Frequently Asked Questions/ Objection Handling

Equity markets (S&P BSE Sensex) have fallen by almost 37% from the beginning of the year (till March 23, 2020) amidst concerns of pandemic. We know that markets are prone to ups and downs but the quantum of decline is an unforeseen situation for some of us and therefore a cause for concern. Below are few commonly asked questions from investors to help you in engaging with your clients and addressing their concerns effectively

1. Markets are underperforming and there is a lot of volatility in the markets. Is it a good time to invest now?

The BSE Sensex has fallen by almost 37% from the beginning of the year till 23rd March 2020 owing to the spread of coronavirus across the world that triggered fears of a recession. However, after the Prime Minister announced the 21-day lock-down on 24th March evening, the markets recovered by almost 10%, reducing the YTD fall in Sensex to 27%. This basically shows the volatility and uncertainty prevailing in the markets currently.

The sharp corrections in the market and the selling pressure due to the Corona virus will continue for some more time. But this is not the first time. During previous pandemics too, markets fell sharply only to emerge stronger than before

Few data points to understand how the markets have reacted to such events in the past:

- Similar to Corona virus, outbreak of SARS had its impact on global as well as Indian stock markets. But one year from then, it generated an absolute return of 77%. This means if you would have invested Rs 1 lakh in the index early in Jan 2003, within a year the same investment would have grown to Rs. 1,77,000
- Markets reacted in a similar way to Ebola, Zika, and Avin i.e. correcting sharply and then bouncing back aggressively

The past events show that the markets have always bounced back more aggressively after a crisis and hence this is good opportunity for an investor to allocate funds in the equity market if they have money to invest with an investment horizon of at least 3 years. The stock valuations are at an all-time low and hence investors will be able to accumulate more number of units at the same investment value.

- The market meltdown has seen 84% stocks go below their five-year and 78% below their 10-year average valuations.
- Market cap-to-GDP ratio – (a ratio used to determine whether an overall market is undervalued or overvalued compared to a historical average. A value between 50 and 75 per cent indicates the market to be modestly undervalued) – has slipped from 79 per cent in FY19 to 58 per cent (FY20E GDP) – much below long-term average of 75 percent and closer to levels last seen during FY09, which clearly states that the market is undervalued.

Hence this is a good time to add more to your existing investments if your asset allocation allows it. What it means is that if you are under-invested in equities or the value of your Equity Portfolio has come down drastically, you can use this time to bring the mix to the level you want to maintain as per the desired levels.

Time in the market is more important than timing the market!

2. Should I discontinue my SIPs?

The market fall is a result of the lockdown globally to contain the fast spreading coronavirus and its likely slowdown of economies globally. The market fall is in line with the global benchmark indices as the domestic market usually tracks the major global indices and is likely to remain volatile in the near future.

However, discontinuing your SIPs now will derail your financial goal and here's why:

- SIP investment works best in market volatility. This is because intermittent market volatility helps average out the cost of your investment thereby enhancing your portfolio performance. Through a SIP you are automatically buying less when the markets are high and more when the markets are low. For instance, of a monthly SIP of 10,000 rupees invested on $20^{th}$of each month, you would have purchased units of Sensex Index as follows:

Date	Sensex Index Close	Units purchased
20-Jan-2020	41528.91	0.24
20-Feb-2020	41170.12	0.24
20-Mar-2020	29915.96	0.33

Source: www.bseindia.com

As you can see, your SIP of 20^{th} March, 2020 helped you buy more units than it did in the previous 2 months of January and February due to market fall

Few of us would not have made a purchased equity mutual funds in the month of March due to fear of losses.

- A SIP helps us overcome these behavioral biases and invest in a disciplined manner. Over the long term, you will benefit from the additional units purchased during market fall which will improve your overall return. The SIP investments are aimed to achieve your long term investment goals. If you discontinue your SIP, you are disrupting your investment plan much more than the market volatility.
- If you stop your SIPs, you will end up having less and therefore risk not meeting your financial goal. This is because, it is very likely that we may not make up for these lost SIP installments in future or end up spending this money elsewhere
- If you stop your SIP now or worse redeem your investment, you will lose out majorly from the market recovery.
- Equity markets across large, mid and small caps have corrected significantly from their peak levels and previous concerns of over-pricing are no longer valid. In fact, most technical indicators are hinting at markets being in the oversold territory which make attractive from valuation perspective. Hence this is a good time to take more equity exposure, as you will be able to accumulate more at the same investment value

3. There are negative returns in debt mutual funds as well, what is the reason for this?

Negative returns in equity mutual fund over the short term is usually expected, however debt mutual funds (especially funds in shorter duration categories) are not expected to generate negative returns usually.

We saw a couple of credit defaults recently like IL&FS, DHFL (Dewan Housing Finance Limited), Indiabulls Finance, Future Group, etc. and this was largely related to the credit risk associated with these papers. Underperformance was also restricted to debt mutual funds that took exposure to these corporate papers (mostly Credit Risk category).

However, more recently, we are seeing negative returns across categories of debt mutual funds. There has been a spike in short term and corporate bond yields from March 2 to March 23, 2020 and 10yr G-sec yield also increased by around 32bps during the same period. The increase in the yields signifies a fall in the price of the bond which in turn would mean less/negative returns for the investors of debt mutual funds. The increase in the yields can be attributed to the outflows of corporate money and the preference towards liquidity in the current market scenario.

We expect strong regulatory intervention and some fiscal stimulus from the government to help contain this flight to safety.

SEBI has come up with recent measures for mutual funds, postponing the MTM (marked to market) recognition for less than 30 day assets among other.

Also March 27, 2020, the RBI cut repo rate by 75bps, CRR by 100 bps and reverse repo by 90bps. In next few months RBI may cut additional repo rate and keep the liquidity in surplus through OMO operation and additional LTRO which could help to bring down the current yields.

In the current market scenario, investors must stick to high quality debt instruments, where the yields seem more attractive. Investors with an investment horizon of 2-3 years can invest in short duration and corporate bond category of debt mutual funds. Please refer to our Funds We Like Section under these categories.

4. Does Arbitrage Funds as a category still make sense?

Arbitrage schemes usually generate better returns in a volatile market but currently because of the selling pressure in the equity market, there has been a sharp contraction of spread in the arbitrage space.

The spread between the cash and the futures market has reduced considerably resulting in poor returns in arbitrage mutual funds. The current downward movement of the market has affected the arbitrage yields negatively.

Considering the above factors, most of the schemes may reduce the percentage of arbitrage allocation in their schemes to mitigate risk of the falling yields (arbitrage schemes can invest a part of their investments in debt instruments while maintaining the limit for equity taxation).

Investors with an investment horizon of less than a year must avoid this category of mutual funds and stay invested in liquid/ short duration funds.

Glossary:

Repo Rate:

Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation.

In case of high inflationary pressures, central banks increase repo rate i.e. makes the borrowing expensive which acts as a disincentive for banks to borrow money from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation.

The central bank takes a contrary position in the event of a recession.

Reverse Repo

Reverse repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) borrows money from commercial banks within the country. It is a monetary policy instrument which can be used to control the money supply in the country.

An increase in reverse repo rate means RBI has increased the rate at which it will borrow money from the commercial banks and they will get more incentives to park their funds with the RBI, thereby decreasing the supply of money in the market.

Open Market Operations (OMO)

Open market operations is the sale and purchase of government securities and treasury bills by RBI or the central bank of the country. The objective of OMO is to regulate the money supply in the economy. When the RBI wants to increase the money supply in the economy, it purchases the government securities from the market and it sells government securities to suck out liquidity from the system.

RBI carries out the OMO through commercial banks and does not directly deal with the public. OMO is one of the tools that RBI uses to smoothen liquidity conditions through the year and minimize its impact on the interest rate and inflation rate levels.

Long Term Refinancing Operation (LTRO)

Under LTRO, RBI will conduct term repos of one-year and three-year tenors of appropriate sizes for up to a total amount of Rs 1 lakh crore at the policy repo rate