ET Q&A

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Fear Psychosis Being Motivated By a Few People: Franklin Templeton

Investors are suffering because of the fear psychosis motivated by a few people, said **Santosh Kamath**, MD and CIO, fixed income, and **Vivek Kudva**, MD, India, Franklin Templeton Asset Management. In a freewheeling chat with **ET's Nishanth Vasudevan**, Kamath and Kudva dismissed rumours about unusual redemptions in Franklin's select debt funds and defended its strategy about long-term illiquid papers in its credit portfolio.
Edited Excerpts:

There is talk that some of Franklin's corporate bond funds seeing redemptions of over ₹2,000-3,000 crore in the last two weeks.

Santosh Kamath: We cannot comment on that. When people quote a number, it is a figment of their imagination. So, when the month-end factsheet comes, we will see what the redemptions are. In a competing world, you don't expect people to talk good about competition.

Some large distributors, in their notes, have highlighted that there could be liquidity issues in your credit funds.

SK: We cannot comment on what others are saying. It could be a genuine difference in views. Now, we do not know things like what is the motive behind it, who has asked them to do it.

But, you are holding a lot of long-dated illiquid papers in your corporate bond funds...

SK: When people look at liquidity, they only look at the asset side of the business. Let us look at the liability side. For example, if a fund has ₹500 crore AUM which includes ₹5 crore ticket size of 100 investors, and there is another fund with ₹50 crore of 10 investors, there is a huge difference in the stress that the two portfolios can take. The second fund is much more vulnerable than the one with ₹5 crore of 100 investors. When we started this business in 2009 just after the financial crisis, we understood how bad the liquidity can go. We were the only fund house to charge a higher exit load for corporate investors. The market was actually charging higher exit load for individuals and lower for corporates. We have seen more issues than a smooth journey between 2010 and 2013. So, we have ensured that the liability side is dispersed. We were the first fund house to put a cap on how much an investor can put money in

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SANTOSH KAMATH
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our corporate bond funds on a daily basis. We also put exit loads on our funds.

Also, investors have to stay put for 36 months if they need the tax benefit. So, there are enough deterrents to redeem.

Let us look at the asset side now. When we buy a paper, we have the basic assumption in our mind that it can get illiquid. We make the portfolio with a very staggered maturity. We want our portfolios to be auto-liquidated and should not be dependent on the market for liquidity. Also, we have options. A company came up to us and said it wanted to borrow for 3 years and would give 10%. Now the yield curve in India is flat in that 2-4-year bucket; all the three years give almost the same rates at around 10%. So, we tell the company, we will give four-year money at 10% on the condition that there would be a put option after three years. Now, if interest rates rise or the company's credit deteriorates, I will exercise this put option. So, I am generating liquidity by not selling in the market.

We have had cases where we have lent huge money to companies and there has been an interest rate reset. So, if we add all these things on the liability side, there is nothing to fear. And if all these things are not sufficient, we have banking lines. Sebi allows mutual funds to borrow 20% of their AUM and fund redemptions. But, we are one of the very few fund houses which have never used those lines to fund redemptions in our corporate bond funds.

Distributors are asking if there can be issues in a liquid fund why not in a credit opportunities fund?

SK: In 2008-09, times were very difficult. There was extreme shortage of liquidity. But, today we have a situation where base rates are getting cut. So, the environment is different. Again, in 2008-09, there was no minimum maturity for liquid funds, which could have even bought a one-year bank CD then. Today, the maximum it can buy is three months. If it buys anything above two months, it gets marked to market. So, most of them will be closer to two months, which means the entire portfolio matures in two months. So, where is the liquidity issue. By any chance, if this event in a mutual fund happened to a bank, there would not have been phone calls. Somehow, that event jolted the market in a big way.

Vivek Kudva: Suppose the same fixed income security was in a balanced fund, nobody would be worried about it. So, it is all their prejudices. In fact, distributors pushing clients to redeem has been a huge loss to customers. Suppose, you invested for two years in a fund and assume that debt funds have given 10% per annum.

So, now you are sitting on 20%. If you had kept it for three years, you would have been eligible for long-term capital gains. So, after capital gains, you would have got approximately 27% returns. Now, if you redeem before three years, you would pay 35% tax. There, the 10% becomes 6.5%. Now, you are okay with that. But, if there is a security which was 2% of the fund and it became zero, you lose 2%. So, are sitting on 20%; you lose 2% and still have 18%. So, the question is how much clients are being forced to give up because of the fear factor.

SK: And this fear psychosis is being motivated by a few people. The poor investor, who does not do the calculation, suffers.

Various mutual funds' debt portfolios including yours have exposure to stressed sectors such as metals.

SK: Debt, according to us, is a very bottoms-up approach. It can never be top-down because in every sector, there is a weak and a strong company. So, it is unfair to say that a sector is stressful and all companies in the sector are weak.