



Radhika Gupta
CEO, Edelweiss Asset Management Limited

AMC Hotseat - Answering the Unanswered

Dear Investors and Advisors,

The roller-coaster ride in the capital markets doesn't seem to end, globally and in India, and no asset class – equities, debt or even oil – was spared from the volatility in the preceding month. Over the last few weeks, many investors and advisors have written asking, not only how they should handle the volatility, but also how they should as mutual fund investors, be better prepared for future volatility? This gives me a lot of hope, because I believe investing is really a journey, about getting better each day. Over the last 15 years, I have two very solid beliefs about investing – firstly, that we should NOT try and predict markets, and the second, that we should and MUST ask better questions about investing. Maintaining that spirit, over the lockdown, I've penned down - ten questions that I would ask asset management companies personally, if I was an investor. Today, I am sharing those ten questions with you.

1. What is your definition of good and bad performance?

This question is important, because the AMC has certain objectives while running its fund, and a certain way it benchmarks its performance. If you don't understand those, and your definition doesn't align with the AMCs, you will always be frustrated. It is advisable not to enter the marriage if there is no unity of thoughts.

2. You outperformed your peers by a huge margin this year? Could you tell me exactly why?

We often question extreme and even slight underperformance of funds, but extreme outperformance should equally be questioned, especially if numbers are way out of line with peers and benchmarks. Extreme outperformance often reveals a lot both about the style of the fund manager and hidden tail risks.

3. What is your edge – is it a unique process, a person, your cost structure, your corporate access?

This is critical to know since performance is sustainable, and what changes – personnel, markets, or regulatory will change that. Sometimes the edge could be nothing, but just distribution - which is also fine, if you as an investor know.

4. When will you underperform, in absolute and relative to others?

The reality of fund management is that all funds will underperform at some point of time because the market conditions are not conducive for all the investment style. If you know this upfront, you will be able to handle this better, because your expectations will be set up accordingly.

5. What does your CEO / board do when your funds underperform?

Over my career, I've learned that underperformance is hard for fund managers – flak from clients and partners, media and internal teams. They need the ability to weather out and for that support from their management, rather than pressure to change the strategy, is very important.

6. Which of your peers are closest to you in approach and which are different?

To genuinely diversify your holdings, you need to diversify across styles. This question will help you understand different styles across funds, and then hold a collection of styles in your portfolio.

7. If you got 10 percent redemptions in a month what would happen? What about 20 percent?

The importance of liquidity is underrated especially in asset classes like credit, mid caps and small caps. It is important to know how the fund is positioned on liquidity because you invest in MFs for liquidity. As I learned in 2008, if you are too big and too illiquid to fail, you often do!

8. What percentage of AUM is owned by the top 10, 20, 50 advisors? Or distributors?

This helps understand the potential liquidity pressure on a fund. Funds that have diversified investor bases are less prone to large single day redemptions that hit your NAV.

9. How did the fund management of the fund change when the fund manager changes?

Fund managers play an important role in the performance of the fund, but consistency of process is equally important. Changing of Fund Managers is a common practice hence, whether the fund has changed the process after such change in fund manager is an important question to ask.

10. Do you have a process document? A document that covers philosophy, but also bounds on duration, credit, conflict of interest, and other matters? When and why do you deviate from it? What will you never do?

Tighter boundaries protect investors, and often the small things like fixed income exposure in a hybrid fund can hurt an investor. A policy document will give you tremendous comfort!

A few investors with whom I have shared these thoughts have asked me, if I ask these questions, will I get answers from the AMCs? Absolutely. If the questions are about returns, the answers are about returns. If the questions are about process, answers will follow. Ask better questions, to get rich answers. As for Edelweiss AMC, in our attempt to be more transparent in communication, we have answered these questions at the start of two funds – Balanced Advantaged Fund and Large Cap Fund – in this month's presentations. Do read in and send your feedback. Based on your feedback, over time, we will extend these to other funds.

I wish you happy questioning and happy investing. Be safe, be happy!

Regards,
Radhika