# ‘Buyers beware’ remains the mantra for PMS investors

**Portfolio management services offer an exclusive and customised product to the well-heeled but the latter need to be on their guard while investing in these**

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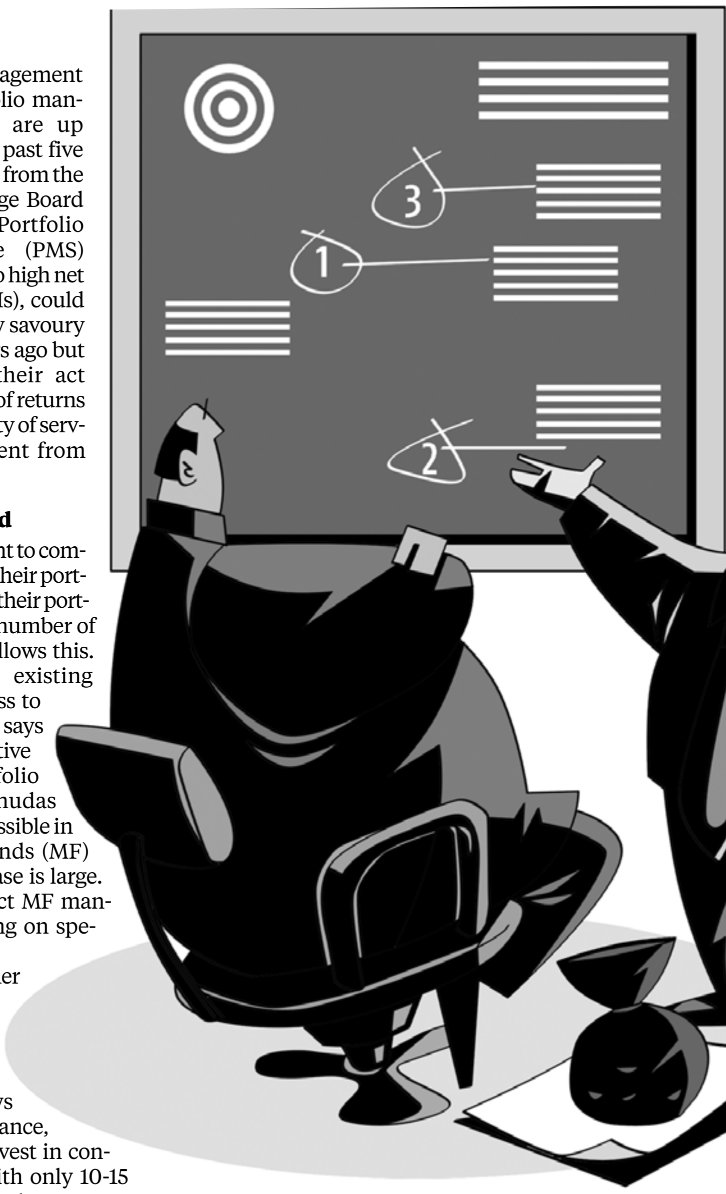

Assets under management (AUM) of portfolio managers in India are up almost 5.5 times in the past five years, according to data from the Securities and Exchange Board of India (Sebi). Portfolio Management Service (PMS) providers, which cater to high net worth individuals (HNIs), could not have enjoyed a very savoury reputation five-six years ago but seem to be getting their act together, both in terms of returns generated and the quality of service offered, as is evident from their rising AUM.

**Exclusive, customised**

Many HNI investors want to communicate directly with their portfolio manager handling their portfolios. PMS, where the number of customers is limited, allows this. “Any prospective or existing investor can have access to our portfolio manager,” says Ajay Bodke, chief executive officer and chief portfolio manager-PMS, Prabhudas Liladher. This is not possible in the case of mutual funds (MF) ,where the customer base is large. Regulations also restrict MF managers from commenting on specific stocks.

HNIs, who have higher risk appetite than the average retail (small) investor, often want to invest in differentiated strategies. PMS allows them to do so. For instance, some might want to invest in concentrated portfolios with only 10-15 stocks. MFs generally have more diversified portfolios. Again, many MFs might not go below a certain level of market cap for fear of lack of liquidity. PMS schemes could go into these less waters in the quest for higher returns.

PMS providers have the ability to offer their clients customised portfolios. An employee with a technology company, who has employee stock options, might not want more stocks of that company in his portfolio so as not to become overly exposed to that stock. He can ask his portfolio manager to exclude these. Such customisation is not possible in MFs.

Many HNI investors also want to pay their portfolio manager based on what they earn. Hence they opt for a performance-based fee model. This option is not available in MFs where expense ratios are fixed.

**Higher risk**

Many of the strategies that PMS players offer have the potential for high returns, but also carry high risks. As Aashish P Somaiyaa, managing director (MD) & chief executive officer (CEO), Motilal Oswal AMC, which offers both mutual funds and PMS, says: “PMS are riskier than MFs and hence are ideal for people who have some experience of investing in equities and are willing to take a little more risk, albeit with professional help.”

One risk PMS investors run is single-manager risk. As mentioned, one needs at least ₹25 crore (in cash and/or equities) to be able to invest in a PMS. Unless your equity portfolio is sizeable, there is the danger that all your equity holdings could be concentrated with one PMS manager. If he underperforms, you suffer. “Invest in PMS only if you have at least ₹1 crore to allocate to equities, so that PMS is only one of the vehicles you use,” says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Risk in PMS also arises from the fact that there could be a gap between promise and performance. “PMS schemes are hard-sold on the promise of outperformance but a significant number of them may not do so,” says a Securities Appellate Tribunal lawyer who did not wish to be identified.

Another issue you are likely to encounter when investing in a PMS is the absence of publicly available aggregated data on historical returns. In the case of MFs, you can go to the website of a rating agency such as Value Research or Morningstar India and find aggregated data of historical returns for various fund categories. They also offer fund ratings. This the task of choosing a fund. PMS players argue that since investors have customised portfolios, comparison is not possible. However, returns of model portfolios ought to be available easily, but that’s not the case. “If you wish to compare the returns of various players, you will have to make the effort to collate the data yourself,” says Dhawan.

**Making the right choice**

Many small entities have started managing portfolios. Do visit Sebi website, which has a list of all the Sebi-registered PMS providers, to ensure the player you plan to go with is listed there.

Look at the record of the scheme. Ask the distributor for the ‘disclosure document’ (the specific name) of several funds. In this document, returns data is available in a Sebi-prescribed format, so you can compare the performance of several. Don’t rely on any marketing literature from the distributor.

Take into consideration the fund’s longevity and the amount of money being managed by the PMS provider. “AUM size does affect the sustainability of the fund and the kind of talent it can hire,” says Dhawan.

Check out the level of risk in the scheme and invest in one that matches your risk appetite. Many PMS providers focus not only on high returns but on consistency of performance, so that their HNI customers can be assured of meeting their financial goals. “Our flagship fund is well suited to form the core of a client’s portfolio and comes with a very low level of volatility and consistent long-term returns,” says Prateek Agarwal, chief investment officer, ASK Investment Manager. Meet the fund manager and understand his investment philosophy. Bodke suggests investors opt for schemes that are process-driven rather than individual-centric.

Next, decide whether to opt for the discretionary or non-discretionary model of investment. In the former, the investor offers full discretion to the portfolio manager to manage his funds. In the latter, the fund manager must take the investor’s consent for each purchase or sale of stocks. Experts suggest that unless an investor is well informed, he may add very little value by retaining the mandate to buy and sell. Says Somaiyaa: “I favour discretionary management where the investment manager is answerable for performance.” (The third model, called advisory, is one where the portfolio manager is paid only for his stock recommendations.)

HNIs also need to decide whether to opt for the fixed or profit-sharing fee model. In the former, the investor pays a fixed upfront fee. Motilal Oswal, for instance, has an annualised fixed fee of 2.5 per cent on average assets which is deducted from portfolio value (debiting happens each month). Profit sharing models can be with or without a hurdle rate (which refers to a minimum level of performance for profit sharing to happen). In the non-hurdle model, Motilal Oswal charges a fixed fee of One per cent and takes 10 per cent of the profit (settled once a year). A profit sharing model with a hurdle rate, it charges a fixed fee of 1.5 per cent and then 15 per cent of profit if the return exceeds 10 per cent. If the return exceeds 15 per cent, the profit share is 20 per cent. Says Agarwal: “The performance fee model aligns the interests of the investor and the portfolio manager better.” Investors who already own a large MF portfolio, where they pay a fixed fee, might also prefer a performance-driven model in PMS.

**Buyer beware**

Even after enrolling for PMS, stay vigilant. Go through audited reports each month to check the portfolio’s performance against its benchmark. Review the portfolio regularly to ensure the manager sticks to the scheme’s mandate. Ensure you are not being saddled with high transaction fees, such as custodian fee, brokerage fee, etc. Also keep an eye on churn. If high churn generates high returns, it is fine. If accompanied by poor returns, that should raise a red flag. Finally, ensure regular reporting of transactions, so you can plan for your advance taxes.

## ‘Investors must be discerning’

**AJIT SHAH** (name changed to protect identity)
Mumbai-based doctor

My early experience with PMS providers was not good but things are getting better. When my sister had enrolled for a PMS six years ago, the distributor filled the form, ticked all the boxes, and got my sister’s signature. In the light of the poor experience she had with the PMS, she realised she had inadvertently handed over more power than she should have. My sister was saddled with huge brokerage fees, as the portfolio manager deliberately churned the portfolio. Some acquaintances of mine have suffered due to poor service. One PMS provider would not give the date of purchase, sale of stocks, capital gains, etc., essential for timely filing of tax returns. He did not even return all the money, claiming he needed to keep a portion to meet contingent tax liability.

Until recently, if there was high churn in your portfolio, the tax department viewed you as a trader than an investor. The portfolio manager’s behaviour could, thus, affect investors’ tax liability. The earlier pooled structure in PMS has been done away with. Now, when you enter into PMS, you have your own demat account where all your shares are kept. You also get regular SMSes from NSDL/CDSL on stocks bought or sold on your account. The better PMS providers offer online access to your portfolio. They also make audited results regularly available . Transparency levels are fairly high now. But, investors need to be discerning.

## GAINING POPULARITY

Total assets managed by portfolio managers are up almost four and a half times over five years

| | AUM (₹ cr) | | |
|---|---|---|---|
| | Discretionary | Non-discretionary | Advisory |
| May 2011 | 1,42,702 | 10,819 | 86,521 |
| May 2012 | 4,32,720 | 21,508 | 68,018 |
| May 2013 | 5,09,914 | 28,844 | 78,450 |
| May 2014 | 6,01,398 | 42,106 | 1,26,669 |
| May 2015 | 7,14,702 | 49,578 | 1,81,917 |
| May 2016 | 8,30,243 | 62,989 | 1,84,041 |

Source: Sebi web site

## INDICATIVE RETURNS OF PMS FUNDS

| PMS | Fund name | Returns* (%) 1-year | 3-year | 5-year | Since inception |
|---|---|---|---|---|---|
| ASK IM | IEP | 4.3 | 32.2 | 22.5 | 21.4 |
| | India Select | 5.2 | 33.7 | 21.5 | 19.6 |
| Motilal | Value | -0.23 | 21.87 | 12.96 | 25.67 |
| Oswal | NTDOP | 3.17 | 35.84 | 28.61 | 17.7 |
| | IOPS | -2.68 | 19.93 | 13.52 | 13.02 |

*3-year, 5-year and since inception returns are CAGR
Composite returns of model portfolios as on June 30, 2016