 Apr 13, 2009

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Monthly Income Plans – The best of both worlds

What is an MIP?

MIP is a hybrid investment plan that invests a small portion of its portfolio, around 15 to 25 percent, in Equities, and the remaining in Debt and Money Market Instruments. This plan is ideal for those investors who score low or medium on their risk profile.

A general misunderstanding about MIP among investors is that it is an investment avenue offering assured monthly returns. From the name you may infer that MIP gives you fixed monthly returns, but that's not the way it functions. "An MIP is generally mistaken for a regular income plan; but actually, it gives you returns based on market performance".

Why invest in MIPs?

Investing, for a general investor has always meant seeking a stable, regular return. One is willing to settle for lower returns as long as the risks are lower. Equity is not the preferred first choice for the risk-averse investor because of the inherent risks attached to it. Moreover, nobody likes his/her principal investment amount to fluctuate wildly. However, one always strives for at least an inflation beating performance from his/her investment without assuming too high risks. This is where MIP steps in to the picture. With a bulk of the total portfolio exposed to debt and cash and much smaller allocations to equity, MIPs have a knack of generating inflation beating returns across market cycles, at considerably low risk and over a medium to long term horizon. In a situation when the equity market is performing well, it will give you above average returns whilst when equity market is not performing well, exposure to debt helps in reducing the downside and generating reasonable returns.

Financial markets have been pretty volatile over the last 15 months or so. And the volatility has spread across asset classes including the so-called safe asset classes such as Gold, Cash and Debt. The sharp downside in equities since January 2008, the rally in commodities in the first half of 2008 followed by a sharp collapse, the initial run in Gold to $1000/oz and then the sharp fall to $700 levels, the liquidity crunch in India in Sep-Oct 2008 following the Lehman Brothers episode in the USA, the explosive rally in debt in the last quarter of 2008 and then the slow, grinding upside in yields in the immediately following quarter, all these are instances of unprecedented volatility in financial markets.

Now, it is very difficult to choose asset classes that will outperform in this kind of a scenario as the change in leadership has been pretty quick and unpredictable. Sticking to any one particular asset class over this period (other than Gold of course) would have led to severe underperformance either absolute or relative. Hence, the situation demands that your portfolio be a judicious mix of asset classes in order to consistently deliver above average returns. But a general investor cannot be expected to be able to build and manage such a diversified portfolio. This is where MIPs, as an investment option comes in very handy.

In fact, MIPs have been in the lime light over the past few months. The return by Crisil MIPEX over a period of last 3 months has been around 5.08%.

Benefits of investing in MIPs:

- MIPs come with highly rated debt papers and flexibility in managing the modified duration which will be quite useful in the current volatile interest rate scenario.
- MIPs come with relatively low Standard Deviation as compared to gilt funds and almost at par with income funds. This gives them the ability to earn better risk adjusted returns.
- Possibility of stable & regular income: MIPs declare dividends on a periodical basis, whenever they have distributable surplus and investors benefit from such form of income as dividends are tax free in the hands of the investors.
- Better returns than Fixed Deposits over the long term: Anecdotal evidence has shown that equity has out-performed all asset classes in the long term. A slight exposure to equities thus helps in generating above average returns whereas exposure to debt helps in reducing the volatility besides giving positive returns in a falling interest rate scenario. Hence an investor can comfortably beat inflation by investing in MIPs over the medium to long term.
- Tax Benefits: Investors in the higher tax bracket get the benefit of lower taxation of debt in 1 year and above period as he gets the indexation benefits.

Who can invest:

Typically, MIPs are suited for investors with a low to moderate risk appetite. For instance, investors who wish to clock higher returns than those offered by fixed deposits or bonds and are willing to take on commensurately higher risk should consider investing in a Monthly Income Plan.

Also MIPs appeal to investors in higher tax brackets for their ability to deliver more competitive post-tax returns vis-a-vis avenues like fixed deposits.

Current Outlook:

Debt

RBI has come with a series of rate cuts and several other measures to boost the economy and with inflation almost coming down from double digit figure to Zero, a benign interest rate scenario is expected. These measures were warranted because of the following reasons:

- **Slowing Growth:** As the IIP growth rate is decreasing and is into negative zone, we can say that the rate of growth is falling with a decreasing rate.
- **Benign interest rate outlook:** The increasing liquidity crunch in the economy and with the prolonging pessimistic scenario it is expected that there can be one more rate cut to give support to the economy.

- **Need to boost sagging credit growth:** Banks have become wary of lending money to the Indian Corporate sector because of the fear of NPA's and also the negative quarterly results of the companies proved to be one more hurdle in the growth of credit.
- **Easy liquidity:** The measures taken by RBI and packages offered will support a soft interest rate regime going ahead in the medium term.

Equity

The equity markets are taken as the leading indicators for the economy growth and the current market scenario suggest the revival is due:

- Equity market bottoms normally coincide with interest rate bottoms.
- Recovery in credit growth marks a recovery in equities too
- Interest rates are likely to bottom out in the 2nd half of CY 2009 whilst credit growth should start recovering around the same time.
- Impact of stimulus packages to start getting felt in the 2nd half of CY 2009.
- **Bernanke** expects US economy to start recovering in 2010.
- Equities anticipate economic recovery and bottom out much in advance.
- Hence 2nd half of 2009 should see equities bottoming out and the start of a gradual recovery.
- Elections to be over by June 1st week, hence election related uncertainty will be over too in the 2nd half of 2009.
- Hence makes sense to be partly invested in equities to generate above average returns from your portfolio in the medium to long term.

Recommended funds:

We advise our investors to invest in MIPs with investment horizon of 1-2 years.

Below mentioned are some good MIPs for investment with a horizon of 1-2 years.

Performance of selected MIPs:

MIPs	Returns %			
	1 M	6 M	1 Year	2 Years
HSBC MIP – Regular	21.42	15.50	4.19	8.16
HDFC Monthly Income Plan - LTP	81.07	16.02	1.69	5.55
FT India Monthly Income Plan	50.46	7.58	-0.78	5.44
ICICI Prudential MIP Plan	74.74	28.40	4.82	6.56
Crisil MIPEX	48.47	14.51	2.96	6.95

Note: Returns as on 08th Apr, 2009
Returns above one year are annualized, others being absolute
Past Performance may or may not be sustained in future.

HSBC MIP Regular:

This fund has delivered 6.00% absolute returns over the last 6 month. It has invested around 80% in NCD and Bonds, 6% in cash and remaining in GOI, FD and Equity. Its portfolio has an average maturity of 4.29 years as per March portfolio.

HDFC Monthly Income Plan :LTP

This fund has delivered absolute returns 6.49% in the last 1 month. Over the last 6 months it has delivered absolute return of 5.28%. It has invested 67% in NCD and Bonds, 25.07% in Equity and remaining in Cash, Govt. securities. Its portfolio has average maturity of 6.16 years as per March portfolio.

FT India Monthly Income Plan:

This fund has delivered 5.26% annualized returns over the last 2 years. Over the last month this fund has delivered absolute return of 4.17%. It has invested 77% in NCD and Bonds and remaining in Cash and Equity as per portfolio on February 28, 2009. The fund has an average maturity of 2.11 years as per March Portfolio.

ICICI Prudential MIP Plan:

This fund has delivered absolute returns of 9.40% over the last 6 months. It has invested 45% in Ncd and Bonds, 22% in Govt Securities and remaining in Equity, F&O and cash as per February portfolio. Its portfolio has average maturity of 10.43 years as per portfolio on February 28, 2009.