ACADEMY

# WMA

CERTIFICATE IN
WEALTH MANAGEMENT

# Session 2- Asset Classes- Debt

# Different Asset Classes

## Active Asset Classes



## Passive Asset Classes


# Introduction to Debt market

# Presentation Order

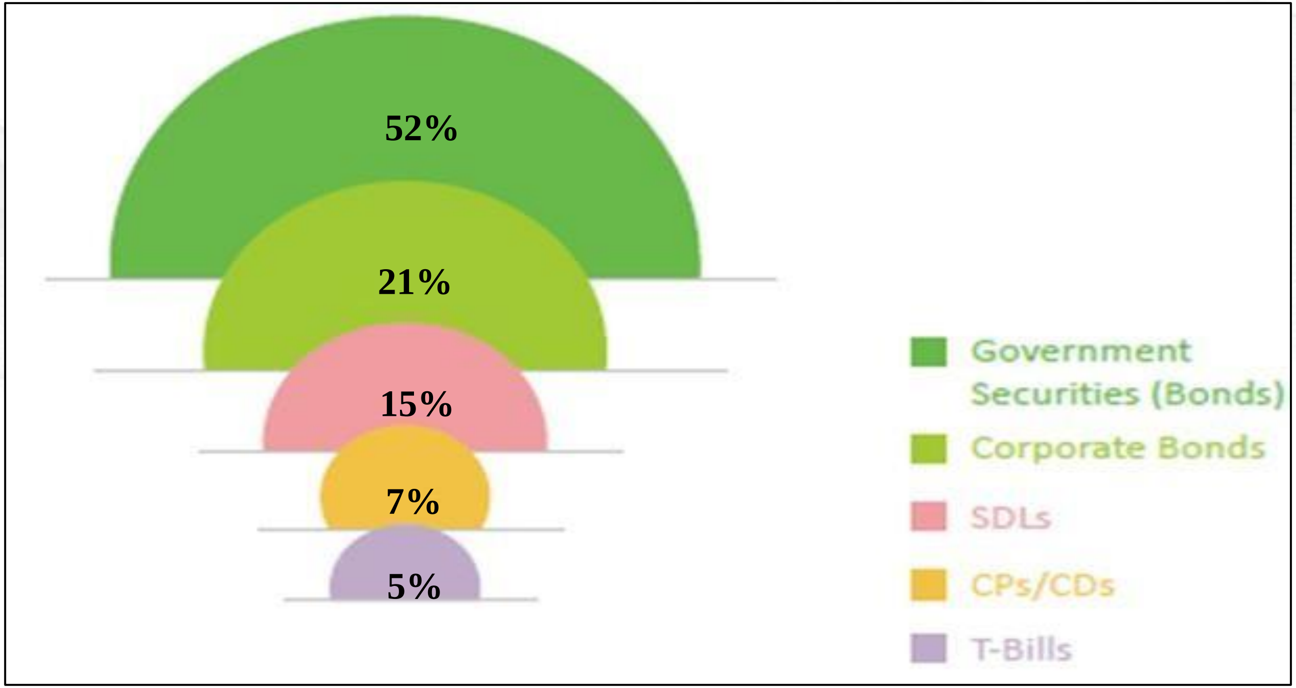
- Fixed Income Market Overview
- Why fixed income
- Types of Instruments
- Instrument ratings
- Basic product Structure
- Few Terminologies
- Yield Curve
- Risk Associated with Fixed Income

# Overview

- The debt market (also known as the credit, bond, or fixed income market) is a financial market where fixed income securities are **issued and traded** usually in the form of bonds

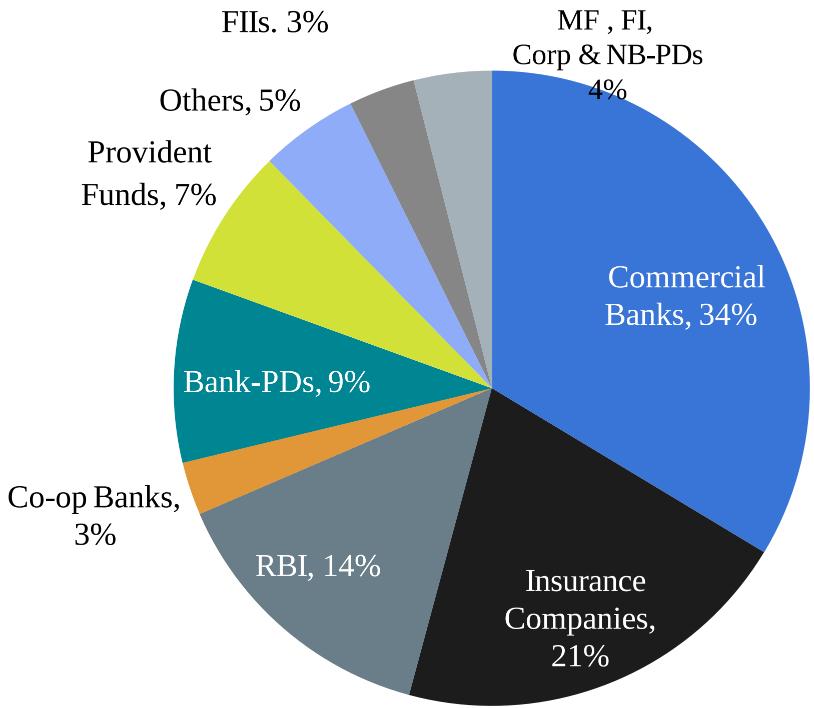
- Debt market consists of three segments
  – Government security market
  – Public sector undertaking bond market(PSU)
  – Corporate security market

# Overview




**Source: RBI, SEBI, CCIL, CRISIL Research**

# Overview


FIIs. 3%
MF , FI,
Corp & NB-PDs
4%
Others, 5%
Provident
Funds, 7%
Commercial
Banks, 34%
Bank-PDs, 9%
Co-op Banks,
3%
RBI, 14%
Insurance
Companies,
21%

# Why Fixed Income Securities

- Government & Corporate can raise money
- Better allocation of capital
- Allows better and more effective public debt management and improves the transmission of monetary policy
- Investor Diversification

# ADVANTAGES OF FIXED INCOME SECURITIES

1. Lower volatility than other asset classes with stable returns.

2. Higher returns than traditional bank FDs.

3.Predictable and stable returns offer hedge against the volatility & risk of equity investments, and thus allow an investor to create a diversified portfolio.

# DISADVANTAGES OF FIXED INCOME SECURITIES

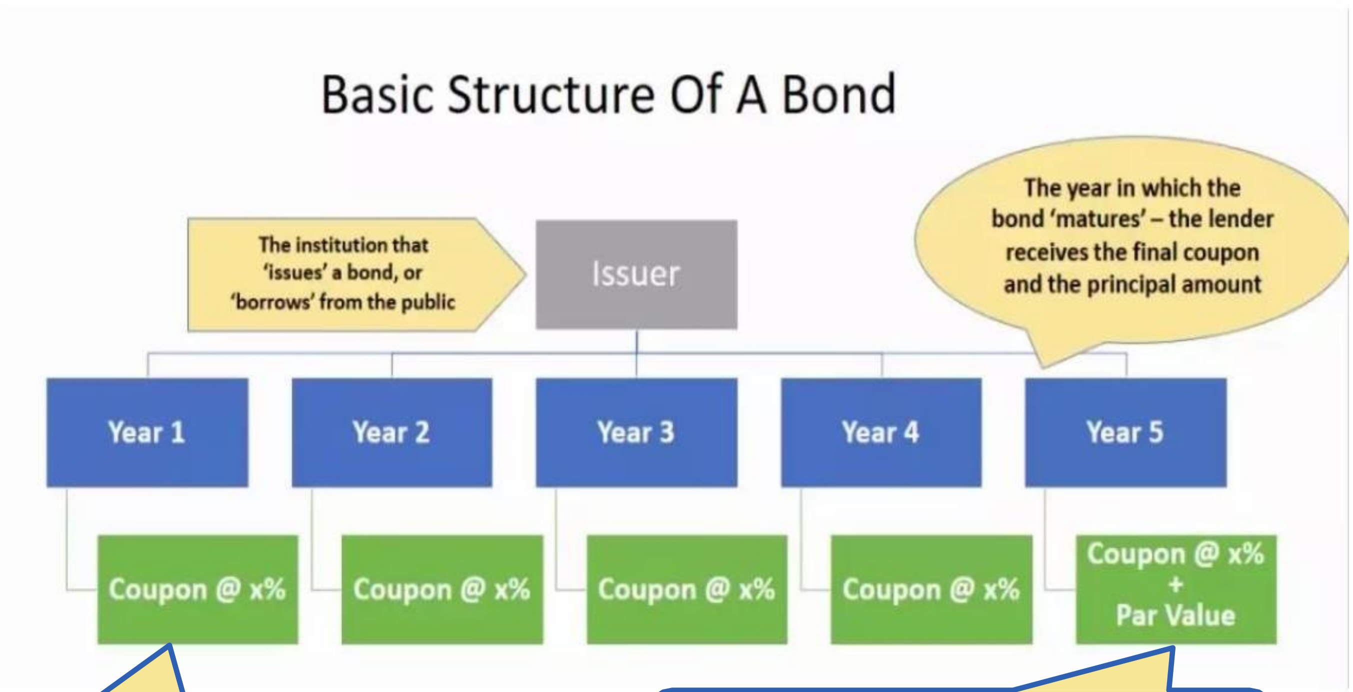
1.Low liquidity: investors' money is locked for full maturity period unless the security is traded in the secondary market.

2.Not actively traded: this lack of competition prevents their prices rising very high.

3. Sensitivity to market interest rate: change in market interest rate changes the yield on held securities.

# Types of Fixed Income Securities

Based on Maturity
•Money Market Instruments
•Debt
–Bonds
–Debentures
•Convertible Debentures
•Non-Convertible Debentures (NCDs)
Based on Collateral
•Secured
•Unsecured




Regular pre-specified payment, based on the interest rates

The amount on which interest is paid, and what the bond holder receives when the bond matures. Also, called the face value.

# Types of Bonds

| | | |
|---|---|---|
| Zero Coupon Bonds | PSU Bonds | Corporate Bonds |
| Perpetual Bonds | Inflation Indexed Bonds | Floating Rate Bonds |
| Junk Bonds | Deep Discount Bonds | Callable Bonds |
| Puttable Bonds | Convertible Bonds | |

# What is a bond rating?

Bonds are rated on the basis of their risk of default

Default: the risk that the lender may not get his money back

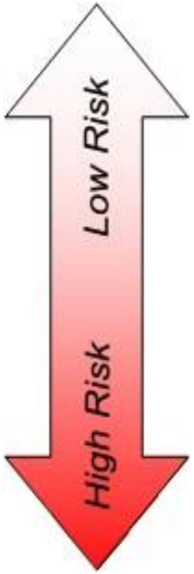
The ratings do not convey other risks: change in liquidity, or interest rates

Bond ratings are carried out by agencies

# Role of Credit Rating Agencies (CRAs)

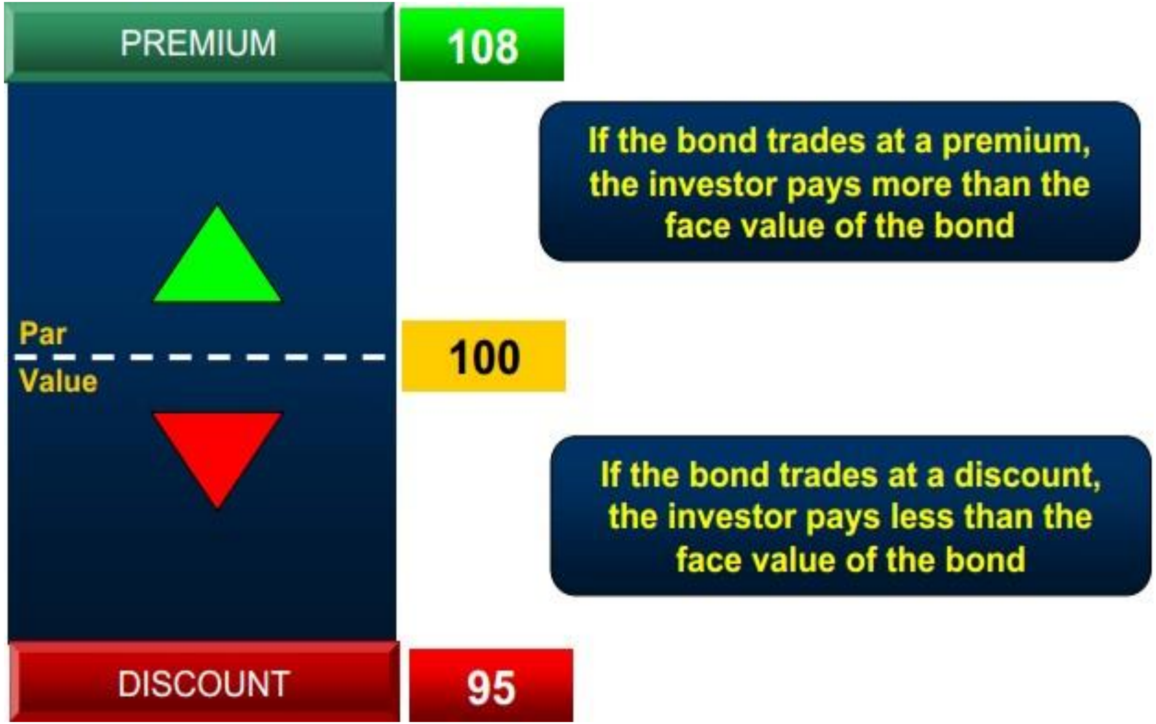
- To protect the interest of the investors.
- To provide an independent source of information on the credit standing of the issuers.
- Transmit information to uninformed investors concerning the default risk of the issuers.

# What are bond ratings?




| Rating for NCDs | CRISIL | ICRA | CARE | FITCH |
|---|---|---|---|---|
| Highest Safety | CRISIL AAA | ICRA AAA | CARE AAA | FITCH AAA |
| High Safety | CRISIL AA | ICRA AA | CARE AA | FITCH AA |
| Adequate Safety | CRISIL A | ICRA A | CARE A | FITCH A |
| Moderate Credit Risk | CRISIL BBB | ICRA BBB | CARE BBB | FITCH BBB |
| Moderate Default Risk | CRISIL BB | ICRA BB | CARE BB | FITCH BB |
| High Default Risk | CRISIL B | ICRA B | CARE B | FITCH B |
| Very High Default Risk | CRISIL C | ICRA C | CARE C | FITCH C |
| Default | CRISIL D | ICRA D | CARE D | FITCH D |

# Par value, premium and discount

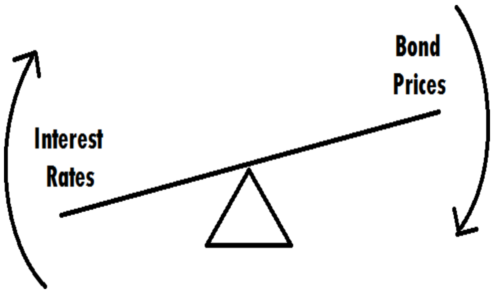


# Few terms in Debt market

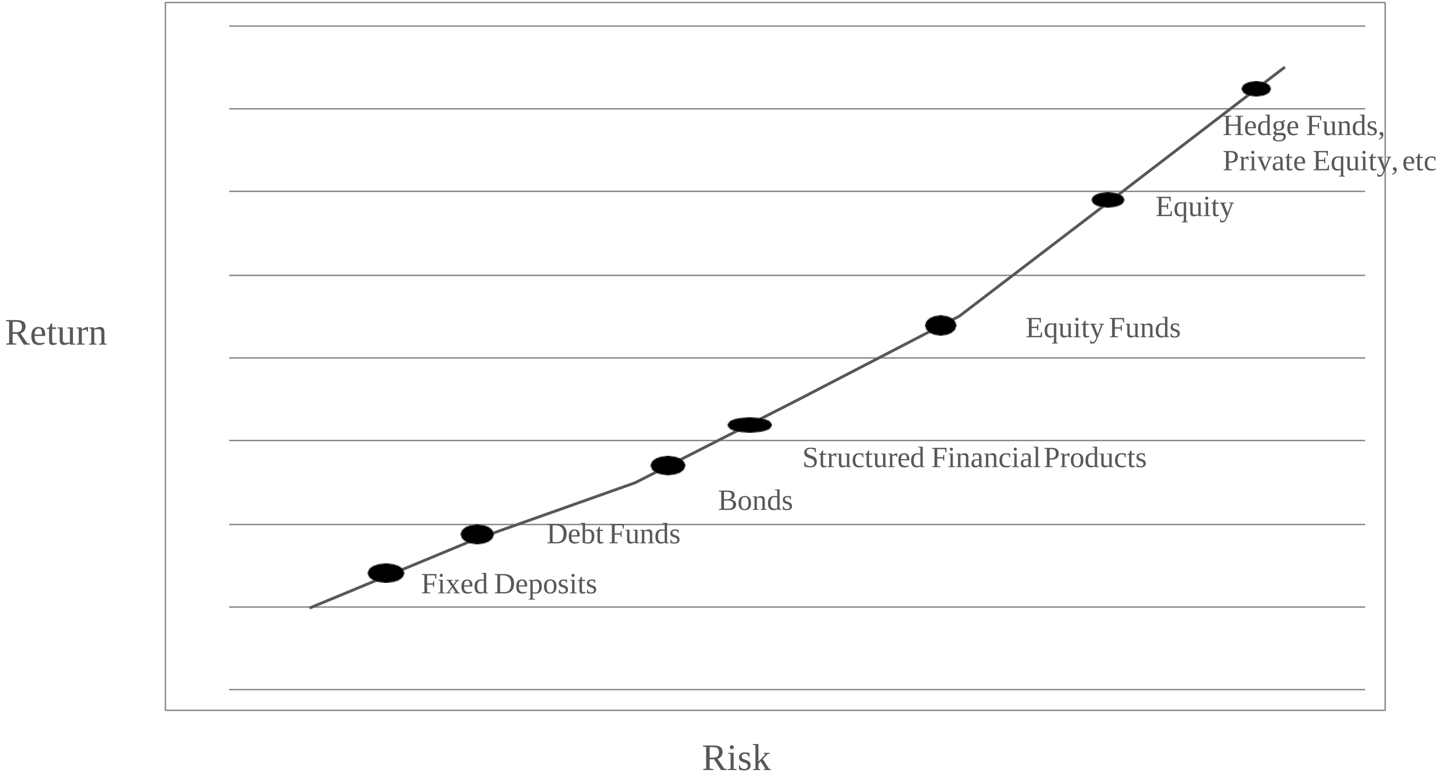
| | | | |
|---|---|---|---|
| Maturity | Coupon rate | Principal | Price/ Face Value |
| Yield to Maturity (YTM) | Current Yield | Yield to Put/Call | Duration |
| Risk Premium | Credit Rating | Yield Curve | Clean Price |
| Dirty Price | Accrued Interest | Redemption | |

# Price & Yield

- Inversely proportional
- When interest rates fall, the prices of bonds in the market rise, thereby lowering the yield of the older bonds and bringing them into line with newer bonds being issued with lower coupons
- Higher the duration or bond maturity higher the impact of change in interest rate

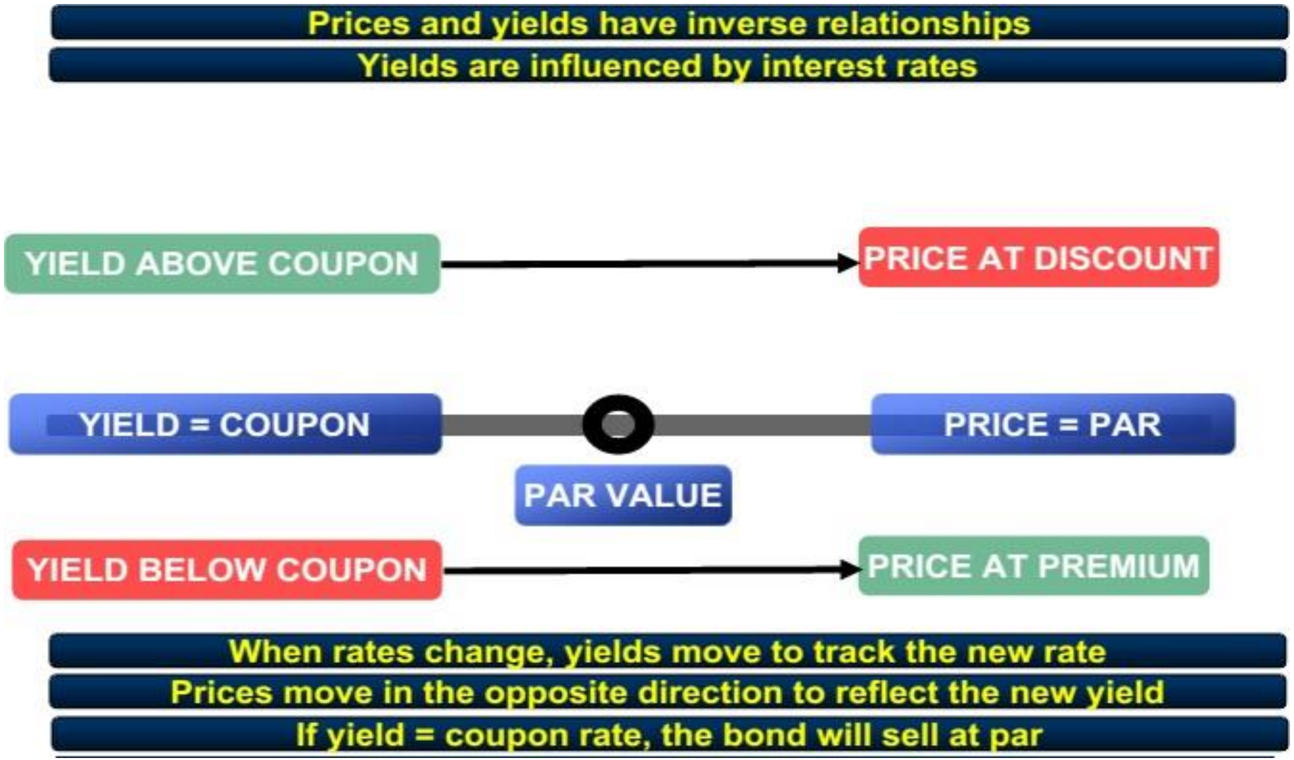


# Positioning of Investments



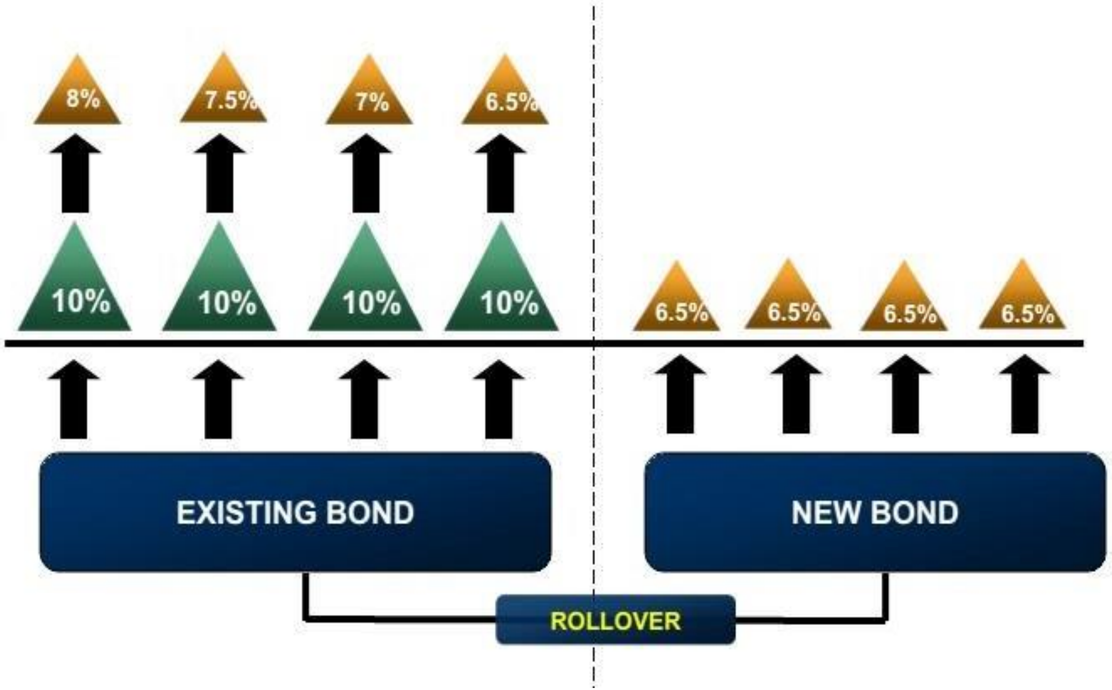
# Risks associated with fixed income investment

INTEREST RATE RISK :



# Risks associated with fixed income investment

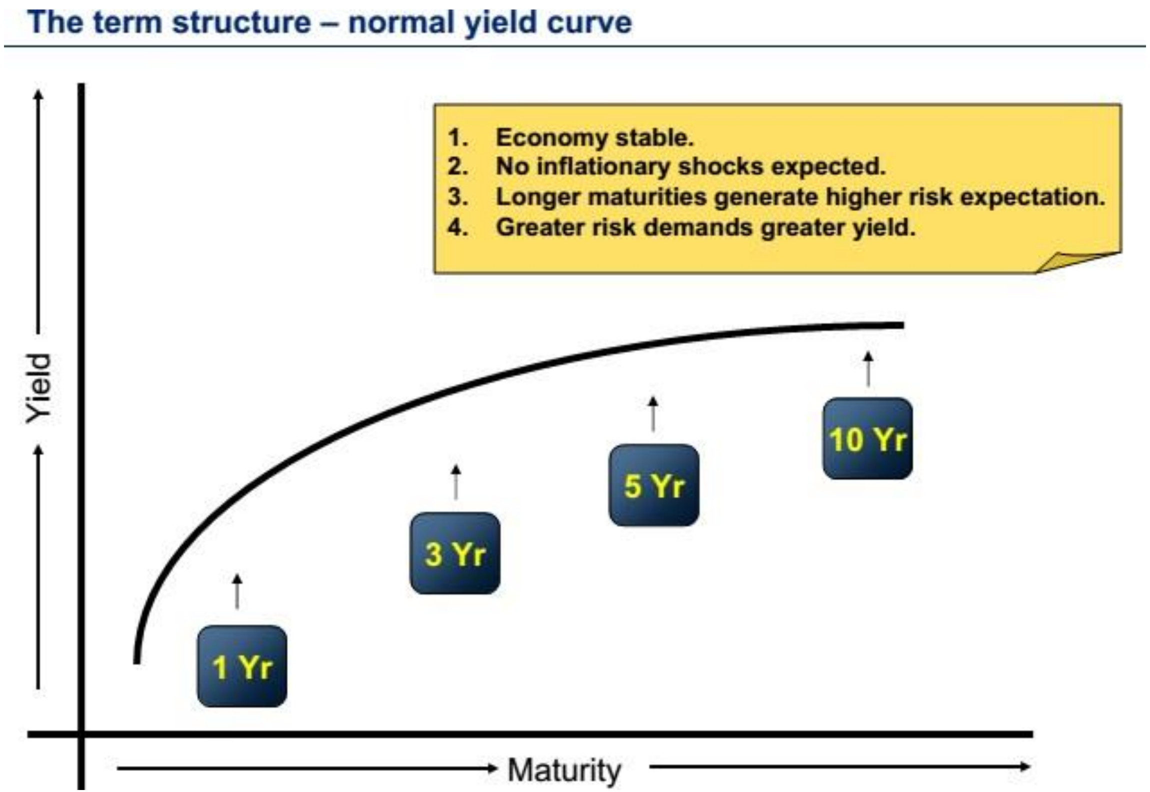
REINVESTMENT RISK :



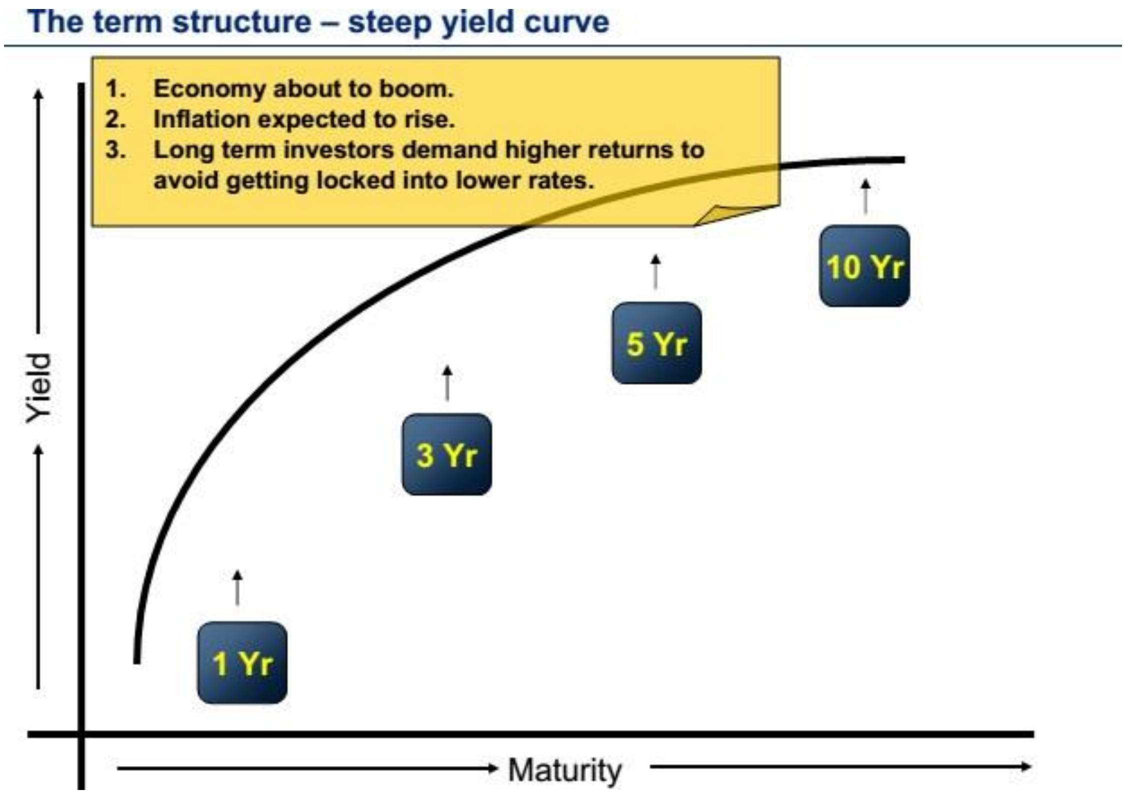
# Indian Debt Market

| Issuer | Instrument | Maturity | Investors |
|---|---|---|---|
| Central Government | Dated Securities | 2-20 Years | RBI,Banks,Insurance Co., PFs, MFs, PDs, |
| Central Government | T-Bills | 91/364 days | RBI,Banks,Insurance Co., PFs, MFs, PDs,Individuals |
| State Government | Dated Securities | 5-10 Years | Banks,Insurance Co.,PFs. |
| PSUs | Bonds | 5-10 Years | Banks,Insurance Co., PFs, MFs, PDs,Individuals, Corporates |
| Corporates | Debentures | 1-12 Years | Banks, Mutual Funds, Corporates,Individuals |
| Corporates, PDs | Commercial paper | 3 months to 1 Year | Banks, Mutual Funds, FI s, Corporates,Individuals |
| Banks | Certificates of Deposit | 3 months to 1 Year | Banks, Corporates |

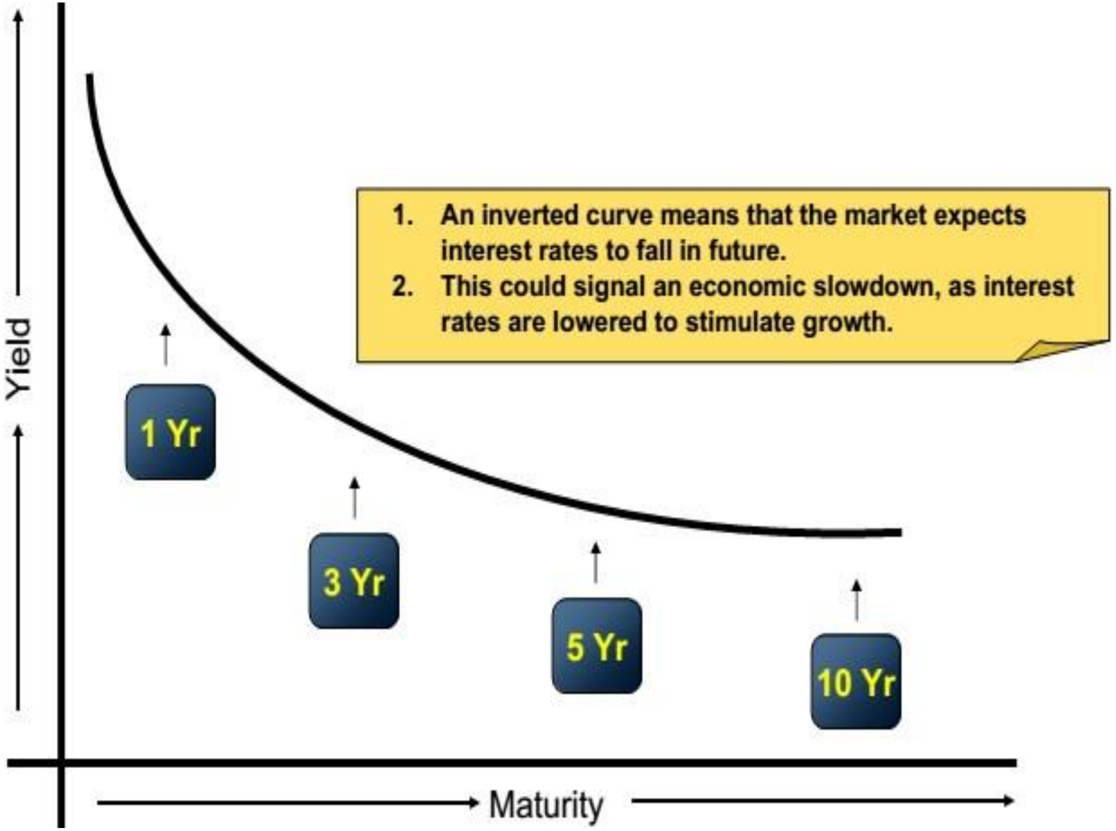
# Yield Curve


The term structure – normal yield curve
1. Economy stable.
2. No inflationary shocks expected.
3. Longer maturities generate higher risk expectation.
4. Greater risk demands greater yield.
Yield
1 Yr
3 Yr
5 Yr
10 Yr
Maturity

# Yield Curve


The term structure – steep yield curve
1. Economy about to boom.
2. Inflation expected to rise.
3. Long term investors demand higher returns to avoid getting locked into lower rates.
Yield
1 Yr
3 Yr
5 Yr
10 Yr
Maturity

# Yield Curve


Yield
1. An inverted curve means that the market expects interest rates to fall in future.
2. This could signal an economic slowdown, as interest rates are lowered to stimulate growth.
1 Yr
3 Yr
5 Yr
10 Yr
Maturity

| Parameters | NCD/Bonds | Corporate Fixed Deposits |
|---|---|---|
| Safety | Secured debt instruments, backed by assets that depositors can claim if the company fails to repay | Unsecured and hence more risky. |
| Liquidity | Tradable on exchanges and hence easy pre-mature exits. Capital appreciation/depreciation possible in case of change in interest rate. | Not tradable on exchanges and pre-mature withdrawal attracts a 1-2% lower rate, as per policy of Company. Returns are fixed |
| Credit Rating | It is mandatory for issuers to get the instrument rated by at least one agency | Mandatory for NBFCs but not for others. |
| Taxation | As per the tax slab of the individual. Except Tax Free bonds, which are not taxable | As per the tax slab of the individual. |
| TDS | Listed NCDs in the demat form have no TDS applicable on their interest payout | TDS is applicable if interest exceeds Rs. 5,000 p.a. |

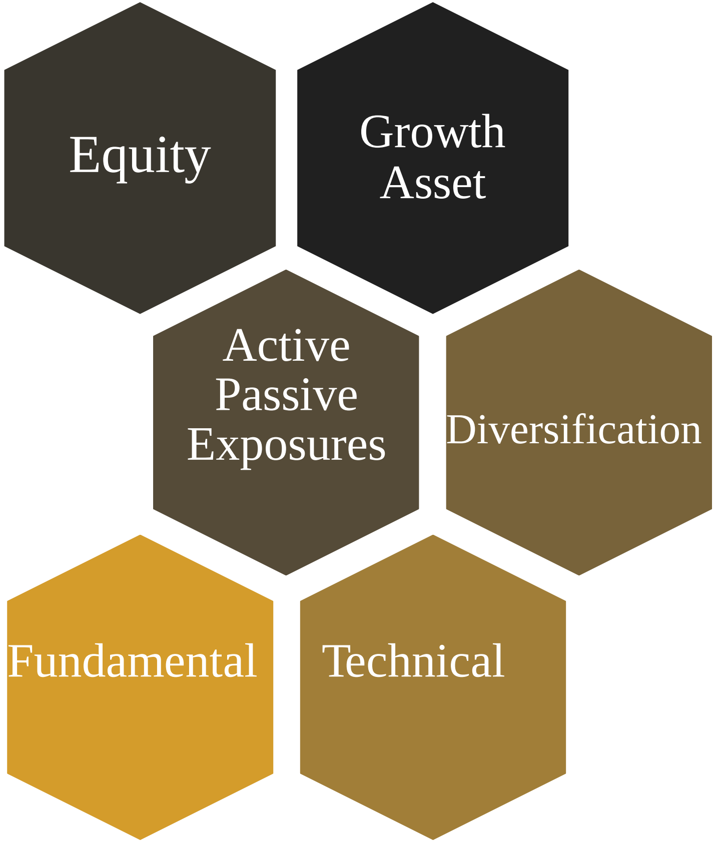
# Debt Mutual Funds

| Debt Mutual Funds | Debt Securities |
|---|---|
| Are professionally managed | Require understanding of security type, issuer credibility, interest regime, etc. |
| Invest in multiple debt securities of varying maturities and coupons offering a diversified and less risky portfolio | Require complete lumpsum investment in one security offering less risk protection |
| Offer redemption at NAV | May lead to losses on sale in case of change in market price or on redemption in the case of rising interest rates |
| Minimum Investment - Low | Minimum Investment - High |
| Offer regular dividend income | Offer regular interest payment |
| Are easy to study, compare and buy | Primary market for debt securities is not as accessible as equity; also not very easy to evaluate performance and risks |
| Can be easily exited at the current NAV price of the fund | Many debt securities cannot be traded in the secondary markets making the investments illiquid |

# TYPES OF DEBT MUTUAL FUNDS

equaliFi

| | |
|---|---|
| Gilt Funds | • Gilt Funds invest in several different types of medium and long-term government securities in addition to top quality corporate debt. They carry sovereign or minimal risk. |
| Income Funds | • Income Funds aim to provide regular and steady income to investors and they generally invest in fixed income securities such as bonds and corporate debentures. |
| Monthly Income Plans | • Monthly income plans invest heavily in debt instruments like debentures, corporate bonds, government securities etc. These funds are for investors, who would like to generate a monthly income for themselves with low to moderate risk. |
| Liquid Funds | • Liquid funds invest in money market and debt securities with a residual maturity of up to 91 days. Assets invested are not tied up for a long time as liquid funds do not have a lock-in period and they do not carry mark to market risk. |
| Fixed Maturity Plans | • Fixed Maturity Plans are close ended funds that invest in debt and money market instruments with maturity period ranging from 3 months to 5 years. They seek to generate steady returns over a fixed maturity thereby immunizing the investor against market fluctuations. |


Equity
Growth Asset
Active Passive Exposures
Diversification
Fundamental
Technical

Equity Products

Stocks

Mutual Fund

PMS

# Thank You