

Debt style box

Debt style box for a debt fund is a broad measure of its portfolio characteristics regarding the credit risk and interest rate risk your debt fund bears. A 3x3 matrix form captures a debt fund's interest-rate sensitivity and portfolio's credit risk. These two major risk factors can affect a bond fund's performance.

Fund Style

		Credit Quality		
		High	Medium	Low
Interest rate sensitivity	High			
	Medium			
	Low			

Broadly, the higher the credit rating, the lower the credit risk of the fund's underlying bonds. The higher the portfolio maturity, the more responsive the fund is to interest rate movements.

The matrix is created for mutual funds having debt in their portfolio, i.e., all debt and hybrid funds. Thus, only one of the boxes in the matrix is marked highlighted, which provides the characteristic credit quality and interest rate sensitivity of the fund's portfolio for a given portfolio disclosure.

There are two parts to the debt style box methodology.

- We calculate the average credit rating of a portfolio. Broadly speaking, the credit rating of each of the debt securities in the portfolio contributes to the overall average credit rating in proportion to their weighted net assets in the portfolio. Once this is arrived at, we assign scores to the credit rating. Our scoring system gives a higher score to the safer bonds, reflecting the low risk of the underlying.

- The style box measures the interest rate risk using the fund’s average maturity. Debt funds usually invest in a number of bonds, with each instrument having a different maturity. And since the maturity of security doesn’t give you a clear picture of the fund’s maturity profile, funds usually disclose weighted average maturity. For example, if a fund owns three bonds of 2-year (₹30,000), 3-year (₹10,000) and 5-year (₹20,000) maturities, its weighted average maturity would be 3.17 years.

Then, we assign ‘High’, ‘Medium’ and ‘Low’ tags to the final credit rating score and average maturity. A ‘High’ flag of credit quality represents low risk, and a ‘High’ average maturity flag represents high-interest rate risk in the portfolio.

Combining the average credit rating flag with the average maturity flag, we arrive at the 3x3 matrix, which represents the portfolio traits of a debt fund.

Example: Suppose we have a debt mutual fund with the below fund style box. Here we can identify that the fund comprises top-quality bonds and is moderately responsive to interest rate movements.

Credit Quality			
High	Medium	Low	
			High
			Medium
			Low