‘I do not see the need to reduce expense ratio in debt funds’

Kumaresh Ramakrishanan, Head - Fixed Income, DHFL Pramerica Mutual Fund feels that the expense ratio in debt funds is competitive and fixed income products will generate good returns in the next financial year.

Banali Banerjee Sep 2, 2016

Can you take us through your investment philosophy?

We manage around Rs. 24,000 crore in debt funds across a range of products.

The guiding principle for us is sticking to the mandate. We have always focussed on generating risk-adjusted returns.

In credit funds, the focus has been on accruals, which means we are looking at investing in securities of issuers which are able to give you a reasonably higher level of returns. We follow a bottom-up approach where we look at issuers in particular sectors which we are comfortable with.

What is your outlook for fixed income market for the next two years?

For the first six months of this calendar year, the returns have been slightly mixed in the fixed income market. February was at the lowest point where yields were at the higher side for all asset classes. But subsequently, starting from March onwards to this financial year, the markets have performed well.

Liquidity has been a big game changer since RBI has now eased the liquidity situation. Due to this, we have seen almost a secular rally on yields. Secondly, the government expenditure has gained momentum in this fiscal year which has also released enough liquidity.

The combination of these factors has led fixed income markets to do well. So going forward, I think the markets will be stable and do well over the next few years.

Where do you see the direction of yield curve in the near to mid-term? What will be the key driving force for yields?

We have had an 80 basis point rally in the last five to six months, so I think the yield will move lower from here. Inflation is the key driving force to help yield move on the lower side. Recently, inflation has not been supportive but in our view it is temporary. We think inflation will cool off due to good monsoon. Our expectation is that inflation should move down to 5% by March 2017. Beyond this number, we would like to see how things pan out in FY18 as RBI targets to bring down inflation to 4%.

What are the key risks for debt market at this juncture?

From a fund manager's perspective, the biggest risk springs up when everything is going in our favour. So we have to be prepared for the negative.

Our government has introduced strong reforms and the parliament has also passed the GST bill. So most of the things are under control now. We have to keep a watch on commodities as crude has been on the softer side for a long time. At this juncture, I don't see any risk for the debt market in India from domestic factors. However, global factors like Fed rate hikes and various geopolitical factors can pose a risk.

With the new RBI governor coming in, what do you expect from the central bank? Do you anticipate rate cuts this financial year?

Urjit Patel was already a part of the existing team with Dr. Rajan. In fact, he was also heading the monetary policy committee and was in charge of key reforms initiated by RBI. So I do not think that there will be much strategic changes. The new governor will push for continuity without trying to alter things too much.

I am not expecting rate cuts in the near term. We might see a rate cut at the end of current fiscal year or may be by the first quarter of next calendar year.

SEBI wants fund houses to reduce expense ratio. Is there any scope of reducing expense ratio in debt funds?

I think the expense ratio in debt funds is very competitive. The TERs have been very reasonable in all fixed income products and I do not see any scope to reduce it.

SEBI has released a report on strengthening corporate bonds market and urged FPIs to invest in corporate bonds. What is your opinion on this?

SEBI and RBI have taken various positive steps to strengthen the corporate bond market over the last three years. But it will take time before it can be fully operational. FPIs understand the corporate bond market really well. So allowing them to invest in corporate bonds directly is a good step. But the only thing to be borne in mind is that corporate bonds are not very liquid and FPIs normally prefer to invest in bonds which have higher liquidity.

Currently, there is hardly any action in AA and below rated debt securities. This may be posing challenge for fund managers to generate alpha. Keeping this mind, how difficult is to generate double digit returns in debt funds?

Schemes which invest in AA securities have been growing. Most fund houses today have corporate bond funds. While liquidity of these bonds is not as good as G-secs or AAA rated funds, it is far better as compared to three years back.

But for lower rated securities, the activity level has been low because every fund house has a mandate for credit securities. In our case, we cannot buy papers below ‘A’ rated securities. So participation in paper rated below A will remain low because investor acceptance of such portfolios is low.

Which category of debt funds would you recommend to investors at this juncture?

It may sound clichéd but investors should follow asset allocation. Investors having the risk appetite to earn higher returns can invest in accrual funds. If they are looking for liquidity, they can invest in duration funds. But I would recommend investors to consider short term funds for a period of three to five years since the yields are relatively attractive in this segment. Also, as rates move lower, investors will generate good returns in these products.