

Is the Time Right to Lock into Closed-Ended MFs?

Such plans give greater flexibility to fund managers and ensure higher fee to distributors

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Mumbai: At least five closed-ended equity funds are currently open for subscription, as financial intermediaries push these instruments with a three-year or longer lock-in periods which give fund managers greater flexibility to manage the money as well as offer better commissions to distributors.

New fund offerings (NFOs) from UTI Focussed Equity Fund, Sundaram Select Micro Cap Fund, Reliance Capital Builder Fund, ICICI Prudential Value Fund and LIC Nomura MF Diversified Equity Fund are currently open for subscription. Since their launch in April 2013, closed-ended equity funds that issue a fixed number of units have mobilised about ₹2,200 crore.

Since closed-ended funds don't allow investors to redeem midway, managers get more freedom to invest the money compared with an open-ended mutual fund which are highly liquid. "In an open-ended fund, when an investor redeems or books profit, the fund manager is forced to sell stocks to pay out the investor, even though he may be bullish on the market," said Sunil Subramaniam, deputy chief executive of Sundaram Mutual Fund. If the fund size is small, the remaining investors could suffer as the selling could hurt the price of stocks held by the fund.

"The lock-in period in a closed-ended

Attractive Returns

Scheme	Launch Date	AUM (₹crore)	Returns Since Launch* (%)
ICICI Pru Value (Series 1)	Oct-2013	643.48	53.8
IDFC Eq Opp (Series 1)	Apr-2013	218.14	64.2
IDFC Eq Opp (Series 2)	Jan-2014	206.28	36.8
L&T Em Businesses	May-2014	139.65	18.9
ICICI Pru Value (Series 2)	Dec-2013	113.18	48.3
Rel Close End Eq (Series b)	Dec-2013	77.49	42.4

*Returns are absolute, Returns as on Aug 18, 2014

Source: Value Research

fund ensures that investors ride out the volatility without making redemptions. The compulsion to stay the course makes these funds a good choice for investors," said Nimesh Shah, MD & CEO of ICICI Prudential MF. The lock-in period, however, prevents investors from booking profits early on in a structured bull market.

Financial advisers feel closed-ended equity funds work well around specific themes, depending on the timing of the NFOs. "Closed-ended funds, with a midcap theme worked well in 2013, as there was a huge valuation gap between large caps and midcaps," said Vishal Dhawan, CFP at Plan Ahead Wealth Advisors. However, with the valuation gap narrowing after a sharp run-up in mid-cap stocks, he says open-ended funds are a better choice now.

Dhawan cited more reasons to choose open-ended funds. "Open-ended funds have a past track record which makes

them easier to evaluate," he said.

Finally, in the case of closed-ended funds, at the end of the tenure, the scheme is forced to sell to return money back to investors irrespective of their requirements.

Open-ended funds help investors understand the fund manager's style and judge the performance of the fund in good as well as bad times. These funds give investors the option to exit as and when they meet their goals or when they feel valuations in the markets are stretched. Closed-ended funds lose out on liquidity. Unlike open-ended funds, which allow the investor to redeem his units whenever he needs money, units in closed-ended schemes can't be redeemed. The units are listed and can be sold on the market, but trading is usually thin and happens at a discount of 20-30% to the net asset value.

According to some critics, selling of closed-ended funds is a strategy of fund houses to incentivise distributors. While open-ended equity funds pay 0.50-0.75% as upfront commissions, closed-ended funds with a 36-month tenure dole out as much as 4.5-5.5%, which they amortise over the next three years.



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