OUTLOOK

FUND MANAGER TALK

AXIS MUTUAL FUND

INVESTMENT AT AXIS MUTUAL FUND

CHANDRESH KUMAR NIGAM

MD & CEO

2016 was an eventful year from all perspectives - domestically and globally, politically and economically, debt markets and equity markets.

Domestic equities started the year in the midst of a large correction, rallied mid-year but have given away all the gains to end broadly flat for the year. Bonds on the other hand saw a substantial rally over the year as yields fell by 124 bps.

But more than the market action, the year gone by will be remembered for the massive upheavals to the status quo that we saw. *This was the year in which a country that created a global empire decided to turn inward, a year in which a billionaire was able to channelise the frustration of the American poor, of the 2 months at the end of the year when virtually every Indian became an economist!*

2016 has also been a year when the retail investors in India have re-iterated their faith in the power of Mutual Funds for their long term savings. For despite the inevitable ups and downs that happen every year, what has remained a constant is the value added by this industry in generating long term wealth for its investors.

At Axis we have always remained committed to a sustainable approach towards investing that puts a lot of focus on quality of portfolios and risk management. For this year end special, we have asked our fund managers to list out how they deliver this approach on a day to day basis while running their portfolios as well as what factors they are looking at as 2017 comes along.

Hope you find this information useful.

OUR STRATEGY RELIES ON BOTTOM UP SELECTION OF QUALITY COMPANIES

- India is essentially a bottom-up market
- Stock selection is key differentiator

Variation in top and bottom stocks over the last 10 years

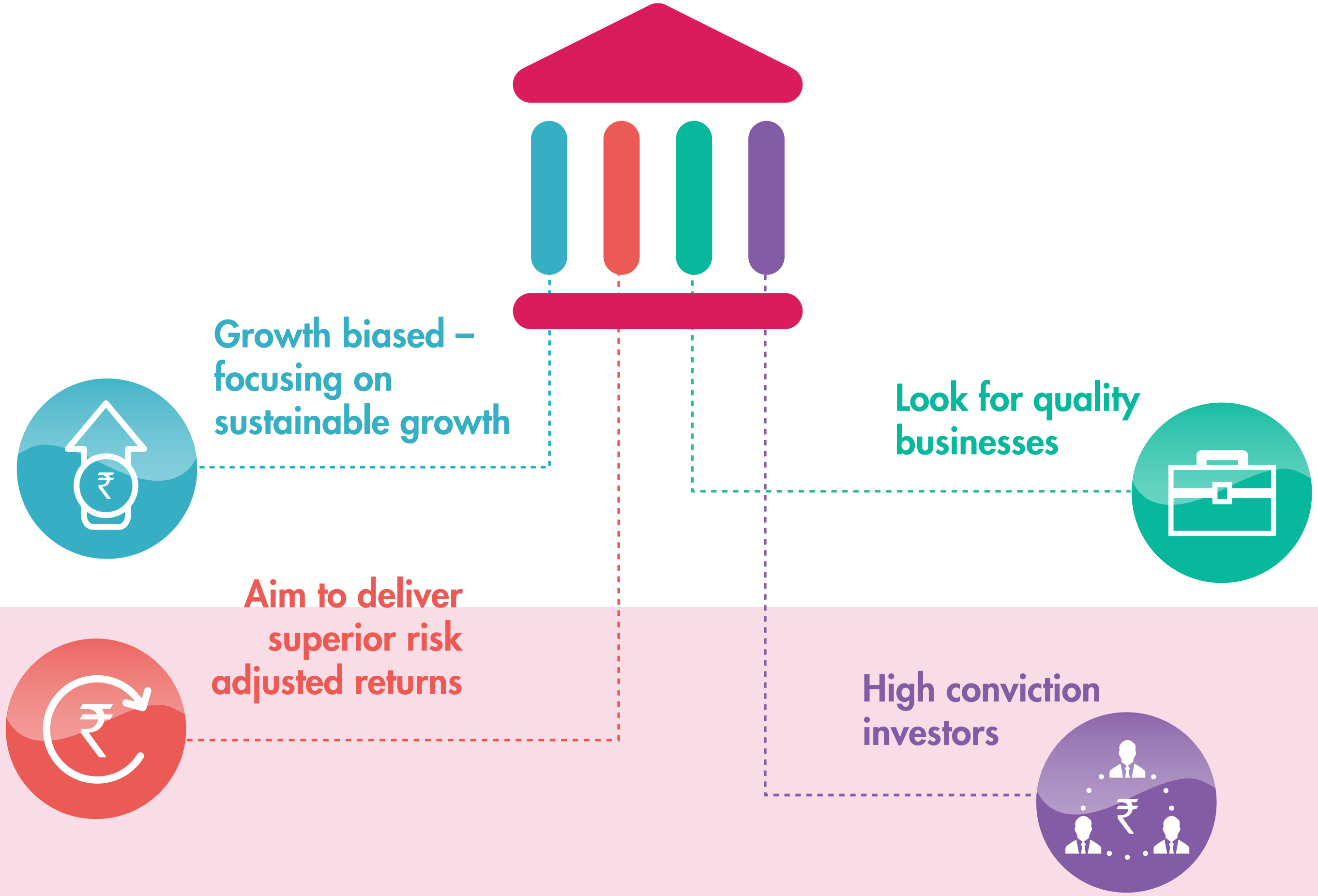
	% CAGR (CY 06-16)
BSE 100 index	8.0
Top quartile	21.5
Bottom quartile	(6.9)

Weak companies have destroyed significant investor wealth

- Our investment process looks at stocks that have the ability to deliver sustainable growth

Source: Axis AMC, Bloomberg. Past performance may or may not be sustained in future.

KEY PILLARS OF AXIS MUTUAL FUND APPROACH



JINESH GOPANI

HEAD – EQUITY

Schemes Managed – Axis Long Term Equity Fund, Axis Focused 25 Fund, Axis Income Saver, Axis Emerging Opportunities Fund - Series 1

How has the transition from Fund Manager to Head of Equity changed your working style?

As the head, it is more about energising the team and keeping them motivated to do their best. As far as my day to day working goes, the style remains the same, just that one needs to apportion time properly between Fund management, Research and Marketing/Sales Engagement.

What changes are you making to the research/investment process since taking over? Do we need to review our investment universe?

The focus is on maintaining continuity. Our investment philosophy of long term thinking and quality portfolio building has been the key to our wealth creating ideas and we don't want to dilute that.

Also within the broad framework , we have always believed in giving liberty to each fund manager to imbibe their own thought process into the portfolio. Thus fund managers have a free hand to take decisions within the universe and the process based on their fund objectives and views.

We have recently had Anupam and Shreyash joining the Axis team. Both have an excellent track record and long term thinking that is aligned with our thought process.

We are also reviewing our research process. We have a large analyst team now and we have tried to make sure that they have the right guidance and that they are able to throw their best, high conviction ideas for the fund managers.

What should be the fund manager's contribution to research team?

Fund Management and research go hand in hand. In fact, *company research is the basic foundation of getting a good quality portfolio*, especially in our case where the focus is on bottom up investing. So as much time as the analysts spend on looking at companies, even fund managers should spend the same on analysing and reviewing companies they have invested in and also work closely with the team to generate new ideas. As business cycles are getting shorter its more important for a FM and an analyst to work closely to get best results.

How do you ensure that all portfolios don't get too similar in terms of stocks and positioning?

We have quite a limited yet differentiated product basket that ensures that all the funds are not too similar. Having said that, the risk of groupthink does exist given our overall philosophy that is the same. Hence it becomes quite important to give independence to the fund managers to bring in their real thoughts into their portfolio in terms of their strategy and positioning towards the market as well as individual stocks. We do not force a common stock view across the entire company.

Also as mentioned earlier, with the joining of Shreyash and Anupam in the team with their vast and successful experience, they will ensure that they provide their own colour to the funds that they manage.

INVESTMENT PHILOSOPHY

We understand the drivers of stock performance in India

Our investment process is designed to exploit opportunities while managing risks arising from these drivers

- Clearly articulated investment strategy
- Well designed investment process
- Embedded risk management
- Experienced team that can execute strategy

What are the variables that you like to track on a day to day basis?

Equity is a long term approach and we don't like to track things on a daily or a short term basis. The team's job is to understand and analyse businesses and make appropriate forecasts of how different variables can impact companies on either a positive or negative basis and ensure that we have a high degree of conviction on our investments.

Please share your outlook for coming the year?

The markets may be volatile in the short term, given that many events are on the horizon. However looking beyond that, *we are positive that we are in the midst of a structural shift in how India does business with demonetisation and GST. Medium term growth outlook remains strong and our job is to find out which companies are best placed to take advantage of the opportunities that are being thrown up by these upheavals.*

We expect growth to improve steadily over the next few quarters. Over the medium term earnings should start reflecting the improvement in the growth environment and has the potential to run ahead of nominal economic growth as the cycle strengthens. Equity market valuations are broadly reasonable. We remain bullish on equities from a medium to long term perspective.

How is difference in opinion between FMs & Analysts handled?

There is a fine balance between the analyst and the fund manager. While the job of analyst is to push hard to convince FMs on their ideas (whether buy or sell), the FM has to look at every stock in the context of the portfolio construction objectives. Opinions might differ in some cases based on the investment horizon and differing objectives amongst portfolio managers. We believe in giving the final say to the fund manager on the portfolio since ultimately the fund manager needs to be solely answerable on the fund's performance.

The important thing is that there is a clear understanding of the stock and the expectations from the company and that decisions are taken with complete transparency and in a process of involving the analysts. *It is crucial for the success of the investment team that analysts have full ownership of the portfolios.*

How do you manage/monitor different types of risks?

We have always had a robust risk management approach in Axis. The key ingredient is the focus on long term and higher quality companies that automatically ensures that we avoid making the big mistakes that can cause permanent wealth destruction. *For us the key criteria for judging a company remains the quality of the management.* Other than that we have a framework of looking at all the individual risks of owning a stock which get captured during the research and portfolio construction phase. We also look at the aggregate portfolio risk performance during the monthly investment reviews.

For an advisor or investor, scheme selection becomes a challenge because certain schemes which perform really well for a specific period, suddenly become under performers. How can scheme selection be done ?

As fund managers it is our responsibility to clearly communicate our investment philosophy and approach. Ultimately it needs to be understood that markets go through cycles and that different styles will have good and bad phases depending on market conditions. The only way of succeeding is to remain committed to a style that can work over the long term instead of chasing the latest fad of the market.

For example the last 12 month have been challenging for Axis as the market has moved away from quality towards value and beta plays. While this is hurting us in the short term, we know that over the long term our approach has generated significant wealth. Hence we need to ensure that we stay the path and remain committed to delivering quality long term portfolios.

In which market conditions do you outperform/underperform?

Our approach of long term investing and tight risk management as been demonstrated as a sustainable wealth generator over the long term. Having said that high quality portfolios work well in sharply falling markets and in stable market conditions but may not work so well when high beta/momentum stocks are in flavour. So *we would view ourselves as stable consistent wealth creators rather than only bull market performers.* Idea is to manage money with tight risk exposure and deliver consistent returns in long to medium term.

For a retail investor looking to invest fresh in equities, what would be your advice at this point of time?

There are always uncertainties in the market and the market is always volatile in the short term. Hence retail investors should always use SIPs to invest into equities. However the key risk today is not from investing but from staying out of the market. We believe that the changes ongoing in the Indian economy should lead to significant wealth creation opportunities for investors over the next 5 to 10 years.

We have seen market cycles turn over time. For instance quality stocks did well over the long term but have underperformed in the last year. What's your view on this? Do you make changes to the portfolio for such changes?

Ideally in long run quality is what delivers wealth and that's how history suggests. Take the example of the IT sector. In the initial years all sorts of companies got the benefit of the bull run and investor frenzy. however when you look back today there are hardly 5-6 large IT cos that really exist in a meaningful manner that have bulk of the wealth from the investor's perspective - these are the quality companies that have been able to take advantage of the market opportunities in a consistent manner while remaining focused on sustainability of performance. So *quality delivers over the long term but we would need to have patience to take advantage of it from the stock market perspective.*

SHREYASH DEVALKAR
SENIOR FUND MANAGER - EQUITY

Schemes Managed – Axis Equity Fund, Axis Midcap Fund

Explain your investment style?

I believe in research oriented investing. All decisions are taken based on a detailed research of the company. Assessment of business for investment is based on three parameters: Growth, Competitive advantage, and Catalyst. Growth orientation is first and foremost parameter in investment decision making for me. The growth may be structural or cyclical in nature.

In India, due to favorable demographics the B2C stories have been structural in nature at large. While Capital goods, infrastructure, commodities are cyclical. Competitive advantage of the company, most of the time it is reflected in market share, number of competitors and return ratios (ROCE/ROE) of the businesses on the sustainable basis.

The third parameter is catalyst for the business to do well atleast from 1-3 year perspective, the catalyst may be by way of regulatory change, wage hikes due to pay commission recommendations etc.

However catalyst by itself is not a decision making tool, unless accompanied by growth and competitive advantage.

Assessment of management is based on management's aspiration for sustainable growth and quality of corporate governance which remains hygiene factor. Normally prefer to look at Valuation in the context of growth of the business, value addition, competitive advantage quality of management, hence PEG (PE/growth) along with ROE is the metric i would prefer over PE to value the company.

How does your style gel with the axis investment process?

I think the approach is essentially similar. The entire focus is on fundamentals from a long term perspective and away from short term momentum and market trading factors. This was one of the appeals for Axis for me. *I think very few companies have the discipline to stay true to this philosophy over the long term especially during challenging times.* The little bit of variation in terms of how the portfolio risk assessment is carried out is a great input for me and is something that I am incorporating in portfolios.

What is your philosophy on portfolio construction - compact vs diversification, single stock positions?

Businesses which are showing signs of structural growth, competitive advantage and leadership in areas of operation comprise core of portfolio, which provides stable returns and also addresses risk part of portfolio. The companies which are successfully challenging the sector leaders and the sectors which are showing signs of consolidation due to excessive stress on profitability in sector, forms some part of portfolio based on opportunities available, which is expected to give additional returns. *For me 35-40 stocks is sweet spot as far as number of stocks are concerned,* since it provides adequate scope for risk management and incubating turnaround ideas in challenger/consolidation segment. I prefer concentrated/high single stock position in structural businesses where leadership is broadly established. While investments which are in consolidating industry, cyclical industry or turnaround sectors, i prefer diversification.

Do you believe in running tactical trades as a part of the portfolio?

As highlighted earlier *I look at growth, competitive advantage and catalyst.* As long as the industry/company fits in that I buy it. Tactical calls are the ones, in my opinion, which are bought with a view to hold for few months. I am not good at identifying such ideas and hence tend to avoid them.

Do you believe in stop loss?

Companies are continuously assessed to validate whether investment thesis as explained earlier is intact. We the team of highly experienced investment professionals at Axis AMC continuously focus on it. If we find any change in investment thesis, business case or any issues on corporate governance then such events trigger sell call, rather than selling action triggered by stock price.

What are the 1-2 most important criteria that you will look at from any company's financials?

Growth, return on capital, operating cash flow generated as a % of PAT for the year, along with free cash flow generated over a block of 5 years, are the key metrics I track. Capital efficiency of incremental capex and acquisitions is important if free cash flow is weak.

Examples of successes/mistakes made from your career?

Identification of structural growth trends in passenger vehicle, food industry, identification of winners in pharma sector and turnaround in Infra/capital goods segment has helped in portfolios. Underestimating the willingness of new players in sectors to run businesses by incurring losses and hurting established players in the process for medium term, has hurt portfolios. Post financial crisis most sectors saw exit of companies which were losing cash, in various sectors, leading to consolidation. However in few segments new players emerged which are willing to lose money in near term for long term gains, this process has been painful for returns in some segments.

What is risk for you? When you see the risk numbers of the fund, are they just the outcome of the portfolio or are the funds managed to arrive at those numbers?

The risk numbers are outcome of portfolio constructed. The approach that Axis has always taken is that a detailed Investment thesis of any company is the best tool to assess its risk and needs to incorporate all the different aspects of risk including quality risk, price risk etc. The statistical risk numbers are outcome of investment process from a portfolio perspective and while we don't target them explicitly, they are important guides to tell us if the investment process is working as planned or not. Apart from risk variables like volatility and tracking error, Portfolio growth vis a vis Index and the PE of portfolio v/s Index are the other parameters to be tracked.

What is your view on the market valuations currently? What are your projections for earnings growth over next year?

Nifty index is now consolidated in quality companies and valuations at 16x based on consensus estimates are reasonable. Long term growth outlook is intact though near term outlook is hazy due to specific events. Consensus estimates at about 15pct yoy which are achievable if growth is back on track sooner than later, as currency comes back in hands of people especially in rural areas. The focus on tax inclusion will benefit listed organized players in long term. *The stage is getting set for a good longer term outcome.*

ANUPAM TIWARI
FUND MANAGER - EQUITY

Schemes Managed – Axis Equity Saver Fund,
Axis Small Cap Fund, Axis Emerging Opportunities Fund - Series 1

Explain your investment style?

My investment style is based on a basic principal of buying good and scalable businesses run by competent management at a reasonable valuation. Further *I am willing to err on the side of valuation but not on quality of business and people running it.* At the same time I keep a track of earning upgrade and downgrade cycle of stocks and accordingly readjust my portfolio.

How does your style gel with the axis investment process?

I guess my investment style is perfectly in sync with Axis process of investment. We at Axis strongly believe that sustainable above average return in medium to long run is generated by buying good quality businesses.

Do you believe in running tactical trades as a part of the portfolio?

Yes. Market is prone to extremes (in both sides positive and negative) and hence it keeps on creating opportunities which can be utilized to enhance returns.

Do you believe in stop loss?

Not in literal sense but yes *if my thesis of buying a stock goes wrong or there is downgrade potential I am happy to change my view irrespective of profit or loss on the position.*

What are the 1-2 most important criteria that you will look at from any company's financials?

Financial statements have their own limitations in giving you complete perspective about any investment; however we need to remember that a company's numbers are reflection of all the efforts done by management and they show you true color of moat and sustainability of earnings. In this perspective every number is important but the classic qualitative factors viz. cash flow and RoIC are the two most important factors for me. Also I give more emphasis to long term trend in numbers as compared to short term and try to understand what are the key factors contributing to these numbers and how sustainable are they.

Can you share some examples of successes/mistakes made from your career?

On successes I was able to identify certain stocks which were not so appreciated by the market at that time and later they performed very well in Auto, Cement and IT space. On failure I had a very big bet on commodity stock which went wrong.

What is risk according to you?

The risk in investing arises from following factors

1. Lack of Discipline - This is a classic risk factor which arises when you leave your well defined strategy of focusing on fundamentals and start following something else under influence of greed and fear. Basically then you are playing in unknown territory and your ability to take sound investment decision is significantly compromised.

2. Not focusing on valuation - Another big risk and one of the reasons for generating sub optimal return is to disregard valuation completely. Though I agree valuation is a very subjective matter and it is more of an art than science but I believe paying an exorbitant price for anything, results in lower returns.

What are the key themes are you betting on in the next three to five years?

Indian consumer focused or related stocks will continue to be in focus as before, even though there is short term problem due to demonetisation. However if US economy keeps its growth momentum sustained then some export sectors can also be a good opportunity, though as of now we need to wait and watch.

ASHISH NAIK
ASSISTANT FUND MANAGER – EQUITY

Schemes Managed – Axis Children's Gift Fund,
Axis Triple Advantage Fund, Axis Income Saver

Explain your investment style?

Growth bias with low beta i.e. low churn and steady compounders. Prefer high ROE companies with scalable growth prospects, that can generate free cash flow on a sustainable basis.

How is the interaction between fund managers and research team?

We have a daily morning meeting where the analysts discuss company/sector specific events, meetings or news. In addition, fund managers interact on a regular basis with analysts whenever necessary.

Analysts also write company/sector notes on a regular basis based on specific events/concalls/meetings/news where they summarise the stock recommendations with either Strong Buy, Buy, Sell or Strong Sell rating and provide 12-month target price on the stocks.

While analysts have their sector and stock views, that are communicated through above mentioned means, portfolio decisions are left upto the respective fund managers and these can differ from analysts' views.

How are you managing the jump from research to fund manager?

I have learnt it over the years from the fund managers, as they focused on newer companies/sectors, while balancing work on sectors under their research coverage. *Basically, it is about building up on what one has mastered over time, remove redundancies, delegate/leverage sell side as well as internal sector experts smartly and do one sector/stock at a time.* Still, it is a long way to go for me, to say confidently that I have understood all sectors.

What is your feedback on the model portfolio process for capturing the best ideas of research analysts?

It has worked well for me, both as an analyst and as a fund manager. *I believe that, as long as the portfolio reflects the best ideas of the analysts and the positioning is communicated clearly to fund managers, model portfolio can add value in the investment process.* Yet things like mirroring sector benchmark or frequent trading can detract the purpose of model portfolio and should be avoided.

Talk about some of the sectors that you like?

Prefer sectors with structural growth drivers (especially domestic economy linked) with low cyclical and commodity related exposure. Like select private financials, consumer, auto and pharma companies.

How and to what extent do you use external research in your investment process?

Analysts as well as fund managers use external research reports to complement internal sector/company level research. In addition, sell side is leveraged for conducting extensive channel/background checks on businesses as well as macro/sector/company specific data requests. Analysts can use sell side financial models of companies, but ultimate ownership of the estimates lies with the analysts itself.

Do you consider yourselves as a fundamental or quantitative manager, or a mixture of both?

We are a "fundamental research process" driven "bottom-up stock picking" investment team.

How do you make sure that you distinguish between fundamental data and the noise on the street?

Fundamentals of a company include it's profitability, balance sheet and cash flow position, over a period of time. *Anything that impacts stock price for a few weeks/months, but does not affect it's medium to long term fundamentals, over say 1-2 years or beyond, is noise.*

What is your advice to new equity investors at this point of time?

Equity is a long term investment whose inherent potential is realized only by compounding i.e. buy-and-hold strategy. One should not try to time the markets, and instead, one should keep investing systematically, as and when there is an investable surplus. Equity is a risky asset, so one needs to invest selectively in good quality companies with strong fundamentals as well as clean and dynamic management. And finally, one should keenly focus on events that can distort the stock fundamentals, over time.

INVESTMENT PHILOSOPHY – FIXED INCOME

Active Management

Active portfolio management style; geared to exploit opportunities and ensure that portfolios reflect the best investment opportunities at all times

Quality Assets

Focus on building a low credit risk portfolio with a continuous focus on the liquidity of the portfolio

Discipline

Investment decisions are an output of a logical and disciplined investment process

Fundamentals Based

Interest rate views are based on a multi-factor process that combines the medium term outlook with the short term outlook

Research Driven

Investment decisions are driven by extensive macroeconomic and company research

Integrated Risk Management

Risk management is embedded in the investment process

Performance Target

We aspire to be above market performers with below market risk

R. SIVAKUMAR
HEAD – FIXED INCOME

Schemes Managed – Axis Dynamic Bond Fund, Axis Triple Advantage Fund, Axis Children's Gift Fund, Axis Equity Saver Fund, Axis CAPRO Series

We have added to the investment team in the last year. Can you explain how the roles are divided?

Our team is built to deliver on our investment process. At Axis, we want to have a process that firstly is able to generate investment ideas and secondly applies the best ideas to each portfolio efficiently. We want to have a consultative process where each member of the team is involved in selecting the best ideas. To bring a certain order to this process we divide responsibilities across various asset classes (e.g. money market, government, corporate bonds, and credit). Once we agree on a set of ideas to implement, the fund managers and dealers execute it across the portfolios depending on the investment mandate and risk.

Duration/dynamic funds can seem difficult to understand for outsiders. Can you explain what process we have put in place for such funds?

Bond prices move inversely to yields. That is falling interest rates (yields) result in rising prices. Longer bonds move more in response to yield changes as compared to shorter bonds, a link called duration of the bond or portfolio.

The process of managing bonds thus comes down to forecasting interest rates. Over time interest rates are dependent on the state of macro-economy. Faster growth and higher inflation lead to rising rates, while a weaker growth environment and lower inflation leads to rate cuts. We focus therefore on analysis of key macro variables and more importantly forecast the likely evolution over the next few months. If the forecast is for rates to rise, we reduce the duration of the fund; and conversely if the forecast is for yields to fall, we increase the portfolio duration. We apply this in a systematic way in an attempt to capture rising prices (when yields fall) while avoiding falling prices (when yields rise).

As our portfolios have become heavier in lower rated corporate bonds, what changes are we making to the research process?

While we have increased our allocation to bonds rated below AAA, we have still retained a quality bias. Our investments have increased primarily in AA rated bonds with some addition in A rated securities. These are still investment grade securities with a high safety rating. *We understand that as we go away from the "crème de la crème" AAA bonds, the need to manage risk rises substantially.* Our research effort is focused on identifying these risks to determine if the companies can navigate a changing business environment. We also put in place tight controls on the portfolios to ensure adequate diversification, that is we would like to invest small amounts across a large number of companies rather than investing larger amounts with fewer issuers. This means that should a company performance deteriorate (for example because of falling demand for its products), only a small part of our portfolio is exposed.

Of course the reason we invest in lower rated bonds is to get a higher yield. Thus another key aspect of our analysis is to determine if we are adequately compensated for the additional risk we assume when going down the rating scale. How does this translate to portfolios? When the spread (the excess yield over AAA) is high, our exposure to lower rated papers increases, while if the spread is low, we prefer to stay away from credit risk. In 2014-15 the spread was low while the economy was still weak: thus our preference for the highest quality debt. Now with the economy showing signs of recovery and spreads having widened we are increasingly looking to add more credits to the portfolio. We need to look at the impact of demonetisation carefully to see if it changes the risk especially if economic activity remains affected for a long period of time.

What are the risk management practices that we follow for monitoring credit portfolios?

The primary risk control over credit risk is diversification. We place strict internal limits (for example 5% for AA names and 3% for A rated issuers) that reduces the impact of an adverse event such as a downgrade. In practice our actual exposures tend to be much below the limits we set for ourselves. And these limits are reviewed from time to time. There is an alternate view that argues for concentrated exposures to few issuers. The argument is that by having a strong understanding of a selected set of companies the *risk can be reduced. However risk management is never about assuming that your analysis is right. It is always about things that can go wrong.* Thus if you are wrong and have a concentrated portfolio, the impact is very large. Having a diversified portfolio reduces the impact of any unexpected event.

The second risk arises from the relative illiquidity of lower rated bonds. If we buy a five-year lower rated bond, we are stuck with the exposure even if our view on the company changes after a year or two. Similarly if the bond gets downgraded, it remains in the portfolio because it is often difficult to sell a downgraded bond. We thus limit the tenor of our credit exposures. Typically we buy credits below three years to maturity. Thus we have the ability to review our exposure regularly and decide if we want to continue the exposure when the bond matures.

In tracking this risk we are looking at some global best practices such as those at Schroders. A metric such as Duration Times Spread (DTS) is a good way of understanding the combination of tenor (duration) and credit risk (spread).

Three risks and opportunities that debt fund investors should watch out for in 2017

The global environment has seen weakening currency while commodity prices have risen sharply. This presents a risk to inflation in the medium term if it persists. A second risk comes from a slow down in economic activity which could affect lower rated companies. To offset any economic slowdown, the government could go for higher fiscal expenditures that could lead to a higher deficit and borrowing.

On the opportunities side, *any economic slowdown would be very positive for long bonds.* We have also seen credit spreads broadly widen in the wake of downgrades earlier in the year and more recently post demonetisation. If the economic impact is relatively limited, the higher credit spreads could be an interesting opportunity in the coming months. Lastly the demonetisation has led to a big increase in the deposit base of banks and has led to a large increase in system liquidity. This will lead to better transmission of RBI cuts into the markets and poses an opportunity for short-term bonds.

How do you think demonetisation will impact the Centre's finances and thus the g-sec market over the medium to long term?

We expect there to be three broad impacts. On the fiscal front the government should see better tax revenues both as a result of one-time schemes and better compliance in the coming years. On the monetary front, this move has resulted in a substantial improvement in banking system liquidity that should keep the system easy for several years.

Lastly there is the potential downside risk to near term growth due to the fall in economic activity due to the withdrawal of currency. *All three impacts are broadly positive for bond markets and we expect yields to remain low for an extended period of time.* This is especially true about short-term securities which are the most affected by the improved system liquidity.

What are the expectations from the budget?

The fisc should get a boost from the demonetisation move as it should lead to better tax compliance. In addition, to the extent of undeposited old notes, the RBI may deliver a special dividend to the government. So the upside to the budget is clear. Having said that there are demands on expenditure that needs to be met – not least to offset any economic weakness in the wake of removal of a significant part of money supply. Thus we expect that the government will use any additional revenue to fund additional expenditure.

The fiscal deficit target for next year is 3% of GDP. However this may be revised based on the NK Singh committee report (for example to a range target instead of a point target).

Your advice for new fixed income investors?

Investors look at fixed income funds to deliver superior returns over alternate instruments such as bank fixed deposits. It needs to be kept in mind that such better returns are accompanied with risk. Some risks like duration risk are immediately visible thanks to the movement in the NAV, while credit risks are not as visible. *A successful investment strategy in fixed income requires a balance of risks rather than concentrating only on credit or duration strategies.*

DEVANG SHAH

SENIOR FUND MANAGER - FIXED INCOME

Schemes Managed – Axis Income Fund, Axis Dynamic Bond Fund, Axis Fixed Income Opportunities Fund, Axis Short Term Fund, Axis Treasury Advantage Fund, Axis Liquid Fund, Axis Constant Maturity 10 Year Fund, Axis Income Saver Fund, Axis Enhanced Arbitrage Fund, Axis Gold Fund, Axis Gold ETF, Axis Hybrid Series

Can you take us through the process of identification and selection of a new credit in the portfolio?

While selecting credits in investment universe we focus on management track record in efficiently running the business and overall financing policies adopted by the management in the past.

Generally we consider securities across the sectors; however the focus is on to identify the securities in the sectors with favourable medium term outlook.

We have restricted our exposures to shorter tenures to sectors which are more exposed to policy related risks and generally exhibit high volatility.

While evaluating structure credit exposure factors which are given due consideration are

- Fair and distress value of the collateral
- Liquidity and tradability of the collateral
- Analysis of credit enhancement and payment mechanism

Overall process involves detailed analysis of sector, financial analysis, deriving an internal rating, study of management track record of the issuer and then sizing the exposure according to fund mandates and requirements.

What are the key parameters that we look at in a company?

While analysing credit basic parameters which we consider are as follows :

A) Qualitative parameters: Management competence, past evidence of financial aggression/ conservatism, feedback of other stakeholders (equity holders, bankers, suppliers, customers and auditor

B) Quantitative parameters: Financial ratios like leverage interest coverage ratio ,debt protection parameters (Debt/EBITDA) liquidity of the issuer and profitability parameters, financial flexibility of the issuer, management track record and their banking relationships

Threshold values for different quantitative parameters would vary across different industries however focus is on reasonable financial flexibility in medium term even in stress scenarios.

The approach is to diversify the credit exposure by limiting the exposures and increasing exposure to number of securities. Further the tenure of exposure is also used as tool to manage risk (shorter tenure exposure to entities with relatively higher credit risk.)

Do we have a target yield in mind when we look at lower rated allocations?

While selecting a lower rated credit , entire focus initially is on understanding and satisfying ourselves with the credit exposure. Once we are comfortable with the credit we look at the spreads of the other issuer in similar sector in determining pricing of the issuer. We also assign probabilities of upgrade/downgrade in deriving the prices for the low rated securities.

How do you expect yield spreads to behave in the coming year?

I feel that year 2017 , except for first few months on account of demonetisation will be good for credit spreads as government will take enough steps to smoothen up the credit and money flow in to various sectors and hence *we believe credit spreads to remain attractive and might compress in next 12-18 months.*

As interest rates bottom, do we expect close ended FMPs to make a comeback?

FMP's do well in a flat to rising interest rate environment, we still feel that there would be a couple of policy rate cuts in CY 17 and hence we believe an actively manage short term fund strategy would deliver superior returns, having said that for investors who are risk averse and want to benefit by locking in rates for them FMP's can be a good investment opportunity.

What are the top 3 market parameters that you look at on a daily basis (besides yield)?

Banking liquidity analysis, curve analysis, credit spreads and anomalies in credit and curve pricing.

What are the challenges of managing a Credit/corporate/accrual bond portfolio vs a dynamic bond portfolio?

Both strategies are run with different mandates and styles.

- Dynamic bond portfolio is best ideas fund and hence the fund is run by allocating the corpus in duration segment or corporate credit depending on macro view.

- While running a credit/corporate bond fund, major parameters to focus are on credit cycle in the economy, issuer analysis, sector diversification, rating diversification and liquidity of portfolio by considering relatively shorter tenure exposures

What do you expect from Union Budget 2016-17?

I believe that Union budget will be a radical one, where despite having challenges on revenue side (on account of suppressed growth on account of demonetisation), fiscal discipline will be adhered to, I feel Fiscal deficit of 3-3.2% of GDP will be maintained. There would be additional and increased rational expenditure towards rural housing ,health education , basic social infrastructure, increasing opportunities for job creation and agriculture.

Advise to investors,

I feel that RBI has already delivered more than 175 bps of rate cuts in this cycle due to significant fall in inflation and slowdown in growth , looking at macro economic variables hence forth like Inflation, growth, CAD , fiscal deficit and relative currency pricing, there is a possibility of additional 1-2 rate cuts in CY17. We feel that impact of demonetisation would be transient and changing global rates environment backed by fiscal push globally will lead to end of easy rates cycle. Thus *we are at the fag end of rate cut cycle.*

In this environment it is advisable for investors to remain tactical about their allocations. Those who want to capture capital gains and are looking for short term deployment opportunities should use long duration funds as a strategy to invest. While those who are looking from a medium term perspective and are targeting better than FD/inflation returns should look to invest in short to medium term funds.

ADITYA PAGARIA

FUND MANAGER - FIXED INCOME

Schemes Managed – Axis Banking & PSU Debt Fund, Axis Treasury Advantage Fund, Axis Liquid Fund

How do you expect liquidity situation to play out going forward?

If you look at liquidity till March, it won't be as usual as it used to be in similar period in previous years. Due to demonetisation and lack of credit growth, banks are sitting on exceptionally high amount of liquidity surplus.

Also, pace of increase in currency in circulation is expected to be lower than historic pace of ~ 15% which will again add to adequate/surplus liquidity with banks. CD issuances would be abysmally low going forward.

Going by current trends of timely Reverse Repos, incremental CRR hike and MSS, we feel RBI is keen to keep overnight rate closer to operating rate.

What are the key factors that you need to consider while constructing/managing liquid portfolio?

Key factors influencing liquid portfolio construction are liquidity stance going forward, credit spreads, spread over operating rate and investor concentration/ investment horizon.

How is managing money market oriented strategies different from duration strategies?

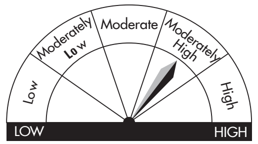
What differentiates money market strategy from duration strategy is investor investment horizon in the funds (especially liquid funds where investor horizon can be as low as 1 day) where we have to optimise both; higher liquidity in the fund as well as higher carry for investors. Also, *in case of duration funds, macro economic factors play more important role than liquidity which is more dominant in deciding strategies for money market schemes.*

What is your advice to investors?

Stay invested in debt funds as a part of their asset allocation strategy depending on their risk appetite and investment horizon.

MODERATELY HIGH

Riskometer



Investors understand that their principal will be at moderately high risk

AXIS EQUITY SAVER FUND This product is suitable for investors who are seeking*
- Capital Appreciation while generating income over medium to long-term
- Provide capiltal appreciation and income distribution to the investors by using equity and equity related instruments, arbitrage opportunities, and investments in debt and money market instrumenets

AXIS EQUITY FUND This product is suitable for investors who are seeking*
- Capital appreciation over long-term
- Investment in a diversified portfolio predominantly consisting of equity and equity related instruments

AXIS FOCUSED 25 FUND This product is suitable for investors who are seeking*
- Capital appreciation over long-term
- Investment in a concentrated portfolio of equity & equity related instruments of up to 25 companies

AXIS LONG TERM EQUITY FUND This product is suitable for investors who are seeking*
- Capital appreciation & generating income over long-term
- Investment in a diversified portfolio predominantly consisting of equity and equity related instruments

AXIS MIDCAP FUND This product is suitable for investors who are seeking*
- Capital appreciation over long-term
- Investment predominantly in equity and equity related instruments of mid-size companies with focus on relatively larger companies within this category

AXIS TRIPLE ADVANTAGE FUND This product is suitable for investors who are seeking*
- Capital appreciation & generating income over long-term
- Investment in a diversified portfolio of equity and equity related instruments, fixed income instrument & gold exchange traded funds

AXIS INCOME SAVER This product is suitable for investors who are seeking*
- Capital appreciation while generating income over medium to long-term
- Investment in debt and money market instruments as well as equity and equity related instruments while managing risk through active asset allocation

AXIS CHILDREN'S GIFT FUND This product is suitable for investors who are seeking*
- Capital appreciation & generating income over medium to long-term
- Investment in debt and money market instruments as well as equity and equity related instruments

AXIS HYBRID FUND This product is suitable for investors who are seeking*
- Capital appreciation & generating income over medium to long-term
- Investment in debt and money market instruments as well as equity and equity related instruments

AXIS GOLD ETF This product is suitable for investors who are seeking*
- Capital appreciation over medium to long-term
- Investment predominantly in gold in order to generate returns similar to the performance of gold, subject to tracking error

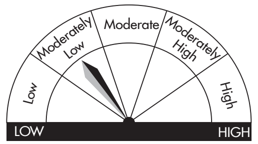
AXIS GOLD FUND This product is suitable for investors who are seeking*
- Capital appreciation over medium to long-term
- Investment predominantly in Axis Gold ETF in order to generate returns similar to the underlying fund, subject to tracking error

AXIS EMERGING OPPORTUNITIES FUND - SERIES 1 (1400 DAYS)
This product is suitable for investors who are seeking*
- Capital appreciation over long-term
- Investment in a diversified portfolio of equity and equity related instruments of midcap Companies

AXIS SMALL CAP FUND This product is suitable for investors who are seeking*
- Capital appreciation over long-term
- Investment in a diversified portfolio predominantly equity and equity related instruments of small cap companies

MODERATELY LOW

Riskometer



Investors understand that their principal will be at moderately low risk

AXIS SHORT TERM FUND This product is suitable for investors who are seeking*
- Regular income while maintaining liquidity over short to medium-term
- Investment in debt and money market instruments

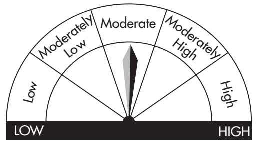
AXIS TREASURY ADVANTAGE FUND This product is suitable for investors who are seeking*
- Regular income over short-term
- Investment in debt and money market instruments

AXIS BANKING & PSU DEBT FUND This product is suitable for investors who are seeking*
- Regular income over short to medium-term
- Investment in debt and money market instruments issued by banks

AXIS CAPITAL PROTECTION ORIENTED FUND This product is suitable for investors who are seeking*
- Regular income over short-term
- Investment in debt and money market instruments

MODERATE

Riskometer



Investors understand that their principal will be at moderate risk

AXIS DYNAMIC BOND FUND This product is suitable for investors who are seeking*
- Optimal returns over medium to long-term
- To generate stable returns while maintaining liquidity through active management of a portfolio of debt and money market instruments

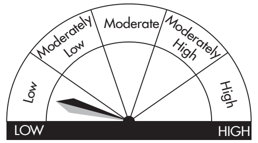
AXIS FIXED INCOME OPPORTUNITIES FUND This product is suitable for investors who are seeking*
- Stable returns in the short to medium-term
- Investment in debt and money market instruments across the yield curve and credit spectrum

AXIS CONSTANT MATURITY 10 YEAR FUND This product is suitable for investors who are seeking*
- Credit risk free returns over medium to long-term
- Investment mainly in Government securities to generate returns similar to that of 10 year government bonds

AXIS ENHANCED ARBITRAGE FUND This product is suitable for investors who are seeking*
- Income over short to medium-term
- Investment in arbitrage opportunities in the cash & derivatives segment of the equity market

LOW

Riskometer



Investors understand that their principal will be at low risk

AXIS LIQUID FUND This product is suitable for investors who are seeking*
- Regular income over short-term
- Investment in debt and money market instruments

*Investors should consult their Financial Advisors if in doubt about whether the product is suitable for them.

AXIS MUTUAL FUND

Disclaimer: Past performance may or may not be sustained in the future.

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