

Principal Mutual Fund

Investment Philosophy



Equity Investment Philosophy

Equity Investment Philosophy & Process

Mission & Key Objectives

Mission - Deliver performance that consistently tracks benchmark and at all times strive to outperform it whilst complying with internal risk policies, investment processes and regulatory requirements

Key Objectives - Our investment process has hence been designed to pursue the following key objectives:

- **Alpha Generation:** We believe that superior stock selection is the most reliable and repeatable source of outperformance
- **Alpha Preservation:** We believe that disciplined portfolio construction is the key to consistency over time
- **Research Integration:** We believe integrated quantitative and qualitative fundamental research is the key to superior stock selection:
 - Our Principal Research Platform (PRP) provides **breadth**
 - Our Research Analyst Expertise provides **depth**
 - Our Systematic process provides **discipline**

Equity Investment Philosophy & Process

Investment Process Overview

Alpha Generation		Alpha Preservation	
Discovery	Due Diligence	Construction	Monitoring
Improving Business Expectation	Sustainability of Trends	Overall Positioning	Research Dashboard
Rising Investor Expectations	Interpretation of Ranking	Systematic Risk Assessment	Portfolio Risk Decomposition Ranking
Principal Research Platform	Research Analyst	Final Buysell decision	Liquidity & Trading Cost
Initial Universe	Focus Universe	Portfolio Managers	All
		Portfolio Candidates	Portfolio Holdings

The process establishes differentiation between our Principal Research Platform (PRP) which provides breadth & focus to our research efforts; and research analysts who provide the much needed depth to create the focused investment universe

Equity Investment Philosophy & Process

Alpha Generation through superior stock selection

- Superior stock selection is at the heart of Alpha generation
- **Investment Philosophy** – Focus on bottom-up stock selection concentrating on differentiating companies relative to their sector peers. We believe this strategy can be applied with relative consistency in both up and down market conditions on an ongoing basis as compared to strategy based on forecast of macro-economic trends that are inherently inconsistent and event-dependent by design
- Our process is focused on early identification of fundamental change. We believe superior stock selection is characterized by companies with:
 - Improving and sustaining business fundamentals
 - Rising Investor Expectations
 - Attractive relative valuations

All these characteristics have to be viewed relative to the:

Sector – Pick true winners based on comparative strengths of the company in its sector.

Benchmark - Ensure that the fund remains “true to label” by consistent benchmark awareness which should be the prime focus during portfolio construction and active calls are taken within specified risk policy limits which are reviewed from time to time.

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Principal Research Platform

- The **Principal Research Platform (PRP)** is a powerful proprietary research tool combining fundamental insights with systematic disciplines and serves as the cornerstone of our research process and focuses our efforts on the “true Winners”
- The Platform works as a filter thereby providing our investment process the desired focus and edge vis-à-vis the competition
- Over 400 Indian stocks are closely and actively tracked by the PRP, based on distinct multi-factor fundamental ranking Models tailored to various sectors
- The PRP combines complex stock evaluation tools obtained from many of the world’s most sophisticated and specialized independent research providers. These inputs are combined in a proprietary and highly customized data management and screening framework
- The PRP factors in both fundamental as well as momentum factors to rank stocks as absolute factor value. The model dynamically focuses on changes in earnings expectations and valuations

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Research Integration

Quantitative Analysis

Discovery

Timely coverage across a broad Universe of investable stocks

Efficiently and objectively identify a focus Universe within sectors

Analysts have full visibility to underlying Factors and inputs for each ranking model

Proprietary Principal Research Platform

Qualitative Analysis

Due-Diligence

Depth of research, identifying the best from amongst highly ranked stocks

Provide industry expertise and forward looking judgment of company specific Prospects and risks

Analysts directly participate in ongoing R&D efforts including model testing & Enhancements

Research Analyst

We believe integrated quantitative and qualitative fundamental research is the key to superior stock selection

Equity Investment Philosophy & Process

Alpha Preservation & Risk Management

- Risk to Return Philosophy – We seek to optimize the risk to reward proposition as against maximization of returns
- Consistent with our focus on active management of stock-specific risk, we carefully monitor the portfolio profile in terms of ‘active ratio’ and ‘coverage ratio’ which measure aggregate active weights in individual stocks and overlap with benchmark holdings, respectively.

While active ratio is a key metric for the alpha generation potential of a portfolio, coverage ratio represents the alpha preservation component needed to maintain the desired beta and style characteristics.

- Restriction on exposure to non-benchmark stocks outside benchmark market cap range
- Sector Limits – Fund specific caps on Overweight / Underweight Positions
- Strict liquidity guidelines to ensure liquidity to meet redemption / asset rebalancing needs even during distressing times
- Regular monitoring of portfolio limits and other risk parameters

Fixed Income Investment Philosophy

Fixed Income – Investment Philosophy & Process

- **INVESTMENT PHILOSOPHY**

“To deliver superior risk adjusted portfolio return in line with the fund objective.”

- **INVESTMENT PROCESS**

Our fixed income investment process includes the following elements:

- **Research**

- Macro-economic Analysis
- Interest Rate Strategy
- Credit Strategy

- **Fund Management**

- Portfolio Construction
- Risk Monitoring

- **Dealing**

- Trade Placement and Execution

Fundamental Research

1. Macro-economic Analysis –

- Involves overview of domestic and international economies, and determining the sector allocation (sovereign, credits, etc.) as well as the interest rate and yield curve strategies.
- Essentially broad based in nature and comprises of primary/secondary research by Fund Managers/Research Analysts coupled with technical inputs through Traders/Dealers.
- Also serves the purpose of determining the credit or interest-sensitive tilt of the portfolio.

2. Interest Rate Strategy – In order to determine the fair value of interest rates, and in turn, the duration stance of the portfolio, the following criteria are used:

- a) Economic Fundamentals – The economic analysis is primarily based upon the macro-economic factor given below.
- Economic Growth
 - Credit Deposit trends
 - Fiscal Situation
 - Inflation
 - Liquidity situation
 - External Sector position
 - Monetary policy stance

Research Contd...

b) Technical Analysis

- Critical towards forming short – term views on interest rate movements.
- Typically involves monitoring of spreads, rich cheap analysis, short term supply trends, regulatory impacts, etc.

c) Market Sentiment

- Due to the fact that fixed income markets in India are relatively shallow, observing changes in market sentiment assumes high significance.
- An important aspect of forming the interest rate strategy involves regular interaction with intermediaries and counterparties which often provides valuable inputs for short term interest rate strategies.

Research Contd...

3. Credit Strategy

- The investment team maintains a record/list of approved Credits, and exposure to any credit can be taken only if the credit under consideration forms part of this list.
- Inclusion and sustainability of a credit in the record/list is determined by the established credit process, which includes two broad areas –
 - ✓ Approval for new credits
 - ✓ Review and monitoring of existing credits
- Short Term ratings are approved by the Credit Committee in India. The investment team maintains a record/list of approved Credits, and exposure to any credit.
- Long Term credit ratings are first approved by Credit Committee in India and then reviewed by Principal International Credit Committee.

In our fund portfolios, we predominantly take exposure only to AAA/AA+/AA credits. Even in that space, we are strongly oriented towards the higher rated (AAA/AA+) credits and our exposure to AA names is very minimal. In respect of short term credits, we would have exposure to P1+/A1+/ F1+ credits in the portfolio.

Portfolio Construction

- The portfolio manager manages the portfolios as per the framework laid down by the investment mandate. Every product has an investment mandate which is a derivative of the offer document.

Constructing a fixed income portfolio comprises of the following:

- ✓ Target duration is arrived by weighing the factors effecting Bond market on a particular scale and then arriving at Bullish/Neutral/Bearish stance, which is then implemented in the portfolio from a medium term view point.
- ✓ Curve positioning is decided based on relative value and expectations of curve steepening/flattening.
- ✓ Credit component is decided based on attractiveness of spreads and liquidity.

Factors Considered - Duration Funds



Factors Considered – Liquid/Ultra Short Term Funds

- Systemic Liquidity
- Repo/reverse repo rate
- Government Cash Balance
- Credit and Deposit growth rate trends
- Mutual Funds flows
- Active Asset liability management based on probabilistic duration of stay of different category of investors.
- Regular stress testing of the portfolio by taking key variables in account like PV01, average maturity, liquidity and change in the curve.

Risk Monitoring & Dealing

Risk Monitoring

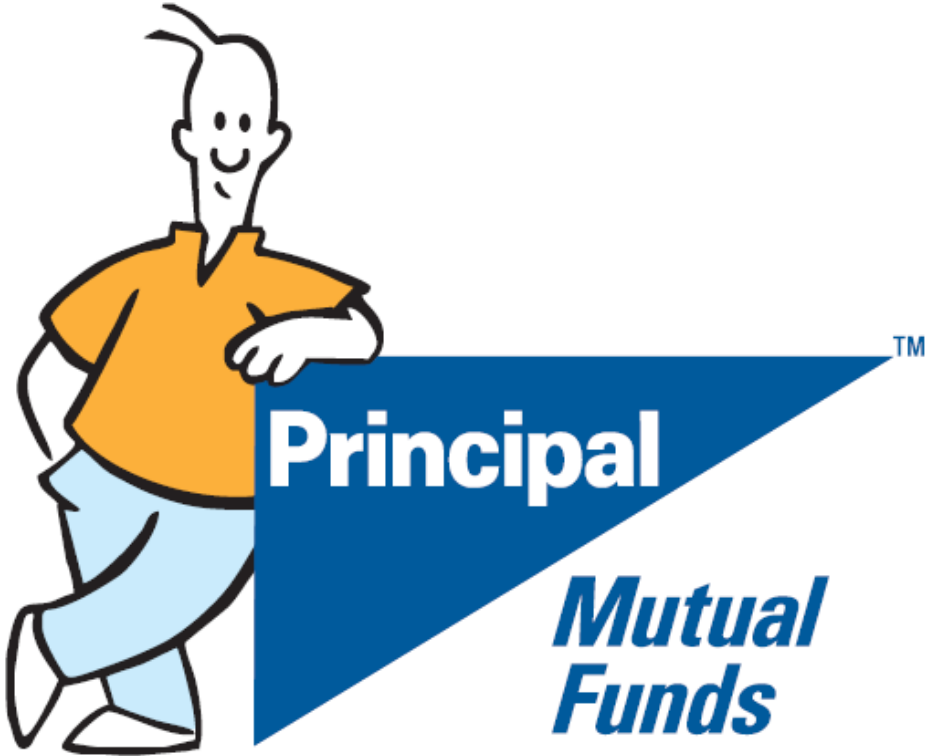
Apart from credit risk monitoring, the following key risks have been identified and tracked:

- Concentration Risk
- Liquidity Risk
- Volatility Risk

Operational Risk

- Near Real time update of securities holding, cash position
- Setting of Deal order & price range limits
- Setting of limits in system based monitoring in compliance with guidelines
- Maintaining records of communication over phone lines
- Dealing desk always attended by some of the team member

Thank you



Disclaimer

Mutual Fund Investments are subject to market risks, read all scheme related documents carefully.