2004	11%	-1%	5%
2005	36%	6%	21%
2006	40%	6%	23%
2007	55%	7%	31%
2008	-52%	27%	-13%
2009	76%	-6%	35%
2010	18%	6%	12%
2011	-25%	5%	-10%

The schemes which allocate their assets to more than one asset classes are called as Hybrid schemes. They are further classified as sub categories according to the proportion of allocation to the each asset classes as Hybrid – Equity Oriented (atleast 65% in equity), Hybrid – Debt Oriented (15-30% in equities), Hybrid – Asset Allocation (predefined allocation between debt and equities). Hybrid – Multi Assets schemes allocate into three asset classes viz, equity, debt and gold.

Here, we have taken Hybrid – Equity Oriented category that comprises 27 schemes for our study. We have excluded children and derivative thematic schemes. This category allocates at least 65% of assets into equity and rest into debt. The allocation ratio may get changed and it is subject to various parameters like market circumstances, fund manager view etc. If fund manager sees an opportunity in equity market, the allocation could go as high as 90% into equities and vice versa.

The debt portion is invested in call, CBLO, money market instruments, short term and long term bonds and sovereign securities. The debt portion performs the task of protecting the downside and the equity portion works towards attaining growth. Thus the investor is able to invest in two asset classes simultaneously by purchasing one mutual fund scheme. This scheme is less risky than a pure equity oriented mutual funds but also generates lower returns in rising equity market conditions.

Mutual Fund Category Analysis contd…

Tax Benefit: The proportion of debt equity allocation is typically 65%:35%. The schemes from the category invest at least 65% in equity and the rest in debt for income tax purposes. The reason being, schemes having investment of above 65% in equity gets the tax treatment of an equity oriented mutual funds i.e. dividend income and long term capital gains are exempted from tax. (In case of debt funds, short term gains are taxed based on the income tax slab of the investor while long term gains are taxed at 10% without indexation or 20% with indexation whichever is lower. Dividend Distribution Tax on dividend income is also levied in debt funds).

Theoretical risk return grid of various categories of mutual funds:

The below matrix shows the risk associated with respective mutual fund categories. The category 'Hybrid Equity Oriented' is placed in fifth in terms of risk. The category is less risky than all other equity oriented categories like Equity sectors, diversified mid cap, diversified large cap and equity-index. Meanwhile, it normally produces more return than all debt and monthly income categories. This category is best suited for investors who expect reasonable return with lesser risk.

Mutual Fund Category Analysis contd…

Relative performance of the top performing schemes from Hybrid – Equity Oriented Category:

Scheme Name	Latest Corpus (Rs Crs)	Expense Ratio (%)	Allocation to Equity (%)	Trailing Return (%)					Standard Deviation	Sharpe	Alpha
				3 Month	6 Month	1 Year	3 Year	5 Year			
Canara Robeco Balance (G)	184	1.66	67.15	2.15	13.28	4.57	13.01		0.67	-0.01	0.01
HDFC Balanced Fund (G)	555	1.98	65.79	-0.74	14.15	1.97	17.11	12.38	0.79	-0.02	0.00
HDFC Prudence Fund - (G)	6249	1.79	74.80	-0.88	13.84	-0.76	16.17	11.26	0.87	-0.03	0.00
Reliance Regular Savings - Balanced (G)	635	2.19	74.81	2.58	16.56	2.08	11.46	12.95	0.86	-0.02	0.01
Category Average:											
Equity - Diversified	-	2.25	-	-1.71	13.43	-4.72	9.35	4.28	1.05	-0.03	0.00
Hybrid - Equity Oriented	-	2.24	71.71	-0.33	11.85	-0.55	9.10	5.94	0.83	-0.03	0.00
Benchmark:											
Sensex	-	-	-	-0.98	9.33	-7.07	5.32	3.31	-	-	-
Nifty	-	-	-	-1.32	10.97	-5.98	6.12	3.94	-	-	-
Crisil Balanced Fund Index	-	-	-	0.35	10.55	-0.75	6.85	6.19	-	-	-

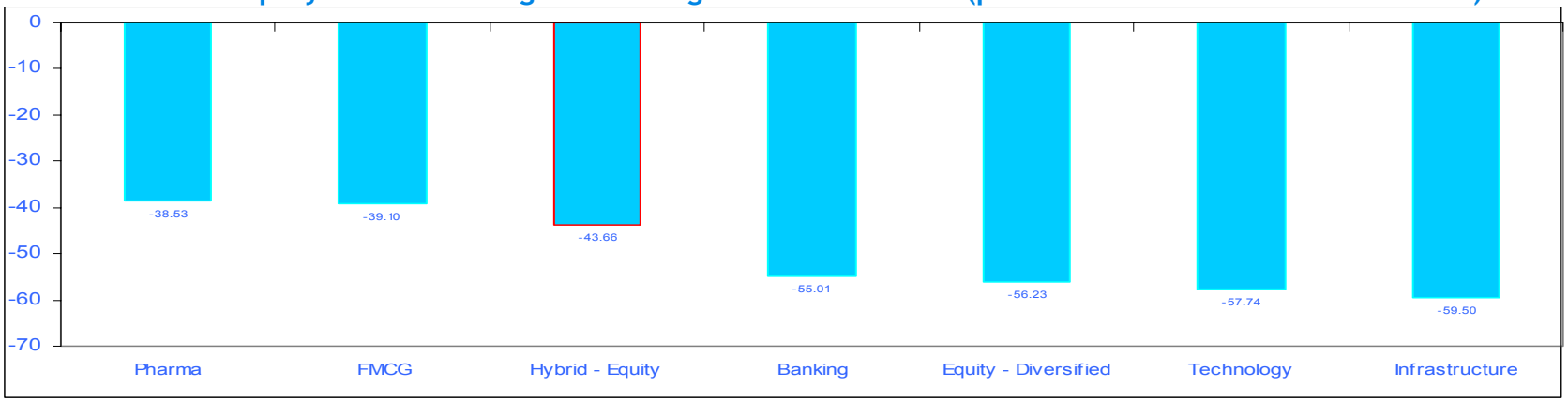
Note: Trailing Returns up to 1 year are absolute and over 1 year are CAGR. NAV/index values are as on July 04, 2012. Portfolio data as of March 2012.

Canara Robeco Balance, HDFC Balanced, HDFC Prudence and Reliance Regular Savings Fund – Balanced are the top performing schemes from the category.

Performance: The performance of the category for all set of periods has been notable. As far as trailing returns are concerned, the Hybrid – Equity Oriented category outperformed or managed to deliver returns in line with the returns of 'Equity – Diversified' and the respective benchmark of 'Crisil Balanced Fund Index' for short term as well as long term periods. The category generated -1%, +9% and 6% of CAGR returns respectively for the one, three and five year periods. Meanwhile, the Equity – Diversified category posted -5%, +9% and 6% of returns while the benchmark Crisil Balanced Fund Index registered -1%, +7% and 6% of returns. The performance of the category during various phases of equity market like bull, bear and volatile periods was also notable. During the period of market correction in 2008, the category withstood the downturn well compared to other equity oriented categories. The category plummeted an average of 43% while the equity diversified categories such as large cap and mid cap witnessed negative 54% and 63% of returns. It is noteworthy to say that the category generated 46% of CAGR return during the bullish period of 2007, better return than that of over all equity category of 34%.

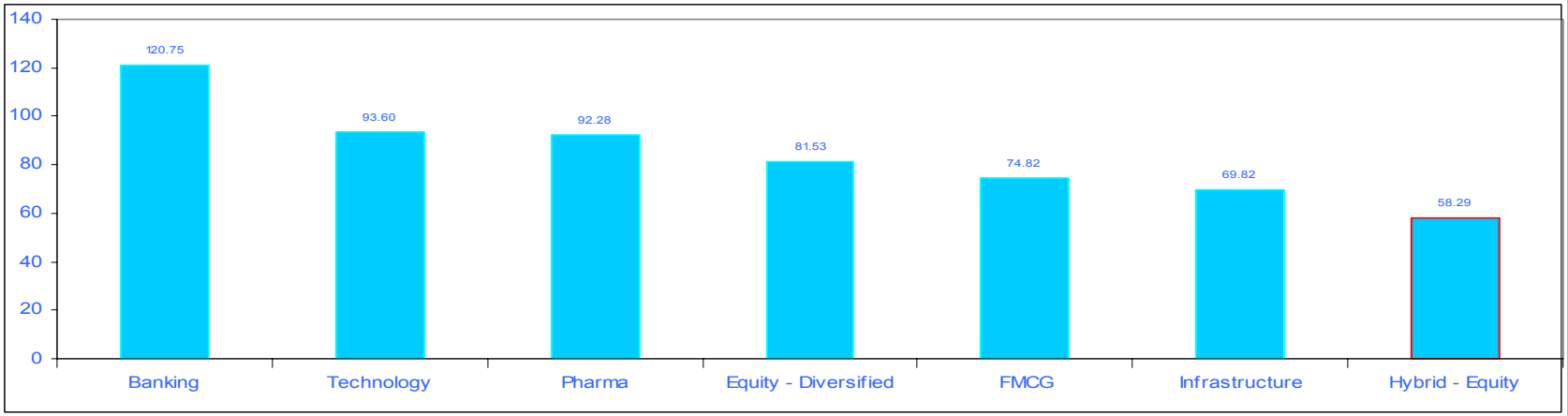
Mutual Fund Category Analysis contd…

Performance of Equity oriented categories during market downturn (period between Jan '08 To Mar '09):



The Hybrid – Equity Oriented category withstood the downturn better compared to other equity oriented schemes with a huge margin.

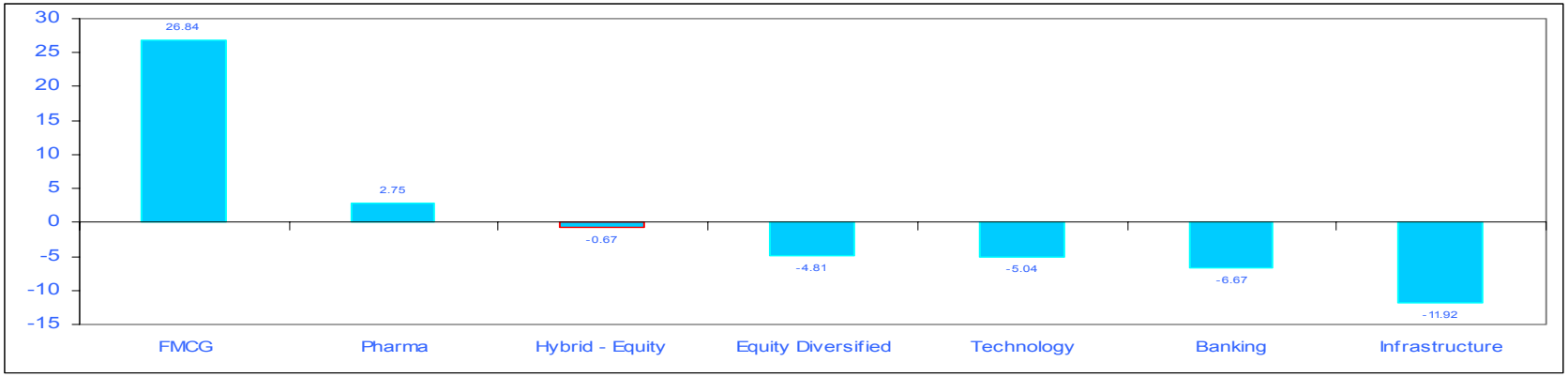
Performance of Equity oriented categories during market rally (period between Mar '09 To Nov '10):



However, the Hybrid – Equity Oriented category generally registers moderate returns and underperforms other equity oriented categories during market rallies given their considerable allocation to debt components.

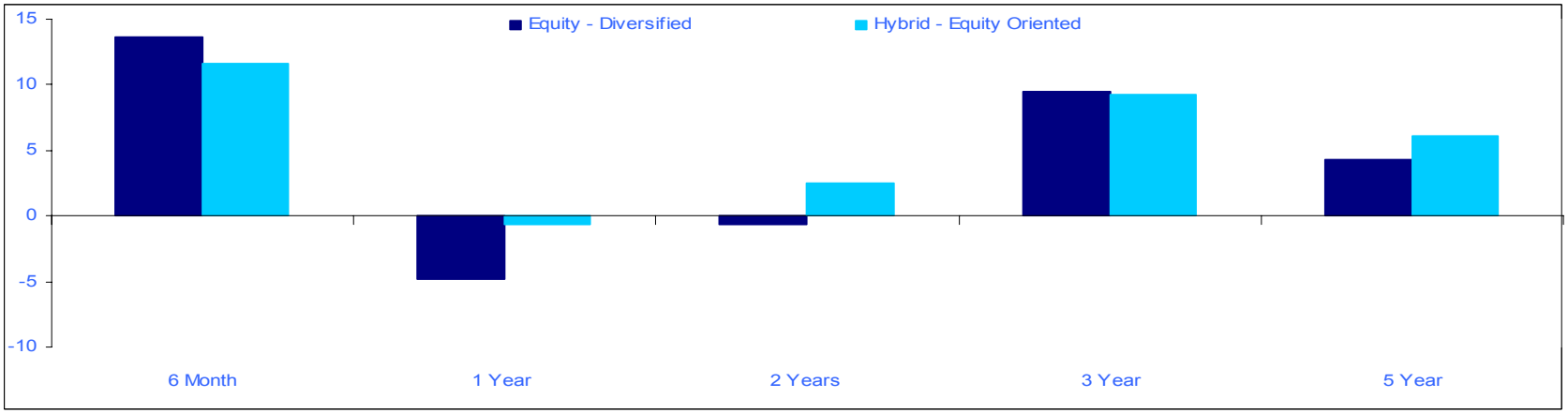
Mutual Fund Category Analysis contd…

Performance of Equity oriented categories during high volatility (period between Nov '10 To July '12):



The diagram shown above is based on one year rolling return that is calculated on daily basis for the above mentioned period. The diagram shows that the performance of the category during volatile period also notable.

Performance of Equity oriented categories in various time frames:



The above diagram (based on rolling return) portrays the outperformance by the Hybrid – Equity Oriented category over long run (barring six months and three year period).

Mutual Fund Category Analysis contd…

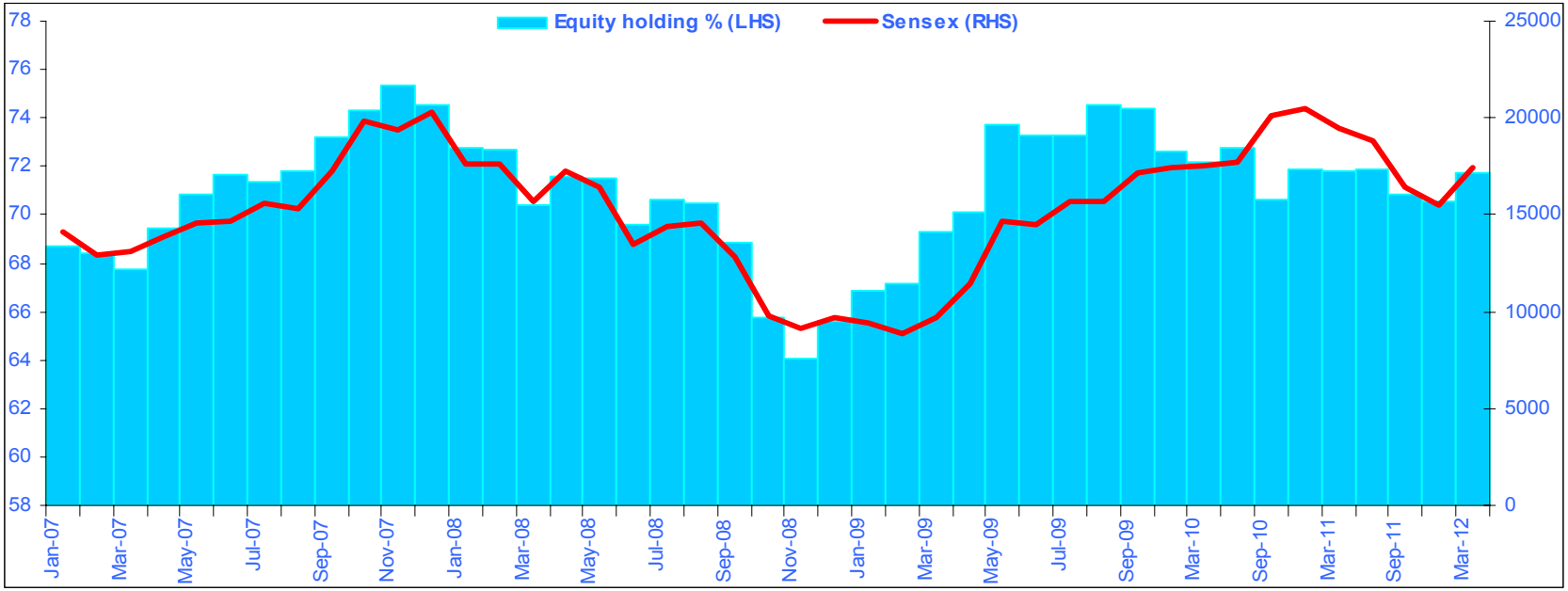
Portfolio:

The last one year portfolio of the category saw allocating their assets into equities to the extent of an average of 70% of the total net assets. The latest portfolio of the schemes as of March 2012 witnessed increased allocation into equity to an average of 71.71%. UTI CCP Advantage Fund is a scheme which held maximum assets into equity among the category to 91% while Sundaram Balanced kept 62% , a least proportion among the category.

Most of the schemes from the category follow multi-cap strategy, investing into equities across sectors and capitalization. The latest portfolio of the category showed decreased allocation into large cap equities to 60% as of March 2012 from 69% in the previous month of December 2011.

SBI, Infosys and ICICI Bank are the most preferred stocks in which the category held Rs. 445 crore, Rs. 413 crore and Rs. 312 crore respectively.

% of assets held in equities by Hybrid - Equity Oriented schemes over periods:

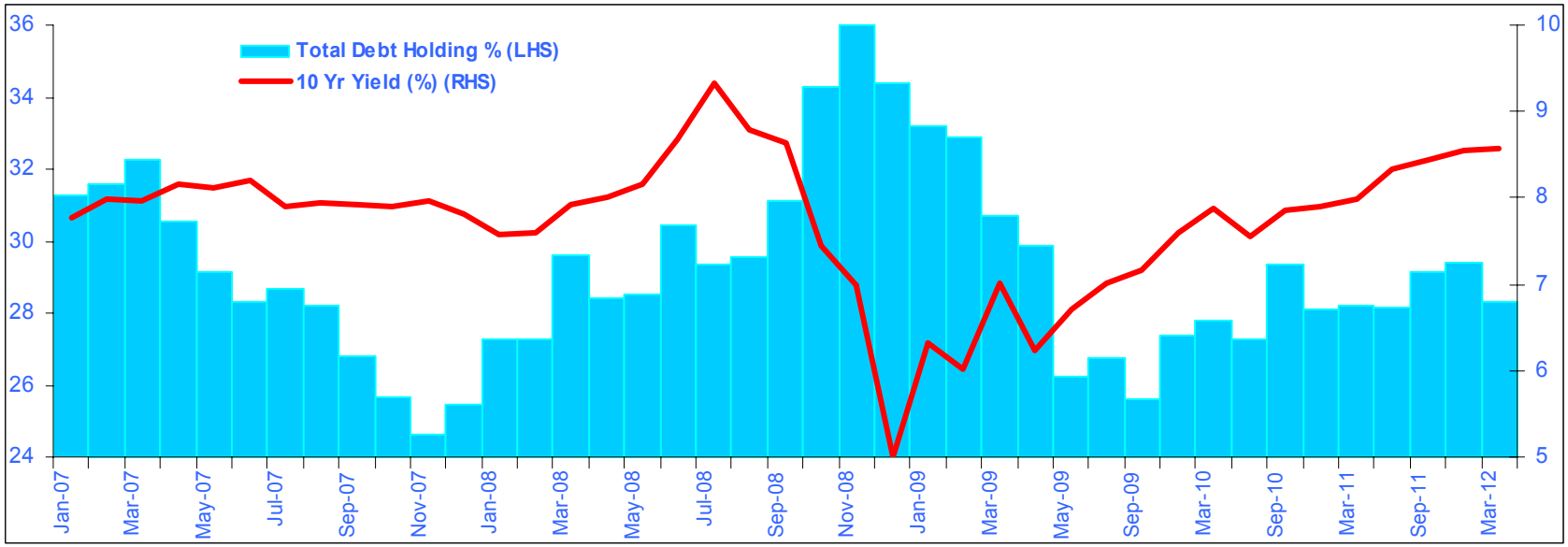


Mutual Fund Category Analysis contd…

As far as debt portion is concerned, the average maturity of the schemes ranges from 0.30 year to 3.30 years (as per the available data for schemes that provide these). The average debt holding of the category as per the latest data (March 2012) was at 28.64%. Most of the schemes prefer to invest in the medium term debt instruments having maturity periods of 3 year to 5 years. There has been a reduction in the allocation to Certificate of Deposits witnessed while looking at last one year portfolio of the category. The latest portfolios of the schemes saw an investment of Rs. 296 crore in CDs which was lower than the allocation of Rs. 569 crore in the month of June 2011. Apart from CDs, major reduction was witnessed in Commercial Papers and T Bills. This allocation trend reveals the respective fund managers' intention on expectation of further cuts in the policy rates.

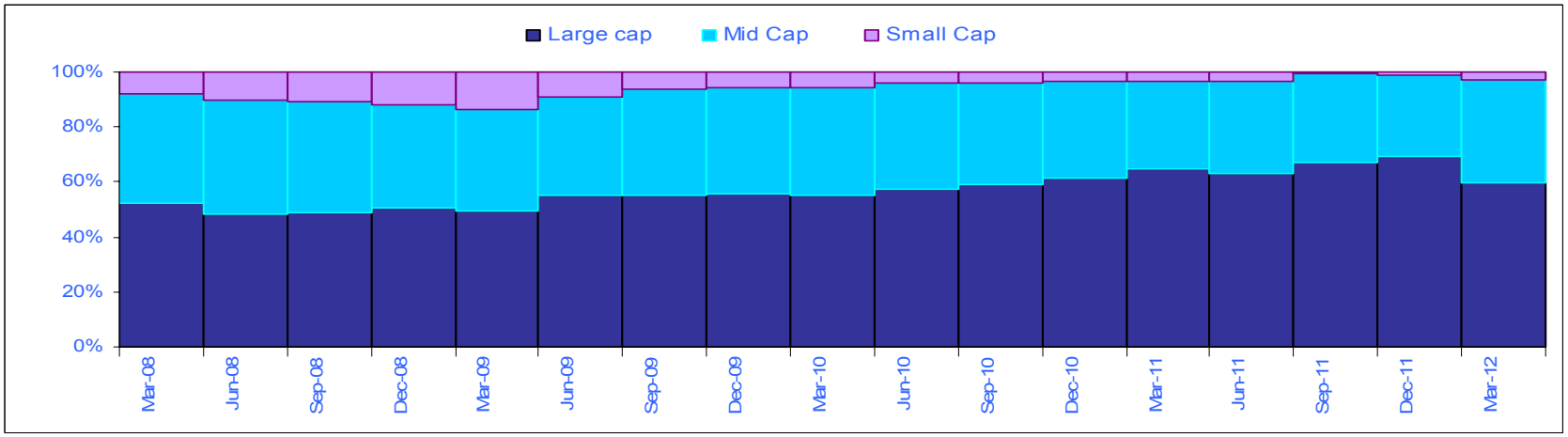
The average turnover of the category as per the latest data was at 85%. DSP BR Balanced is the one which churned the assets most in the last six months period (213% of turnover ratio) while the UTI balanced is the least in terms of rebalancing the portfolio which turnover ratio was only 5%.

Allocation to debt components by Hybrid - Equity Oriented schemes over periods:



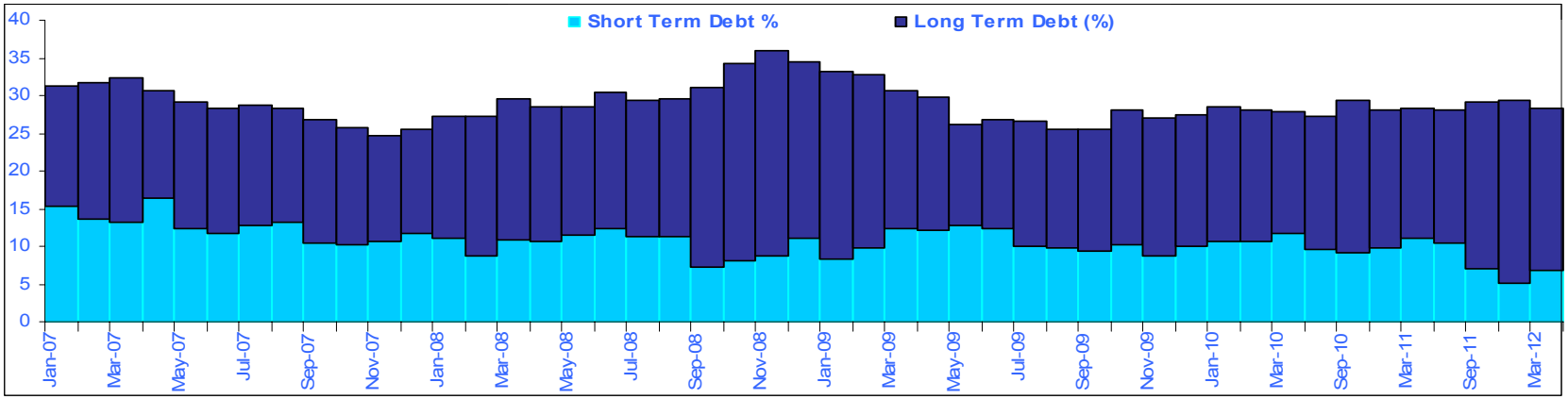
Mutual Fund Category Analysis contd…

Break up of market capitalization on equity portion in Hybrid - Equity Oriented schemes over periods:



Decrease in allocation into large cap stocks witnessed in the latest portfolio as the fund managers bet on mid and small cap stocks.

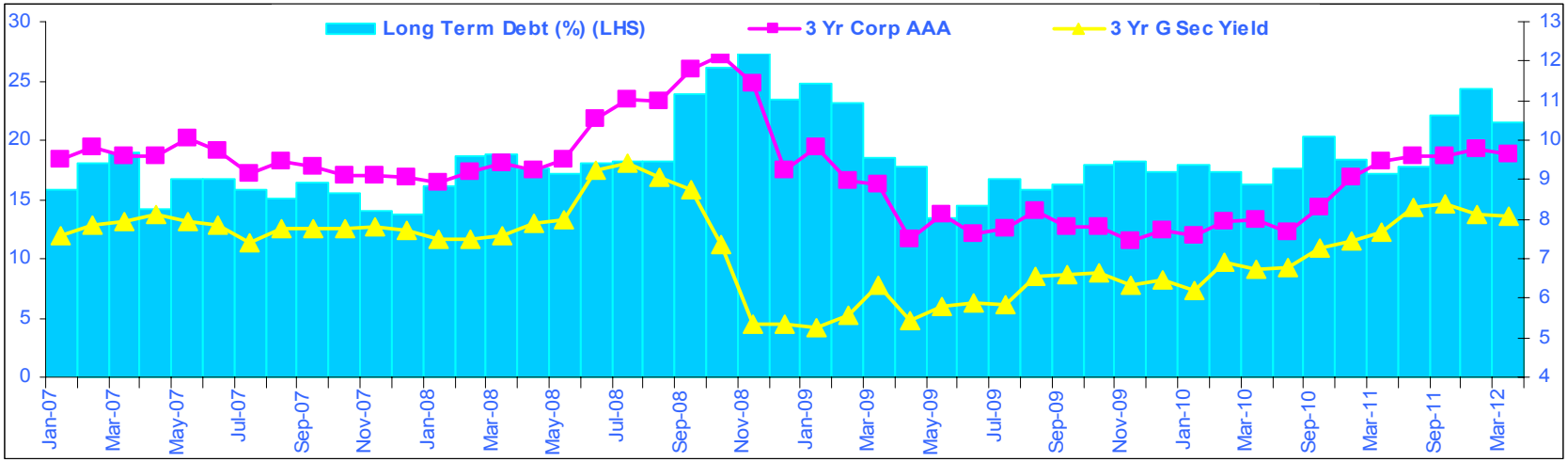
Bifurcation of debt investments by Hybrid - Equity Oriented schemes over periods :



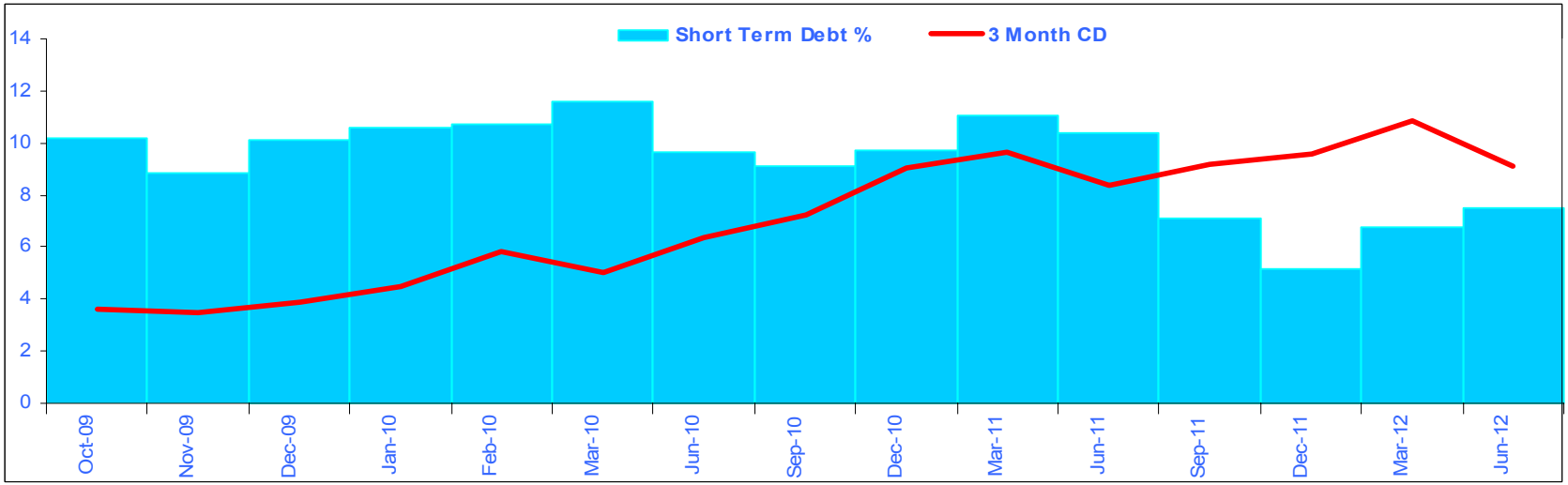
Increased allocation trend in long term debt instruments depicts the expectation of moderation in the policy rates.

Mutual Fund Category Analysis contd…

Investment trend in long term debt instruments by Hybrid - Equity Oriented schemes over periods:



Investment trend in Short term debt instruments by Hybrid - Equity Oriented schemes over periods:



HDFC securities

Mutual Fund Category Analysis contd…

Basic details: The Hybrid – Equity Oriented category is less risky as compared to equity diversified schemes and other equity oriented schemes. As per the standard deviation which was calculated for last one year period for the category at 0.86% while for the equity diversified was at 1.05%. The AUM of the category stood as on 31 March 2011 at Rs. 11,927 crore. Average expense ratio as per latest data was at 2.23%. Exit load is charged by the schemes as 1% if the units are redeemed before one year of allotment.

Analyst: Dhuraivel Gunasekaran.

(Database sources: AMC Sites, NAVIndia and Ace MF)

HDFC Securities Limited, I Think Techno Campus, Bulding –B, "Alpha", Office Floor 8, Near Kanjurmarg Station,
Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone (022) 30753400 Fax: (022) 30753435

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