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LIC Balanced Advantage Fund NFO review: Should you invest in the scheme?

The fund will use its own in-house model to ascertain the equity-debt split

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Nudged in part by **rising inflows into balanced advantage funds (BAFs)** and also by the healthy returns delivered by the category, **LIC Mutual Fund** has launched its own BAF.

LIC Balanced Advantage Fund (LBAF) will invest in a mix of equity, debt and money market instruments. It aims to reduce volatility by

switching between equity and debt, if one asset becomes too hot to handle.

The performance of LBAF is benchmarked against the LIC MF Hybrid Composite 50:50 Index. The benchmark index is built by giving equal weightage to **Nifty 50** and the 10-Year G-Sec Index. The equity portion of the scheme will be managed by Yogesh Patil, while the debt part will be taken care of by Rahul Singh.

What works

Balanced advantage funds, also known as dynamic **asset allocation** schemes use various tools to ascertain if stocks are attractive. Some rely on valuation tools such as price to earnings and price to book ratios, or a combination of many factors to ascertain how much to invest in stocks and in bonds. LBAF will use its own in-house model to ascertain the equity-debt split. The model uses interest rates, one-year forward price earnings ratio and earnings yield among many factors as its guide.

When interest rates rise, equity markets usually correct. The reverse also holds good. Yogesh Patil, Head-Equity, LIC Mutual Fund says, “The inverse correlation between equity and interest rates is core to our asset allocation model. Forward price to earnings multiple band arrived at using interest rates and earnings yield help to increase allocation to equity when it is attractive, and reduce when it has run up.”

For its equity allocation, LBAF will invest significantly in large-sized companies. On the fixed-income side, the fund will be

conservative and stick to high-quality bonds issued by governments, public sector undertaking and AAA-rated private sector corporates.

Like all balanced advantage funds, the scheme will maintain gross exposure to equities, using spot-future arbitrage, at 65 percent even if the net exposure may be less than the threshold. This ensures that the scheme is treated as an equity fund for the purpose of taxation.

"As investors swing between the excitement of the uptrend in the equity market and the fear of high valuations, there is a need to earn better yield on their fresh investments looking for less allocation to equity," says Ravi Kumar TV, Founder of Gaining Ground Investment Managers. The balanced advantage fund category has given good risk-adjusted returns across market cycles, he adds.

What doesn't

One of the key metrices that the fund would follow is the inverse relationship between stock prices and bond yields, to decide its equity-debt split. There may be periods when the assumption may not hold good and could impact the scheme's performance. Joydeep Sen, Corporate Trainer-Debt says, "Though the idea of allocating money based on interest rate movements looks interesting, investors need to watch the execution of the strategy and the investment outcomes in the real world."

Patil explains that "the scheme can take advantage of the sharpest moves in stock markets that may be short-lived. So a flash crash can be used to deploy more money in equity. Also, equity can be sold in a flash up-move."

However, to avoid over trading, he adds that the **asset rebalancing** is done only when the recommended allocation changes by at least two percentage points.

What should you do?

Investing in a scheme that allocates money to equities and still aims to contain downside is an attractive idea for investors who are worried about the future course of the stock market. Though the idea of allocating sums to stocks and bonds using a dynamic model without a human bias may be tempting, there are many BAFs in the market that already come with a track record.

The new fund offer will close on November 3, 2021.

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