

Managing Non SLR Investments

A Perspective

by

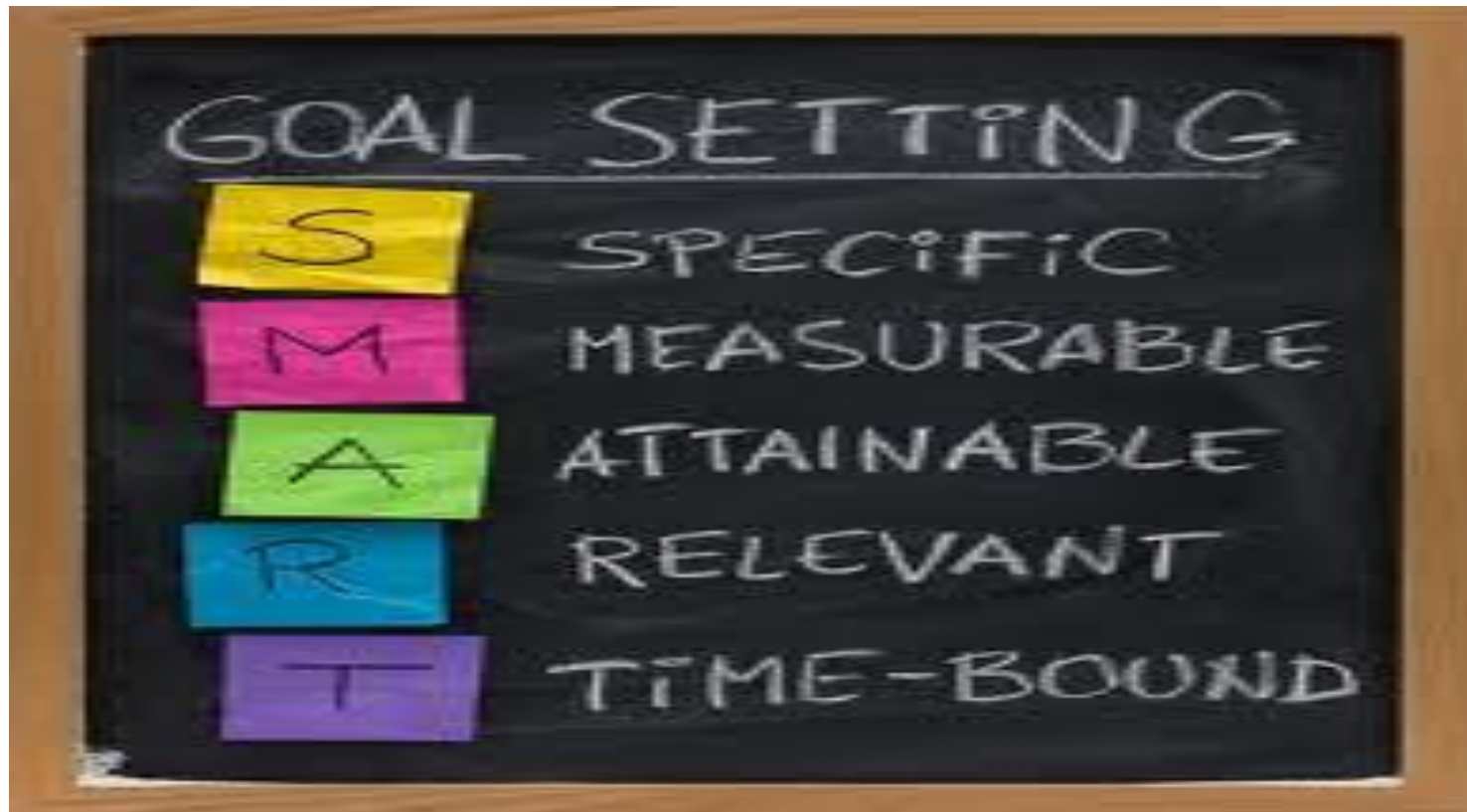
KN Vaidyanathan

Chief Risk Officer – Mahindra Group

Views expressed here are personal

Presentation Flow

- Defining Portfolio Objective – Beyond Accounting
- Individual Asset Classes in Non SLR
 - Issues / Challenges
- Myths and Perspectives
- System wide Issues
- Portfolio Performance Evaluation



Portfolio without objectives is like
football without a goalpost

A few banks Non SLR Portfolio

Bank	Shares	Shares	Bonds	Bonds	Sub	Sub	Others	Others
	F 12	F11	F12	F11	F12	F11	F12	F11
A	7	16	29	28	12	9	52	47
B	4	5	30	26	10	10	56	59
C	0	1	5	3	4	4	91	92
D	2	3	68	66	1	1	29	30
E	15	17	30	30	7	11	48	42
F	1	0	41	24	0	0	58	75
G	0	0	16	26	0	0	84	74

Sub – Investment in Subsidiaries. Others – MF / CD / PSU Deposit. Source – Banks AR

Portfolio Objectives

- Liquidity
 - What do I give up
- Return of Principal
 - Full or Part of the Portfolio
- Return on Principal
 - Optimizing Yields
 - Stop Loss
- Portfolio Rebalancing
 - Preset and Reset

A few banks Non SLR Portfolio

Bank	Shares	Shares	Bonds	Bonds	Sub	Sub	Others	Others
	F 12	F11	F12	F11	F12	F11	F12	F11
A	7	16	29	28	12	9	52	47
B	4	5	30	26	10	10	56	59
C	0	1	5	3	4	4	91	92
D	2	3	68	66	1	1	29	30
E	15	17	30	30	7	11	48	42
F	1	0	41	24	0	0	58	75
G	0	0	16	26	0	0	84	74

Sub – Investment in Subsidiaries

Others – MF / CD / PSU Deposit

A few banks Non SLR Portfolio

Bank	Shares	Shares	Bonds	Bonds	Sub	Sub	Others	Others
	F 12	F11	F12	F11	F12	F11	F12	F11
A	7	16	29	28	12	9	52	47
B	4	5	30	26	10	10	56	59
C	0	1	5	3	4	4	91	92
D	2	3	68	66	1	1	29	30
E	15	17	30	30	7	11	48	42
F	1	0	41	24	0	0	58	75
G	0	0	16	26	0	0	84	74

Sub – Investment in Subsidiaries

Others – MF / CD / PSU Deposit

A few banks Non SLR Portfolio

Bank	Shares	Shares	Bonds	Bonds	Sub	Sub	Others	Others
	F 12	F11	F12	F11	F12	F11	F12	F11
A	7	16	29	28	12	9	52	47
B	4	5	30	26	10	10	56	59
C	0	1	5	3	4	4	91	92
D	2	3	68	66	1	1	29	30
E	15	17	30	30	7	11	48	42
F	1	0	41	24	0	0	58	75
G	0	0	16	26	0	0	84	74

Sub – Investment in Subsidiaries

Others – MF / CD / PSU Deposit

Non SLR Investments

- Equities
 - Investment in Subsidiaries
 - Other Equities
 - Listed
 - Unlisted
- Mutual Funds
 - Equity MF
 - Debt MF
 - Money Market MF (Liquid MF)
- Corporate Bonds
- Commercial Paper

Equities

- Strategic Investments. Define Objectives
 - Subsidiaries
 - Market Infrastructure Institutions

Decision Point – Should these be counted in Treasury performance?

- Portfolio Investments. Define Objectives
 - Listed Equities
 - Unlisted Equities

Equities – Portfolio Investment

- Investment Strategy
 - Growth Investing
 - Value Investing
- Risk Evaluation
 - Margin of safety
 - Market cycle
 - Performance Benchmark – NIFTY / SENSEX
- Unlisted Equities
 - Venture Capital / Private Equity
 - Valuation – Cost, LoCoM, Fair Valuation
- Surrogate Exposure through Equity MF
- Investing in Index / Index Funds

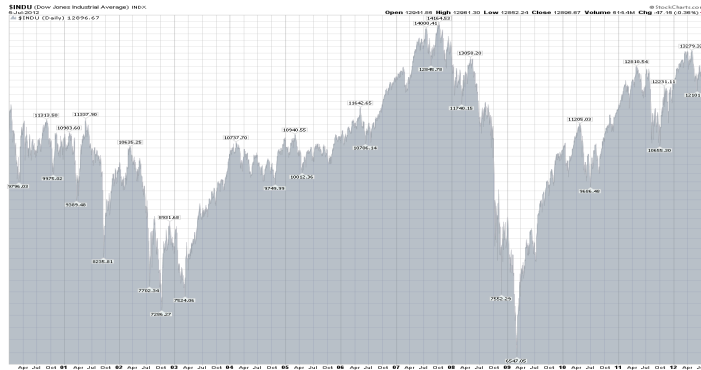
Investing Myth

Timing markets is not important.

Time in markets is.

..... Popular Wisdom

Over time, TIMING is everything



<<Dow Jones since 1/1/2000

Nikkei since 1985 >>



Look for Contra Indicators



Look for Contra Indicators

- **Real Estate v BSE Realty Index**

Real Estate prices in India – GOING NORTH

NHB Residex Mumbai

193 (Oct-Dec 2011 Index)

194 (Jul-Sept 2011 Index)

Base Year: 2007 = 100

BSE Realty Index

Oct 2007 10,502

July 2012 1,692

Drop of over 85%

Look for Contra Indicators

- **China GDP v Shanghai Composite Index**

Average GDP Growth over 33 years > 10%

Average GDP Growth over 10 years > 10%

Shanghai Comp Index

Oct 2007 ~ 6000

July 2012 ~ 2200

Drop of over 65%



Debt Mutual Funds

- Issues to consider
 - Security selection process
 - Valuation. Marked to Model
 - Concentration
 - Asset Side
 - Liability Side
 - Fees / Expenses
 - Exit Load
 - Mark Up / Mark Down
 - Fixed Maturity Plans

Liquid Mutual Funds

- Issues to consider
 - Liquidity – near cash (CBLO), illiquid holdings (CP/CD)
 - Valuation – marked to market / model
 - Transmission Risk (Case Study – 2008 Global / India experience)
 - Tax Arbitrage – past, present and DTC
 - Circular Investing – regulatory frown

For MMMF, if you break the BUCK, you break the BACK

Commercial Paper

- Research and experience shows that companies access CP market when
 - Investment needs high
 - Rollover risks low
 - Cash holdings low
- Question to ask. Are CPs a bridge finance for
 - Working capital
 - Long term funding
- Is the price adequate in a risk – reward ratio
- Does the price build in ‘disruptive’ market / financial distress

Corporate Bonds

- **Investment strategy**
 - Trading
 - Accrual
- **Investment evaluation**
 - Sources of Information
 - Rating
 - Benchmark
 - Liquidity
- **Risk management**
 - Liquidity
 - Market risk v credit risk
 - End use tracking

Valuation Challenges

- Based on G-Sec Yield Curve
- Emphasis on rating to determine spread
- Uniformity in spread of rated over G-Sec
- Uniformity in spread of unrated over G-Sec
- Net Asset Value v Net Realizable Value
- Absence of Volume weights
- Risk of imputed / implied liquidity
- No mark up/ mark down

Dispersion of Holdings

Investors	Data as on	GOI and Other Related Securities (\$ Bln)	Money Market & Corporate Bonds(\$ Bln)	Total (\$ Bln)
Banks	As on August 2011	375.20	67.15	442.35
Mutual Funds	As on August 2011	1.49	107.08	108.57
All Insurance Companies	As on June 2011	142.36	194.92	337.29
Retirement Funds	As on March 2010	36.63	54.94	91.36

Source – Bloomberg

Myth of Ratings

Their 'standards' made the world 'poor'
And, sometimes they get away being 'moody'

Myth of Ratings

Their 'standards' made the world 'poor'
And, sometimes they get away being 'moody'

Rating is NOT a LEAD Indicator

Rating is a LAG Indicator

Story of Lehman and AIG

Moody's, Standard & Poor's, and Fitch Ratings all maintained at least A ratings on AIG and Lehman Brothers up until mid-September of last year.

Lehman Brothers declared bankruptcy Sept. 15, 2008.

The federal government provided AIG with its first of four multibillion-dollar bailouts the next day

Story of Indian RE firm

- Dec 2008 Rating Agency downgrades an RE firm from A – to BBB –
- Jun 2009 Rating Agency downgrades this RE firm from B – to D

Story of Indian RE firm

- | | |
|----------|---|
| Dec 2008 | Rating Agency downgrades an RE firm from A – to BBB – |
| Jun 2009 | Rating Agency downgrades this RE firm from B – to D |

PRE THAT

- Promoter borrowing against pledged shares
- Short term borrowing from NBFC
- Rollover of loans with banks

US Rating

S & P v Warren Buffet

Aug 2008

- S & P downgrades US from AAA to AA
- Warren Buffet disagrees and believes US deserves a 'Quadruple A' rating (> AAA)

	Then	Now	Change
30yr Mortgage	4.39%	3.56%	+ve
10yr Treasury	2.56%	1.51%	+ve
Dow	11444	12676	+ve
Unemployment	9.10%	8.20%	+ve

Concerns in Rating

Analysis	v	Opinion
Liquidity	v	Solvency
Single Firm	v	Systemic
Efficient Market	v	Black Swan
Independent	v	Transmission
Convergence	v	Divergence

Rating is AN Input. Not THE Input

Go Beyond Accounting

Held to Maturity)	Satisfies
Held for Trading)	Accounting
Available for Sale)	Requirement

Go Beyond Accounting

Held to Maturity)	Satisfies
Held for Trading)	Accounting
Available for Sale)	Requirement

BUT INTERNALLY DO

Marked to Market
Or
Marked to Model

Why Marked to Market or Model

- True and Fair value of portfolio
- Better estimate of 'risk' adjusted 'returns'
- Early warning signals to trigger action
- Assist decision making in incremental investments / portfolio hedging

BIG COST –

- Increased volatility in portfolio. Start with internal review / MIS

Marked to Market

To do an effective marked to market,
Is Secondary Primary and Primary Secondary

Marked to Market. Yes.

But where is the market???

Issued v Traded

Yearr	G-Sec Issued	G-Sec Traded	Corp Bonds Issued	Corp Bonds Traded	CP / CD / ST paper issued
	INR Crores	INR Crores	INR Crores	INR Crores	INR Crores
2008-09	273,000	8,321	174,327	571	188,100
2009-10	451,000	10,424	189,478	1,543	126,386
2010-11	437,000	10,333	192,175	2,328	40,577

Need multiple data points on yield curve. Need to consider market-making

Source – RBI / NSE / FIMMDA

Market Making

Organization should be driven by

- Deal origination
- Trading
- Market Making
- Distribution

In short, need to build Debt Capital Markets

Tracking End Use of Funds

- Periodic scrutiny of performance reports
- Regular visits & inspection of hypothecated securities
- Scrutiny of books of accounts
- Stock audits
- Borrowers' certificate
- Review of internal audit findings

BUT THESE ARE FOR LOANS.

What about securities?

Skill Developments

- Professional Strengths in DCM
 - Origination
 - Distribution
 - Trading
 - Market Making
- Expertise in products / asset classes
 - Derivatives – Futures / Options
 - Derivatives – Currency, Interest Rate, CDS
 - Equities, Commodities, Real Estate

Portfolio Performance Evaluation

- Distinction between Strategic v Portfolio Investments in Treasury performance evaluation
 - Investment in Subsidiaries
 - Investment in Unlisted Equity
- Portfolio Yield Measures
 - Absolute total return
 - Excess over risk free returns
 - Active v Passive Investing

Portfolio Performance Evaluation

- Portfolio Benchmark
 - Driven by Portfolio Objective
 - Asset Class
 - Overall Portfolio
 - Risk Adjusted Returns
- Attribution Analysis
 - Asset class allocation
 - Investment selection
 - Market timing

Thank You

KN Vaidyanathan
Chief Risk Officer
Mahindra & Mahindra Ltd

Vaidyanathan.KN@mahindra.com
(+91 22) 2497 8097
www.mahindra.com

All views expressed are personal and do not reflect the views of Mahindra Group