



Fitch Downgrades Capital Alliance Investment Grade Fund to 'BBf(Ika)'/ 'S4(Ika)', Maintains RWN

Fitch Ratings - Shanghai - 12 Apr 2023: Fitch Ratings has downgraded Capital Alliance Investment Grade Fund's National Fund Credit Quality Rating to 'BBf(Ika)' from 'Af(Ika)' and its National Fund Market Risk Sensitivity Rating to 'S4(Ika)' from 'S1(Ika)'. Fitch has maintained the ratings on Rating Watch Negative (RWN).

KEY RATING DRIVERS

The downgrade was driven by the portfolio composition changes and extended duration of the underlying assets, as well as investment strategy adjustments.

The fund has substantially increased its exposure to Sri Lankan government securities within a month to about 40% of the portfolio as of end-March 2023. Fitch rates the Sri Lankan government's local-currency debt at 'CC', indicating that default is probable. The fund has also shifted towards longer-dated assets to lock in high interest rates.

The RWN reflects the weak credit profile of the fund's investible universe. Fitch recalibrated the Sri Lankan National Rating scale after the [downgrade](#) of the sovereign's Long-Term Local-Currency Issuer Default Rating in December 2022. Following that, Fitch downgraded [10 domestic banks](#) and [five domestic finance and leasing companies](#).

We aim to resolve the RWN in the next six months, depending on how the credit quality of the banks and non-bank financial institutions evolves.

NATIONAL CREDIT QUALITY

The current 'BBf(Ika)' National Fund Credit Quality Rating considers both the fund's actual and prospective credit quality. The fund's weighted-average rating factor (WARF), Fitch's proprietary measure of fund credit risk, increased to 11.2 (within the 'BBf(Ika)' rating range of 6.1-15.8) by end-March 2023, from 1.4 (within the 'Af(Ika)' rating range of 0.9-2.1) at end-February 2023. A fund's WARF is a function of the credit ratings of the securities held in a fund's portfolio and their remaining term to maturity, weighted by market value.

Fitch bases the WARF on Fitch ratings where available. Fitch assumes that securities that are not publicly rated by any globally recognized rating agencies carry 'CCC(Ika)' ratings for the purpose of its WARF calculation. An estimated minimum rating provided by the relevant analytical team at Fitch would be used if it is available. The exposures to these securities would be limited to below 20% of the portfolio.

MODERATE TO HIGH SENSITIVITY TO MARKET RISKS

The National Fund Market Risk Sensitivity rating reflects Capital Alliance Investment Grade Fund's moderate to high sensitivity to interest-rate and spread risk. The fund's weighted average maturity and weighted average life increased substantially within one month to 25 months and 39 months, respectively, by end-March 2023 from five months and 18 months at end-February 2023. About 35% of the assets carry floating interest rates.

FUND PROFILE

The fund is an open-ended fixed-income fund that mainly invests in Sri Lankan banks and non-bank financial institutions. It seeks a high level of current income, targeting a competitive return that is consistent with liquidity and capital preservation.

The fund was launched in 2013 and is domiciled in Sri Lanka. It is authorised and regulated by the Sri Lankan Securities and Exchanges Commission. The fund's assets are segregated with the trustee, Deutsche Bank AG, Colombo Branch, a subsidiary of Deutsche Bank AG (BBB+/Positive/F2). The fund size was around LKR15 billion at end-March 2023.

INVESTMENT MANAGER

We regard Capital Alliance Investments Limited as a suitably qualified, competent and capable investment manager for the fund. The manager was founded in 2011 and is majority owned by Capital Alliance Limited, with a minority holding by Sri Lanka Insurance Corporation Limited (National Insurer Financial Strength: A(Ika)/RWN). The manager was the country's second-largest investment manager, with a market share of about 25%, and total assets under management of LKR45 billion in unit trust funds as of end-February 2023.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The upgrade of the fund's National Fund Credit Quality Rating is less likely, given that it is currently on RWN. The National Fund Credit Quality Rating could be upgraded if the fund adjusted its investment guidelines to focus only on higher quality securities. The National Fund Market Risk Sensitivity Rating could be upgraded if the fund's investment strategy facilitates a shorter duration.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The National Fund Credit Quality Rating could be downgraded if the portfolio suffers negative rating migration or if the fund's strategy changes to invest in lower-quality securities. The rating is also sensitive to exposures that are not publicly rated by a globally recognised rating agency and where Fitch may have more conservative credit views than other rating agencies. The National Fund Market Risk Sensitivity Rating could be downgraded if the investment guidelines allow the fund to increase duration risk.

RATING ACTIONS

| ENTITY / DEBT ↕ | RATING ↕ | PRIOR ↕ |
|--|----------------------|----------------------|
| <input type="text"/> | <input type="text"/> | <input type="text"/> |
| Capital Alliance Investment Grade Fund | Natl Fund Cr Qual | BBf(Ika) ⬇ |
| | Downgrade | Af(Ika) ⬇ |
| | Natl Sensitivity | S4(Ika) ⬇ |
| | Downgrade | S1(Ika) ⬇ |

PREVIOUS Page of 1 **NEXT**

[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- [Bond Fund Rating Criteria \(pub. 16 Aug 2022\)](#)

ADDITIONAL DISCLOSURES

- [Solicitation Status](#)
- [Endorsement Policy](#)
- [Potential Conflicts Resulting from Revenue Concentrations](#)

ENDORSEMENT STATUS

Capital Alliance Investment Grade Fund -

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