NEW FUND OFFER

Bet on the dragon

High net worth investors seeking geographic diversification may invest in Benchmar Mutual Fund's recently launched ETF, Hang Seng BeES

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BENCHMARK Mutual Fund, which has carved a niche for itself by focusing exclusively on the passive investment space (its product offerings include only exchange traded funds or ETFs and one index fund), has now launched its first international ETF, Hang Seng BeES, based on Hong Kong stock exchange's Hang Seng index.

Rajan Mehta, executive director at Benchmark MF, cites two reasons for choosing the Hang Seng to launch their first international ETF. "One, our dipstick survey showed that Indian investors are keen to diversify by investing in the Chinese market as it is growing faster than the Indian market. Currently they are not interested in any other market. Secondly, while taking exposure to the Chinese economy via the Hong Kong route may not give 100 per cent exposure, from the operational and regulatory perspectives this option is simpler."

Advantages

Here are some of the benefits that Indian investors stand to reap by investing in the Hang Seng BeES:

GEOGRAPHIC DIVERSIFICATION. India-specific issues will not affect the Hang Seng. For instance, the Indian government's large budget deficit could have an impact on stocks listed on the Indian stock exchanges, but stocks belonging to the Hang Seng will be immune to this issue. Similarly, if at some point the Indian economy and markets go through a lean patch, the investor will have an alternative to fall back on.

Further, investing in this ETF will give you a chance to profit from the growth of the world's fastest-expanding economy.

EXPOSURE TO LARGER BUSINESSES. The Hang Seng offers exposure to businesses that are much larger than what the Indian stock markets offer. For instance, the largest bank included in the Hang Seng is HSBC while the largest bank available in India is State Bank of India. The former is much bigger than the latter. Says Mumbai-based financial planner Vishal Dhawan: "The advantage of investing in large global businesses is that the investor's single-geography risk gets curtailed. For instance, during the recent financial crisis some of HSBC's businesses — say in the US and the UK — were affected, but their Asian businesses were relatively insulated."

EXPOSURE TO DIFFERENT BUSINESSES you invest in the Hang Seng, you get exp sure to China Life, the largest insurar company operating out of Hong Kong. India, you can't buy insurance stocks a stand-alone basis; you have to buy the as part of other businesses. For instance you wish to invest in HDFC Life I surance, you have to invest in HDF the mother company.

HIGHER DIVIDEND YIELD. The Hai Seng offers much higher divider yield (3.25, as on January 29, 201 than the Nifty (1.01 per cent).

LOWER VOLATILITY. The Hang Sen index is much less volatile than the Nift which means that exposure to it wi reduce the fluctuations in the value c your portfolio.

Disadvantages

DON'T EXPECT EM-TYPE RE TURNS. Investing in the Hang Seng, however, is not equivalent to investing in the Chinese economy. Only about 54 per cent of the stocks in this index have exposure to the Chinese economy; the rest belong to Hong Kong-based companies, and Hong Kong is more of a developed market rather than an

emerging market (EM).

Hence, it is unlikely that you will get from the Hang Seng the kind of returns that you are likely to get from the Nifty. If you compare the returns between October 2004 and January 2010, the Hang Seng gave a compounded annual return of 12.01 per cent while the Nifty gave a return of 22.2 per cent. The reason for this differential: the local index is fully invested in a rapidly growing emerging market while the Hang Seng is not.

ADVERSE TAXATION. The tax rules applicable to the Hang Seng BeES are not as favourable as those applicable to an Indian equity-based ETF. The Hang Seng BeES will be treated as a non-equity fund, hence long-term capital gains tax will be applicable to it (it is zero in case of Indian equity funds). If you have invested in the fund for over a year, your long-term capital gains will be taxed at 10 per cent, or you may index your gains and pay at the rate of 20 per cent. Short-term capital gains will be taxed at the marginal tax rate.

FOREIGN-EXCHANGE RISK. Any appreciation in the value of the rupee vis-à-vis the dollar will adversely affect the returns from this fund. (The Hong Kong dollar is pegged to the US dollar at a fixed exchange rate.)

INADEQUATE DIVERSIFICATION. If you are investing in this index for the purpose of diversification, that objective may not be fully met. The correlation between the Nifty and the Hang Seng index is quite high at 0.64 (for diversification you should have negative correlation). "The experience of the past few years tells us that international flows often dictate market movements. You could end up discovering that there is a fair degree of similarity in how the two indexes move," says Dhawan.

KEY FACTS

NAME OF FUND.	Hang Seng BeES
FUND TYPE.	Open-ended listed ETF
NFO OPENED ON.	Feb. 15, 2010
NFO CLOSES ON.	Feb. 24, 2010

HIGH SINGLE-SECTOR CONCENTRATION. Fifty per cent of this index is composed of financial stocks. This amounts to a very large exposure to a single sector. Indian indexes such as the Nifty are far more diversified. Says Pune-based financial planner Veer Sardesai: "Any news that is negative for the financial sector in this region — an increase in interest rates, re-intensification of the global financial crisis — will have an adverse impact on this index."

ETF or actively-managed fund?

Another decision you must take is whether you would like exposure to the Chinese economy through an ETF or through one of the actively-managed funds available in India (Fortis, Mirae, and JP Morgan offer actively-managed funds focused on this region). Sardesai favours taking the ETF route. "Over the long run an ETF is advantageous as you do not have to bear the fund-manager risk. There is no danger of the fund manager who got the good returns changing his job," he says.

Dhawan agrees. "You are likely to have much more information about your home market than about an international market. For an Indian investor, therefore, it makes sense to initially have exposure to the Chinese market through an index-linked fund. As the investor's international portfolio grows and he begins to appreciate the risks and rewards of such investments better, he can start looking at actively-managed funds. Based on his knowledge he can pick the right managers," he says. Besides, Dhawan feels, the very best of China-centric active funds available internationally have not yet come to India, so investors would do well to wait for some more time.

Who should invest?

Indian investors who have hardly any exposure to the Indian markets or who have a small corpus size (say, Rs 5 lakh) should avoid this fund. Only after you have adequate exposure to the Indian markets and your corpus size has become fairly large, say Rs 20-25 lakh, should you invest in an international fund such as this.

According to financial planners, a high net worth investor's exposure to this fund should range from 5-10 per cent of his equity portfolio.

Finally, a word of caution for those who decide to invest. The Hong Kong market closes down at 1.30 PM India time. While trading in this index will continue so long as the Indian market is open, the bid-ask spread is likely to increase (i.e., the difference between the price at which the ETF will be sold and bought will increase). To avoid this case of pricing inefficiency, conduct your sales and purchases at a time when both the markets are open. ♦

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