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From the
Editor's Desk

"The measure of intelligence is the ability to change".

This famous quote by Albert Einstein holds true for the modern day investor. The financial environment is dynamic and ever-changing which means we need to remain flexible and adaptable in our investing approach even though our goals may remain the same.

Budget 2018 saw the Finance Minister announce the introduction of a long-term capital gains (LTCG) tax on the sale of equity shares and equity-oriented mutual funds. Although the tax rate is only 10%, this may be a significant cost to investment and must be factored in while planning an investment strategy.

In this issue, you will find editorials on the impact of the budget on investment strategies and the market, debt funds, benefits of ELSS, employer-employee insurance, and more. A flowchart detailing the new LTCG provisions in the FAQ section will also be helpful to investors.

Hope you find this edition as informative as the previous one.

Best,

Tushar Goyal
Editor-in-Chief

Punji (*noun / Hindi*) - **Capital** *meaning, wealth in the form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing.*

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Creating a Mighty Ocean of Wealth with Little Drops of ELSS

Why do people invest in financial instruments? A primary reason is to harness a source of income without working hard the entire life. This needs some smart thinking in terms of investing one's corpus in the right instruments and at the right time.

While an ELSS offers an effective way to make a tax-saving investment, an SIP is a great way to invest regularly without affecting one's lifestyle. Bring these two together and you have a recipe to accumulate wealth over the long-term, while also enjoying tax benefits.

WHAT IS AN ELSS?

An Equity Linked Savings Scheme (ELSS) is a type of diversified equity mutual fund that invests the majority of its corpus (>65%) in equity-related products. It is an open-ended fund that qualifies for tax exemption under Section 80(C) of the Indian Income Tax Act, 1961, offering the twin advantages of capital appreciation and tax benefits. No tax is levied on long-term capital gains from these funds.

One can invest up to Rs. 1.5 lakhs in an ELSS in a financial year to avail tax benefits. Tax savings of up to Rs. 46,350 can be achieved by making an investment of Rs. 1.5 lakhs where the investor falls in the top income tax slab of 30% (inclusive of the applicable cess of 3%). However, the tax saving may differ depending on the applicable tax slab of the individual investor. If the investment exceeds this amount, the excess amount doesn't qualify for tax benefit under section 80(C). This acts as a huge incentive for most investors to park their funds in eligible schemes. By investing through the SIP route, ELSS offers great savings and tax benefits, without hurting your cash flow at the end of the year.

An ELSS comes with a lock-in period of 3 years for investors to avail tax exemption on returns, which is still one of the shortest compared to other tax-saving options. Other investment products that provide tax benefits such as insurance, PPF, NSC, EPF etc. have a minimum lock-in period of 5 years. While this could be seen as a drawback by some, it is a positive if one considers the fact that the 3-year lock-in removes the temptation of withdrawing one's money and allows it to grow. Moreover, if one invests in an ELSS each year, the first investment amount can be withdrawn after the third year. The investor can withdraw the amount of Rs. 1.5 lakhs every subsequent year, which also funds his 80(C) deduction for that year. Thus, by investing for three years, the ELSS itself can fund future investments if the investor so wants.

While equity investments are subject to market risks, ELSS offers the chance to earn higher returns with tax exemption. Traditional savings offer about 6-8% of returns but investing in an ELSS can produce higher returns in favorable stock market conditions.

WHOM ARE ELSS FUNDS SUITABLE FOR?

ELSS is an instrument that is ideal for persons from every economic background including business persons, senior citizens, and salaried employees. It does not have an age limit - one can start as early as possible. It is also ideal for those who are aged but willing to take some risk with their investments. Moreover, ELSS serves the best for those investors that don't believe in putting all eggs in one basket. Some of the advantages of investing in an ELSS are:

- Long-term growth via capital appreciation
- Affordable investment through the SIP route, with minimum monthly amount of just Rs. 500
- Minimum lock-in period of just 3 years, considerably less than other tax-saving options
- Potential to earn substantially higher returns compared to traditional tax-saving options
- Power of compounding helps earn in multiples of the principal invested

WHAT ARE THE DIFFERENT TYPES OF ELSS FUNDS?

ELSS funds come in two types:

Growth

Here, the holder receives no dividends but only reaps the benefits at maturity. This helps appreciate the NAV and thus multiply profits. However, this is completely dependent on market conditions.

Dividend

Here, the investor enjoys dividends as compared to a lump sum amount at the end. The advantage here is that any dividend is entirely tax-free.

To understand these options in detail, stay tuned for our next issue.

WHAT IS SIP?

A Systematic Investment Plan (SIP) is a mutual fund scheme wherein a small amount of money is invested in a specific fund on a monthly basis. It is the ideal way to start investing in the equity market and build long-term savings. With an SIP, one need not actively time the market, eliminating the worry of missing a windfall or insulating the corpus from the market lows. Investors can choose from different categories of funds - diversified equity funds, balanced funds, mid and small cap funds, gold funds and so on. Some of the primary advantages of an SIP are:

- **Rupee cost averaging:** Rupee cost averaging is a major driver of the popularity of SIPs. With a long-term investment approach, rupee cost averaging can even out market ups and downs, allowing the investor to reap maximum benefits on their investment over time. By investing a fixed amount every month, investors are able to purchase more units when the price is lower, reducing the average cost of the financial asset over time. Thus, an investor would end up buying more units when markets are down and less units when they go up.
- **Power of compounding:** The earlier you start, the more returns you enjoy. SIPs allow investors starting off earlier with a small amount to benefit more than someone starting later with a big amount, thanks to the power of compounding that helps one earn return over their returns.
- **Discipline:** A disciplined approach towards investment helps investors maintain an unemotional, rational outlook, especially when stock markets are volatile. Investors often shy away from equity markets because of their volatility, giving up on the opportunity to generate higher returns over the long-term. To make the most of this, you need to not just regularly invest but also stay invested.

Investors should note that SIPs are open-ended mutual funds where they can invest and redeem at any point in time. There is no fixed tenure for running a SIP, with a full or partial withdrawal being possible during or after the fund tenure.

BRINGING THE TWO TOGETHER

Smart investors aim to save money and invest with a long-term perspective. Equity mutual funds are one of the best ways to achieve this goal. Not only do investors get capital appreciation benefit, they also receive high inflation-beating returns, allowing for the accumulation of wealth over a period of time. There is also the benefit of diversification - investing in equity mutual funds means spreading your investment in different sectors, hedging future losses and minimising market risk in your overall portfolio.

While ELSS is a good tax deductible investment, SIP is an ideal way to invest over the long-term. By combining the two, investors have a powerful tool of wealth creation and tax-savings over the long-term ■

Budget Impact

The new LTCG provisions

BUDGET 2018 has been largely aligned with the Government's long-term objectives of clean money, agriculture and infrastructure sector growth, housing for all, rural development etc. On the investment front, Budget proposals have been a mixed bag of give and take. On one hand, a host of tax benefits to senior citizens leaves them happy and on the other, the levy of long-term capital gains (LTCG) tax on equity and equity-oriented schemes is being viewed as a big retrograde step.

The good news for senior citizens is in terms of:

- Tax exemption on interest income on deposits with banks and post offices increased from Rs. 10,000 to Rs. 50,000 per year. TDS will now apply only on income in excess of Rs. 50,000
- Health insurance policies - Deduction claimable on premium paid increased to Rs. 50,000 from Rs. 30,000
- Expenditure on treatment of critical illnesses can be claimed up to Rs. 1 lakh
- Interest on FD under sec 80C made for the stipulated 5 years has been made tax exempt

Given that post office schemes and fixed deposits comprise a big chunk of senior citizens' retirement corpus, this will result in a significant rise in their savings if their income falls in the taxable bracket.

LONG TERM CAPITAL GAINS TAX

LTCG on equity existed a few years back at 20% but was abolished when the Securities Transaction Tax (STT) was introduced. This was done to promote investments into the country's economy and boost capitalisation.

The FM in his Budget speech stated that this tax favouritism created a bias against manufacturing, leading to more business surpluses being invested in financial assets. To set right this incongruity, he stated "I propose to tax such long term capital gains exceeding Rs. 1 lakh at the rate of 10% without allowing the benefit of any indexation. However, all gains up to 31 January, 2018 will be grandfathered. Further a dividend distribution tax (DDT) of 10% on equity-oriented funds has also been imposed to provide a level playing field across growth-oriented funds and dividend distributing funds. DDT will be deducted by the AMC, as is the case with debt-oriented funds today. All these provisions will be applicable from 1 April 2018."

Scenarios

1 An equity share is acquired on 1 January 2017 at Rs. 100. Its fair market value on 31 January 2018 is Rs. 200 and it is sold on 1 April 2018 at Rs. 250. As the actual cost of acquisition is less than the fair market value as on 31 January 2018, the fair market value of Rs. 200 will be taken as the cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 250 – Rs. 200).

2 An equity share is acquired on 1 January 2017 at Rs. 100. Its fair market value on 31 January 2018 is Rs. 200 and it is sold on 1 April 2018 at Rs. 150. In this case, the actual cost of acquisition is less than the fair market value as on 31 January 2018. However, the sale value is also less than fair market value as on 31 January 2018. Accordingly, the sale value of Rs. 150 will be taken as the cost of acquisition and long-term capital gain will be NIL (Rs. 150 – Rs. 150).

3 An equity share is acquired on 1 January 2017 at Rs. 100. Its fair market value on 31 January 2018 is Rs. 50 and it is sold on 1 April 2018 at Rs. 150. In this case, the fair market value as on 31 January 2018 is less than the actual cost of acquisition, and therefore, the actual cost of Rs. 100 will be taken as actual cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 150 – Rs. 100).

4 An equity share is acquired on 1 January 2017 at Rs. 100. Its fair market value on 31 January 2018 is Rs. 50 and it is sold on 1 April 2018 at Rs. 50. In this case, the actual cost of acquisition is less than the fair market value as on 31 January 2018. The sale value is less than fair market value as on 31 January 2018 and also the actual cost of acquisition. Therefore, the actual cost of Rs. 100 will be considered the cost of acquisition. Hence, the long-term capital loss will be Rs. 50 (Rs. 50 – Rs. 100) in this case.

IMPLICATIONS OF LTCG TAX

- All transactions till 31 March 2018 shall continue to be exempt
- Transactions after 1 April 2018 will be taxed as per the budget proposal
- Grandfathering provision means that the cost of acquisition will be the highest price of the underlying asset as on 31 January 2018
- The first Rs.1 lakh gain exemption will protect small investors and hence, this may typically affect HNIs.

Long-term capital loss arising from transfers made on or after 1 April 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed losses can be carried forward to subsequent eight years for set-off against long-term capital gains

EFFECT ON INVESTMENT PSYCHOLOGY

Will the impact of LTCG tax, which would narrow down the difference between LTCG and STCG tax to just 5%, bring about any behavioural changes in the investor? Any answer to this question may be premature but the grandfathering provision could prove the overall impact on market sentiment to be quite negligible. Investors will now just have to build in a 10% pay-out as LTCG in their return expectation.

LTCG cannot be considered the sole underlying trigger to market fall post Budget; the market turmoil was also not isolated to the Indian market. Global markets witnessed a more or less similar situation. Compared to all other investments, equity and equity related instruments' return would still remain far superior in the long term ■

Contributed by
Pradeep Agarwal

Investing
in Holding Companies

Stock exchanges house a variety of companies. In valuing a security, the earnings and cash flows are generally taken into consideration and an estimate of value versus price is used to decide if the current market price is attractive from a trading or investing perspective. Even for companies that are asset-rich, the market value will generally, in the long-term, converge around the cash flows from the underlying assets unless the asset is likely to be sold off and cash realised for the investors. In these cases, called value unlocking in common parlance, the market value of an asset will be reflective in the market price of the security.

However, an interesting category of listed companies is investment or holding companies – companies which hold investments in other listed companies. A large part of the balance sheet (capital employed) lies in financial investments, which are often investments held in group companies (belonging to the same set of promoters/management).

A variation of the above example is companies that have a strong underlying business but still derive substantial value from their holdings in other companies, often group companies. These companies are listed and with fairly successful ventures that have performed well over a period of time, the promoters have floated new ventures, funding them via the listed company. Thus, these companies have turned into holding companies.

Investment companies are interesting because they are generally traded at prices far in excess of the cash flows (dividends) from their investments. But at the same time, they do not trade at prices close to the market value of the underlying assets but at significant discounts of 30-80%. The discount to the underlying investments varies through market cycles. Generally, in bull markets, the discount reduces to about 30-40% and in bear markets the discount widens, often up to 70-80% of the underlying investment value.

As a result, the opportunity in holding companies is two-pronged. Returns are multi-fold due to increase in value of the underlying investments and reduction of the discount factor from a bear market to a bull market.

Let us take a hypothetical example of company A with underlying investments of Rs. 100 and traded at market capitalisation of Rs. 30 (discount of 70%). Let us assume, through the market cycles, the underlying investments go up in value from Rs. 100 to Rs. 200 and the discount factor narrows to 40%. The market capitalisation of Company A will now go up from Rs. 30 to Rs. 120 (300% growth). The reverse will play out in bear markets - the holding company will fall disproportionately since not only the value of the underlying assets fall but the discount factor also rises. This is shown in the table below:

	Bear Market	Bull Market
Value of Underlying Investment	100	200
Discount	70%	40%
Value of Company A	30	120

Now we will see some examples of investment/holding companies and how the market values them. The table below summarizes some of the investment/holding companies.

(Rs. In crores)

Name of Company	Market Value of Investments (approx.)	Market Capitalisation	Discount
Tata Investment Corporation	8,524	4,800	44%
Pila Investments	10,500	2,400	77%
Balmer Lawrie Investments	1,700	1,000	41%
Bengal & Assam	4,000	2,300	43%
Summit Securities	1,750	1,200	31%

TATA INVESTMENT CORPORATION LIMITED (TICL)

TICL is one of the holding companies for the Tata Group of companies. However, it is like a mutual fund that also trades/invests in other listed companies. It derives its income from dividends, interest on surplus funds, and profit on sale of trading/investments.

As of January 18, 2018, the market value of the investments was close to Rs. 8,524 crores. This included shares in Tata Group companies and others. This is shown in the table below. If we break up the market capitalisation of the investments in Tata Group companies, which will never get sold, and other investments which are tradable, then the market capitalisation breaks up as shown in the table below:

(Rs. In crores)

	Market Value of Investments	Discount	Market Capitalisation
Investments in Tata Group Companies	5,803	64%	2,079
Other Investments	2,721	0%	2,721
Total	8,524	44%	4,800

PILANI INVESTMENTS AND INDUSTRIES CORPORATION (PIIC)

PIIC is the holding company that derives substantial value from its holdings in the companies of the BK Birla and Aditya Birla Group. The market value of the holdings in various companies (Century Textiles, Grasim, Ultratech, Hindalco etc.) is almost Rs. 10,500 crores, while the market capitalisation of Pilani is a mere Rs. 2,400 crores, a discount of almost 77%.

BENGAL AND ASSAM COMPANY (BAC)

BAC is the investment and holding company of Delhi-based JK (Singhania) Group (JK Tyre, JK Paper, JK Lakshmi Cement etc.). BAC, its subsidiaries, and associates hold substantial stakes in JK Group which has market value upwards of Rs. 4,000 crores. The market capitalisation of BAC is about Rs. 2,300 crores.

BALMER LAWRIE INVESTMENTS (BLI)

BLI is a unique company that it is owned by Government of India. It is the holding company of Balmer Lawrie & Co. (BLC), a diversified PSU with business interests in Oils & Lubricants, Industrial Packaging, Multi-Modal Logistics, Travel and Tourism, Tea etc. The market value of the holdings in BLC is about Rs. 1,700 crores while the market capitalisation of BLI is Rs. 1,000 crores.

SUMMIT SECURITIES (SS)

SS is the Investment/Holding Company of RPG Group with large holdings in Ceat, KEC International, Zensar Technologies etc. The market value of the investments is Rs. 1,750 crores and the market capitalisation is Rs. 1,200 crores ■

Vivek Mavani

Vivek Mavani is a SEBI Registered Investment Advisor based in Mumbai

Breaking the myth

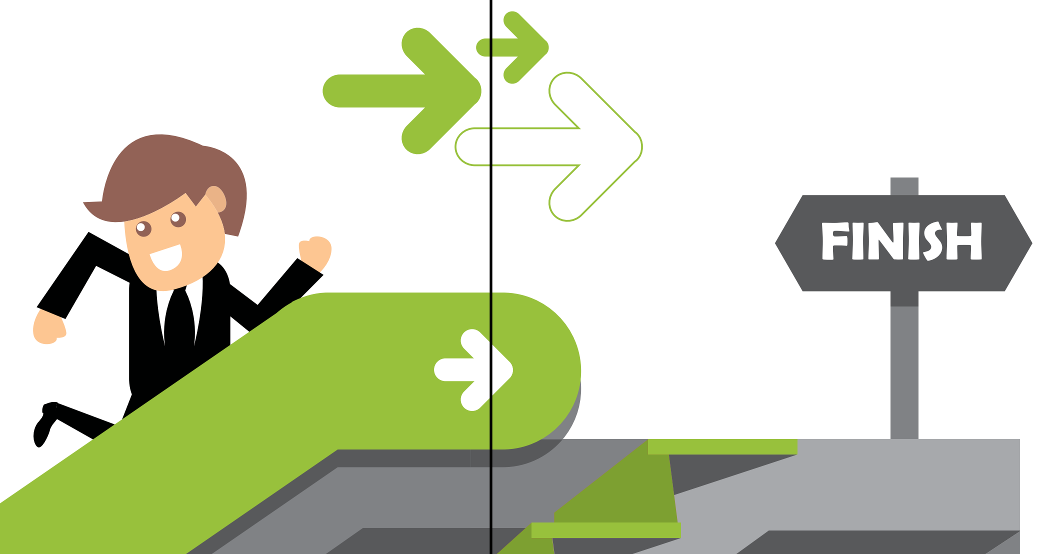
Fixed Deposits V/s Debt Funds

- A Case Study

For most people, fixed deposits are a popular answer to 'Where should I invest?'. Although fixed deposits are secure and provide steady interest, they aren't the ideal low-risk option for investing your money.

Debt funds, on the other hand, are not just an equally safe investing bet but are also ideal for achieving short-term goals for which an investor holds capital but there is some time before the actual spending occurs. Instead of keeping it lying idle, the money can be invested in a debt fund without any risk to capital (as opposed to equity).

Conservative investors can also park long-term funds in debt funds when instead of significant capital appreciation, safety of capital is the objective. Debt funds are the most suitable for individuals and institutions with a low-risk appetite or those looking for a safe avenue to park their funds, such as NGOs and RWAs. Not to mention the tax benefits an investor can receive by investing in debt funds (or mutual funds in general) vis-à-vis investing in fixed deposits. Let's consider an example.



Debt funds coupled with a Systematic Withdrawal Plan can offer a great investment option for investors looking for regular income from their invested corpus with minimum tax liability.

Say, a retired individual has a corpus of Rs. 1.5 crores and requires an annual income of Rs. 12 lakhs for his maintenance. He decides to invest his corpus in a low-risk instrument that earns 8% p.a. interest. Let us consider two investment scenarios – a bank fixed deposit and a debt fund.

FIXED DEPOSITS VS DEBT FUNDS

	FIXED DEPOSITS	DEBT FUNDS
INCOME COMPARISION		
Corpus (Rs.)	15,000,000	15,000,000
Interest Rate	8%	8%
Interest Amount Per Year (Rs.)	1,200,000	1,200,000
Income Generated (Rs.)	**1,200,000**	**88,889****
Income Tax	30%	30%
Tax Payable Amount (Rs.)	360,000	26,667
Income Net Off Tax	**840,000**	**1,173,333**
CASH FLOW COMPARISION		
Monthly Cash Withdrawl/ SWP (Gross)	100,000	100,000
TDS	10%	NIL
Net Cash in Hand (Monthly)	**90,000**	**100,000**

** By the end of the year, the individual would have withdrawn Rs. 12 lakhs but the entire sum would not be considered his income. The income part (calculated pro-rata to its capital) amounts to Rs. 88,889 (Rs. 12 lakhs * 12 lakhs/1.62 crore). Thus, he only needs to pay tax on Rs. 88,889.

Thus, we see how investing in mutual funds is advantageous not just because of the better returns or higher liquidity, but also because of several other benefits like taxation and cash flow. Alignment of investments with financial goals is the purpose as well as the result of sound financial planning

Choosing The Right Debt Fund

Know all about modified duration and volatility

For those looking for regular income with low-moderate risk, debt funds serve as one of the best investment options. Understanding the workings of debt funds is crucial to making rewarding investment decisions. Once you develop a basic understanding of fixed income (debt) investments, it's time to level up and look at more advanced concepts.

There are two main strategies that are employed for fixed income investing:

Hold Till Maturity: This is a common 'accrual' strategy wherein the fund invests in fixed income instruments and holds them until maturity, thus earning interest over its tenure. Let us understand this through a bond investment illustration.

Say, a fund invests Rs. 1 lakh in a bond with the face value of Rs. 100 and coupon rate of 8%, due in 6 months and maturing in 2 years. If the bond was purchased for Rs. 101, a total of 990 units were bought. Suppose interest rates shoot up after the bond is purchased and bond price rises to Rs. 98 after a month (since interest rates and bond prices are inversely related). The book value of the investment thus drops to Rs. 97,030, resulting in a loss of Rs. 2,970 for the investor. Post six months, the investor receives a coupon interest of Rs. 7,920 (8% of Rs. 100 multiplied by the total number of bond units - 990). Next year, there is a coupon payment of the same amount. When the bond matures 2 years from purchase, the investor receives the face value. Hence, the maturity amount will be Rs. 99,010 plus the additional coupon interest of Rs. 15,840. Therefore, the investment of Rs. 1 lakh has generated Rs. 114,940.

Thus, despite making a loss of Rs. 2,970 in the first month, the investor still makes an overall profit of Rs. 14,850 on the initial investment, by holding the bond until maturity, irrespective of the price fluctuation that happened in the interim. This exemplifies the hold till maturity strategy, the objective of which is to generate a stable income. Some examples of funds which hold till maturity include short-term debt funds, fixed maturity plans, liquid funds, credit opportunities funds, ultra-short-term debt funds etc.

Duration Calls: This strategy involves the fund manager observing the trajectory of interest rates. Here is the rationale behind the inverse relationship between bond price and interest rates, which forms the basis for a duration call strategy. Suppose you purchased a 20-year bond with a coupon of 9% on a face value of Rs. 100 one year back. If interest rates went down by 1% during the year, the bond yield would decline, prompting new issuers to offer a lower coupon rate. Because your 20-year bond yields a higher interest than the one currently being offered, investors who are keen

on earning a higher interest would be willing to pay an amount greater than the original Rs. 100. Thus, you could sell the bond at a higher price and thus earn a profit, over and above the coupon payment received already. Also note that if interest rates were to rise, the effect on the bond price would be the opposite.

Additionally, the price sensitivity of a bond to a change in interest rate relates directly to its maturity period. Compare an investor who holds a bond with 9% coupon for 10 years with another who holds a bond of 9% coupon for 1 year. If interest rates decline, the first one earns a higher interest rate for a longer period of time compared to the second. Thus, investors would be willing to pay a higher price for longer maturity bonds compared to shorter maturity bonds when interest rates fall. However, if interest rates rise, the price of bonds with longer maturity will fall more than that of shorter maturity bonds.

So, if you are looking for capital appreciation along with the income, employ a duration call strategy i.e. invest in longer maturity bonds when the interest rates are expected to fall. Examples of debt funds that take duration calls based on interest rates are long-term gilt funds, dynamic bond funds, income funds etc.

When it comes to fixed income investment, the two most important concepts are:

- Yield to Maturity
- Modified Duration

Understanding them will help you make superior investment decisions.

YIELD TO MATURITY

Yield to Maturity (or YTM) is the return an investor earns on holding a bond until maturity. In the case of a debt fund, it is the return the fund earns by holding securities in its portfolio till maturity.

> Debt funds serve as one of the best investment options for investors looking for regular income with low-moderate risk. Understanding the workings of debt funds is crucial to making rewarding investments decisions.

For instance, consider a debt fund's portfolio with a YTM of 10% and a duration of 2 years. If there is no fluctuation in the portfolio, the fund will earn a return of 10% (before expenses), as long as it holds the securities in its portfolio for the entire duration of 2 years. If the expense ratio of the fund is 1%, the investor earns 9% interest.

An investor can see the YTM of a debt mutual fund scheme in its monthly factsheet. If it reflects a high YTM, the investor will gain high returns for accrual-based debt funds. However, it is also possible for fund managers to achieve a higher YTM by investing in lower rated papers. Hence, it is advisable investors ensure they understand and are comfortable with the credit risk of the fund before investing.

MODIFIED DURATION

Simply put, modified duration is the price sensitivity of a bond to changes in either yield or interest rates. Therefore, if interest rates decrease by 1% and the modified duration of the bond of 10 years, the bond price will increase by 1%.

If you invest in a low modified duration (2 years or less) bond, you minimise interest rate risk. Subsequently, if you wish for capital appreciation and expect declining interest rates, choose funds with a higher modified duration. For those with a moderate risk appetite, a modified duration of 3 to 5 years is suitable, while those with a higher risk appetite can choose funds with a modified duration of over 5 years.

Say, an investor chooses a fund with a modified duration of 5 years and YTM of 9% with an expense ratio as 1%. The investor predicts the interest rate to increase by 50 bps during the year.

Thus, his expected return would be = YTM + Interest Rate Change * Modified Duration – Expense ratio

= 9% + 2.5% - 1%

= 10.5%

It is also prudent to understand risk when forming a return expectation. Assuming that interest rates go up by 50 bps during the year, the return is = 9% - 2.5% - 1% = 5.5%

Thus, investors should thoroughly consider the risk-return trade-off when making decisions. It is important to keep in mind that risk is a function of probabilities. If the probability of a favourable event (interest rates declining, in this case) is high, investors must also consider their gain.

Understanding how debt funds work is the first step in making an informed investment choice. By internalising and applying both basic and advanced concepts, investors stand to earn superior returns on their fixed income investments ■

A Guide to Employer-Employee Insurance

WHAT IS EMPLOYER – EMPLOYEE INSURANCE?

The employer-employee structure is one where the company buys insurance but the beneficiary is an employee. It is a benefit conferred by the company on select employees. In the current scenario of high attrition, this is particularly relevant to retain your valuable human resources. The employer-employee concept works as a loyalty reward program for the employees for their long-term service.

The insurance is also relevant for promoter-run companies where the promoter would like his or her insurance expenses paid for by the company (since the promoter would also be an employee). A common misconception is that employer – employee insurance and Keyman are the same. While Keyman can only be a term life cover, employer-employee can be any kind of insurance. In Keyman, the insurance claim on death is paid to the company and is subject to Income Tax. However, in an employer-employee arrangement, the claim on death is paid to the company and is subject to Income Tax. However, when it comes to employer-employee, the claim is paid to the employee's family and is tax-free.

WHAT ARE THE BENEFITS OF THE SCHEME TO THE FIRM AND THE EMPLOYEE?

This scheme helps the firm reduce attrition and promotes peace of mind in employees. It is definitely a catalytic factor for an employee when the employer takes insurable interest in their life. The employee gets the benefits of the insurance cover without paying for it. The maturity or death benefits belong to the employee. This concept can be used to purchase any kind of insurance except child plans and pension plans. It is, however, most common for life insurance purchases.

WHO CAN BE COVERED UNDER EMPLOYER – EMPLOYEE SCHEMES?

A sole proprietor, a corporate or a legal firm with a minimum of 5 employees can buy this policy. A single cheque has to be drawn by the employer for all the employees he wants to cover.

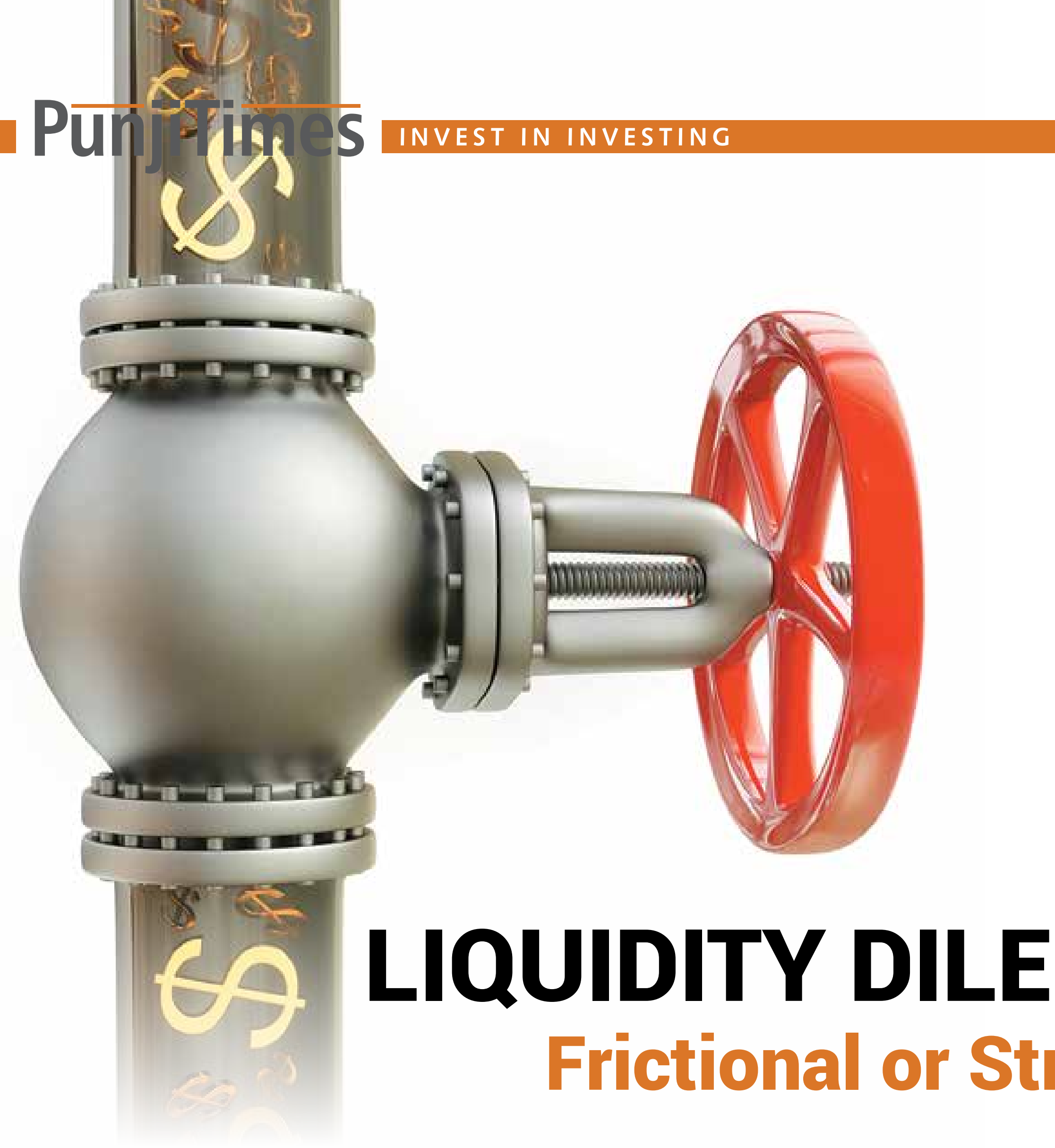
Indian employees who are on payroll of the company are eligible for an employer-employee insurance policy. NRI employees can also apply for the policy, provided the employer has a registered office in India. The employee should be more than 18 and less than 60 years of age to be eligible for the policy.

HOW CAN SMES BUY THIS SCHEME AND AVAIL OF THE TAX BENEFITS?

An employer can decide the beneficiaries of an insurance on the basis of CTC, qualification, experience and previous record of the employee.

A proposal form stating that they have opted for the employer–employee scheme and will be paying premiums on behalf of the employee has to be signed by an authorised signatory of the employer along with the stamp of the entity. It should also mention the names of the employees to be covered along with the plan type, term, sum assured, and the riders. An assignment duly filled in and signed by the authorised signatory in the name of the employee should be submitted to the insurer at the proposal stage. The nomination form duly filled in and signed by the employee making a nomination should also be submitted at the proposal stage ■

Contributed by
Aviva Life Insurance



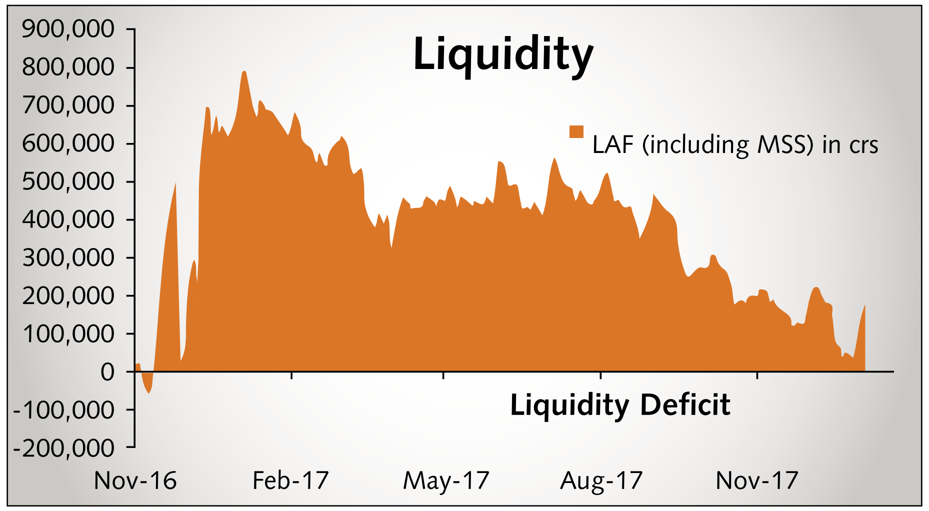
LIQUIDITY DILEMMA

Frictional or Structural?

The government demonetised high-value currency notes in November 2016 and rolled out GST last July, both of which had a significant yet contrasting impact on liquidity in the system. The biggest immediate impact from demonetisation was a huge surplus in liquidity in the banking system. However, post-demonetisation, the phase of liquidity surplus has been normalising.

Banking liquidity (RBI LAF balances) has contracted from a Rs. 7.9 lakh crore surplus to a surplus of Rs. 1.8 lakh crores (till 3 January, 2018) as shown in the chart below:

The sharp reduction in banking liquidity over the last 12 months has been on account of re-monetisation, forex intervention, currency leakage due to festive season, cash build-up by the government and OMO bond sales.



The major drain on LAF balances in the last 3 months has been due to following reasons:

- Accumulated government cash balances (~ Rs. 2 lakh crores as of 29 December, 2017)
- Festive currency in circulation outflow and forex intervention (Rs. 80k crores)
- OMO bond sales since June 2017 (~ Rs. 90k crores)

Of the above mentioned factors, accumulated government cash balances is relatively temporary ("frictional" in RBI terms), while the other factors are structural in nature. Having said that, this sharp fall in liquidity has been spooking investors and they seem to have perceived this situation as a tightening of liquidity.

But is liquidity really tight today?

We believe that liquidity cannot be measured by standalone LAF balances but is a function of three components:

Structural core liquidity = Banking liquidity (LAF balances) +/- Government Cash balances +/- MSS (any RBI intervention)

We can infer from the above equation that structural liquidity (ending Dec 17) is positive ~ Rs. 2.5 lakh crores. (LAF balances = -Rs. 50K,Government Cash balances = Rs. 2 lakhs, MSS = Rs. 1 lakh crores)

Factors that reduce structural liquidity are:

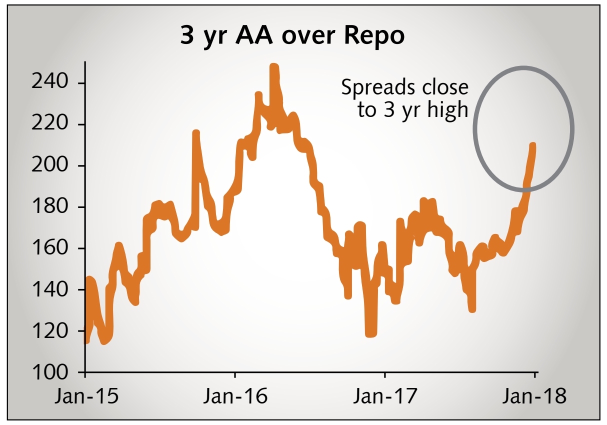
- Currency in Circulation (approximately Rs. 1.25 - 1.5 lakh crores annually)
- FX swaps/ OMO intervention (Rs. 50k - 75k annually)
- Cash reserve requirements (CRR on incremental Deposit growth - Rs. 5-10k annually)
- Any other RBI intervention

All the above factors put together means it will take at least 6-12 months for structural liquidity to dry up. Hence, we expect structural core liquidity in system to remain positive for a while.

Impact on fixed income market

The perceived liquidity tightness along with diminishing rate cut expectation led to a sell off and volatility in bond markets including the short end of the curve (1-3 year segment – in the last couple of months).

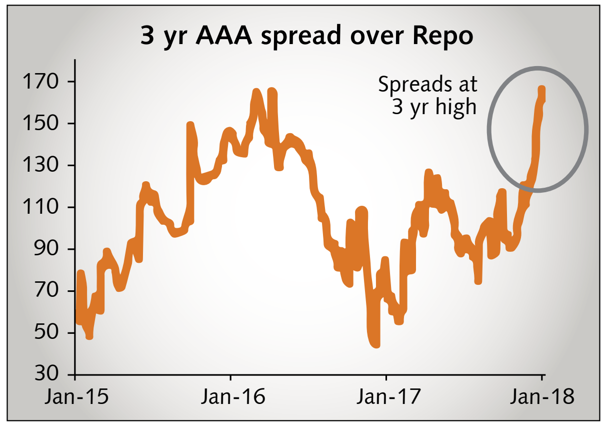
While short-term corporate bonds might continue to see some volatility in Q4 of FY 2018 as we enter a period of credit growth & supply of bonds, we believe that they should remain well bid and find them quite attractive from a spreads and valuations perspective.



Currently, 1 to 3 yr AAA/AA corporate bond segment is offering attractive spreads (over policy rate of 6%) of close to 3 year highs as shown in the chart above.

Market View

Long duration (10 year bonds/G-Sec): We believe that the RBI rate cut cycle is broadly over. Any significant, sustained lowering of yields from here on looks very limited. 10-year benchmark is currently hovering around 7.30-7.35% range and we expect it to trade in an elevated range for a while. We don't see any structural bull market rally in long government bonds unless growth and inflation surprises on the downside.



Short – Medium duration (1-3 year corporate bonds): This segment looks attractive to us from a carry and valuation perspective. At the same time, general easy liquidity has kept 3-6 months money market yields depressed and hence steepness in 1-3 year segment seems to offer the best opportunities.

Credit (Non-AAA 1-3 year corporate bonds): Recent banking recapitalisation, recovery in growth and improved corporate profitability is improving the credit cycle, thus making the corporate bond segment attractive from a risk-reward perspective. Also, non-AAA corporate bonds spreads are trading between 100-200 bps over AAA segment, which we believe could compress on improved credit environment and offer opportunities for investors over a period of time.

Outlook

We expect a neutral rate environment for the next 6-12 months. Short to medium-term duration offers attractive valuations and low volatility. Hence, unless structural core liquidity goes from the surplus zone to neutral, we suggest investors to stay invested in ultra-short-term to short-term funds.

Currently, the short-term money market yields (2-3 months) are at 6.65-6.70% while 1-3 year short term corporate bonds are trading at 7.25% - 7.6% range. As liquidity returns, we expect some flattening of the curve.

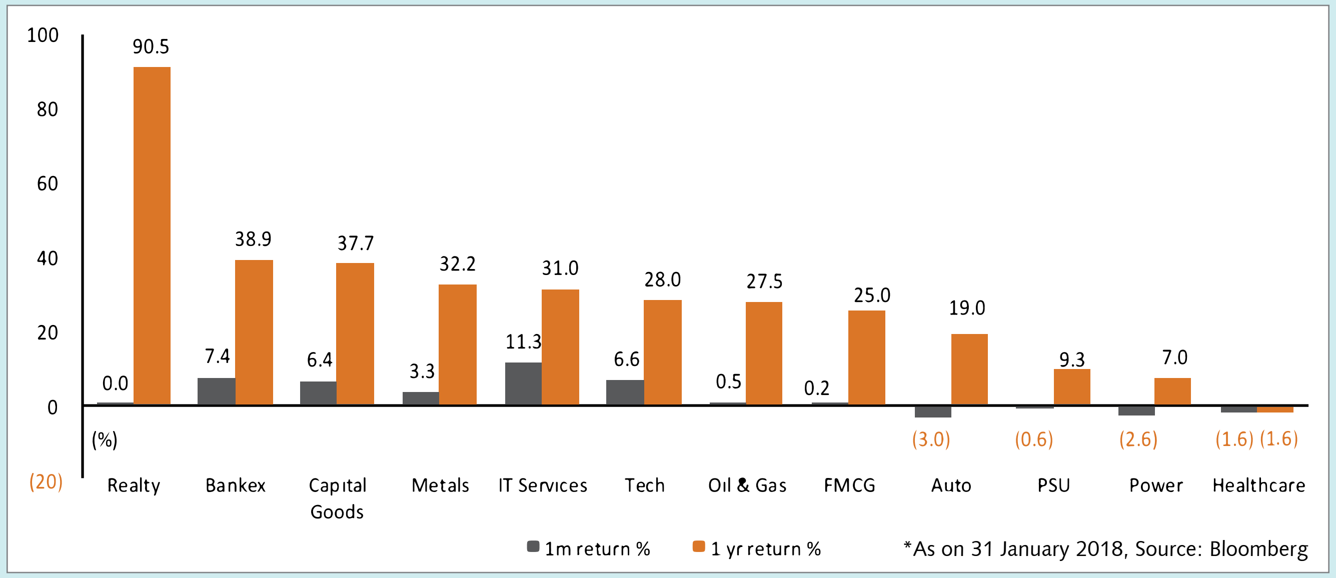
Given our market view on limited rate cuts, improving corporate profitability and looking at a favourable risk reward perspective, we continue to advise investors to stay invested in short to medium-term corporate bond strategies ■

Contributed by
Axis Mutual Fund

The much awaited Union Budget for FY19 focussed on the themes of rural development, improvement of the agricultural economy, and Make in India. Allocations for rural, agriculture, healthcare, and education sectors have, thus, increased. To boost rural incomes, the government has also proposed fixing the minimum support price (MSP) for all summer (kharif) crops at a minimum of 1.5x the cost incurred by the farmer. All efforts will be made to ensure that in the event of market prices falling below the MSP, the farmers get a price closer to the MSP. The focus of government policy has been towards removing the middle man and helping the farmer reap the benefits of higher productivity. Apart from rural and agriculture spend, the thrust on infrastructure development continues with increased spend on roads and railways.

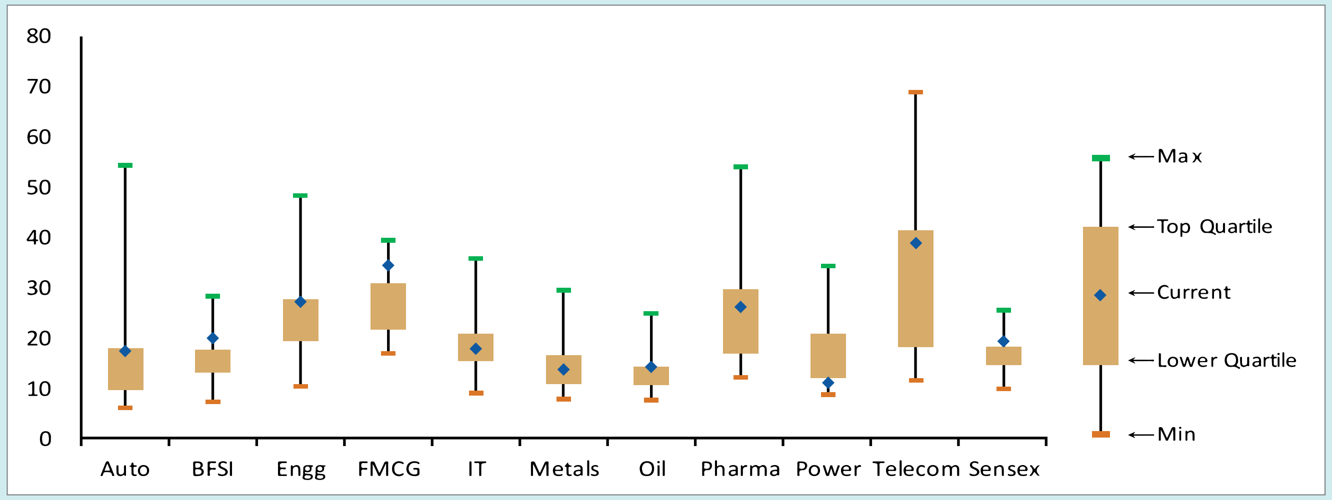
One of the key focus areas of the Budget this time has been 'Make in India'. With the implementation of GST, excise duty changes fell outside the ambit of the Budget. However, there is a significant support for 'Make in India' in terms of increase in custom duties on select products. The products have been selected in areas where Indian industry already has or can develop manufacturing capacities in a reasonably short time. The custom duty increase is aimed mainly to benefit consumer electronic manufacturing (mobiles & TV), agricultural processing (fruit juices,

Strong performance by majority sectors over the last 1 year; Pharma lagging in returns



*Past performance may or may not be sustained in the future.

Power at lower end of valuations, other sectors moving towards upper end of valuation zone



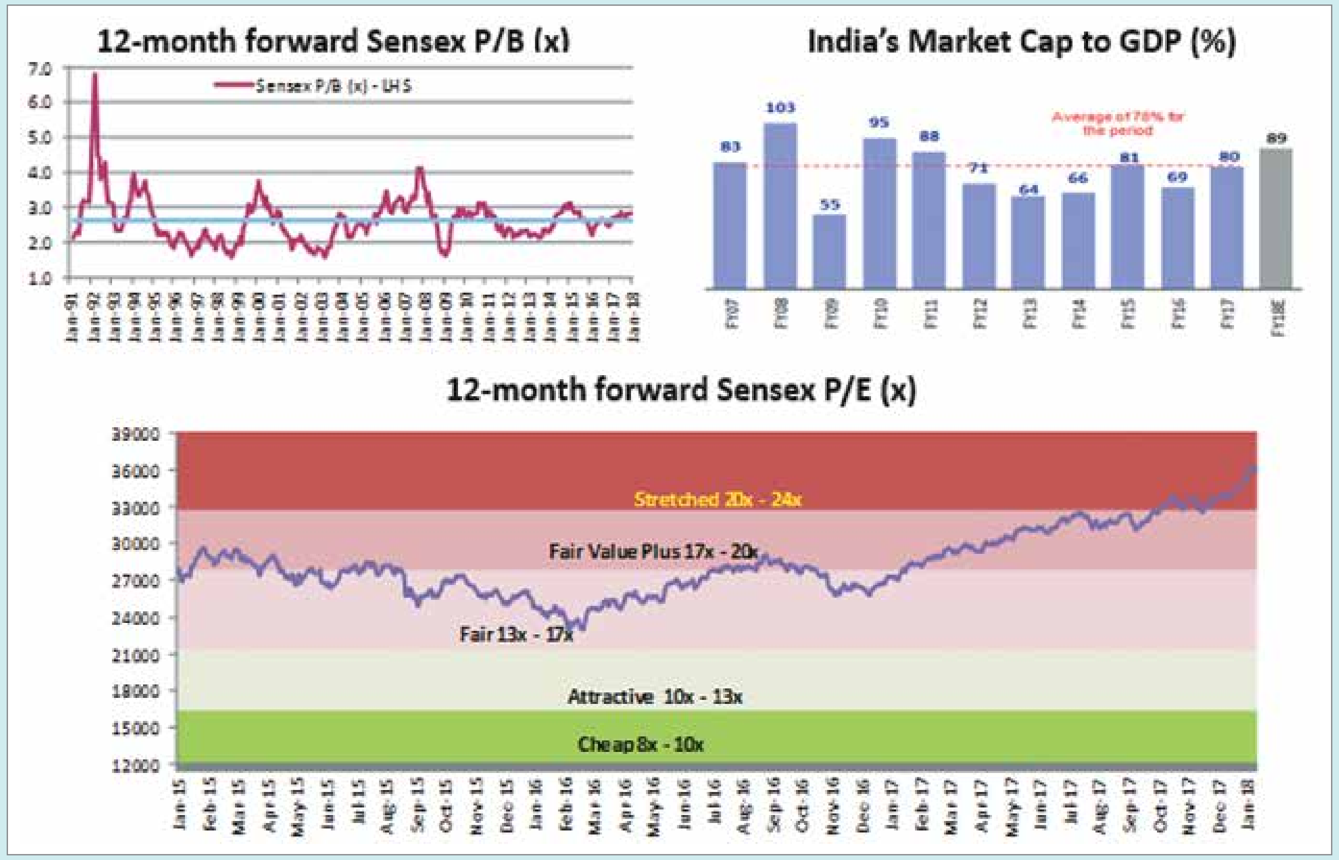
Source: Axis Capital, Bloomberg Note: * Since April-2005

edible oils, and other processed foods), and automobiles. The Budget also tries to spur indigenous industries and small and medium enterprises (SMEs) through the reduction in corporate tax rate to 25% for companies with turnover of up to Rs. 250 crore.

The government announced a national healthcare scheme to cover an estimated 10 crore families, providing Rs. 5 lakhs per family per year. Post the fairly successful implementation of the crop insurance scheme last year, this bodes well towards providing health insurance for a large part of the Indian population. Though currently many of the private players have been vacating the government health insurance space, it is likely that the scheme would generate fresh interest in the segment.

The Budget, while deviating from fiscal consolidation in the near term, does seek to move back to the path of fiscal prudence over the medium term. Overall, it tries to take the middle path between fiscal prudence and the needs of the economy. The more important takeaway is that this increased borrowing is not being wasted on populism and freebies, instead being routed towards more productive infrastructure creation. The commitment to long-term fiscal consolidation has been outlined in the Budget. While the fiscal deficit target is set at 3.3% of GDP for FY19E, the path towards reaching 3% fiscal deficit by 2021 has been outlined.

Strategy for Investments in the Current Scenario for Equity Investor

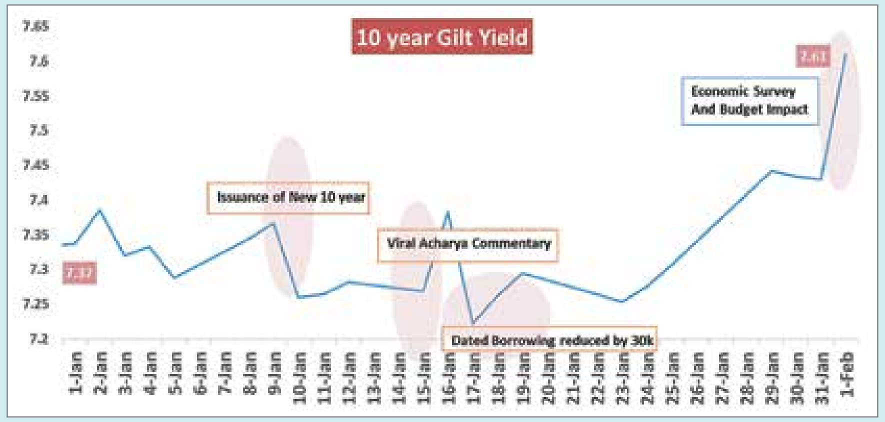


One of the biggest benefits of GST implementation is expected to be improvement in tax compliance. This is reflected in the expectation that the budget sets out for improvement in gross tax/GDP ratio from 11.6% in FY18RE to 12.7% in FY21E.

The imposition of the Long Term Capital Gains (LTCG) tax of 10% (without indexation) on equity markets and equity mutual fund units is a downer for market sentiments. The impact however, would be contained due to the grandfathering clause, which exempts long-term capital gains on purchases up to 31 January, 2018. While the imposition of the LTCG is a negative overall, this does not really alter the fundamentals of the market, which would focus more towards improvement in the core earnings trajectory of corporates in India.

Finally, the budget points towards the need to develop the corporate bond market in India. While no concrete steps have been announced, SEBI would mull over the proposal of asking large companies to raise 25% of their debt requirements from the debt markets. Further, some of the tax hurdles relating to resolution of debt of companies referred to NCLT (National Company Law Tribunal) under the bankruptcy code have been resolved. This would finally pave the way for resolution of large corporate debt and help many corporate banks clean up their balance sheets.

10-year Gilt Yield for the Month of January



KEY EVENTS FOR THE MONTH OF JAN 2018

- **Rural development, agricultural growth, Make in India:** key thrust areas of the Budget
- FY18 fiscal deficit at 3.5% of GDP as against the earlier targeted 3.2%; target for FY19 set at 3.3% of GDP; medium-term fiscal deficit target of 3% of GDP pushed till 2021
- **Monetary policy:** RBI stays on hold along expected lines, likely to keep rates unchanged in the near term and remain data dependent; inflation clearly has upside risks
- In its latest outlook, the IMF raised its forecasts for global growth to the fastest since 2011, upgrading projections for major economies including the U.S., Germany, and China. As per the forecast, India is expected to reclaim its tag as the 'fastest growing major economy' with growth estimated at 7.4% and 7.8% in FY18 and FY19, respectively
- The government announced the much awaited details of the Rs 2.11tn bank recapitalization plan unveiled in Oct-17, beginning with a capital infusion of ~Rs880bn (~US$13.8bn) into public sector banks in this fiscal year
- November 2017 IIP surged to 8.4% from 2.2% in October, led by the manufacturing sector. Output of capital goods further improved to 9.4% from 6.6% in October 2017. Electricity production inched up to 3.9% vs. 3.2% and mining also rose marginally to 1.1% in November
- December trade deficit rose to a 3 year high of $14.88bn from $13.8bn in the previous month led by a rally in crude and gold prices
- **Inflation:** Retail inflation stood at 5.21% in the month of December 2017 - higher than 4.88% in November 2017 (M-o-M basis) and 3.41% in December 2016 (Y-o-Y basis)
- U.S. economic growth unexpectedly slowed to 2.6% (from 3.2% in third quarter) in the fourth quarter as the strongest pace of consumer spending in three years resulted in a surge in imports. This slowed growth in 2017 to 2.3%
- Federal Reserve officials meeting for the last time under Chair Janet Yellen, left borrowing costs unchanged but emphasised upon their plans for further hikes ■

Key Variables & their Impact on Interest Rates in 2018

Key Variables	Short-term (3-6 month)	Medium-term (6 month- 2 years)
Inflation	↑	↓
Rupee	↔	↔
Credit Demand	↔	↑
Government Borrowing	↑	↓
RBI Policy	↔	↔
Global Event Risk	↔	↔
Corporate bond Spread	↑	↑
Debt Fill flow	↔	↔
Liquidity	↔	↔

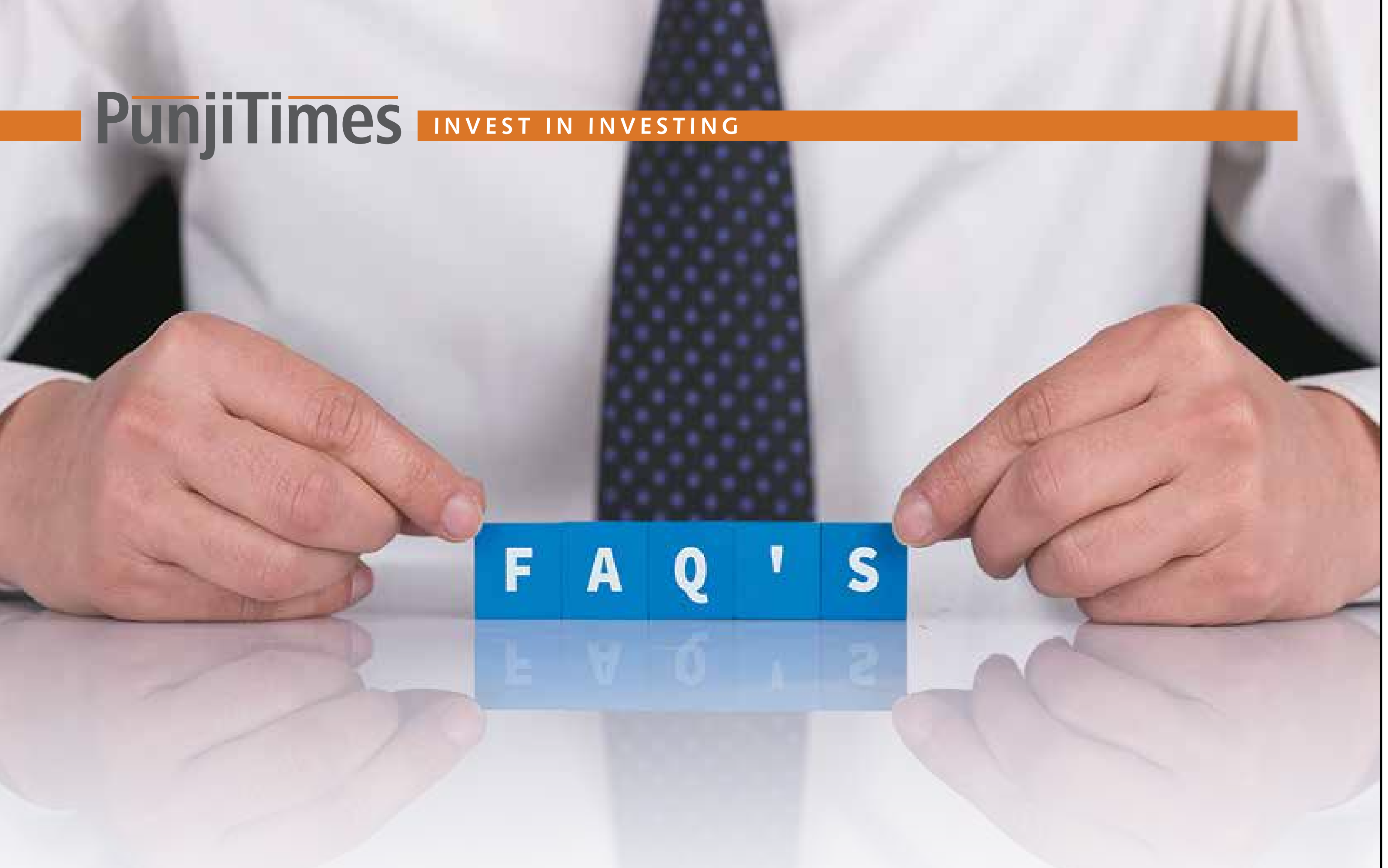
Source: RBI, Bloomberg

Debt Market Snapshot

Items	Jan-18	Dec-17	Change
Reverse Repo	5.75%	5.75%	Nil
Repo	6.00%	6.00%	Nil
CRR	4.00%	4.00%	Nil
SLR	19.50%	19.50%	Nil
Mibor Overnight	6.00%	6.20%	-20 bps
Call(O/N)	5.92%	6.10%	-18 bps
CBLO	5.85%	5.82%	3 bps
1 yr T Bill	6.55%	6.40%	15 bps
10 G Sec	7.43%	7.32%	11 bps
5 Year AAA	7.74%	7.66%	8 bps
USD/INR	Rs. 63.68	Rs. 63.93	0.25paise

Source: RBI, Bloomberg

Nilesh Shah,
Managing Director,
Kotak Mutual Fund



Long Term Capital Gains

LTCG tax proposed in Finance Bill 2018

Q What is the meaning of long term capital gains under the new tax regime?

Long term capital gains refers to gains arising from the transfer of long-term capital assets. The Finance Bill, 2018 proposes to provide for a new long-term capital gains tax regime for the following assets–

i. Equity Shares in a company listed on a recognised stock exchange;

ii. Units of an equity oriented fund; and

iii. Units of a business trust.

The proposed regime applies to the above assets, if–

a) the assets are held for a minimum period of twelve months from the date of acquisition; and

b) the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1 October 2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).

Q What is the point of chargeability of the tax?

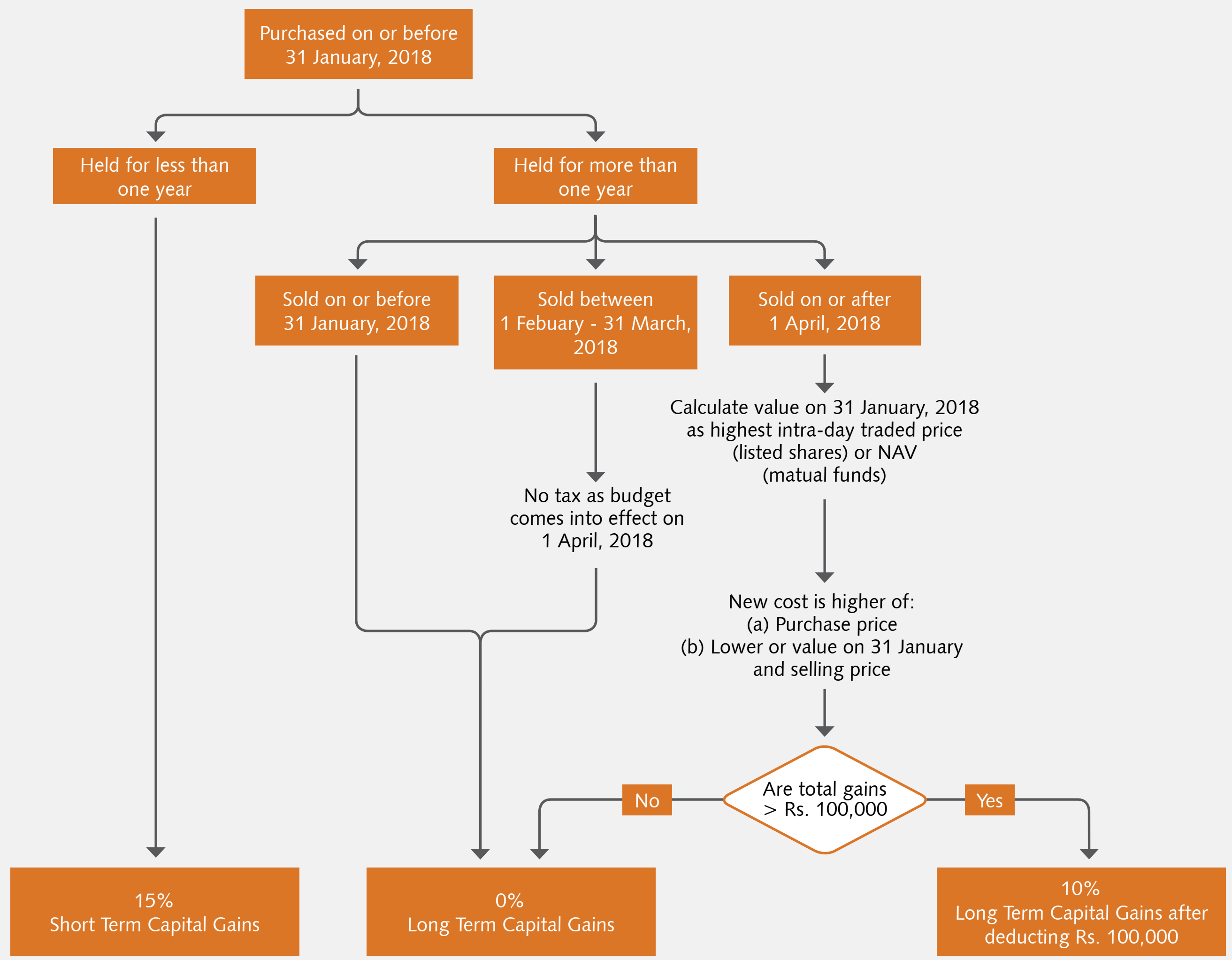
The tax will be levied only upon transfer of the long-term capital asset on or after 1 April, 2018, as defined in clause (47) of section 2 of the Act.

Q What is the method for calculation of long-term capital gains?

The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.

Capital Gains Tax made easy

Equity Shares and Equity Oriented Mutual Funds purchased on or before Jan 31, 2018



Q How do we determine the cost of acquisition for assets acquired on or before 31 January, 2018?

The cost of acquisition for the long-term capital asset acquired on or before 31 January, 2018 will be the actual cost or fair market value of such asset as on 31 January, 2018, whichever is higher.

Q How will the fair market value be determined?

The fair market value means the highest price of such share or unit quoted on a recognized stock exchange on 31 January, 2018. However, if there is no trading on 31 January, 2018, the fair market value will be the highest price quoted on a date immediately preceding 31 January, 2018, on which it has been traded ■

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High
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HIGH
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Mutual fund investments are subject to market risks, read all scheme related documents carefully.