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Chief Investment Officer

From CIO's desk – September 2013

Birla Sun Life Insurance Company Ltd.

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Q1. What has been the key macroeconomic concern impacting market sentiment?

Ans. The main worry has been the deceleration in growth. GDP growth for 1QFY14 has been much lower at 4.4%. While Agriculture grew at 2.7% and Services at 6.6%, there has been a significant slowdown in the Industrial sector, which grew at just 0.2%. The HSBC India PMI, a key manufacturing index, dropped to below 50 which signals a contraction in manufacturing activity. While Industrial production will take time to pick up, agriculture growth for the year should be good as we have had an above normal monsoon. Government spending has also been high and this will be a positive. There is still optimism that GDP growth will pick up on account of the following

1. improvement in global growth
2. a recovery in industrial production and exports as the rupee weakens and
3. eventual easing of interest rates as the currency stabilizes.

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Q2. Are we seeing increased action on the reform front?

Ans. We have seen quite a few policy measures over the last few days.

The Lok Sabha passed the Pension Fund Regulatory and Development Authority (PFRDA) bill. This bill allows 26% foreign investment in the Pension sector. Many more Pension Fund Management companies will be enthused to set up shop in India and channelize long term retail savings into asset markets.

The Cabinet Committee on Investments has cleared a further 34 infrastructure projects involving investments of nearly Rs.1.4 lakh crores. These include 17 power projects with investments of over Rs.95,000 crores. The investment cycle will gradually revive once implementation of these projects start.

The Lok Sabha cleared two more key legislations – the Food Security Bill and the Land Acquisition Bill. The Food Security Bill is an initiative to ensure food and nutritional security to about 67% of the Indian population. The social and economic impact of this bill will be significant, as it will ensure that no Indian goes hungry. There has been criticism from some quarters that the Food Security Bill, when implemented, will result in an increase in the subsidy burden and be inflationary. While there is no doubt that the overall food subsidy burden will increase, this increase is expected to be just 0.3% of GDP, which is quite manageable. In fact, in the current year, there will be no additional fiscal burden on this account. The inflationary impact will be limited as there is not expected to be any additional procurement of cereals. The big positive will be that disposable incomes of the poorer households will increase, giving a boost to consumption and consequently economic growth.

The Land Acquisition Bill is also a very important piece of economic legislation. It will result in farmers and other landowners getting a fair deal when their land is acquired for projects. While the higher compensation of 4x of the market value for rural land and 2x of the market value for urban land could significantly increase the land costs for large infrastructure and industrial projects, the big advantages will be that it will make the process of land acquisition more transparent, reduce legal hassles and help avoid time delays.

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Q3. The Reserve Bank of India Governor has announced a spate of measures. How will they impact asset markets?

Ans. The new RBI Governor, Dr Raghuram Rajan, made a number of announcements that are fairly significant and send out a positive message to investors and financial markets. Some of the measures announced are:

RBI will enter into swap arrangements with banks which raise fresh long term foreign currency NRI deposits at a cost of 350 basis points. It is expected that banks will be able to raise over US$10 billion under this route which will go a long way in funding our current account deficit.

RBI has also increased the overseas borrowing limits of banks and will offer to swap borrowings raised under this route at a concessional rate. Banks are expected to be able to raise a further US$10 billion through this route.

RBI announced that it will launch inflation bonds linked to the consumer price index (CPI) for households. This will improve savings from households and lead to less buying of gold as household buy gold as an inflation hedge.

RBI announced that it will shortly allow well run scheduled commercial banks to open branches without having to obtain RBI permission and that new bank licenses will be issued by January 2014. All this will speed up the financial inclusion process and increase participation in financial markets.

Asset markets reacted very positively to these measures, with the currency appreciating, bond yields falling and equity values moving up.

Q4. Why are ULIP funds good investment vehicles as compared to other similar investment vehicle?

Ans. Many of our policyholders wonder why they should buy ULIPs instead of other similar investment products. At the outset, it is important for investors to understand that their buying decision has to be a function of their financial goals and risk appetite. Where ULIPs stand out as a superior option is that they are a transparent, long term and flexible retail financial product. Not only do they offer insurance protection but also provide an opportunity of wealth creation using a disciplined goal-based investment approach. They are truly long term investment options, where investors need not worry about the short term volatility that characterize most asset markets. For investors who stay invested in ULIP funds for a substantial period of time, the overall expenses are also lower than other similar options.

It is therefore worth analyzing the returns a ULIP investor would receive as compared to an investor who chooses to invest in a mutual fund and buy insurance through a term plan. Our analysis indicates that over a 20 year term, the IRR generated by the ULIP option was 8.74% as against IRR of 8.29% using the second combination.

Considering a 30 year person investing in ULIP and mutual fund for a term of 20 years and earning a return of 10% p.a, ULIP would outperform mutual fund return as shown below:

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Insurance

Considering 10% return on ULIP and MF below values are arrived

Product	Annual Premium	Sum Assured	Paying Term	Total Premium paid	Fund Value on Maturity	XIRR
ULIP	500000	5000000	5 yrs	2500000	10471447	8.74%
Term Insurance	7865	5000000	20 yrs	157300	NA	NA
Mutual Fund	468540	NA	5 yrs	2342700	9134095	8.29%

*** The values demonstrated are for illustrative purpose only**

Birla Sun Life Insurance

Q5. What asset allocation strategy would you recommend to ULIP investors?

Ans. Given that insurance products are long-term in nature, the age of an individual buying a ULIP product will be an important factor in determining the asset allocation. A generally recommended investment strategy for an individual, based on age, could be as follows:

We urge policyholders to review their asset allocation and use the 'Fund Switch' option at the appropriate time to maximize their fund returns.

Age Bracket	Asset Allocation				
	Equity Funds	Bond Funds	Liquid Funds	Total Debt	Total
18-25Yrs	100	0	0	0	100
26-32 Yrs	100	0	0	0	100
33-38 Yrs	100	0	0	0	100
39-45 Yrs	80	20	0	20	100
46-55 Yrs	70	30	0	30	100
56-65 Yrs	60	40	0	40	100
66 Yrs and above	50	40	10	50	100

The above table may be aligned to our Life Cycle Investment Option.

Disclaimers

The premium paid in Unit Linked Life Insurance policies are subject to investment risks associated with capital markets and the NAVs of the units may go up or down based on the performance of the fund and factors influencing the capital market and the insured is responsible for his or her decision. The comments made herewith are informed views rather than firm predictions. BSLI recommend that these general views should be cross-verified and reaffirmed before being used for personal financial planning purpose. Any decision taken on basis of this information should be basis the policyholder/ customers judgment or discretion and after taking necessary advise from its financial advisor. Neither Birla Sun Life Insurance Company Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations.