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Comparative study of Portfolio Management Services (PMS) & Mutual Funds (MF) in India.

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Abstract

Portfolio Management Service (PMS) is a tailor made professional service offered to cater the investments objective of different investor classes. The Investment solutions provided by PMS cater to a niche segment of clients. The clients can be Individuals or Institutions entities with high net worth.

Mutual fund is a professionally-managed investment scheme, run by an asset management company (AMC) that pools together a group of people and invests their money in instruments/assets for a common investment objective. As compared to PMS, MFs have a wider range of investment options, that an investor can invest in based on his risk profile.

The objective of this paper is to compare the features of the Portfolio Management Service and Mutual Funds and analyze their performance over a period of time. Secondary Research would be used to analyze the performance of PMS v/s MF.

Keywords*: PMS, AMC*

Research Methodology

The primary source of the information in this research study is the secondary data. Based on the objectives of the study the available information on the websites of various Asset Management Companies (AMC's) has been extensively used to complete the research.

Introduction

Portfolio management services (PMS) and mutual funds (MF) are two different avenues of investing in stocks or bonds. Although both of them are indirect ways of investing in the markets, there is a lot of difference between the two.

Portfolio Management Services (PMS)

Portfolio Management Service (PMS) is a tailor made professional service offered to cater the investments objective of different investor classes. The Investment solutions provided by PMS cater to a niche segment of clients. The clients can be Individuals or Institutions entities with high net worth.PMS is a type of wealth management service that offers a range of specialized investment strategies to benefit from the opportunities in the market, and is managed by professional portfolio managers. There are two types of portfolio management services (PMS):

Discretionary PMS

Non-discretionary PMS

In discretionary portfolio management, the portfolio manager individually and independently manages the funds of each client. But in non-discretionary portfolio management, the portfolio manager manages the funds in accordance with the directions of the client. The portfolio manager cannot make buy-sell decisions at his own discretion; he has to refer to the client for every transaction.

Mutual Funds (MF)

A mutual fund is a professionally-managed investment scheme, run by an asset management company (AMC) that pools together a group of people and invests their money in instruments/assets for a common investment objective.As compared to PMS, MFs have a wider range of investment options, that an investor can invest in based on his risk profile.

Comparison of features PMS vis-à-vis Mutual Funds:

1. Transparency and Regulations: Mutual funds are more transparent as compared to PMS as they are tightly regulated by SEBI whereas PMS are not very transparent in their disclosures.

2. Minimum Investments: PMS is typically a high-end product meant for high net-worth individuals (HNIs) because the ticket size is very high (minimum investment of Rs 25 lakh). In mutual fund minimum investment starts from Rs 500. Hence, mutual funds cater to a much wider investor universe.

3. Fees & Charges: As compared to mutual funds, PMS charges a very high fee for management of portfolio. It charges various kinds of charges and fees such as:

Entry Load – An entry load is usually charged at the time of buying the PMS.

Fund Management Charges – Every PMS scheme charges fund management charges, which is variable in nature as per the PMS Provider.

Profit Sharing - Some PMS schemes also have profit sharing arrangements, wherein the provider charges a certain amount of fees or profit over the stipulated return generated in the fund. There is no profit sharing in MF. Once the fund management charge is paid, all the appreciation is owned by investors.

Fixed Fee - Some PMS schemes might have a fixed component in the place of the profit sharing component and charge investors a fixed monthly fee. This is not a percentage based fee and is decided before investing in the PMS. It could depend on the size of the portfolio.

MF on the other hand, have a minimal expense ratio and exit load (up to a certain period). Hence, MF are more cost effective than PMS.

4. Risk: MF gives various options and diversification, suitable for investors with different risk appetites. For instance, a risk-taking investor can opt to invest in an aggressive equity fund whereas a risk neutral or risk averse investor can invest in balanced or other less risky funds. In comparison to MF, PMS investments are riskier as these products usually hold a very concentrated portfolio of 20-30 stocks. Investing in a concentrated portfolio can be very risky as compared to well diversified mutual funds. Generally, MF invests in more number of stocks (varies from fund to fund) compared to PMS.

Further, SEBI has imposed restrictions on MFs which take positions in derivative instruments. However, PMS do not have any such restrictions, they are actively managed and take considerably higher risky positions which could provide huge upsides; however, if it goes wrong, the portfolio could drag down considerably.

5. Consistency: It is a common belief that PMS always generates superlative returns as compared to mutual funds. However, if we look at historical performance, mutual funds have given high returns in a consistent manner, over the years.

6. Complexity: While evaluating the performance of a PMS, a retail investor will have limited access to data and also it is much more complex. Mutual funds, on other hand are simple to understand and all the information about the fund is easily available on the AMC's website from time to time.

7. Liquidity: Since, PMS generally have a lock-in period and high exit charges, it is illiquid compared to mutual funds. Mutual funds can be liquidated (unless it is close ended and has a lock in) very easily at very less exit load applicable, if any.

8. Taxability: When an individual invests in mutual funds, he is allotted units. On redemption, units redeemed are subject to long term/ short term capital gains tax based on the holding period. In between, any transactions related to buy/sell of shares by the fund manager does not attract any tax for the investor. Where as in PMS capital gains are computed on each underlying transaction done by the fund manager. In the structure of PMS, all the stock holdings are directly in the name of investor (not units of a scheme). So, every time the portfolio manager sells a share, there is an incidence of capital gain/loss for the individual investor. If the share is held for less than 12 months, short term capital gains will be taxed @ 15 percent. To conclude tax implication in mutual funds for an investor is only when he is exiting the fund. In PMS, there may be tax implication even while you are still invested in the same.

9. Dependency: PMS are more prone to psychological biases of the portfolio manager. Most of the investment decisions taken in PMS depends mainly on the portfolio manager's judgment. This is because the portfolio holding is more concentrated, hence there is a lot of dependence on the fund manager's stock picking ability. In mutual funds, fund manager takes investment decisions which are more process oriented and risk mitigated. Even though some PMS do have processes is place, the one's followed by mutual funds are much more transparent and tightly regulated, in comparison.

Performance of PMS vis-à-vis MF, Nifty Midcap & Nifty over a period of 10 years:

A PMS portfolio, generally being a concentrated portfolio consisting of around 20-25 stocks, each portfolio company can be given the required dedicated time and effort and many new opportunities can be looked for. Hence, it has got potential to give manifold returns. In the past professional fund management has generated better returns than Direct Equities. Moreover, PMS have generated superior returns as compared to MFs & Indices (proxy for direct investment) over longer tenures. Over a period of last 10 years PMS have given a return of 4.4x whereas; MFs have given a return of 3.0x and Nifty Midcap & Nifty have given a return of 2.3x & 1.7x respectively.

Conclusion

PMS in India is still in its nascent stages and has a long way to go. The investment solutions provided by PMS cater to a niche segment of clients. PMS are available in two variants i.e. Discretionary and Non-Discretionary; whereas Mutual Funds are only Discretionary in nature. Minimum investment for PMS is 25 lakhs as per SEBI regulation; whereas investments in MF can be started with a meager amount of Rs. 500/- only. MFs are much more transparent in nature comparison to PMS. Fees and charges are much higher in PMS in comparison to MFs. Some PMS also offer profit sharing schemes. Risk involved with investment in PMS is much higher than that in MFs; as MFs offers diversification and are usually restricted from taking positions in derivative instruments. MFs have offered more consistent returns over a period of time in comparison to PMS. Investment in MFs offers higher liquidity in comparison to investment in PMS. MFs offer more tax efficient investments in comparison to PMS. The PMS platform is ideal for experienced investors who seek to invest for long-term wealth creation. Although, PMS is risky investment but they have generated superior returns as compared to MFs & Indices (proxy for direct investment) over longer tenures. Over a period of last 10 years PMS have given a return of 4.4x whereas; MFs have given a return of 3.0x and Nifty Midcap & Nifty have given a return of 2.3x & 1.7x respectively. As most of the Indians, restrain from taking heavy exposure in stock market due to the Risk involved. For Indian middle class; mutual funds would remain one of the best suited ways of investing in the stock markets. Investing a meager amount of Rs. 500/- per month in Mutual Funds through Systematic Investment Plan (SIP) would help them in tiding over the psychological barrier associated with investment in stock market.PMS and Mutual Funds are two different products catering to the needs of different class of investors and are equally good.

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