

All about Roll-Down Strategy

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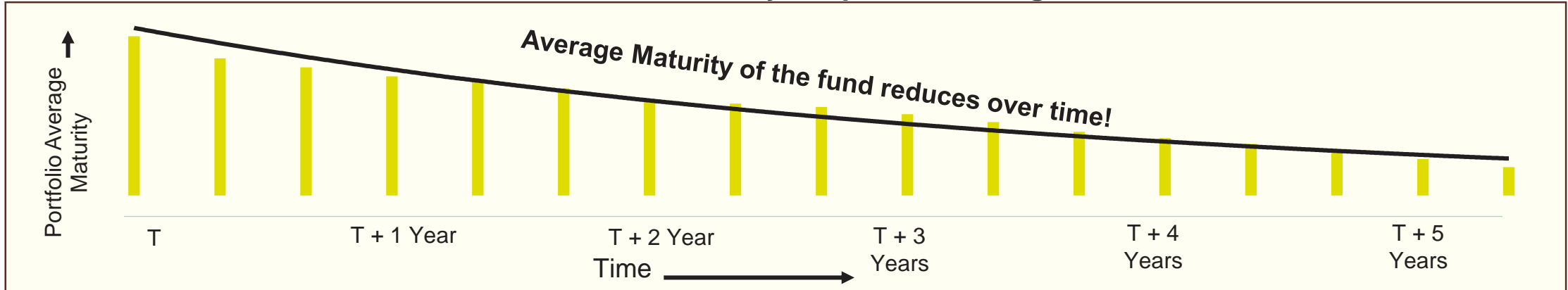


What is Roll-Down Strategy?

- Roll Down strategy is an accrual strategy.
- Fund manager creates a portfolio of a certain target date & lets the maturity of the portfolio fall gradually over a period of time, the fund is said to be following a roll-down maturity structure. Effectively, the portfolio maturity duration comes down over a period.
- Since the duration of the bond reduces over time, the interest rate risk also reduces.
- Whenever the fund sees inflows, it buys securities to bring weighted average portfolio maturity closer to the target date as per the rolldown strategy, and hence the portfolio average maturity continues to roll down.



Residual Portfolio Maturity keeps Decreasing with Time!



The above graph is for illustration purpose only to indicate the reducing average maturity of the portfolio over a roll-down term

- Few Fund Houses across several debt fund categories e.g. Long Duration, Corporate Bond, Banking & PSU, Money Market funds use roll-down maturity strategy
- Target Maturity Funds launched in recent years are also examples of following roll-down strategy

Benefits of Roll-Down Strategy

High Liquidity

High liquidity with no lock-in
(open-ended debt scheme)

High Quality

Usually invest in sovereign (G-Sec, SDLs) or highly rated (AAA corporate, PSU and Banking) instruments

Low interest rate risk

No interest rate risk if bonds are held till maturity

Predictable Returns

Predictable rate of return over the defined time period

Tax Efficient Returns

Enjoys benefit of long term capital gains taxation (including indexation benefits), if held more than 3 years



Illustration: Tax Efficiency over 3 years Investment Horizon

- Tax plays a vital role for making investment decisions, specifically for debt products
- Investors can avail indexation benefit if investment is held for more than 3 years

Details	Fixed Deposit	Debt MF
Investment Amount (Rs.)(Assumed)	1,00,000	1,00,000
Investment Date	01-Apr-18	01-Apr-18
Maturity Date	31-Mar-22	31-Mar-22
Tenure (yrs)	4	4
Assumed rate of return	7.00%	7.00%
Maturity Amount	1,31,080	1,31,080
Capital Gain	31,080	31,080
Indexation Cost	NA	14,535
Taxation	Income Tax slab rate - 30%	20% post indexation
Inflation indexed purchase value = original amount * (CII of the current year/CII of the purchasing year)	NA	1,16,544
Tax payable (Rs.)	9,324	2,907
Post Tax Income (Rs.)	1,21,756	1,28,173
Net return	5.04%	6.40%

Superior returns compared to traditional investments

Here, **Debt Funds** are more tax efficient for long term investment period than FD

This is for illustration purpose only. FD is taxed at 30% and Debt MF is taxed at 20% post indexation. Cess and surcharge are excluded.

Risks of Roll-Down Strategy



- ❑ An investor should be aware when the end of roll-down term of the fund is near. This is because – unlike a close-ended scheme (like FMP) which automatically pays out investors the proceeds at maturity, it is not the case for open-ended debt schemes.
- ❑ **Interest rate risk:** The interest rate risks for the funds following roll-down strategy would depend upon the modified durations of these funds. The higher the modified duration, the higher the interest rate risk. Though, modified duration gets on reducing as the fund approaches its roll-down term.
- ❑ **Impact of large inflow/outflow:** The portfolio manager aims to keep the portfolio composition static, still there is a risk that the YTM's may change slightly up or down with large capital inflow or outflow as securities purchased / sold will be based on availability / liquidity in the market.



Thank You!

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