

New SEBI Valuation Guidelines & Positioning of DSP BlackRock Fixed Income Funds

DSP BLACKROCK
MUTUAL FUND



Dhawal Dalal

Senior Vice President,
Head - Fixed Income

Preface:

New SEBI norms on Mark-to-Model of non-traded Money Market Assets with residual maturity of more than 91 days are going to be applicable from August 1, 2010. These new guidelines are aimed at ensuring the valuation of such assets closer to the prevailing market level, rather than at the carrying cost* as under the current valuation guidelines.

Likely Impact:

The new valuation guidelines are likely to result in higher volatility in the daily returns of some fixed income schemes such as Liquid Plus Funds, which predominantly invest into money market assets. These assets will be marked-to model at the prevailing YTM from August 1, 2010. Considering the fact that money market yields have gone up in recent months, we believe that some investments may face price depreciation due to implementation of these new mark-to-model guidelines. Liquid Plus Funds have been preferred investment avenue for institutional investors due to superior tax-adjusted returns compared to Liquidity Funds. We believe that the likely impact of these new valuation norms on individual funds will be based on the following factors:

- Current YTM of the asset - Lower the YTM, higher will be the impact
- Residual Maturity of the asset - higher the residual maturity, higher will be the impact
- Credit Rating of the asset - lower the credit rating of the asset, higher will be the impact

Investor Reaction:

We believe that most institutional investors are likely to remain cautious ahead of the upcoming Credit Policy due on July 27, 2010 as well as implementation of the new valuation guidelines. We anticipate that they will possibly switch into Liquidity Funds from Liquid Plus Funds on or before August 1, 2010 as Liquidity Funds do not have investments with residual maturity beyond 91 days. Therefore, Liquidity Funds are not likely to get affected at all due to these new norms. We also believe that institutional investors may consider investing in such Liquid Plus Funds that have little or no exposure to assets with residual maturity beyond 91 days. Institutional investors will consider investing back into Liquid Plus Funds with assets maturing beyond 91 days after they ascertain the impact of the new regulation.

DSP BlackRock Fixed Income Fund Positioning:

Keeping in mind these new valuation guidelines and current term structure of money market yields, we have repositioned some of our fixed income funds. This repositioning is aimed at articulating our fixed income investment strategy in a clear manner. They are summarized in the following table:

As on July 16, 2010	DSP BlackRock Liquidity Fund	DSP BlackRock Money Manager Fund	DSP BlackRock Floating Rate Fund	DSP BlackRock Strategic Bond Fund	DSP BlackRock Short Term Fund
Size	Rs. 1,523 crore	Rs. 685 crore	Rs. 2,098 crore	Rs. 891 crore	Rs. 771 crore
Average Maturity	0.12 years	0.14 years	0.17 years	0.26 years	0.25 years
Portfolio YTM	6.18% pa	5.99% pa	5.55% pa	5.57% pa	5.95% pa
New Positioning	No change	Depending on the Fund Manager's view the Fund may have up to 10% of its assets maturing beyond 91 days	Depending on the Fund Manager's view the Fund may have up to 25% of its assets maturing beyond 91 days	The Fund will continue to focus predominantly on Bank Assets with active portfolio duration management	Active portfolio duration management
Exit Load / Lock-in	No Lock-in	No Lock-in	No Lock-in	No Lock-in	No Lock-in
Who should invest?	Credit conscious investors with ST surplus liquidity	Credit conscious investors with ST surplus liquidity	Credit conscious investors with some appetite for volatility	Credit conscious investors with some appetite for volatility	Credit conscious investors with some appetite for volatility
Ideal Horizon for investment	Up to 1 month	Up to 1 month	Up to 3 months	Up to 3 months	Up to 6 months
Expected Daily Return Volatility	Lower	Lower	Moderate	Moderate	Higher

How Should One Invest Going Forward?

We believe that investors should no longer focus only on the past performance of the fund before making an investment decision. From now on, investors will have to focus on a host of factors before investing in a particular fund in our opinion. Some of them are summarized below:

Factors	Rationale
Credit Quality of Portfolio	The new valuation guidelines are now going to value assets based on their credit rating and duration. Now, funds will have to factor in the price impact of purchasing a lower credit quality asset.
Average Maturity	The new valuation guidelines are now going to value assets based on their credit rating and duration. Higher the average maturity, higher will be the daily volatility in returns.
Sector Allocation	The new valuation guidelines will now differentiate among various asset classes such as Bank, Corporate, NBFC, ABS, Real Estate etc. and value them appropriately.
Fund Manager's Interest Rate Views	Fund Managers will no longer be able to focus only on optimizing portfolio YTM going forward as assets are now going to be valued daily based on the prevailing term structure of rates. Their views on interest rates will have greater bearing on their future performance.
Investment Horizon	Investors will have to define their investment horizon and risk tolerance going forward. We expect daily return volatility to average out over time. Therefore, investors will now have to exhibit some degree of patience in order to achieve the expected return.

Summary:

To summarize, we believe that Indian fixed income fund management is ready to take a giant leap forward in terms of management and investment style. It may take a while but it is definitely going to be good for both the investor as well as for the industry as these new guidelines will force both the fund manager and investors to think differently and adapt their existing investment style.

** Carrying cost means at cost plus interest accrued till the beginning of the day plus the difference between the redemption value and cost spread uniformly over the remaining maturity period of the instruments.*

DSP BlackRock Liquidity Fund (DSPBRLF) is an open ended income Scheme, seeking to generate a reasonable return commensurate with low risk and a high degree of liquidity, from a portfolio constituted of money market securities and high quality debt securities. **Asset Allocation:** Money market securities and/or Debt securities* with maturity of 91 days - 80% - 100% (* Debt securities may include securitised debts upto 30% of the net assets.) **Features:** No entry/exit load. Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SWP and STP facilities available in each plan of the scheme. Minimum investment - Regular Plan - Rs. 5,000; Institutional Plan - Rs. 5 crore. Declaration of NAV on all days. Redemption normally 1 Business Day. Previous day NAV applicable for all applications received prior to cut off time subject to specified conditions. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID).

DSP BlackRock Money Manager Fund (DSPBRMMF) is an open ended income Scheme, seeking to generate reasonable returns commensurate with low risk and a high degree of liquidity, from a portfolio constituted of money market securities and high quality debt securities. **Asset Allocation:** Money market securities and/or debt securities which at the time of purchase have residual or average maturity of less than or equal to 367 days or have put options within a period not exceeding 367 days: 65%-100%; Debt securities, which, at the time of purchase have residual or average maturity of more than 367 days: 0%-50% (Debt securities may include securitised debts up to 75% of net assets). **Features:** No entry/exit load. Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SWP and STP facilities available in each plan of the scheme. Minimum investment - Regular Plan - Rs. 5,000; Institutional Plan - Rs. 5 crore. Declaration of NAV on all Business Days. Redemption normally within 2 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID).

DSP BlackRock Floating Rate Fund (DSPBRFRF) is an open ended income Scheme, seeking to generate interest income through investments in acceptable floating rate assets commensurate with the credit risk. The Scheme may also invest in fixed rate debt securities. **Asset Allocation:** Floating rate debt securities* or money market securities: 65% to 100%; Fixed rate debt securities: 0% to 35% (Debt securities may include securitized debts upto 60% of the net assets). **Features:** No entry/exit load. Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the scheme. SWP and STP facilities available in each plan of the scheme. Minimum investment - Regular Plan - Rs. 5,000; Institutional Plan - Rs. 5 crore. Declaration of NAV on all Business Days. Redemption normally within 2 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID).

DSP BlackRock Strategic Bond Fund (DSPBRSBF) is an open ended income scheme, seeking to generate optimal returns with high liquidity through active management of the portfolio by investing in high quality debt and money market securities. **Asset Allocation:** Money market securities and/or Debt securities with residual or average maturity of less than or equal to 367 days or put options within a period not exceeding 367 days: 0% - 100%; Debt securities which have residual or average maturity of more than 367 days: 0% - 100% (Debt Instruments may include securitised debts up to 75% of the net assets). **Features:** Minimum investment: Regular Plan - Rs. 5,000/-, Institutional Plan - Rs. 1 crore. Declaration of NAV on all Business Days. Entry/Exit Load - Nil. Redemption normally within 3 Business Days. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID).

DSP BlackRock Short Term Fund (DSPBRSTF) is an open ended income Scheme, seeking to generate income commensurate with prudent risk, from a portfolio constituted of money market securities, floating rate debt securities and debt securities. **Asset Allocation:** Money market securities, floating rate debt securities whose coupon(s) are reset at least once a year, fixed rate debt securities having an average or residual maturity <= 367 days or having put options within a period not exceeding 367 days: 50%-100% (Floating rate debt securities will include fixed rate debt securities swapped for floating rate returns by using derivatives); Fixed rate debt securities having a residual or average maturity > 367 days and floating rate debt securities where the next reset date is more than 367 days from the date of purchase: 0%-50% (Debt securities may include securitised debts up to 60% of the net assets). **Features:** No entry/exit load. Sale and redemption of Units on all Business Days at Purchase Price and Redemption Price. Switching facility subject to prevailing terms of the relevant schemes. SWP and STP facilities available. Minimum investment - Rs. 5,000/- . Declaration of NAV on all Business Days. Redemption normally within 1 Business Day. Nomination facility available, subject to applicable conditions as per the Statement of Additional Information (SAI) and Scheme Information Document (SID). **Statutory Details:** DSP BlackRock Mutual Fund was set up as a Trust and the settlors/sponsors are DSP ADIKO Holdings Pvt. Ltd. & DSP HMK Holdings Pvt. Ltd. (collectively) and BlackRock Inc. (Combined liability restricted to Rs. 1 lakh). Trustee: DSP BlackRock Trustee Company Pvt. Ltd. Investment Manager: DSP BlackRock Investment Managers Pvt. Ltd. **Risk Factors:** Mutual funds, like securities investments, are subject to market and other risks and there can be no assurance that the Scheme's objectives will be achieved. As with any investment in securities, the NAV of Units issued under the Scheme can go up or down depending on the factors and forces affecting capital markets. Past performance of the sponsor/AMC/mutual fund does not indicate the future performance of the Scheme. Investors in the Scheme are not being offered a guaranteed or assured rate of return. Each Scheme/Plan is required to have (i) minimum 20 investors and (ii) no single investor holding >25% of corpus. If the aforesaid point (i) is not fulfilled within the prescribed time, the Scheme/Plan concerned will be wound up and in case of breach of the aforesaid point (ii) at the end of the prescribed period, the investor's holding in excess of 25% of the corpus will be redeemed as per SEBI guidelines. DSPBRLF, DSPBRMMF, DSPBRFRF, DSPBRSBF and DSPBRSTF are the names of the Schemes and do not in any manner indicate the quality of the Schemes, its future prospects or returns. For scheme specific risk factors, please refer the Scheme Information Document (SID). For more details, please refer the Key Information Memorandum cum Application Forms, which are available on the website, www.dspblackrock.com, and at the ISCs/Distributors. Please read the Scheme information Document and Statement of Additional Information carefully before investing.