

## MFs offer crop funds for high yields

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MUMBAI: The possibility of unexciting returns on bond funds is prompting some investors to park their money in funds that invest in special credit opportunities. Credit opportunities funds, or crop funds, are structured to deliver higher returns by taking exposure to relatively low-rated, but high-yield bonds.

While crop funds are increasingly becoming popular among investors, some of the conservative market experts fear a deep credit squeeze or a string of payment defaults could result in loss of investments.

Currently fund houses like Templeton, DWS, Reliance Mutual, Religare Mutual and Kotak Mutual Fund have crop funds with varying investment styles and structures.

Such schemes could be appropriate for investors who are looking for higher yields by taking on additional risk, says **Maneesh Kumar, managing director, Burgeon Wealth Advisors.**

There are good quality papers that can provide juicy yields; but then, the characteristics of a generic credit opportunity fund include leverage, securitization of debt, capability to short (sell) and partially-disclosed portfolios, Mr Kumar adds.

However, crop funds are not meant for investors whose risk profile is low.

Says Anil Rego, CEO, Right Horizons Wealth, One should also restrict the amount one invests in such funds to not more than 25% of the overall portfolio, Mr Rego adds.

Credit opportunity funds first caught the fancy of investors in mid-2009 when yield spreads (the difference in yields between benchmark sovereign paper and corporate bonds) widened to between 200-300 basis points. The credit market presented an attractive risk-return profile as even good companies found it difficult to raise debt. This led to crop funds becoming the fastest-growing category within debt mutual fund schemes.

Though short-term yields have softened, crop funds continue to offer returns that are 75-125 bps higher than liquid plus schemes which currently yield 4-5%.

While the return profile is attractive, credit opportunities funds are causing heartburn to risk-averse investors and conventional fund experts. According to wealth managers, investing in unrated or low-rated papers is fraught with risks.

In the event of a liquidity crunch or unforeseen redemption, fund managers will find it difficult to sell the papers or may have to do so at deep discounts, say experts.

While fund managers running crop funds agree to the inherent risks in these funds, they argue that a short-term debt fund has the same risk traits as a "crop fund".

We only invest in papers of good quality companies. For sure, risk in a crop fund could be marginally higher than a liquid plus or short-term bond fund; but then, these funds take adequate care to secure investment portfolios, said Ashish Nigam, head, fixed income, Religare Mutual Fund, which runs a Rs 2,000-crore crop fund.

Fund managers claim to have a series of checks and balance in place for managing crop funds. Proper due diligence of the paper issuer, lower investment ticket sizes (to negate bulk redemption risk), portfolios with shorter average maturity duration and restricted use of unsecured debt wraps (pass through certificates etc) top the risk check list.

The credit quality of the portfolio will not be diluted. We'll just exploit the mis-pricing in different debt instruments, says Lakshmi Iyer, head (fixed income & product), Kotak Mutual Fund, which is currently raising initial investments for its Credit Opportunities Fund. According to Ms Iyer, Kotak's crop fund will invest at least 35% of the corpus in papers with a maturity of less than one year. This will reduce volatility and provide higher liquidity in the portfolio, she adds.

Default risk is not high in low-rated papers (up to AA-rating) of quality companies. Liquidity cannot be guaranteed though, say debt raters.

It is wrong to say low-rated papers are unsafe. We've not come across any major credit defaults in low-rated papers. Long-term investors should start looking at instruments below AAA levels; investors would benefit from wider spreads in lower-rated papers, said Tarun Bhatia, director, capital markets, Crisil Research.

The difference in yields (in normal terms) between a highest-rated corporate paper (AAA rated paper) and good-quality/low-rated paper could be between 125-300 bps.