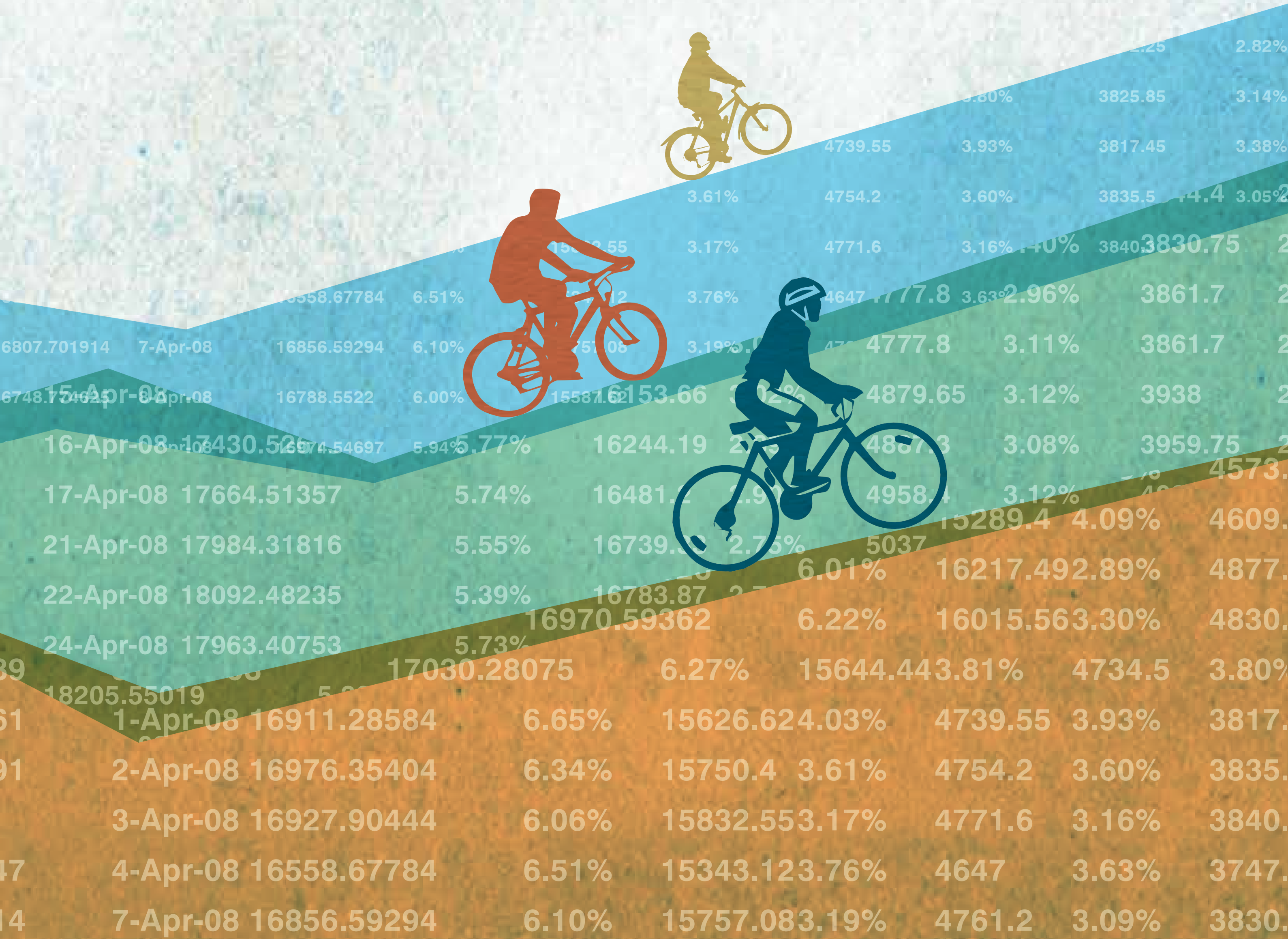
CRISIL RESEARCH

AMFI

CRISIL-AMFI Mutual Fund Performance Insights




Long
Term
Growth

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Foreword

India is a savings dominated market but people invest largely in guaranteed return products such as bank fixed deposits. Reserve Bank of India data shows that Indians have parked almost 50% of their savings in bank deposits, while less than 5% of assets have gone into market-linked investment avenues such as mutual funds. Despite improvement in best practices and transparency, most investors are unaware about the benefits of investing through mutual funds. Today, investors across gender, age and risk appetite can buy mutual funds to meet any of their lifetime goals. For instance, equity and debt funds can be used for planning long-term goals based on risk appetite of investors. Likewise, liquid funds are ideal for managing surplus cash flows while gold funds offer the benefits of diversification. Awareness about these benefits is, however, limited.

A key reason for low awareness is lack of common metrics for assessing the value created by investing in mutual funds vis-a-vis other investment avenues. To address this gap, CRISIL Ltd. (CRISIL) and the Association of Mutual Funds in India (AMFI) have jointly launched a family of mutual fund performance indices across various categories. These indices, the first of their kind in the country, represent the performance of various mutual fund categories and enable comparison of these categories with appropriate benchmarks across time frames and market cycles.

The indices, based on time series data since 1997, have been developed and will be maintained by CRISIL. The indices cover five broad mutual fund categories – equity funds, equity linked savings schemes (ELSS), debt funds, money market funds and hybrid funds. Various sub-categories of these indices have also been launched.

In commemoration of this launch, CRISIL-AMFI have released a compendium of seven articles in this booklet which highlights the performance of various mutual fund categories represented by these indices. The articles highlight the performance trends across bull and bear market phases, besides comparing category returns with their respective benchmarks and traditional savings instruments. For example,

- The CRISIL-AMFI Equity Fund Performance Index has given an annualised return of 22% since April 1, 1997, as compared to annualised returns of 12% and 13% by the benchmarks CNX NIFTY and CNX 500, respectively during the same period.
- The CRISIL-AMFI Equity Fund Performance Index has never given a negative return for any five-year period on a daily rolling basis since April 1, 1997.
- The CRISIL-AMFI Money Market Fund Performance Index has consistently outperformed the savings bank rate in the range of 110 to 550 basis points.
- The CRISIL-AMFI Debt Fund Performance Index outperformed fixed deposits (FD) by a significant margin during declining interest rate cycles.

As these indices reflect the performance of mutual funds at an aggregate level, an investor who would have invested in top performing mutual funds would have generated even higher returns.

As the industry matures and mutual funds become the prime instruments for long and short-term savings, it will become increasingly important to provide the right kind of support to retail investors to make informed investment decisions. CRISIL-AMFI performance indices are clearly a step in this direction where investors can use them as standard performance metrics to understand the benefits of mutual fund investing. This is also in line with CRISIL's objective of making markets function better and improving connect with retail investors.

The CRISIL-AMFI MF performance indices will be updated on a quarterly basis and will be available on www.crisil.com and www.amfiindia.com.

We hope you find this compendium informative.

H.N. Sinor
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Managing Director and Chief Executive Officer
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1 Mutual Funds – An Overview

1 Mutual Funds

An effective investment vehicle for retail investors

India has one of the highest savings rate globally. This penchant for wealth creation makes it necessary for Indian investors to look beyond the traditionally favoured bank FDs and gold towards mutual funds. However, lack of awareness has made mutual funds a less preferred investment avenue.

Mutual funds offer multiple product choices for investment across the financial spectrum. As investment goals vary – post-retirement expenses, money for children's education or marriage, house purchase, etc. – the products required to achieve these goals vary too. The Indian mutual fund industry offers a plethora of schemes and caters to all types of investor needs.

What are mutual funds?

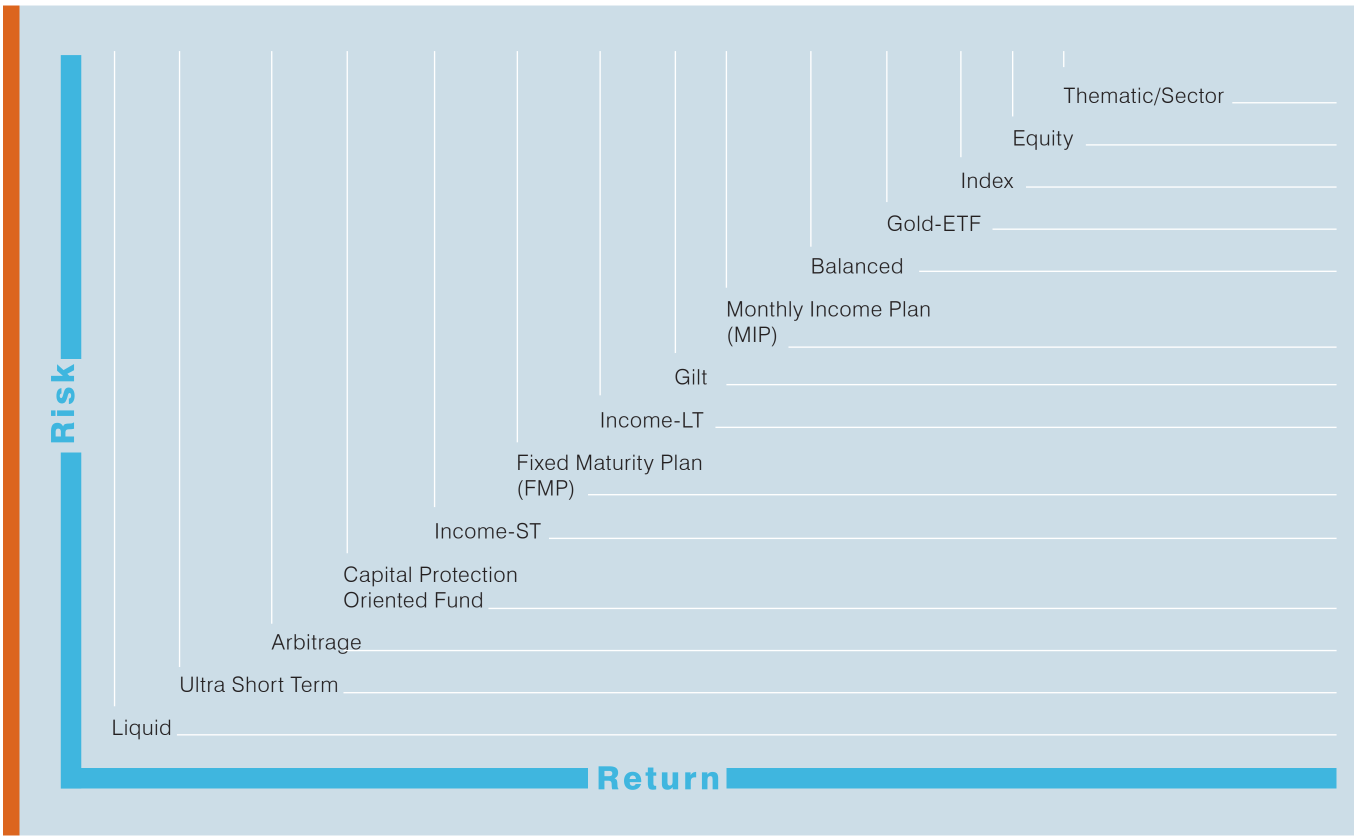
A mutual fund is a professionally managed investment product that collects money from a number of investors and invests the same in equities, bonds, money market instruments and/or other securities. Mutual funds are ideal for investors who either lack large sums for investment, or for those who neither have the inclination nor the time to research the market, yet want to grow their wealth. The money collected in mutual funds is invested by professional fund managers in line with the scheme's stated objective. In return, the fund house charges a small fee which is deducted from the investment. The fees charged by mutual funds are regulated and are subject to certain limits specified by the Securities and Exchange Board of India (SEBI).

Investors of all categories can invest on their own but a mutual fund is a good choice for the only reason that all benefits come in a package. Read on to see how.

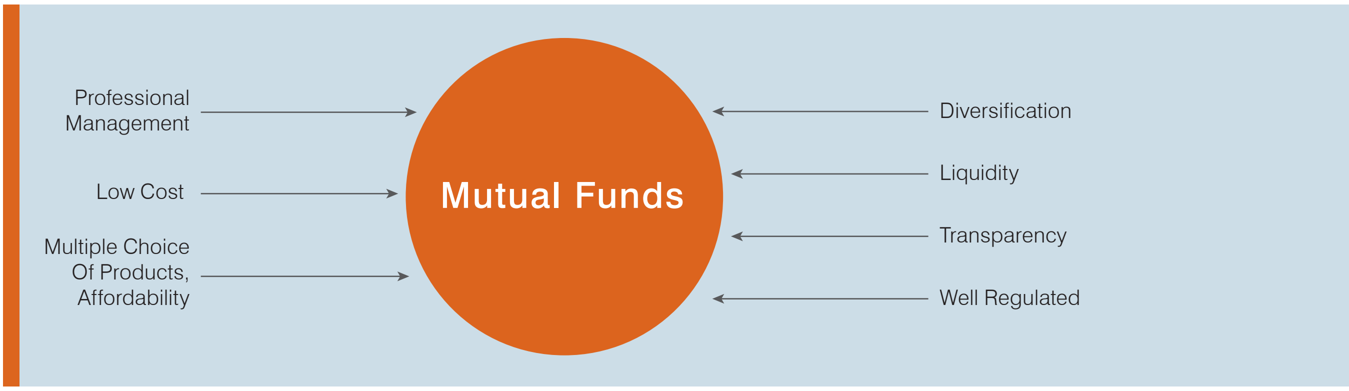
A plethora of schemes to choose from

Mutual funds are favoured globally for the variety of investment options they offer. There is something for every profile and preference.

Chart 1: Risk/Return trade-off by mutual fund category



Advantages of mutual funds



Professional management: Mutual funds are managed by experts. A mutual fund is an inexpensive way for investors to get a full-time fund manager to manage their money.

Low cost: Mutual funds are a relatively less expensive mode of investment compared with direct investments in capital markets. SEBI has abolished entry loads (costs) for mutual fund investors who invest directly through the channels owned by asset management companies. However, investments made through intermediaries are charged a nominal transaction fee of Rs.150 for every new folio, and Rs.100 for every transaction thereafter in excess of Rs.10,000. Exit loads (costs) are mostly applicable to short-term investors who exit within a span of one year from the date of investment. Most of the funds in categories like liquid funds do not levy exit loads. Also because of their scale, mutual funds benefit from lower brokerage, custodial and other fees charged to them by the service providers thus making them more cost effective as compared with direct investing.

Choice of product and affordability: Mutual funds offer a variety of schemes across asset classes to suit varying needs over an investor’s lifetime. Even a small investor can afford to invest in equity and debt markets as the minimum investment amount in a scheme can be as low as Rs.500.

Diversification: Mutual funds diversify risks across a large number of stocks/securities, which may otherwise not be feasible for retail investors. Funds not only invest in several companies across industries and sectors, but also across asset classes such as equity (including international equity), debt, commodities, etc. This helps reduce portfolio risk as all asset classes/securities seldom decline at the same time and in the same proportion.

Liquidity: Mutual funds offer convenience and ease of liquidity. Depending on their category of investment, investors can get the money back promptly for the open-ended schemes at the applicable net asset value (NAV) from mutual funds within 1-3 days of applying for redemption. For close-ended schemes, one can sell units on a stock exchange at the prevailing market price or avail of the facility of repurchase through mutual funds at the applicable NAV which some close-ended and interval schemes offer periodically. Also, some fund houses offer the convenience of buying and selling of mutual fund units through an online platform.

Well regulated: All mutual funds are registered with SEBI and function within the provisions of these regulations which are designed to protect the interests of investors. The operations of all mutual funds are regularly monitored by SEBI. Post the 2008 liquidity crisis, SEBI has introduced several new measures to protect the interests of retail investors.

Transparency: Mutual funds regularly disclose all information pertaining to schemes such as the latest NAV (declared daily) and full portfolio details (disclosed monthly). They also release a monthly factsheet that contains performance and portfolio related information of schemes. These are prominently displayed on the websites of the respective fund houses. Further, SEBI and AMFI disclose industry level information such as fund house and scheme-wise industry assets, cash flows within the industry, scheme offer documents, AMC financial account statements, etc. on their website.

Tax advantage

Mutual funds are a tax-efficient form of investment for a retail investor.

Product	Short-term Capital Gains Tax@	Long-term Capital Gains Tax	Dividend Distribution Tax*
Equity-oriented Funds**	15.450% (15% + 3% Cess)	Nil	Nil
Debt-oriented Funds	As per income tax bracket of the investor	10.300% without indexation; 20.600% with indexation	28.325% (25% + 10% Surcharge + 3% Cess)
Money Market & Liquid Schemes	As per income tax bracket of the investor	10.300% without indexation; 20.600% with indexation	28.325% (25% + 10% Surcharge + 3% Cess)

Tax rates applicable for Financial Year 2013-14

@Surcharge at the rate of 10% is levied in the case of individual/HUF unit holders whose income exceeds Rs.1 crore.

*Deducted at source – payable by the scheme

**Securities Transaction Tax (STT) is deducted on equity funds at the time of redemption or switch to other schemes

Indexation (for tax purposes) allows the returns generated on the investment to be adjusted for inflation (real returns). The benefit of indexation is that investors are taxed only on the real returns generated from the debt-oriented fund. The indexed value of initial investment (initial investment adjusted for inflation prevailing during the year) is deducted from the redemption amount for calculating capital gains. As a result, the investor's tax liability is reduced by the extent of inflation prevailing during the investment period.

Conclusion

Mutual funds offer an excellent avenue for retail investors to participate and benefit from the uptrends in capital markets. While investing in mutual funds can be beneficial, selecting the right fund can be challenging. Hence, investors should do proper due diligence of the fund and take into consideration the risk-return trade-off and time horizon. Further, in order to reap maximum benefit from mutual fund investments, it is important for investors to diversify across different categories of funds such as equity, debt and gold.

2 CRISIL-AMFI MF Performance Indices

2 CRISIL-AMFI MF Performance Indices

An introduction

Background – As part of CRISIL's ongoing research on mutual funds, CRISIL has carried out a study of mutual funds' performance for a period of more than 15 years from 1997. CRISIL has created fund performance indices based on the performance of mutual fund schemes across categories including equity, equity-linked savings schemes (ELSS), debt, money market and hybrid. The performance of these indices was compared with other investment options such as equity benchmarks (CNX NIFTY, CNX 500, etc.), small savings schemes (Public Provident Fund) and bank deposits (fixed deposit, savings bank rate).

Methodology of Index Construction – The indices are constructed using schemes that are ranked by CRISIL under its quarterly Mutual Fund Rankings. The list of indices is as follows:

CRISIL – AMFI MF Performance Indices

Sr. No.	Index	Inception date
1	**CRISIL – AMFI Equity Fund Performance Index**	**1-Apr-1997**
1.1	CRISIL – AMFI Large Cap Fund Performance Index	1-Apr-2000
1.2	CRISIL – AMFI Diversified Equity Fund Performance Index	1-Apr-2000
1.3	CRISIL – AMFI Small & Midcap Fund Performance Index	1-Oct-2004
2	**CRISIL – AMFI ELSS Fund Performance Index**	**1-Jun-2001**
3	**CRISIL – AMFI Debt Fund Performance Index**	**1-Apr-2000**
3.1	CRISIL – AMFI Income Fund Performance Index	1-Apr-2000
3.2	CRISIL – AMFI Gilt Fund Performance Index	1-Apr-2000
3.3	CRISIL – AMFI Short-Term Debt Fund Performance Index	1-Apr-2002
4	**CRISIL – AMFI Money Market Fund Performance Index**	**1-Apr-2000**
4.1	CRISIL – AMFI Liquid Fund Performance Index	1-Apr-2000
4.2	CRISIL – AMFI Ultra Short Fund Performance Index	1-Apr-2007
5	**CRISIL – AMFI Hybrid Fund Performance Index**	**1-Apr-2000**
5.1	CRISIL – AMFI MIP Fund Performance Index	1-Jan-2002
5.2	CRISIL – AMFI Balanced Fund Performance Index	1-Apr-2000

Key highlights of mutual fund performance depicted by indices

- **CRISIL-AMFI Equity Fund Performance Indices have significantly outperformed the relevant benchmark equity indices**
  - CRISIL-AMFI Equity Fund Performance Index has given an annualised return of 22% in the past 16 years since 1997, higher than the 12% annualised returns from CNX NIFTY and 13% from CNX 500.
  - CRISIL-AMFI Equity Fund Performance Index has never given negative returns for any 5-year period since 1997.
  - Even during volatile times (the last decade included two bull and two bear phases), the CRISIL-AMFI Equity Fund Performance Indices have delivered superior returns as compared with the CNX NIFTY.
- **CRISIL-AMFI ELSS Fund Performance Index outperformed market indices and generated higher return than small saving schemes**
  - In the past 10 years, CRISIL-AMFI ELSS Fund Performance Index outperformed CNX 500 and Public Provident Fund (PPF) rate by 6% and 18% respectively.
- **CRISIL-AMFI Money Market Fund Performance Index has consistently given better returns than the savings bank rate.**
- **CRISIL-AMFI Debt Fund Performance Index outperformed fixed deposits (FD) during declining interest rate cycles but underperformed during rising interest rate cycles.**

3 Key Insights

3 Equity Funds

Sustainable risk-adjusted long-term returns

Thinking long-term? Thinking superior returns? Go the equity way. Historical performance of equity indicates that, though uncertainty is unavoidable in the short term, this category fetches superior risk-adjusted returns over the long-term. Mutual funds are an effective investment vehicle for retail investors to participate in equity markets.

CRISIL's study reveals that, over the past 16 years, equity mutual funds have outperformed the broader market index, CNX 500, during most of the market phases. The CRISIL-AMFI Equity Fund Performance Index has delivered a significant outperformance over benchmarks such as CNX NIFTY and CNX 500. The magnitude of outperformance is higher over a longer investment horizon, reinforcing the industry adage that investments in equity mutual funds should have a long-term horizon. The study also highlights the fact that at an aggregate level, equity funds have never given negative returns over any five-year investment horizon since 1997.

CRISIL has created indices that reflect the performance of funds at an aggregate level. These indices are based on mutual fund schemes ranked under CRISIL Mutual Fund Rankings on a quarterly basis. CRISIL-AMFI Equity Fund Performance Index consists of mutual fund schemes from diversified equity, large-cap equity and small and mid-cap equity categories.

Since 1997, CRISIL-AMFI Equity Fund Performance Index has created close to four times the wealth of the CNX NIFTY

The CRISIL-AMFI Equity Fund Performance Index acts as a barometer to showcase how mutual funds have performed over a specific time period. Our study reveals that the CRISIL-AMFI Equity Fund Performance Index has given an annualised return of 22% over the past 16 years while the CNX NIFTY has given an annualised return of 12%, and the CNX 500, 13%. Thus, it can be seen that equity mutual funds have created significant wealth for mutual fund investors. At an aggregate level, Rs.1,000 invested in equity mutual funds on April 1, 1997 would have grown to Rs.22,950 as on March 31, 2013 vis-à-vis Rs.6,930 in CNX 500 index & Rs.5,860 in CNX NIFTY. **Chart 1** depicts the superlative performance of the CRISIL-AMFI Equity Fund Performance Index and the consistency of the performance over the past 16 years.

Chart 1: CRISIL-AMFI Equity Fund Performance Index vs. Benchmarks

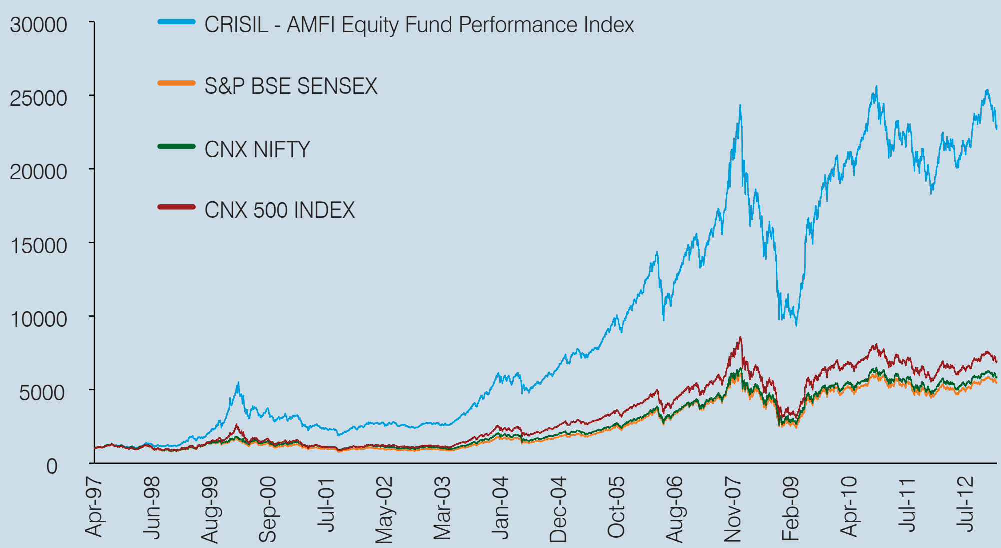


Table 1 highlights that over the past 10 years, the CRISIL-AMFI Equity Fund Performance Index or other sub-indices such as large cap, diversified equity or small and mid-cap have given superior returns as compared with the various market indices over different time periods. As CRISIL-AMFI Fund Performance Indices showcase the performance of mutual funds at an aggregate level, an investor who would have invested in top-performing mutual funds would have generated even higher returns.

Table 1: CRISIL-AMFI Equity Fund Performance indices have always given higher returns than the benchmark across different time periods except in the last one year

Index	1 Year (%)	3 Year (%)	5 Year (%)	7 Year (%)	10 Year (%)
CRISIL-AMFI Equity Fund Performance Index	5.66	3.61	6.15	8.43	24.53
CRISIL-AMFI Large Cap Fund Performance Index	6.23	4.10	6.39	8.71	23.66
CRISIL-AMFI Diversified Equity Fund Performance Index	4.66	2.79	5.64	8.51	25.70
CRISIL-AMFI Small & Midcap Fund Performance Index	7.14	5.24	6.44	6.95	–
CNX NIFTY	7.31	2.68	3.72	7.60	19.24
S&P BSE SENSEX	8.23	2.43	3.78	7.60	19.97
CNX 500 Index	5.13	0.96	3.01	6.21	20.26
CNX Midcap Index	-4.02	-1.33	3.47	6.42	–
S&P BSE Midcap	-3.22	-3.36	-0.91	2.00	–

Performance as on March 31, 2013

CRISIL-AMFI Equity Fund Performance indices have outperformed respective benchmarks in different market cycles

The key responsibility of fund management is to manage portfolios proactively during various market cycles. Be it a bull or a bear phase, active fund managers are expected to identify trends and take necessary action on portfolio construction to ensure that the portfolio outperforms market indices. CRISIL's study shows that the outperformance of the CRISIL-AMFI Equity Fund Performance Index is not limited to a bull run; the index has outperformed in a bear phase as well.

Starting April 1, 2000, CRISIL identified three bear and two bull phases. The return delivered by the CRISIL-AMFI Equity Fund Performance Indices was compared with the relevant benchmarks across these market cycles. **Table 2** shows that the CRISIL-AMFI Equity Fund Performance Index has outperformed the CNX 500 in two bull and bear phases.

Table 2 – Performance during market phases

Period	From Date	To Date	Annualized Returns (%)						
			CRISIL-AMFI Equity Fund Performance Index (%)	CRISIL-AMFI Large Cap Fund Performance Index (%)	CRISIL-AMFI Diversified Fund Performance Index (%)	CRISIL-AMFI Small & Midcap Fund Performance Index (%)	CNX NIFTY (%)	CNX Midcap Index (%)	CNX 500 Index (%)
Tech Bubble	1-Apr-00	30-Sep-01	-41.40	-38.08	-49.24	–	-29.05	–	-41.04
Bull Phase of 2003-07	1-Apr-03	31-Dec-07	59.54	56.00	63.47	–	46.97	–	53.14
Sub-prime Crisis	1-Jan-08	31-Mar-09	-47.52	-43.21	-47.33	-58.48	-43.42	-55.67	-49.55
Sharp Bounce Back Post Sub-prime Crisis	1-Apr-09	31-Dec-10	58.93	52.92	58.57	76.77	48.77	71.87	53.83
European Crisis	1-Jan-11	31-Mar-13	-2.56	-1.90	-3.54	-0.94	-3.36	-7.70	-4.67

Long-term investing is rewarding

When it comes to investing in equities, 'think long-term' is the golden rule of thumb. Staying invested for a longer time frame not only eliminates the impact of short-term market volatility but also helps generate positive returns.

To look at the benefits of long-term investments, CRISIL looked at five-year returns on a daily rolling basis starting from April 1, 1997 of the CRISIL-AMFI Equity Fund Performance Index. The study revealed that the CRISIL-AMFI Equity Fund Performance Index never delivered negative returns for a five-year investment horizon on a daily rolling basis in the last 16 years, despite the fact that equity markets witnessed three bear phases during this period.

Table 3: CRISIL-AMFI Equity Fund Performance Index – Daily rolling five-year return analysis (April 1, 1997 to March 31, 2013)

	Return		
	CRISIL-AMFI Equity Fund Performance Index (%)	CNX NIFTY(%)	CNX 500 Index (%)
Min	0.76	-5.65	-3.28
Max	55.01	44.52	48.13
Average	22.23	13.52	15.43

Conclusion

The CRISIL-AMFI Equity Fund Performance Index clearly reveals that equity mutual funds have given higher returns than broad market indices. As most retail investors may not have an in-depth understanding of the financial markets, or may not have sufficient time to track the markets, direct equity investment can prove to be risky. CRISIL believes that investing in mutual funds is the ideal way for retail investors to reap returns and create wealth as they are managed and supervised by professional money managers. The study also brings out the benefits of long-term investing. The findings are more relevant today, when the markets are globally integrated and, hence highly vulnerable to global events as evident from the back-to-back sub-prime crises of 2008 and the European crisis of 2011.

4 Balanced Funds

A strong and simple asset allocation option

One of the golden rules of financial investment is – “Don't put all your eggs in one basket.” Diversifying investment across asset classes plays an important role in building long-term financial security. Most investors today face a dilemma of varying their allocation towards equity. Balanced mutual funds offer a simple solution to this dilemma, if investors are comfortable with the asset allocation pattern followed by these funds; 65-80% into equity and the balance in debt instruments. These also insulate the investor from making hasty investment decisions when there are sudden changes in equity markets. CRISIL’s study reveals that in the last ten years balanced funds at an aggregate level witnessed lower capital erosion when the markets declined. Balanced funds also enabled investors to capitalise from gains in equity markets by delivering returns higher or similar to those of the CNX NIFTY, thus highlighting the benefits of asset allocation.

CRISIL has created indices that reflect performance of funds at an aggregate level. The indices are based on mutual fund schemes ranked under CRISIL Mutual Fund Rankings on a quarterly basis. CRISIL-AMFI Balanced Fund Performance Index consists of mutual fund schemes from the balanced fund category.

Performance analysis

Balanced funds (measured by the CRISIL-AMFI Balanced Fund Performance Index) have outperformed CRISIL Balanced Fund Index (the category benchmark), CNX NIFTY and CNX 500 across various time frames analysed, as on March 31, 2013 **(see Table 1)**. CRISIL’s study also shows that the balanced fund category has managed to achieve the objective of delivering returns higher or in line with the equity markets and minimising losses when equity markets deliver negative returns. The CRISIL-AMFI Balanced Fund Performance index has given higher returns than the CNX NIFTY in three out of five market cycles since April 1, 2000 **(see Table 2)**.

Table 1 - Performance

Index	3 Years (%)	5 Years (%)	7 Years (%)	10 Years (%)
CRISIL-AMFI Balanced Fund Performance Index	5.96	9.11	10.31	20.60
CRISIL Balanced Fund Index	4.64	5.78	8.17	14.72
CNX NIFTY	2.68	3.72	7.60	19.24
CNX 500 Index	0.96	3.01	6.21	20.26

Performance as on March 31, 2013

Table 2 – Market phase analysis – CRISIL-AMFI Balanced Funds Performance Index

Period	From Date	To Date	CRISIL - AMFI Balanced Fund Performance Index Annualised Return (%)	CNX NIFTY Annualised Return (%)
Tech Bubble	1-Apr-00	30-Sep-01	-33.80	-29.05
Bull Phase of 2003-07	1-Apr-03	31-Dec-07	42.11	46.97
Sub-prime crisis	1-Jan-08	31-Mar-09	-35.93	-43.42
Sharp bounce back post Sub-prime crisis	1-Apr-09	31-Dec-10	51.67	48.77
European crisis	1-Jan-11	31-Mar-13	0.78	-3.36

Benefits of investing in balanced funds

1 **Diversification –** One of the key benefits of investing in a balanced fund is the mix of debt and equity investments. The diversification between equity and debt protects the portfolio from downside risks if either equity or debt enters a bearish phase. While equity has the potential to deliver superior long-term returns, debt provides stability to the portfolio.

2 **No manual rebalancing of asset allocation –** In line with the investment goal, investors need to periodically rebalance their equity and debt investments if held separately. However, this can be a tedious exercise, besides having tax and cost (of rebalancing) implications. Market sentiments tend to drive asset allocation decisions, if done manually, which may not be in the best interest of investors.

These challenges can be avoided by investing in a balanced fund as the responsibility of asset allocation and portfolio rebalancing lies with the fund manager, and investors get the benefit of both equity and debt by investing in one fund.

3 **Tax benefits –** Most balanced funds maintain at least 65% exposure to equities, thereby allowing them to be taxed like equity funds. These funds enjoy tax-free returns for holding periods greater than one year. Dividend distributed by balanced funds is also tax free.

Table 3 – Tax implications*

Based on equity exposure	Investment held for less than one year	Investment held for more than one year
Minimum 65% exposure in equities (taxed like equity funds)	• **For growth option -** 15.45% (including cess) • **For dividend option -** Nil to the extent of dividend declared	• **Nil**
Less than 65% exposure in equities (taxed like debt funds)	• **For growth option -** As per the investor's income tax slab • **For dividend option -** 28.325%, including surcharge and cess to the extent of dividend declared	• **For growth option -** lower of 10.3% without indexation or 20.6% with indexation • **For dividend option -** 28.325%, including surcharge and cess to the extent of dividend declared

*Tax rates applicable for Financial Year 2013-14

Conclusion

Asset allocation is an important aspect to be considered while building a portfolio for long-term investing. Balanced funds provide a readymade solution to the investor's need for a well-diversified portfolio. Historical performance of these funds merit investor's attention for this category. Coupled with tax benefits from balanced funds, this category is an optimum choice for one's portfolio. The fund manager's ability to rebalance the equity and debt allocation helps investors as they need not maintain separate portfolios for equity and debt. One must, however, conduct some due diligence before investing in balanced funds. Investors can select funds by analysing their track record of performance as well as portfolio composition.

5 Monthly Income Plans

An alternative to long-term fixed deposits

Indian investors' preference for guaranteed returns has made bank FDs the largest portion of India's savings pie. In their quest for safety, long-term investors often miss out on the extra return they can generate by having a marginal exposure to equity. Most investors are unaware of hybrid mutual funds, which not only offer convenience and liquidity but also come with better tax benefits vis-à-vis bank FDs.

Monthly Income Plans (MIPs) are mutual funds that provide an optimal combination of equity and debt for risk-averse investors. These funds invest a majority of their portfolio (at least 70%) in debt and the rest in equities and are ideal for an investment horizon of greater than three years. CRISIL's analysis reveals that MIPs have given better tax-adjusted returns than 3 Year FDs.

CRISIL has created indices that reflect the performance of funds at an aggregate level. The indices are based on mutual fund schemes ranked under CRISIL Mutual Fund Rankings on a quarterly basis. The CRISIL-AMFI MIP Fund Performance Index consists of mutual fund schemes from MIP-Conservative and MIP-Aggressive categories. The equity allocation for MIP-Conservative and MIP-Aggressive funds ranges from 0-15% and 15-30%, respectively.

CRISIL 3-Year FD Index is a time weighted index that takes into consideration the simple average of FD rates of top three (by total deposits) public and private sector banks.

MIPs outperform FDs

CRISIL's study on mutual funds' performance over the past 10 years reveals that at an aggregate level, MIP funds (measured by the CRISIL-AMFI MIP Fund Performance Index) have outperformed the 3-Year FD Index over 1, 5, 7 and 10 year periods **(See Table 1).**

Table 1 – Annualised performance (%)

Indices	1 Year (%)	3 Years (%)	5 Years (%)	7 Years (%)	10 Years (%)
CRISIL-AMFI MIP Fund Performance Index	8.48	7.20	8.79	8.45	9.42
Benchmark - CRISIL Monthly Income Plans Index	9.06	6.81	6.95	7.33	8.28
3 Year FD Index	8.40	8.27	8.10	7.60	7.45

Performance as on March 31, 2013

More tax-efficient than bank FDs

MIPs, which are taxed similar to debt-oriented funds, attract a lower tax rate than bank FDs, except when an investor falls in the lower tax bracket of 20% and 10%. **(See Table 2)**

Table 2 – Comparison of tax rates – MIPs vs. bank FDs

Holding period	Tax rate – MIPs	Tax rate – Bank FDs
Less than one year - Dividend option	28.325%, including surcharge and cess, deducted at source	As per individual tax slab rates with maximum tax rate of 30.9% and minimum of tax rate of 10.30%
Less than one year - Growth option	As per individual tax slab rates with maximum tax rate of 30.9% and minimum tax rate of 10.30%	
Greater than one year - Dividend option	28.325%, including surcharge and cess, deducted at source	
Greater than one year - Growth option	Long-term capital gains tax of 20.6% or 10.3% (including cess) with or without taking inflation indexation into account respectively	

Tax rates applicable for Financial Year 2013-14

In Table 1, even though the CRISIL-AMFI MIP Fund Performance Index underperformed the 3 Year FD Index, the tax benefit resulted in a higher post-tax return. **(See Illustration 1)**

In Illustration 1, an investor who is in the highest tax bracket would have earned a return of 7.20% (post-tax) over a 3-year period in a MIP as against 5.85% in a 3-year bank FD. Similarly, for a 5-year investment horizon, an investor would have earned a post-tax yield of 8.79% in a MIP as against 5.85% in a FD benchmarked to the 3-year FD Index. This indicates that post-tax, MIP funds yield better returns vis-à-vis bank FDs, where the interest earned would be taxed based on the individual's tax slab. Additionally, if an investor falls in the 20% tax bracket, post-tax yield on FDs will be 6.67% for three years and 6.62% for five years which is still lower than the post-tax yield of a MIP fund.

Illustration 1 - Comparison of post-tax returns – MIPs vs. bank FDs

Investment Type	Amount Invested (Rs)	Indicative Yield (%)	Pre-tax Returns (Rs)	Tax Rate (Highest) (%)	Post-Tax Returns (Rs)	Post-Tax Annualised Yield (%)
Post tax returns for 3 year investment horizon						
3 Year FD Index	500,000	8.27*	134,592	30.90	93,003	5.85
CRISIL-AMFI MIP Fund Performance Index	500,000	7.20 ^	115,963	20.60**	115,963 @	7.20
Post tax returns for 5 year investment horizon						
3 Year FD Index	500,000	8.10*	238,072	30.90	164,507	5.85
CRISIL-AMFI MIP Fund Performance Index	500,000	8.79 ^	261,930	20.60**	261,930@	8.79

Tax rates applicable for Financial Year 2013-14
Analysis as on March 31, 2013
*3-year return of FD Index
^3-year return of CRISIL-AMFI MIP Fund Performance Index
**Assuming an investment of 3 years
@Indexation benefits have resulted in nil tax

How to choose MIPs?

Conservative investors, with a greater than 3-year time horizon, can enhance their portfolio returns by investing in equities through the MIP route. The category not only offers higher returns than 3-year FDs but also helps cushion the downside risks of the equity market.

Each MIP has a stated asset allocation that sets an upper limit on the equity component. Based on this cap, MIPs can be categorised as conservative (cap up to 15%) and aggressive (between 15% and 30%). Within the stated equity cap, a fund manager may alter the portfolio's equity exposure based on the prevailing market scenario. This asset allocation strategy ensures that MIPs are less risky than pure equity funds and only marginally more risky than pure debt funds.

Investors seeking regular income can select from monthly, quarterly, half-yearly or annual dividend options. However, MIP schemes are not obliged to provide any 'monthly income' (dividend) as the name suggests. This is dependent on the scheme's cash flows. A growth option is also available to investors who do not require any regular dividend income.

6 Long-Term Debt Funds

An ideal avenue to invest during a declining interest rate scenario

"long-term debt funds provided the highest returns when interest rates declined."

While traditionally bank FDs comprise a bulk of the fixed income investment space, debt mutual funds are also an ideal avenue for investors due to their inherent qualities of professional management, liquidity and tax efficiency. Among debt mutual funds, long-term debt funds provided the highest returns when interest rates declined. CRISIL's study shows that long-term debt funds have outperformed bank FDs by a significant margin during declining interest rate cycles since April 1, 2000.

Long-term debt funds are of two types – income funds and gilt funds. Income funds invest a majority of their corpus in long-term corporate debt papers and government securities. Gilt funds invest only in securities issued by central and state governments, thereby carrying lower credit risk than income funds. The average maturity of long-term debt funds can range between a few months to 25 years, depending on the prevalent interest rate scenario. These funds are suitable for investors with a long-term investment horizon.

CRISIL has created indices that reflect the performance of funds at an aggregate level. The CRISIL-AMFI Debt Fund Performance Index consists of gilt funds, income funds and short-term debt mutual fund schemes which form a part of CRISIL Mutual Fund Rankings.

CRISIL 3-Year FD Index is a time weighted index, which takes into consideration the simple average of FD rates of the top three (by total deposits) public and private sector banks.

Long-term debt funds benefit in a declining interest rate scenario

The value of a debt fund's portfolio is inversely related to the interest rate movement. The portfolio value rises when interest rates fall and vice-versa. The longer the maturity period of the portfolio, the greater is the impact of a change in interest rates.
Thus, long-term debt funds benefit the most when interest rates fall. CRISIL's study of long-term debt funds (measured by the CRISIL-AMFI Debt Fund Performance Index) reveals that these funds have outperformed the 3-Year FD Index by a significant margin when interest rates fell. Gilt funds (represented by the CRISIL-AMFI Gilt Fund Performance Index) generated the highest returns during these phases. **(See Table 1)**

Table 1 – CRISIL-AMFI Debt Fund Performance Index vs. 3-year FD rates

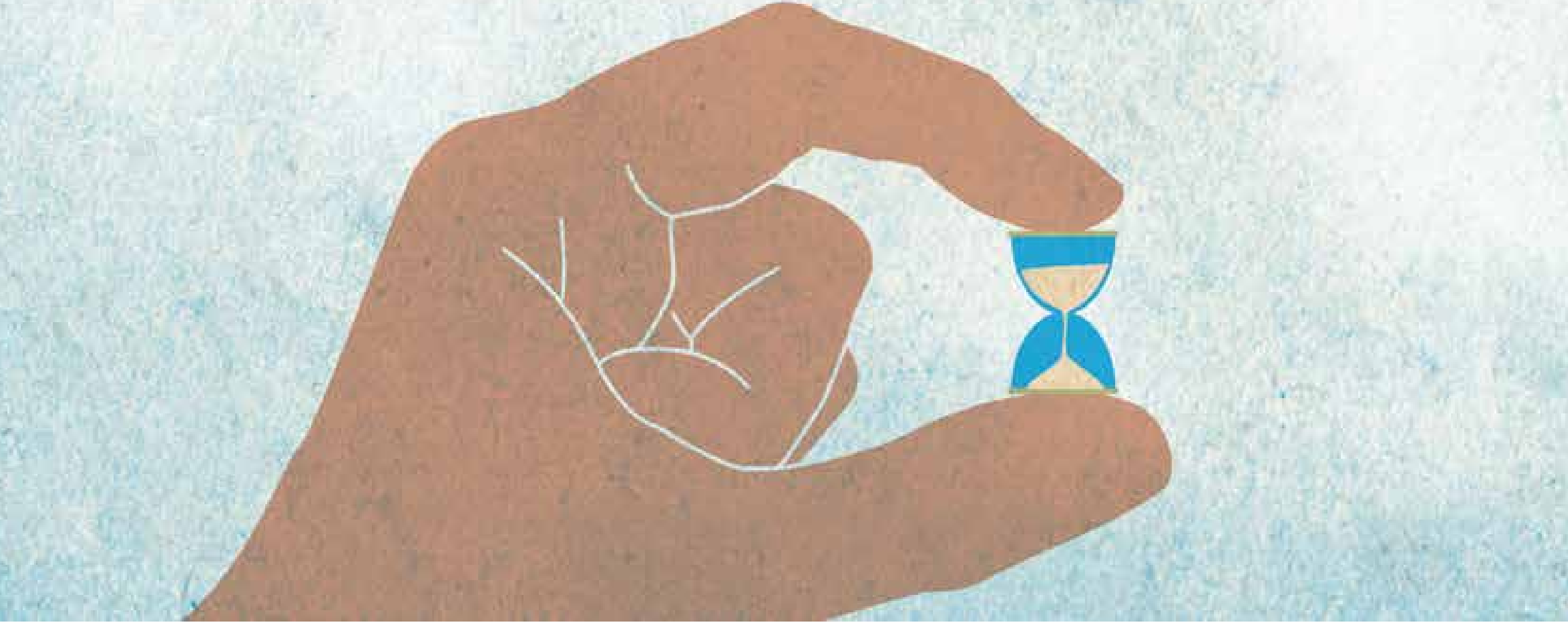
Period	From Date	To Date	10-year Government Security Yields (%)		Annualized Returns (%)				3-year FD rates at the beginning of the period (%)
			As on "From date"	As on "To date"	CRISIL-AMFI Debt Fund Performance Index (%)	CRISIL-AMFI Income Fund Performance Index (%)	CRISIL-AMFI Gilt Fund Performance Index (%)	CRISIL-AMFI Short Term Debt Fund Performance Index (%)	
Secular decline in yields in 2000-04	01-Apr-00	30-Apr-04	11.10	5.19	11.93	12.04	16.46	–	10.5
Flat or high interest rate period of 2004-08	30-Apr-04	31-Jul-08	5.19	9.54	4.54	4.20	3.25	6.42	5.38
Sharp correction in yields in 2008^	31-Jul-08	31-Dec-08	9.54	5.32	14.07	19.18	25.71	5.12	7.88*
Flat or high interest rate period of 2008-13	31-Dec-08	31-Mar-13	5.32	8.11	6.35	5.83	2.96	7.70	9.88

*1-year FD rate
^Absolute returns

Conclusion

Historically, long-term debt funds have given superior returns over FDs in a falling interest rate scenario. The quantum of returns depend on the pace and degree of the decline in interest rates. Investors should consider the following while investing in long-term debt funds:

1. **Interest Rate Risk –** Investors should look at the underlying interest rate cycle before investing. Long-term debt funds benefit from a falling interest rate regime.
2. **Credit Risk –** Investors can gauge the credit risk of a debt fund by looking at the rating distribution of the portfolio.
3. **Concentration Risk –** Funds that have a diversified portfolio of debt instruments but do not concentrate on a few sectors or issuers are ideal.
4. **Exit Loads –** Investors must check whether any exit load is applicable for early withdrawal from an open-ended debt fund.



7 Short-Term Debt Funds

A suitable alternative to short term fixed deposits

Fixed income is a very important component of an investment portfolio, especially for conservative investors who want stable returns. In India, retail investment in debt is mainly associated with FDs and there is a lack of awareness of debt mutual funds. Short-term debt fund is one such category investing in short-term corporate debt papers, money market instruments such as certificates of deposit (CDs), commercial papers (CPs), etc. and government securities whose residual maturities range up to three years. These funds are suitable for investors with a medium-term investment horizon.

There are several distinct advantages that debt mutual funds offer over FDs. Debt funds provide investors access to portfolios of varying maturities and credits which can lead to higher returns over FDs. Debt funds also provide additional benefits of liquidity and tax efficiency. CRISIL's study of short-term debt funds over the past 10 years reveals that the returns on these funds have been higher than investments in 1-year FDs. On a year-on-year basis, these funds have outperformed 1-year FDs during a declining interest rate scenario.

CRISIL has created indices that reflect the performance of funds at an aggregate level. The CRISIL-AMFI Short-Term Debt Fund Performance Index consists of short-term debt mutual fund schemes which form a part of CRISIL Mutual Fund Rankings.

CRISIL 1-Year FD Index is a time-weighted index which takes into consideration the simple average of FD rates of the top three (by total deposits) public and private sector banks.

Short-term debt funds give better returns than 1-year FDs

CRISIL's study reveals that short-term debt funds (measured by the CRISIL-AMFI Short-Term Debt Fund Performance Index) have given better returns than the 1-Year FD Index across time frames. **(See Table 1)**

Table1: CRISIL-AMFI Short-Term Debt Fund Performance Index vs. 1-Year FD Index

Indices	1 Year (%)	3 Years (%)	5 Years (%)	7 Years (%)	10 Years (%)
CRISIL-AMFI Short-Term Debt Fund Performance Index	10.05	8.17	7.99	8.01	7.20
1-Year FD Index	9.07	7.92	7.80	7.38	6.85

Performance as on March 31, 2013

Short-term funds outperform 1-Year FD Index during falling interest rates

While short-term funds have outperformed the 1-Year FD Index over a long time frame, on a year-on-year basis, these funds have done well in the years in which interest rates have fallen. (There is an inverse relationship between interest rates and the price of debt securities, i.e. when interest rates rise, the price of the security falls and vice-versa.) As shown in Table 2, during falling interest rate scenarios, the CRISIL-AMFI Short-Term Debt Fund Performance Index has given superior returns over 1-year FDs. Importantly, in six out of the 11 financial years, the CRISIL-AMFI Short-Term Debt Fund Performance Index has shown better returns than 1-year FDs. Even in the years in which they have underperformed, the underperformance is not significant.

Table 2: Comparison of year-on-year performance of CRISIL-AMFI Short-Term Debt Fund Performance Index with 1-Year FD rates

Year Ending	1 Year Returns (%)		
	10 Year Yield Trend	CRISIL-AMFI Short-Term Debt Fund Performance Index	1 Year FD Rates (%)
31-Mar-03	▼	8.08	8.13
31-Mar-04		6.27	5.88
31-Mar-05		4.54	5.13
31-Mar-06	▲	5.16	5.25
31-Mar-07		6.94	5.75
31-Mar-08	▼	9.21	7.00
31-Mar-09		9.01	7.50
31-Mar-10		6.43	8.05
31-Mar-11	▲	5.35	6.13
31-Mar-12		9.17	8.25
31-Mar-13	▼	10.05	9.04

Short-term debt funds are tax efficient

Short-term debt funds have a considerable tax advantage over FDs. While the interest earned on deposits is added to one's income and taxed at the applicable rate, income from short-term debt funds held for more than one year is treated as long-term capital gains and is taxed at a lower rate. For a holding period of more than a year, the long-term capital gains tax rate applicable is lower at 10.3% without indexation or 20.6% with indexation benefit. Indexation (for tax purposes) allows the returns generated on the investment to be adjusted for inflation. Thus, investors in the higher income tax slab of 20% and 30% are likely to gain by investing in short-term debt funds on account of the lower tax rate and indexation benefit. However, if the investment horizon is less than a year, the tax is as per the individual tax slab. Further, for investors that fall in the highest tax bracket of 30%, the dividend option (reinvestment or payout) provides a tax advantage vis-à-vis FDs because the dividend distribution tax (DDT) is charged at 28.325% (25% plus 10% surcharge plus 3% cess).

Illustration 1 – Comparison of post-tax returns – Short-Term Debt Funds vs. Bank FDs

Investment Type	Amount Invested (Rs)	Indicative Yield (%)	Pre-tax Returns (Rs)	Tax Rate (Highest) (%)	Post-Tax Returns (Rs)	Post-Tax Annualised Yield (%)
1 Year FD Index	5,00,000	9.07*	45,350	30.90	31,337	6.27
CRISIL-AMFI Short-Term Debt Fund Performance Index – Dividend	5,00,000	10.05 ^	50,250	28.33**	39,158	7.83
CRISIL-AMFI Short-Term Debt Fund Performance Index – Growth	5,00,000	10.05 ^	50,250	20.60**	48,690@	9.74

Tax rates applicable for Financial Year 2013-14
Analysis as on March 31, 2013
*1-year return of FD Index
^ 1-year returns of CRISIL-AMFI Short Term Debt Fund Performance Index. For dividend option, it has been assumed that the total income earned is distributed as dividend
**Assumes an investment of 1 year and 1 day
@Indexation benefits have resulted in lower tax liability of Rs. 1,560

In Illustration 1, an investor in the highest tax bracket would have earned a 1-year return of 9.74% (post tax) by investing in short-term debt funds as against 6.27% in a 1-year bank FD. This indicates that post-tax short-term debt funds yield better returns vis-à-vis bank FDs, where the interest earned would be taxed based on an individual's tax slab.

Conclusion

For a conservative investor, protection of the investment is critical. However, financial prudence dictates having liquidity for emergency as well as capital appreciation. If one seeks capital appreciation and tax benefit, along with reasonable safety of capital, short-term debt funds are a good alternative to FDs. However, unlike FDs, short-term debt funds do not have fixed returns. Returns in debt funds fluctuate depending on the movement in interest rates. When interest rates are falling, short-term debt funds have given higher returns than FDs. Thus, investors can take tactical decisions and time their investments in short-term debt funds.

8 Money Market Funds

A better option to savings bank deposits

Savings bank deposits have been the retail investors' preferred investment option to park surplus cash. Most investors regard these as the only avenue while some believe parking surplus cash elsewhere can erode their capital and does not provide liquidity. CRISIL's recent study draws attention to a more attractive option – money market mutual funds. The analysis underlines that surplus cash invested in money market mutual funds earns high post-tax returns with a reasonable degree of safety of the principal invested and liquidity.

Money market funds

Money market funds are of two types - liquid funds and ultra short-term funds. These funds invest into short-term corporate debt papers, CDs, CPs and government treasury bills (T-bills) to generate optimal returns while maintaining safety and high liquidity. Redemption requests in these funds are processed within two working days.

Comparison between liquid funds and ultra short-term funds

Sr. No.	Particulars	Liquid Funds	Ultra Short-term Funds
1	**Portfolio average maturity**	60 days and below	1 year and below
2	**Taxation for individual**		
2.1	Growth options		
2.1.1	Short-term capital gains	As per individual's tax bracket	As per individual's tax bracket
2.1.2	Long-term capital gains	Lower of 10% without indexation and 20% with indexation plus 3% cess	Lower of 10% without indexation and 20% with indexation plus 3% cess
2.2	Dividend options		
2.2.1	Dividend distribution tax (deducted at source)	28.325% (25% + 10% surcharge + 3% cess)	28.325% (25% + 10% surcharge + 3% cess)

Tax rates applicable for Financial Year 2013-14

CRISIL has created indices that reflect the performance of funds at an aggregate level. The CRISIL-AMFI Money Market Fund Performance Index consists of liquid and ultra short-term mutual fund schemes which form a part of CRISIL Mutual Fund Rankings.

CRISIL Savings Bank Deposit Index is an index that tracks the returns on savings bank deposits, which takes into consideration the simple average of savings bank deposit rates of the top three public and private sector banks (by total deposits).

Money market funds outperform savings bank deposit

CRISIL's study shows that money market funds (measured by the CRISIL-AMFI Money Market Fund Performance Index) have outperformed savings bank deposits across all time horizons. **(See Table 1)**

Table 1: CRISIL-AMFI Money Market Fund Performance vs. Savings bank deposit

Indices	1 Year (%)	3 Years (%)	5 Years (%)	7 Years (%)	10 Years (%)
CRISIL-AMFI Money Market Fund Performance Index	9.00	8.04	7.47	7.48	6.73
CRISIL-AMFI Liquid Fund Performance Index	8.95	7.95	7.29	7.33	6.62
CRISIL-AMFI Ultra Short Fund Performance Index	9.06	8.10	7.56	-	-
Savings Bank deposit	4.00	3.81	3.69	3.64	3.60

Performance as on March 31, 2013

The tax advantage

Investments in money market funds are more tax efficient than parking money in savings bank deposits.

As outlined in Illustration 1, an investor who is in the highest tax bracket would have earned a 1-year return of 8.90% (post-tax) if the investment was in a money market fund (growth option) as against 3.38% in a 1-year savings deposit.

Illustration 1: 1-year returns across investment types for Rs.500,000 invested

Investment Type	Indicative Yield (%)	Pre-tax Returns (Rs)	Tax Rate (Highest) (%)	Post-Tax Returns (Rs)	Post-Tax Annualised Yield (%)
Savings bank deposit	4.00*	20,000	30.90	16,910^ ^	3.38
Liquid fund – dividend	9.00^	45,000$	28.33	35,067	7.01
Ultra short-term fund – dividend	9.00^	45,000$	28.33	35,067	7.01
Liquid fund – growth	9.00^	45,000	20.60**	44,521@	8.90
Ultra short-term fund – growth	9.00^	45,000	20.60**	44,521@	8.90

Tax rates applicable for Financial Year 2013-14
*Average of top three public and private sector banks (by total deposits)
^1-year returns of CRISIL-AMFI Money Market Fund Performance Index has been used to highlight the relative tax benefits. For dividend option, total income earned is assumed to be distributed as dividend.
^ ^Interest income up to Rs.10,000 is tax-exempted
**Assumes an investment of 1 year and 1 day
@Indexation benefits have resulted in lower tax liability of Rs.479
$Dividend income earned

Conclusion

Money market funds are an alternate investment avenue for individuals willing to take marginal risk to park their short-term surplus funds. While savings bank deposits are easier to access and offer some degree of principal protection, the higher yield combined with liquidity and taxation benefits make money market funds an attractive option.

Annexure Mutual fund category definitions

Sr. No.	Investment Category	Investment Objective	Nature of Scheme with indicative time horizon (short/medium/long-term)
1	Large Cap Equity	Investment in equity and equity-related securities including equity derivatives predominantly in large cap stocks	This scheme is suitable for investors who are seeking long-term capital growth.
2	Diversified Equity	Investment in equity and equity-related securities including equity derivatives across market capitalisation and sectors	This scheme is suitable for investors who are seeking long-term capital growth.
3	Small and Midcap Equity	Investment in equity and equity-related securities including equity derivatives predominantly in small and mid-cap stocks	This scheme is suitable for investors who are seeking long-term capital growth.
4	Thematic - Infrastructure Funds	Investment in equity and equity-related securities including equity derivatives of companies from a specified sector.	This scheme is suitable for investors who are seeking long-term capital growth.
5	Equity Linked Savings Scheme (ELSS)	Investment in equity and equity-related securities including equity derivatives across market capitalisation and sectors. Also have a 3 year lock-in period and provide income tax exemption under section 80 C up to Rs.1 lakh	This scheme is suitable for investors who are seeking long-term capital growth.
6	Index	Investment in equity securities in the same proportion as the underlying index	This scheme is suitable for investors who are seeking long-term capital growth.
7	Balanced	Investment in equity and equity-related securities as well as fixed income securities (debt and money market securities).	This scheme is suitable for investors who are seeking long-term capital growth and current income.
8	Monthly Income Plan	Investment in equity and equity-related securities as well as fixed income securities (debt and money market securities).	This scheme is suitable for investors who are seeking long-term capital growth and current income.

Sr. No.	Investment Category	Investment Objective	Nature of Scheme with indicative time horizon (short/medium/long-term)
9	Long-Term Gilt Funds	Investment in government securities	This scheme is suitable for investors who are seeking long-term income
10	Long-Term Income Funds	Investment in Debt/Money Market Instrument/Govt. Securities.	This scheme is suitable for investors who are seeking long-term income
11	Short-Term Income Funds	Investment in Debt/Money Market Instrument/Govt. Securities.	This scheme is suitable for investors who are seeking medium-term income
12	Ultra Short-Term Debt Funds	Investment in Debt/Money Market Instrument/Govt. Securities.	This scheme is suitable for investors who are seeking short-term income
13	Liquid Funds	Investment in Money Market Instrument/Govt. Securities.	This scheme is suitable for investors who are seeking short-term income

CRISIL Limited

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent and integrated research house. We provide insights, opinions, and analysis on the Indian economy, industries, capital markets and companies. We are India's most credible provider of economy and industry research. Our industry research covers 70 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 4,500 primary sources, including industry experts, industry associations, and trade channels. We play a key role in India's fixed income markets. We are India's largest provider of valuations of fixed income securities, serving the mutual fund, insurance, and banking industries. We are the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today India's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectorial linkages. We deliver our research through an innovative web-based research platform. Our talent pool comprises economists, sector experts, company analysts, and information management specialists.

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Association of Mutual Funds in India

About AMFI

Association of Mutual Funds in India (AMFI) incorporated in 1995 under Section 25 of the Companies Act, 1956, is the Trade Body of all the Mutual Funds registered with SEBI. At present AMFI has 46 Members. It is a non-profit organisation, committed to develop the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interest of Mutual Funds and their unit-holders.

AMFI is governed by the Board and the Directors are elected by the members every year. AMFI has developed a unique style of functioning through Committees, constituted by the Board on various subjects. At present AMFI has 6 Standing Committees.

About AMFI's Activities

AMFI plays an important role in liaising with Regulatory Bodies, Ministry of Finance, etc. on matters pertaining to the Mutual Fund Industry.

AMFI formulates guidelines on several operational and compliance areas with a view to comply with statutory requirements, such as Valuation of Securities, etc.

AMFI carries out the activities of registering Mutual Fund Distributors and assigns them an ARN (AMFI Registration Number).

AMFI being the Industry Body disseminates information pertaining to the Mutual Fund Industry on its website, which is widely used by the Analyst, Media and Research Institutions.

Another important activity undertaken by AMFI from its inception is Investor Awareness Programme (IAP). Over the years, AMFI itself and through AMCs and various bodies organised a large number of Awareness Programmes.


Long
Term
Growth

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