Annual Investor Report 2020-21

IN ULIP PRODUCTS THE INVESTMENT RISK IN THE INVESTMENT PORTFOLIO SHALL BE BORNE BY THE POLICY HOLDER

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Aviva Investor

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2020 has been a particularly eventful year, marked by the global pandemic of Covid-19 leading to notable changes in lifestyles, economies and markets. When the pandemic initially started spreading to various countries, no one could have predicted the impact it would have and there were a wide of possible outcomes the entire ecosystem could have faced. The fear was palpable as countries started locking down one after another, while witnessing immense pressure on the public healthcare facilities. The fear reached the markets too with most equity indices correcting by 20-40% in a matter of weeks, the steepest fall in such a short duration. Financial conditions grew severely tight across the globe and there seemed no end to it. But the governments of the major economies recognized the scale of the problem that they were addressing.

The governments of the world launched massive fiscal packages to support lost incomes, lost jobs, support small businesses and stimulate demand. Not only were the governments extremely quick to provide support, but the size of the fiscal packages were also very large and unprecedented in nature. On the other hand, global Central banks were also very swift to come to the rescue of the markets, providing enormous amount of liquidity and funding to the markets, triggering easy flow of credit to the system, and easing interest rates with such accommodation that it eased financial conditions significantly in a manner that the economies could run in an undisrupted manner and the market functioning could be orderly. The good thing was that these measures were taken in co-ordinated fashion with global involvement- supported by US, Europe and Japan and the emerging markets and thus the impact of all the global monetary and fiscal stimulus on the global economy was amplified.

In India, RBI also acted promptly to address the tightening of financial conditions– maintaining INR stable by intervening in the FX market and also trying to keep the lending rates lower by cutting policy rates and infusing surplus liquidity in the form of LTROs & OMOs. RBI cut the reverse repo rate to 3.35% and repo to 4%- bring short term borrowing rates for corporates to record lows. RBI also tried to address the immense risk aversion of the banks by announcing TLTROs and specifically for the distressed NBFCs. It also provided a loan moratorium period for borrowers to address the cashflow issues arising due to stoppage of economic activity caused by the pandemic. RBI also encouraged banks to raise equity capital to address the poor risk capitalization and the poor risk appetite of the banks in wake of uncertainty on non-performing loans.

The Central government was also very proactive in announcing various rescue, relief and stimulus packages in tranches along with adoption of various structural reforms. While the government claimed that the total relief provided was in excess of Rs 20 trn, actual cash outgo was not more than 3 trn as a large part of the relief was in form of loans and guarantees. The measures were primarily directed towards MSMEs, NBFCs, migrant workers and poor, infrastructure creation, improved business environment and other long term reforms.

Now, as the financial year comes to a close, the Covid-19 pandemic seems far less deadly than originally envisaged, notwithstanding the fact the surge in cases keep happening in waves globally. However, economies have now adopted to this challenge and healthcare facilities are in a better position to address rising cases. Vaccines have also been rolled out and is gradually picking up pace globally. Hopefully the pandemic will be history by the end of 2021 and we can look forward to normalcy in living mobility. The most important challenge in front of the governments globally is to address the disproportionate scar that the pandemic has left on the lower strata of the society and thus to ensure that the economic growth continues unabated in a structural manner even post the pandemic is over.

Equity Markets
FY21 was a year of recovery for the risk assets globally after a sharp fall in Mar-2020 led by the covid19 pandemic in the world. Nifty index gained 70% in FY21, 2nd best performer globally and valuations of risk assets expanded across the globe supported by a massive monetary stimulus. The mid and small cap indices rose 102% and 126% during the same period but they had also suffered a larger impact and among the sectors, automobiles, IT and realty were the best performers whereas fmcg and energy gained the least. All sectors were in the green in FY21. The primary market came back to life after initial few months of inactivity at the start of the year, with highest ever amount of Rs1.9tn of equity raised via various modes. Also, India continues to outperform peers on FII flows.

Portfolio positioning and risk management
Being defensive was the key focus area for the funds in the light of the outbreak of the pandemic. Gradually, as clarity emerged in the extent of impact and the measures announced by the various governments and central banks, the portfolio stance was gradually changed to adapt to the sectors that showed signs of improvement such as automobiles as the economy returned to normalcy, we consequently increased exposure to the mid and small cap stocks, which benefitted from the recovery.
Robust risk management practices are followed in portfolio positioning and performance analysis. Portfolio performance and positioning is frequently monitored using attribution analysis. The investment policy sets maximum limits on exposure to Mid/small caps stocks in the portfolio which limits risk to the portfolio to acceptable levels. Any divergence from such limits and deviation in performance is highlighted to the fund manager who has to take corrective actions.

Fixed Income Markets
Fixed Income markets saw another year of gains as Gsec and Corporate bond yields fell across the curve in a highly accommodative monetary policy environment induced by Covid shock. RBI supported the economy in an unprecedented way by easing the financial conditions significantly through cutting of policy rates (repo to 4% and reverse repo to 3.35%) and adopting a variety of unconventional monetary policy tools to aid monetary transmission and improve credit flow to various sectors of the economy. Even in the midst of higher than target inflation for most of last year, RBI choose to look through the transitory food inflation and remain accommodative, thereby supporting the economy though negative real rates and very low cost of borrowing for corporates. At the end of the year, as the Covid concerns started to ease and growth recovery picked up momentum, we saw bond yields again moving back up and further charged by an fiscally expansive budget presented for the fiscal year 2021-22. After three years of falling bond yields and good bond portfolio returns, we expect returns from fixed income to be relatively subdued this year.

Portfolio Positioning: Duration Strategy and Risk Management
We maintained an overweight position on duration for most part of last year as we believed the Central Bank would continue to maintain lower bond yields to support the economy amidst the Coronavirus shock. As the dynamic changed gradually, we booked some of the profits from the overweight positions. Some of our credit exposures had defaulted in FY20 amidst the NBFC crisis and IL&FS crisis, we expect some recoveries on them in the current financial year. New credit risks in the portfolios have been monitored with utmost attention and addition of new credit exposures have been made after a thorough analysis and due diligence process. Existing credits are being monitored regularly for any developments that could be beneficial or detrimental to the standing of the particular entity. With regards to duration and asset allocation, we are currently equal-weight on duration and are overweight government securities as we believe corporate spreads will rise once the accommodation cycle reverses.

Risk control : As a measure of risk control, the investment committee reviews on a quarterly basis, the portfolio composition and the performance vis-a-vis benchmarks of all the funds under management. The investment committee lays down the Investment Mandates and Philosophy which are reviewed periodically. All investments are made within the Parameters laid down by the Investment Mandates and Philosophy.

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