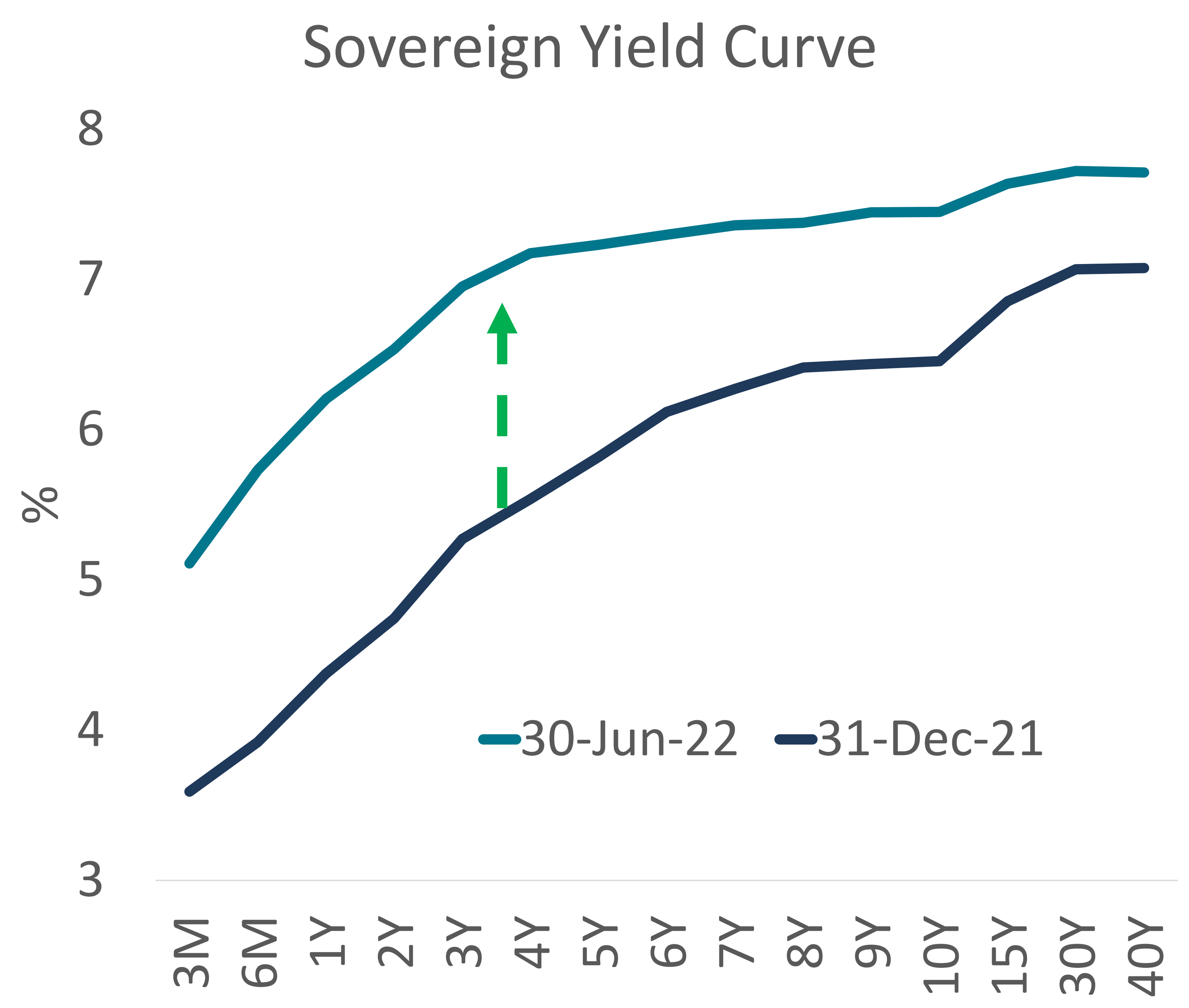
DSP MUTUAL FUND

# NAVIGATING FIXED INCOME VOLATILITY

## What has happened so far?

- Marcus Tullius Cicero, a famous philosopher had once said that 'Prudence in action avails more than wisdom in conception'. Fixed income investors today are struggling to find the fine balance between the wisdom and action.

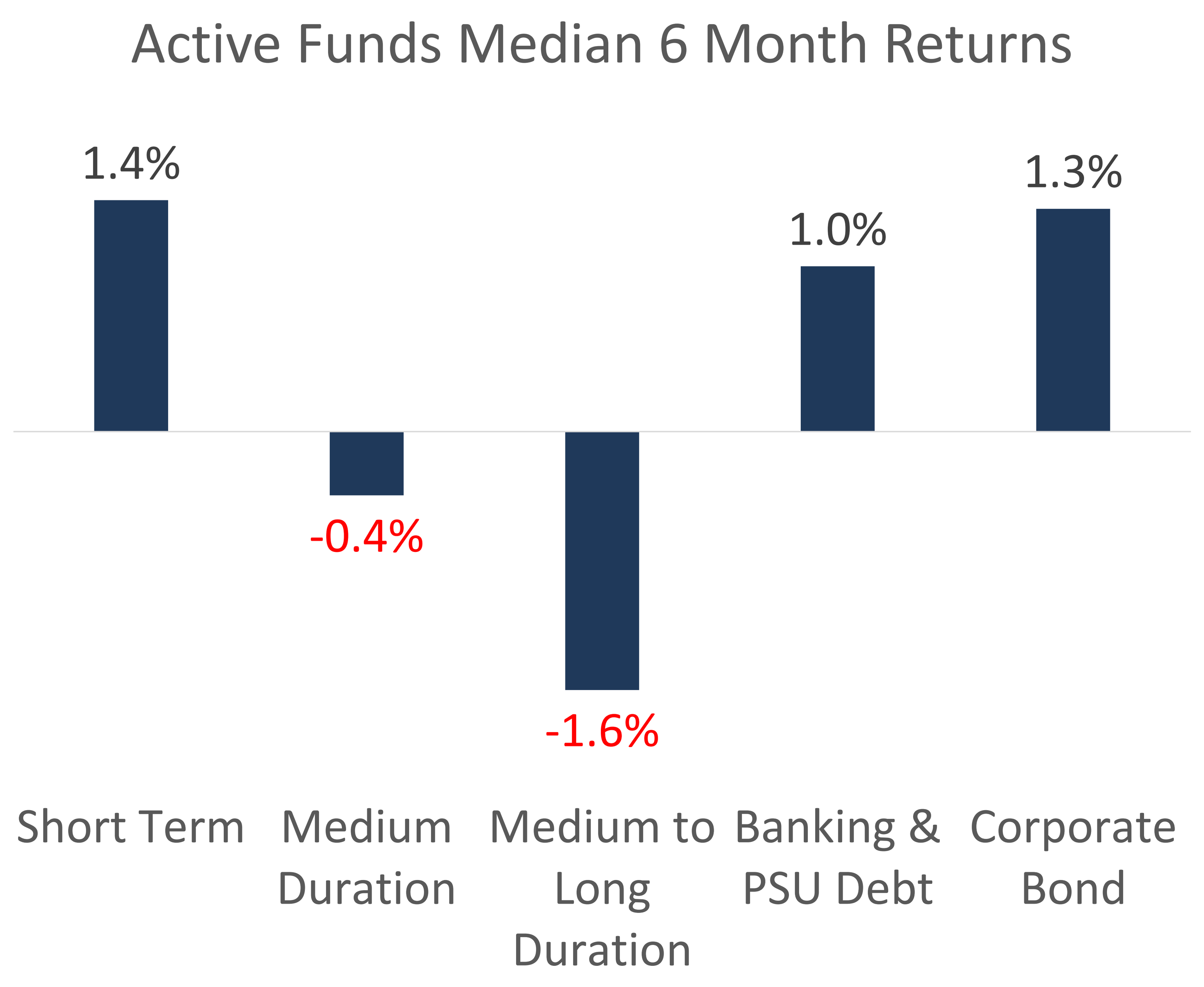
- Last 6 months has been very volatile with interest rate rising across tenure owing to
  - Higher inflation
  - Increase in repo rates.

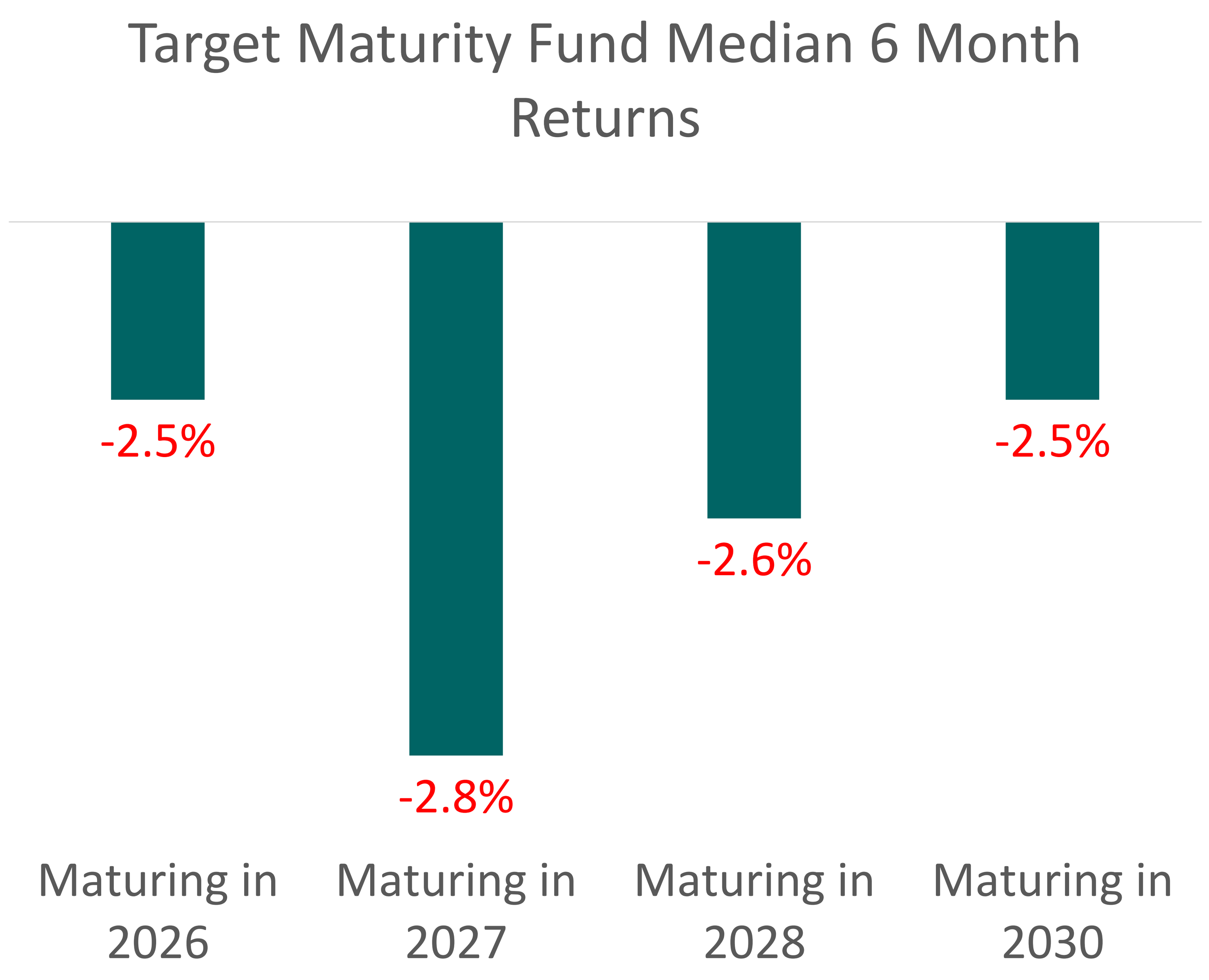



Source – Bloomberg; Data as on 30 Jun 2022

- Interest rates movement bring mark to market impact. While investors enjoy it when rates are going down, it can be painful when rates are going up, especially with frequent reporting and monitoring of investments.

- In the last 6 months, most of the active debt funds in duration categories have given very low to negative returns. Similarly, higher duration target maturity funds have also been negative.




Source – MFIE; Data as on 30 Jun 2022; Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. There is no assurance of any returns/capital protection/capital guarantee to the investors in the Scheme.

# What generally happens during rising rate?

- Typical behaviour of investors during rising rate environment is to stay put at the short end of the yield curve and wait to raise duration when yields rise.

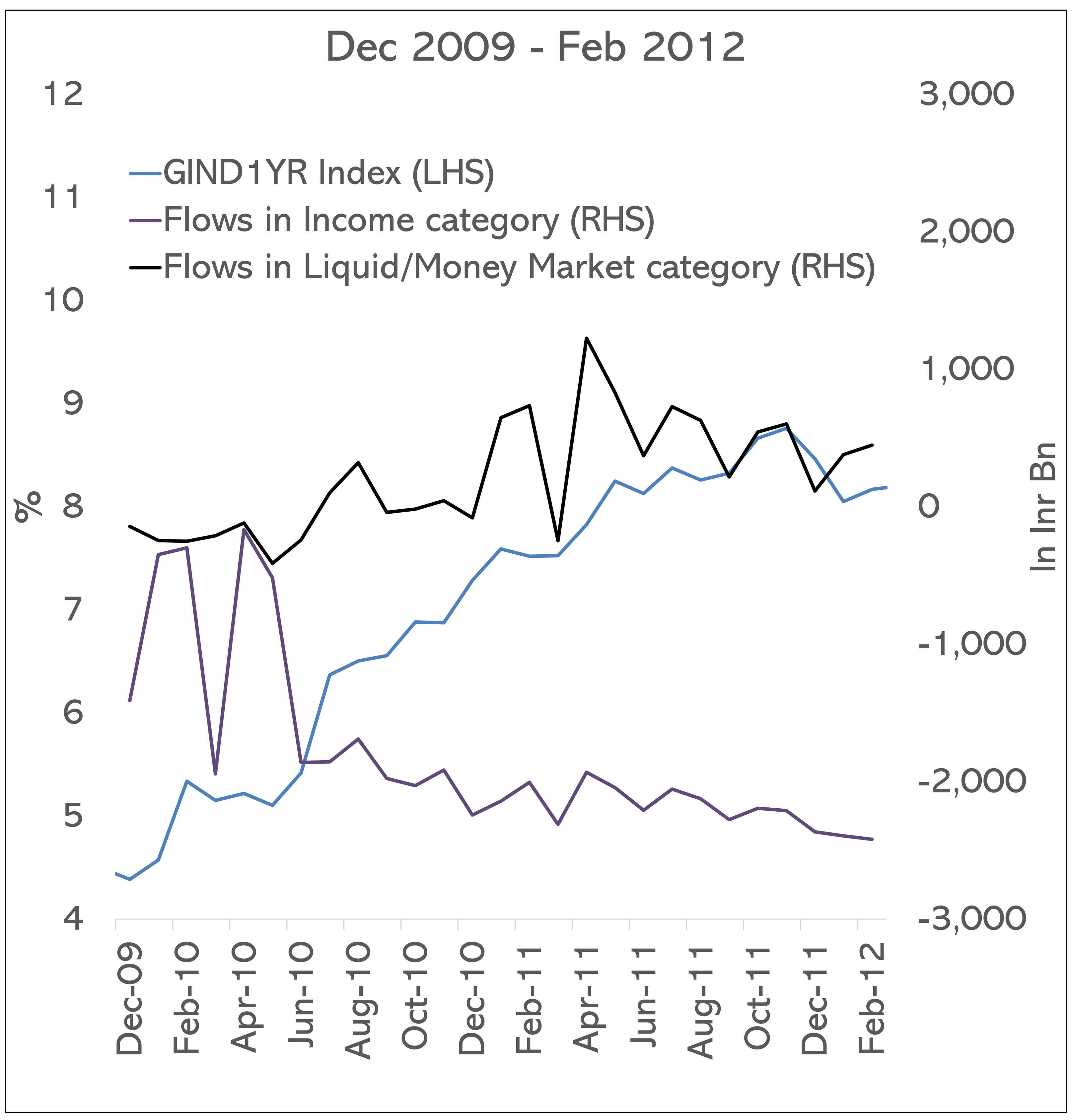
- Historically, whenever rates went up, money has moved to liquid/money market category while moved out from duration.

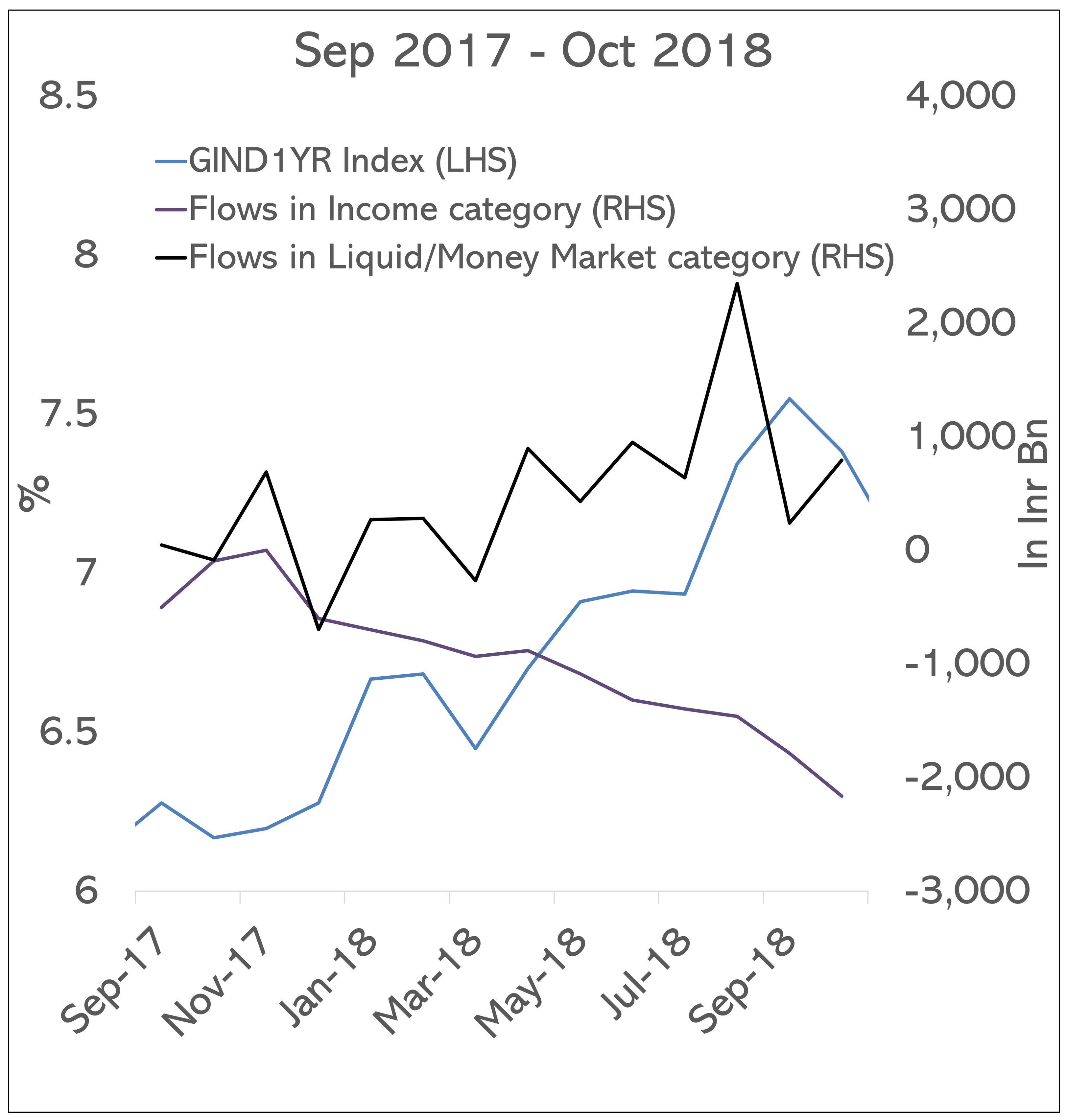
**Flows from Dec 2009 - Feb 2012**

| Income | Liquid/Money Market |
|---|---|
| -2,41,877 crs | 44,883 crs |

**Flows from Sep 2017 – Oct 2018**

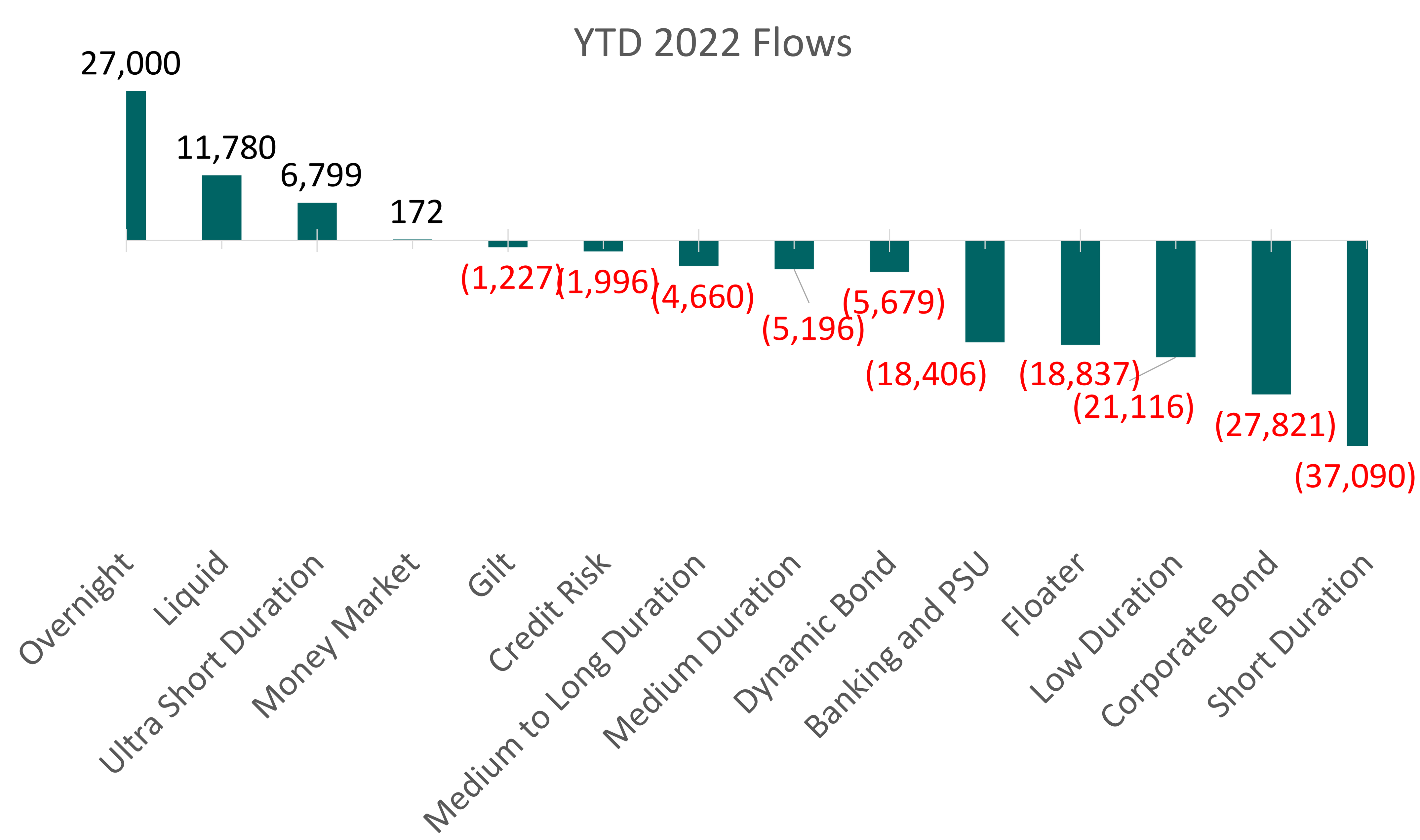
| Income | Liquid/Money Market |
|---|---|
| -2,16,333 | 79,350 |




Source – AMFI

- Same behaviour has been seen in the last 6 months where investors have withdrawn significant money from duration funds and significant inflows have been witnessed in money market/Liquid funds




Source – AMFI; Data as on 31 May 2022

## What can be the drawback of this investor behaviour?

- The strategy of "*parking money in Liquid/Money market during rising rate & investing in duration category when rates peak out*" is very rational as it helps to minimise mark to market loss and earn higher accrual by investing at higher duration at higher rates. *However, there are 2 drawbacks*

    - **TIMING -** Investor may not be able to perfectly time interest rates movement. Further, waiting for too long by parking money in Liquid/Money market fund can lead to opportunity loss if yield curve is steep
    - **TAX** – Redeeming money from Liquid/Money market segment can attract taxes at maximum marginal rates (~42.7%) considering highest slab. This can also reduce 1 year of indexation benefit if holding period is beyond financial year

- Another interesting observation is that every time, we have seen outflows from short to medium duration, the future returns have been impressive for the category. This happens due to the investor behaviour of getting out when pain from the category is highest.

- During the similar time frames, this is how the returns look if an investor held on to his Short-Term Category Investments vs Parking in Liquid and Shifting after one year. These are gross returns and do not account for short term capital gain taxation impact on the shift of investments from Liquid category. Thus, the net tax return shall be further sub optimal in the below mentioned periods.

| | Invest in Short term category from June 2009 till Jun 2012 | Invest in Liquid fund from Jun 2009 till Jun 2010 and then invest in Short term category from Jun 2010 till Jun 2012 |
|---|---|---|
| Returns | 6.90% | 6.60% |
| | Invest in Short term category from CY 2017 till CY 2019 | Invest in Liquid fund for CY 2017 and then invest in short term category for CY 2018 & 2019 |
| Returns | 5.70% | 5.60% |

*Source – MFIE; Category average returns considered for Liquid & Short term funds for regular plan; Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. There is no assurance of any returns/capital protection/capital guarantee to the investors in the Scheme.*

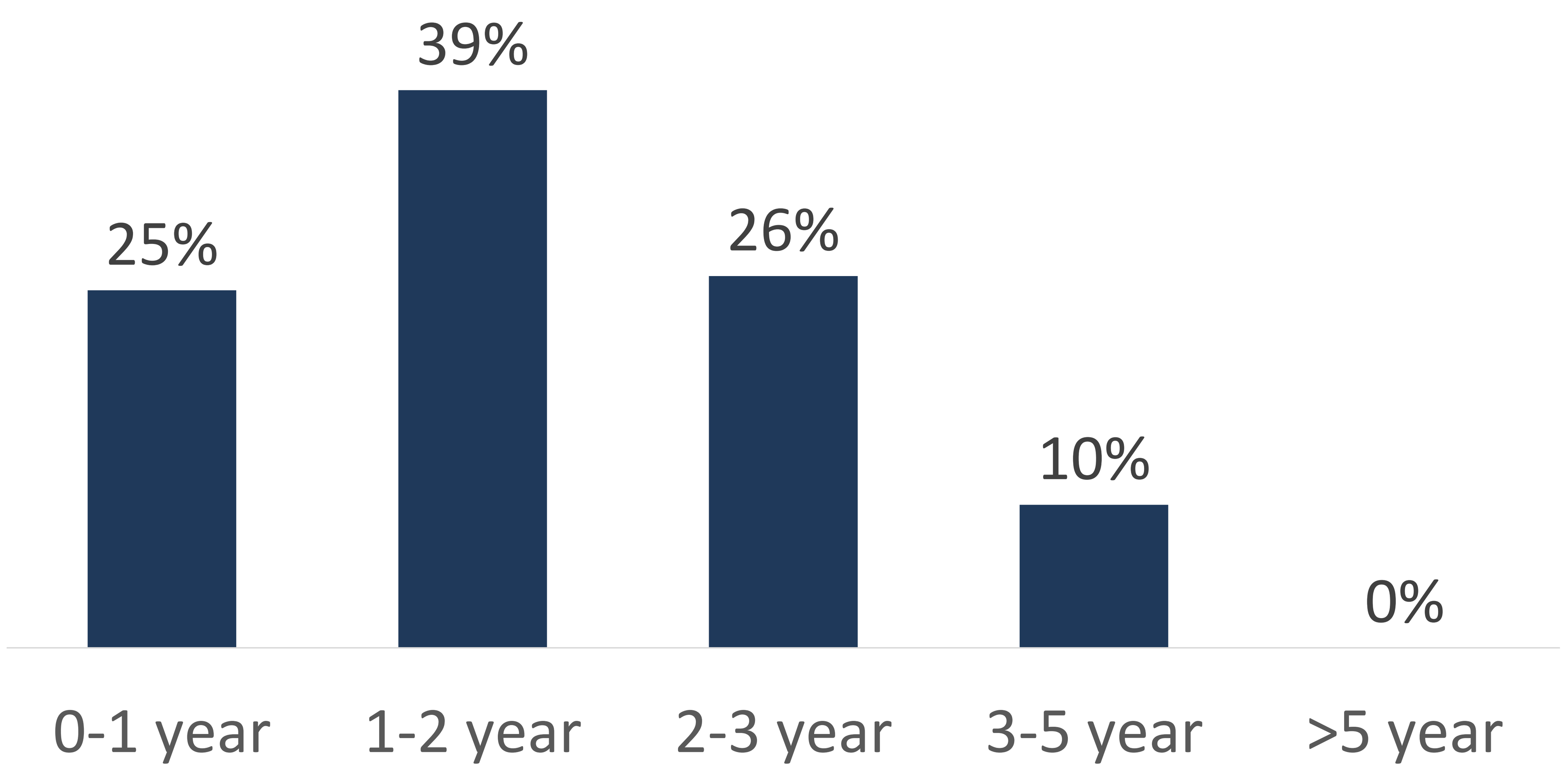
## How does DSP Short term fund help in addressing it?

- DSP Short term fund maintains high credit quality, avoids extreme duration risk. It has ability to shift duration between 1y to 3y as the rate rise or fall.

- Fund has around 90% allocation to 0-3 years bucket uniformly distributed

- When the rates are at elevated level, the fund can increase allocation to 3-5 years bucket by reallocating shorter tenure holdings (0-3 years)

**Maturity wise bucketing**




Source – Internal; Data as on 25 Jul 2022

- *All the above can be done without any tax implication in the hands of investor*

- Also, past data shows that just staying put in a DSP Short Term Fund has merit over "Combining liquid/ money market now and short term category later".

A quick reckoner about funds portfolio allocation strategy:

- More allocation to corporate bonds if the spreads with G-sec are wide
- Periodical allocation to Government securities & SDLs during low credit spreads as well as to improve credit quality of the portfolio
- Allocation to NBFCs when NBFC spreads (over AAA corporate) are attractive
- Respect duration boundaries by not exposing investor to securities with 5 yr+ maturity unless its tactical short-term bet
- Maintains credit and duration discipline.

***DSP short term fund is positioned to navigate rate cycles and be a potential fund for your long investment needs.***

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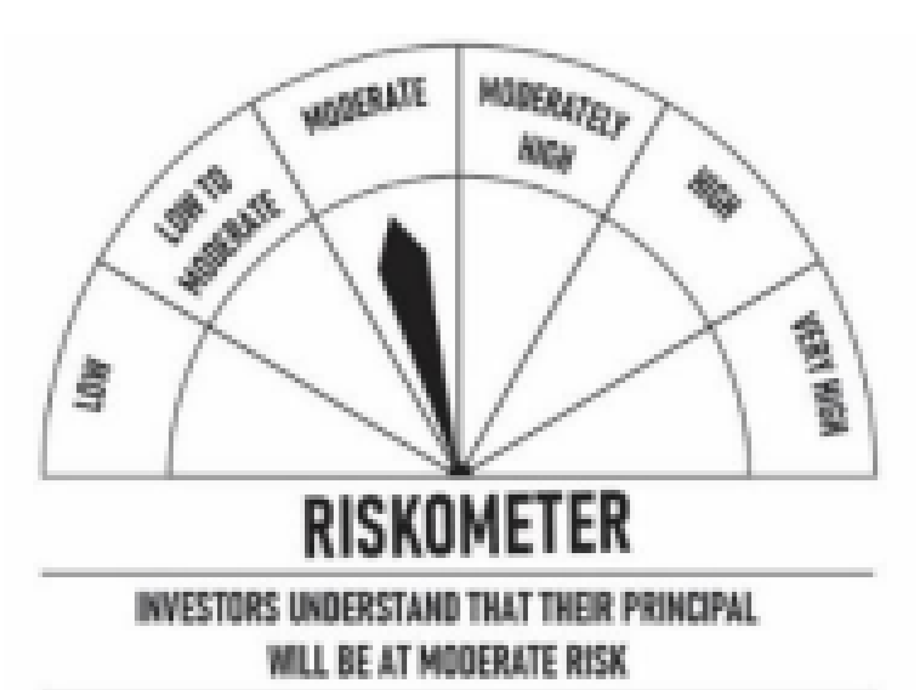
For complete details on investment objective, investment strategy, asset allocation, scheme specific risk factors and more details, please read the Scheme Information Document, Statement of Additional Information and Key Information Memorandum of respective scheme available on ISC of AMC and also available on www.dspim.com

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

| Fund | Product Suitability | Riskometer (DSP Short Term Fund) | Riskometer (CRISIL Short Duration Fund AII Index ) |
|---|---|---|---|
| **DSP Short Term Fund**<br>*(An open ended short term debt scheme investing in debt and money market securities such that the Macaulay duration of the portfolio is between 1 year and 3 years (please refer page no. 19 under the section 'Where will the Scheme invest?' for details on Macaulay's Duration). A moderate interest rate risk and relatively low credit risk.)* | This product is suitable for investors who are seeking*<br>•Income over a medium-term investment horizon<br>• Investment in money market and debt securities<br>* Investors should consult their financial advisers if in doubt about whether the Scheme is suitable for them. |  |  |

**Potential Risk Class Matrix:** The potential risk class matrix of DSP Short Term Fund based on interest rate risk and credit risk is as follows:

| Potential Risk Class | | | |
|---|---|---|---|
| **Credit Risk →**<br>**Interest Rate Risk ↓** | **Relatively Low (Class A)** | **Moderate (Class B)** | **Relatively High (Class C)** |
| **Relatively Low (Class I)** | - | - | - |
| **Moderate (Class II)** | **A-II** | - | - |
| **Relatively High (Class III)** | - | - | - |