Recently, I was travelling from Mumbai to Pune by train, with about 100 other co-passengers on board. Since it was early in the morning, I decided to take a nap and have my coffee after crossing Lonavla. However, I woke up to find out that I was now travelling to Bangalore. When I enquired about the reason for the same, I was told that there was another train with about a 1000 passengers, routed towards Bangalore, which, due to some fault in its engine, could not go ahead. Hence, they decided to attach all the bogies of the Bangalore bound train to the one going to Pune and the passengers of Pune train were given a 5 minutes window to either alight from the train or travel to Bangalore. Since I was asleep, I had missed that chance to alight from the train. Though astounded, I had some questions in mind:

Couldn't they just change the engine of the Bangalore train? In which world does it make sense to attach those bogies to a Pune-bound train and then re-route it to Bangalore?
Was the 5-minutes window allowed for exit, sufficient? How many others like me, were asleep and hence had missed that exit opportunity?
What was a passenger who was supposed to reach Pune, do, when he inadvertently reached Bangalore?
Why was it that only my train going to Pune, was chosen for this re-routing exercise? Was it because it had only 100 passengers on board?
Finally, what were the Railways authorities thinking? Probably that they were too big and could easily get away with this?
Now as strange as this may sound to you, but this imaginary incident is very similar to what happened at HDFC Mutual Fund with the investors of two of its equity-oriented funds. These 'Equity fund' investors' train is now inadvertently headed towards 'Balanced fund' allocation. For context, read Pune train as 'Equity oriented funds', Bangalore train as 'Balanced funds', "5 minutes alighting window" as a load free exit from funds, and the "Railway body" as HDFC Mutual Fund.

Mint recently published an article on how HDFC AMC has rejigged some of its funds post re-categorization and change in regulations for Mutual funds by SEBI (Please read the full article here). The article highlighted two issues with this rejig, which we too have discussed below, but we feel that there is another important issue which an investor should take cognizance of.

HDFC Growth Fund, an equity-oriented fund (~INR 1,100 crore corpus) was converted into HDFC Balanced Advantage Fund and then the HDFC Prudence Fund (~INR 36,500 crore

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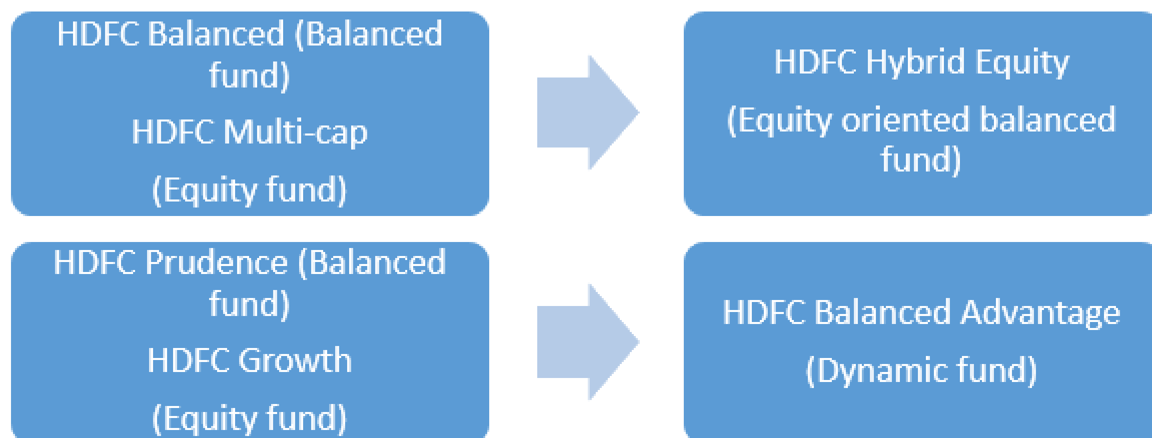
corpus) was merged into it. Similarly, HDFC Premier Multi-Cap Fund, an equity fund (~ INR 300 crore corpus) was converted into HDFC Hybrid Equity and then HDFC Balanced (~INR 20,000 crore corpus) was merged into it.



Investors of HDFC Growth Fund and HDFC Premier Multi-Cap Fund (both equity-oriented funds), many of who (being retail investors), even if they were given a load-free exit option due to a change in strategy, might have missed this update and inadvertently changed their asset allocation on a more conservative side (but are now invested in balanced funds instead).

The article highlights the two following issues in this merger:

1. Despite change in categorization, the fund house intends to run HDFC Balanced Advantage Fund and HDFC Hybrid Equity Fund in a style that is similar to how they were run earlier.

Talking of the first issue, HDFC Prudence Fund, an erstwhile balanced fund (which could invest 40-75% in equities and the rest in debt) was converted into HDFC Balanced Advantage Fund, a dynamic fund (which practically can invest ‘everything or nothing’ into equities and the balance in debt). But in a communication that the fund house sent out to all its distributors, it said nothing has changed with the erstwhile HDFC Prudence Fund. This means that HDFC Balanced Advantage Fund will still invest ~40-75% in equities, essentially giving it

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the characteristic of a balanced fund 'for all practical purposes' rather than a dynamic fund. A dynamic fund could invest 100% into equities during distressed equity markets or 100% in debt during volatile equity markets. Since HDFC Balanced Advantage Fund will limit its equity allocation to ~40-75%, as against other funds in the category which might have a more dynamic allocation, the investors of HDFC Balanced Advantage Fund might thus be getting a product that is not true to its label (though still complying to be within the category as such).

2. The modus operandi for aligning these funds to SEBI defined categories, though compliant to regulations, in our opinion was not as per the best practices that should have been employed, i.e. the equity oriented funds should have been merged with some other equity fund rather than a balanced fund.

The second part of it is even more interesting, as the path adopted for conversion of these funds into revised categories, has a story to tell. Now this story needs a background as well – The way in which balanced fund was/are being marketed to investors, as an alternate for fixed deposits and *regular* dividend-paying instruments.

HDFC Prudence Fund being no different, has built a track record of paying regular dividends. However, SEBI rules mandate that dividends can be paid out of booked profits only. On comparing HDFC Growth Fund and HDFC Prudence Fund, it was clear that HDFC Growth Fund has dividend distributable per unit of ~Rs.60 vs. ~Rs.15.5 for HDFC Prudence Fund. Therefore, it became imperative to merge HDFC Prudence (the larger fund) into HDFC Growth (the smaller fund).

Now while this is just one case, there could be more in the MF space; some learnings that investors should take from this case or some questions that we may want to ask ourselves or our advisors are:

Are these Mutual funds really 'buy and hold' or 'buy and forget' instruments?
How is an investor supposed to identify such a change in the strategy of a fund?
And finally, what should be an investor's response to such a change in strategy?
Even if these funds are a passive part of investment for a retail investor, he should always have an eye on such changes in strategy or asset allocation. We do not suggest that one should check daily or even weekly NAVs, but one could prevent an inadvertent change in asset allocation or style drift by following some simple things like reading factsheets, checking notices on fund houses websites, reading blogs such as this, that highlight such

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drifts in style/strategy, etc.

Happy Investing!!

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