Portfolio Management Services

Overview of the Industry and Products

PMS v/s MF v/s Direct Equity

Allocation of Individual Savings

- Real Estate - $ 10 trillion
- Debt - $ 2.5 trillion
- Gold - $ 2.0 trillion
- Equity - $ 200-250 billion (market size $1-1.3 tn)

Out of this less than $ 150 billion is managed by professional investors

Factors which affect decision..

- Manage yourself or engage professional help?
- Tax implication
  - Real estate & gold – low tax impact as held “for ever”
  - Debt – MFs can provide very good tax shelter
  - Equity – can vary depending on style
- Variability in Return (Risk)
  - Highest in equity

Under-penetrated industry

- Equity – about 20%
- Debt – about 5%
- Gold & Real Estate – negligible
- Equity is seen as the most risky as indicated by
  - Low allocation
  - Higher proportion of expertise sought

The choice of Direct Investment Vs Managed Money is most relevant in case of equities

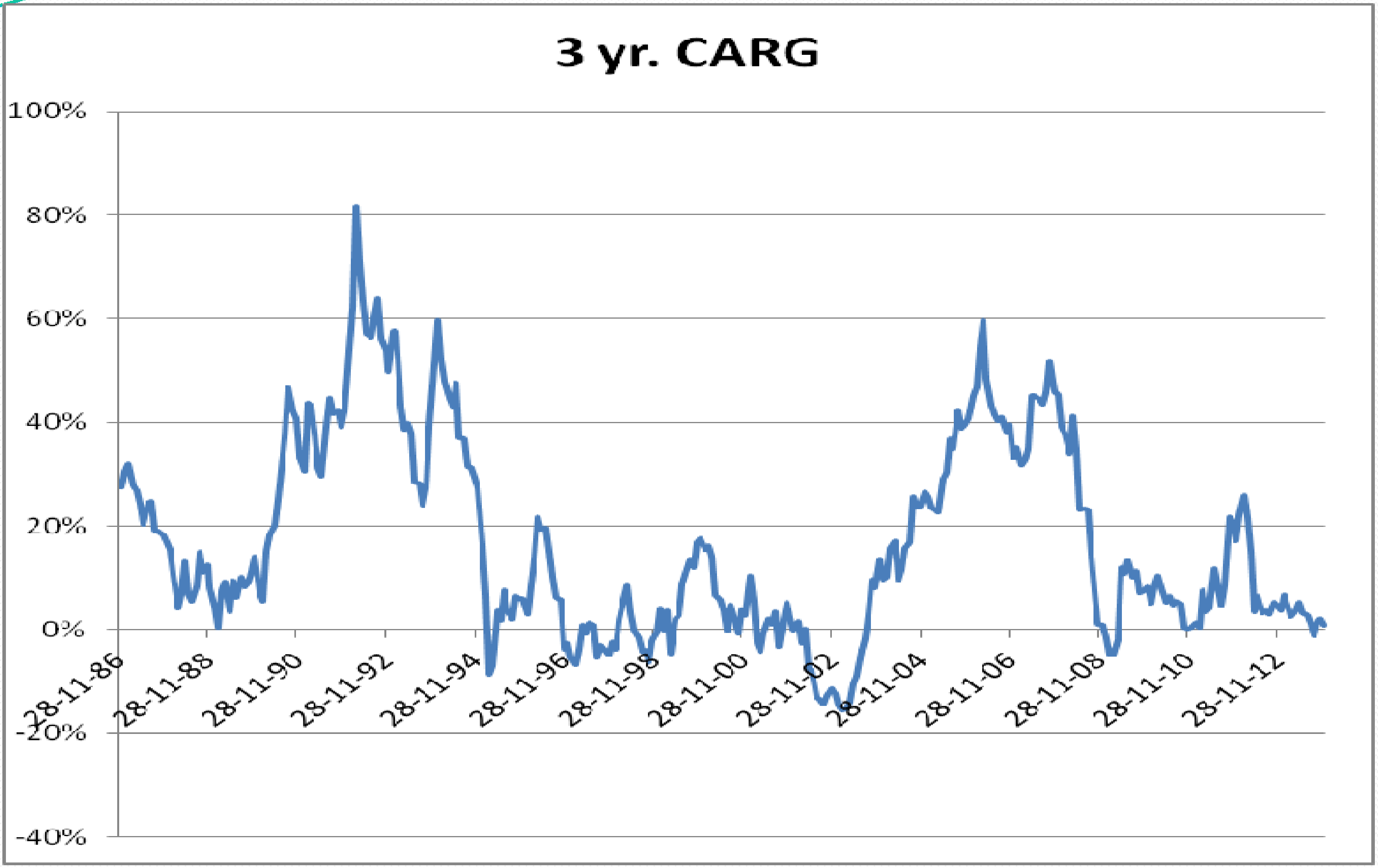
The case for equities

- Over the past three years market has returned only 7% (November 2013)
- Including dividend this is less than 4% per annum
- What is the case for investing in equities?
  - Investors in 33-years since 1981 averaged return of
  - 17.4% CARG over 3-year periods;
  - 17.1% CARG over 5-year periods;
  - 16.7% CARG over 10-year periods
- In 1988 March the BSE Sensitive Index was 390…it has gained 16.5% over last 26 years
  - This is despite zero return in last six years (in 2008 it was 21%)

Equity as an asset class has delivered consistently high returns for investors—I would estimate 16%

Time Horizon

- Equity investment is best made with a long term horizon
- A wealth building approach rather than a income generation approach works best
- Small investors in equity tend to be swayed by market … increase allocations after run up
  - Very often IPO is primary form of investment, supply drives demand
- <u>Better</u> results can be achieved by investing uniform amounts over long period of time
  - More knowledgeable investors can “time” the market but that has implications


3 yr. CARG
100%
80%
60%
40%
20%
0%
-20%
-40%
28-11-86
28-11-88
28-11-90
28-11-92
28-11-94
28-11-96
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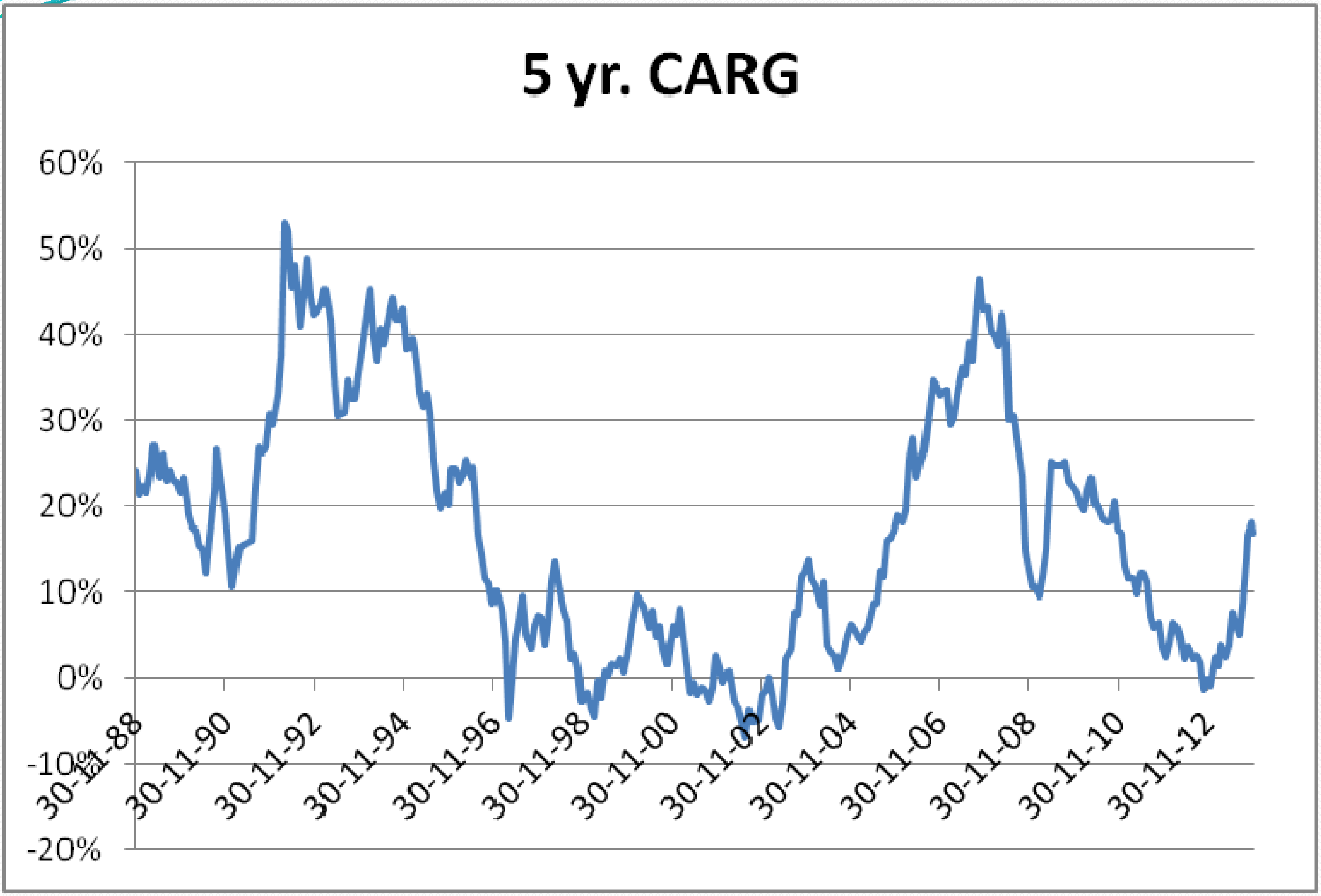
5 yr. CARG
60%
50%
40%
30%
20%
10%
0%
-10%
-20%
30-11-88
30-11-90
30-11-92
30-11-94
30-11-96
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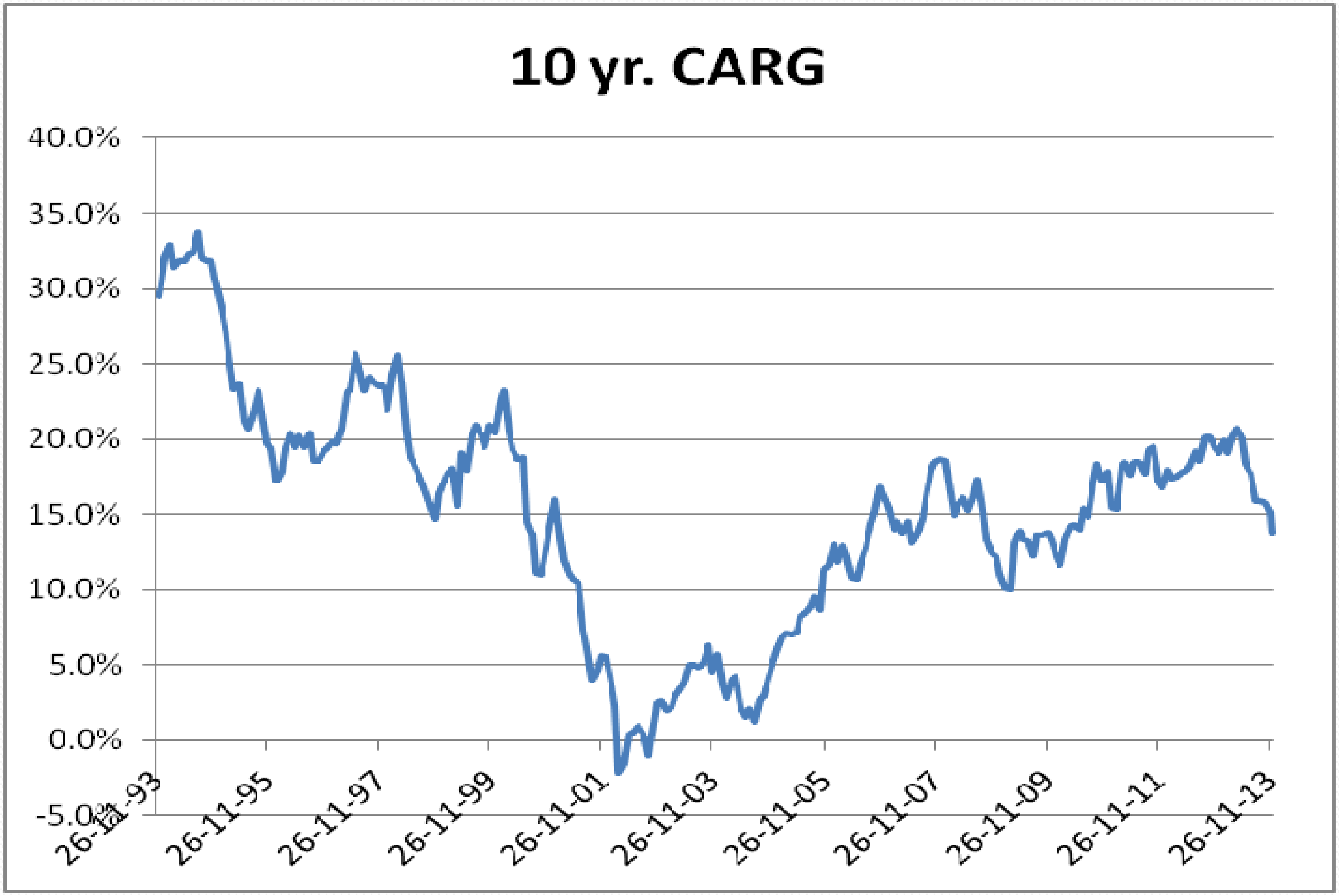
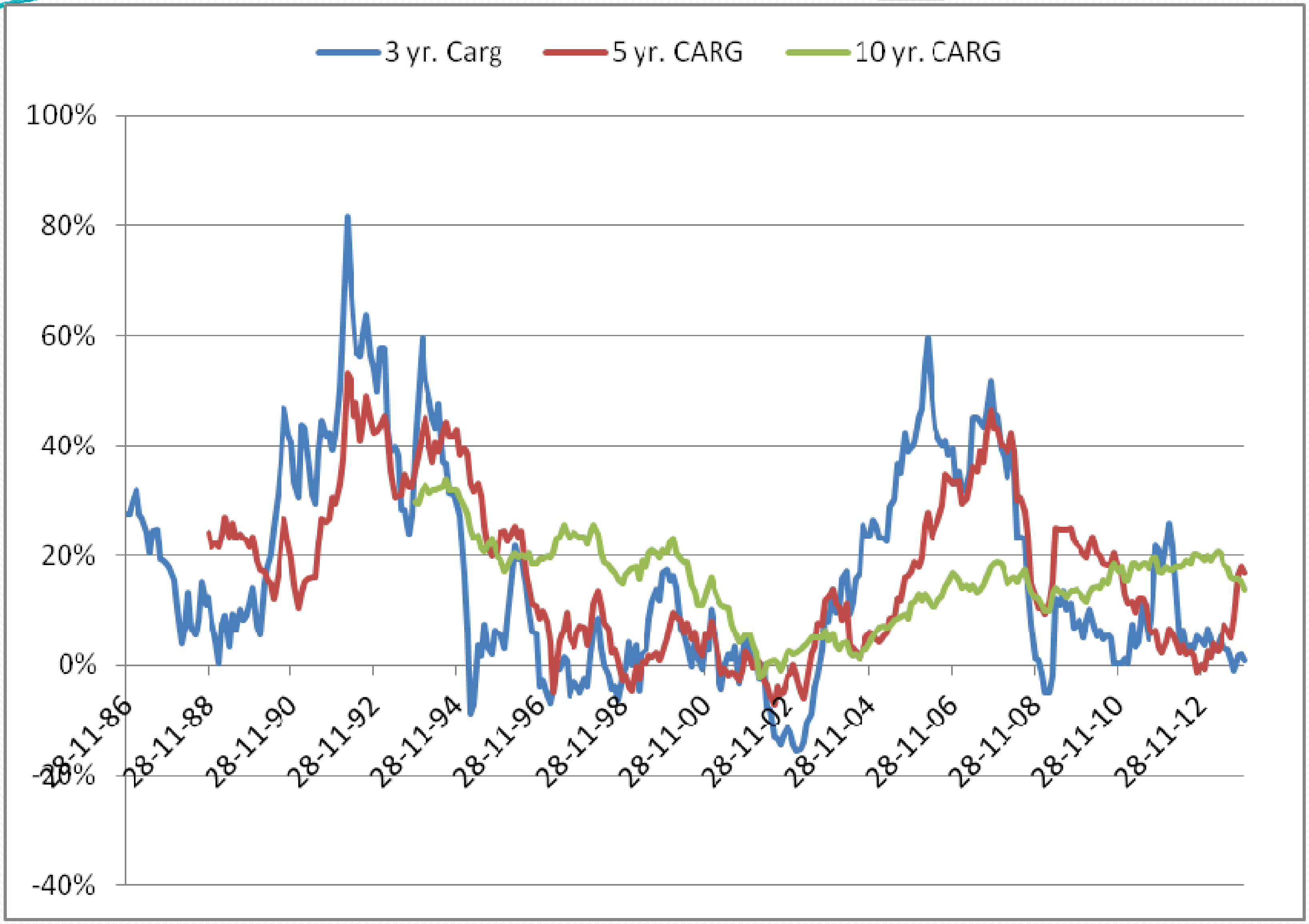

10 yr. CARG
40.0%
35.0%
30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
26-11-95
26-11-97
26-11-99
26-11-01
26-11-03
26-11-05
26-11-07
26-11-09
26-11-11
26-11-13


3 yr. Carg
5 yr. CARG
10 yr. CARG
100%
80%
60%
40%
20%
0%
-20%
-40%
28-11-86
28-11-88
28-11-90
28-11-92
28-11-94
28-11-96
28-11-98
28-11-00
28-11-02
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28-11-10
28-11-12

CARG RETURNS%	3-YRS	5-YRS	10-YRS
(Returns on a market portfolio)			
ZERO & BELOW	13.9%	9.5%	1.1%
ZERO TO 10%	32.8%	26.8%	17.8%
10% TO 15%	8.3%	11.0%	19.6%
15% TO 20%	6.7%	12.2%	30.1%
20% & ABOVE	38.3%	40.5%	31.5%
NUMBER OF OBSERVATTIONS (MONTHS)	360	336	276
		(Period Jan'1981 – Dec'2013)	

SHARE OF MARKET CAPITALIZATION

(Figures in Rs. Cr)

	Sept'13	Sept'08	Sept'03
Mutual Funds	**209,599**	**148,742**	**31,242**
% of Total Listed Equity Market	*3.3%*	*3.7%*	*3.6%*
Bodies Corporate	**265,978**	**184,716**	**25,869**
% of Total Listed Equity Market	*4.2%*	*4.6%*	*3.0%*
Individuals	**522,442**	**362,121**	**107,768**
% of Total Listed Equity Market	*8.3%*	*9.1%*	*12.5%*
Total Domestic Public Shareholding	**998,019**	**695,578**	**164,878**
% of Total Listed Equity Market	*15.9%*	*17.5%*	*19.1%*
Total Listed Market Cap	**6,295,484**	**3,984,568**	**861,126**

Source: SIMPL, Ace Equity

Note: Sample list represents all companies listed on BSE and NSE.

SHARE OF DOMESTIC PUBLIC SHAREHOLDING (Excludes Insurance)

(Figures in Rs. Cr)

	Sept'13	Sept'08	Sept'03
Mutual Funds	**209,599**	**148,742**	**31,242**
% of Domestic Public Shareholding	*21.0%*	*21.4%*	*18.9%*
Bodies Corporate	**265,978**	**184,716**	**25,869**
% of Domestic Public Shareholding	*26.7%*	*26.6%*	*15.7%*
Individuals	**522,442**	**362,121**	**107,768**
% of Domestic Public Shareholding	*52.3%*	*52.1%*	*65.4%*
Total Domestic Public Shareholding	**998,019**	**695,578**	**164,878**

Source: SIMPL, Ace Equity

Note: Sample list represents all companies listed on BSE and NSE.

AUM for PMS

			As of Sept'13
	Discretionary	**Non-Discretionary**	**Advisory**
No. of Clients	**46445**	**5100**	**10586**
AUM (Rs. in crore)			**104877***
Listed Equity (Active PMS Managers)	15097	4558	
Unlisted Equity	1570	72	
Plain Debt	495785	20868	
Structured Debt	724	651	
Equity Derivative	97	-2	
Mutual Fund	4469	5358	
Others	14125	345	
Total	**531866#**	**31849**	**104877***
Source: SEBI			
Notes:			
1. * - Value of Assets for which Advisory Services are being given.			
2. # - Of the above AUM Rs.496755.4 crore is contributed by funds from EPFO/PFs.			
3. The above data is based on the monthly reports received from portfolio managers.			

Movement towards delegation

- There is a small shift towards money management
- Yet the bulk of money in equities is self managed
  - Favorable tax treatment – Zero % LTCG, Zero tax on Dividend
  - Inconsistent performance of money managers

Manager Can Add Value

- By investing in "better" stocks
  - Research and philosophy helps
- By investing in "better" times
  - Investor can allocate money regularly in small installments, hold for long term and be closer to average return
  - They can "time" the market by reducing allocation at peaks and increasing in troughs

    Risk is higher because of greater dispersion of returns

“Better” stocks

- Variability in performance of stocks is significant
- You can do better than average returns by investing in better stocks
- Over the past three years market has yielded near 7% return (Nov-2010 to Nov-2013)
  - Top 10% yielded 70%+
  - Bottom 10% lost over 75%
  - Only Top 25% offered over 11% return (average over 20% CARG)
  - Bottom 25% lost over 50%

A managed portfolio can add value by buying better stocks

Direct Investment in Equities

- By far the most widespread
- It is estimated that MFs account for 20% of domestic public shareholding and PMS accounts for about 1.5%
- Two classes of investors
- Small Investors
  - Relatively small allocation of savings to equity
  - Mainly invest through IPO and remain passively invested
- "Big timers" who consider themselves experts

Others generally gravitate towards managed funds

Large Investors – Direct Investment

- Professional investors
  - Often part of capital markets
  - Family investment offices
- Must have
  - Strong decision making skills
  - Risk management process
  - High degree of personal engagement with the investment process
  - Reasonably large involvement (over Rs. 100 crores) – otherwise costs are high
- Enterprising investors with skill & confidence with smaller portfolios
- Advantage: no agency issues

Best results can be obtained if sufficient time & effort are put in

Why MF for Small investors?

- Generally do not have the ability to pick stocks
- Tend to decide on sentiment rather than analysis
- Can not afford the cost of infrastructure to do research
- Poor timers in market – should do "dollar cost averaging"
  - Easier to invest small savings regularly through MFs - SIP

Large investors: Direct, PMS or MF?

- It depends more on personality type
- Delegators tend to be comfortable with MF
- Those who like control will prefer Direct Investment
  - Very often not connected to ability at inception
- If they have good experience & more time, might become specialist investors
- If they have bad experience or time pressured, shift to PMS/MF

Small investors can definitely benefit from MF

Direct Investment– When to and when not

- Ability to read financial statements and value stocks
- Well developed philosophy of investment
- Risk Management
- Decision making skills
- Time availability
- Very large investors who can hire skills: family investment office

Unless these skills are available/can be developed better results can be obtained by outsourcing management

MF/PMS very different

- In the way they are sold
  - MFS are sold through distributors
  - PMS involves a direct relationship
- In the way funds are managed
  - MF money is pooled and sold as units
  - In PMS each portfolio is distinct
- In the way they are structured
  - MFs are more diversified
- Return Expectations
  - MFs will try to match market
  - PMS will mostly try to "outperform"
- In the way the returns are taxed
- In the way performance is reported
  - Aggregation can only give a general idea in the absence of pooling

PMS and MF

- Stock selection and investment decisions are made by a fund manager acting as delegate of the investor
- MF is a product, PMS is a service – by nature customized rather than standardized: portfolio performances can & will differ
- Unlike MF -- where there is an offer document -- in PMS the relationship is governed by an agreement between the Portfolio Manager and the client
- Past performance and other information are available through a disclosure document which is updated at least once in six months
  - The Disclosure Document must be shown to investor at least two days before agreement is signed
- Minimum investment size is Rs. 25 lacs (earlier Rs. 5 lacs) --- significantly higher than Mutual Funds (Rs.5000)

PMS and MF

- Both are regulated activities but PMS is "light touch"
- MF more tightly regulated because accessing funds of small investors
- MFs have become more accepted and mainstream – PMS is still not widely used
- Tax status of MF investments is crystal clear – there are certain issues in PMS

Total equity funds under PMS are less than 10% of under MF

Five Major Differences

- Assets are held in the investors' name
- There are no marketing costs
    - There *<u>are</u>* performance fees – expectation of superior performance
- Taxation of gains are treated very differently
- Less restrictions on portfolio structure – generally more thematic and concentrated
- More flexibility in allocation

1. Assets in Investor Name

- Ownership
  - In MF the investor owns a unit – a fractional ownership of the fund, in PMS investor owns individual stocks
- Significant implications for liquidity
  - Unit holder can redeem in accordance with the term governing the fund *without any reference* to liquidity of underlying portfolio
  - In PMS the investors liquidity depends on liquidity of individual stocks in portfolio
- Investors are generally better informed and aware of what stocks are bought for their account and what activity has taken place
- Knowledgeable investors prefer PMS as they can see/discuss stocks and "know" the fund manager

Investors in PMS can review their statements and keep better watch on how their money is being managed

2. Management Cost

- Regulations allow MFs to recover their marketing costs within limits
- PMS recovers only direct costs like custody, accounting charges, audit costs etc apart from fund management fees – can vary, negotiable
  - Fees are typically 0.5% to 1.5% + performance fees
  - Performance fees are typically 20% of excess returns
  - *Can vary depending on terms*
- Regulations governing cost recovery differ but in general the fixed costs of fund management are lower in PMS
- Most PMS have performance fees – expectation of more variability in returns

3.Tax treatment very different

- In MFs individual transaction gains are not taxed– only on redemption
  - Investor can obtain long term capital gains even if fund adopts short term strategies
  - Tax treatment is unambiguous
- In PMS every transaction is subject to taxation just like direct investment
- Whether treated as Capital Gains or Business Income will depend on the way the portfolio is managed -- ambiguity
- IT has taken the view in many cases that it is business income – a risk

In PMS the investor is concerned with style as it affects liquidity and tax treatment

4. Thematic and concentrated

- MFs are more tightly regulated in terms of portfolio diversification
- Tend to hold more liquid portfolios also because of valuation guidelines (for NAV) /redemption requirements
- PMS has significantly more flexibility and this should result in more concentrated portfolios
- More risk in PMS -- variability in performance
  - In relation to broad market
  - Liquidity
  - Between portfolios
- Trade off is, more capable of out-performing benchmarks
- Stock selection/timing plays a greater role

Investor is better informed of & concerned with portfolio components and allocation

5. Flexibility in cash/equity allocation

- Equity MFs enjoy significant tax benefits – but must hold over 65% in equity
  - Equity MFs typically rarely hold much cash
  - Over long periods of time returns of equity MF schemes will track market performance
- Portfolio manager in PMS can make a call to decrease/increase equity allocation based on overall market outlook
  - No regulatory constraint
  - Better communication with investor
- PMS managers often target absolute returns

This is probably the single biggest advantage of PMS over MF

Who should prefer PMS over MF?

- Sophisticated investors who have understanding of investment process
- Higher allocation to equities
  - Investors can devote more time
  - Legal requirement of minimum investment
- Focus on absolute return rather than market performance/ out-performance
- More suited for long term investors who can avail of zero long term capital gain

How to choose

- Investors in MF should emphasize track record and diversify
  - Should prefer index funds as low cost alternative
- Investors in PMS should evaluate philosophy and style
  - Decision largely based on assessment of CIO capability and style
  - Should look for compatibility in style
  - Must engage with CIO periodically and evaluate performance
  - Focus on adherence to 'style'

Regulated Activity

- Portfolio Management is an activity Regulated by SEBI
- Regulated by Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993
- Encompasses discretionary/non-discretionary and advisory
- Registration with SEBI as a Portfolio Manager is mandatory before any individual or entity can offer these services to clients

Minimum Requirements

- Experience in Capital Market of ten years and qualifications in finance/law required for Principal Officer
- Minimum Net Worth of Rs 2 crores
- Required infrastructure in the form of offices and computers etc

SEBI will grant a license as Portfolio Manager which is renewable every three years

Ongoing Requirements

- Principal Officer
- Compliance Officer
- Maintenance of net worth above Rs. 2 crores
- Disclosure Document: updated every six months
- Website and access to clients through website
- Renewal of license every three years

Regulation is "light touch"

Difference from MF (for Service Provider)

- Cost of setting up and operations are lower than in MF
- More affordable for professionals
- Breakeven levels are lower for manager
- Fees are negotiated with client and often include performance fees

Thank You