Marzban Irani, CIO, Fixed Income, LIC Mutual Fund Asset Management

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In an interaction with Shweta Papriwal, Editor, indiainfoline.com, Mr. Marzban Irani, CIO – Fixed Income, LIC Mutual Fund Asset Management Ltd said, "Investment goals of debt funds are meant to preserve the capital and Equity funds are meant to enhance the capital."

What is your current view on Debt funds?

August 2021 Monetary Policy reflects a change in thought process with 1 member (out of 6) dissenting the accommodative stance which coupled with the announcement of liquidity normalizing measures (Source: Minutes of Monetary Policy Committee). With these cues, liquidity is expected to moderate from October 2021.The first step is to absorb the liquidity followed by change in stance by year-end and rate hike in 2022.

Since the transition in interest rate cycle is inevitable, Investors can stay invested if the fund is running lower maturity and remain invested at shorter end of the yield curve. New investors are advised to choose short duration categories like overnight fund, Liquid Fund and Low duration Funds

Should the debt mutual fund investors start looking more towards equity fund given the bullish market?

The asset allocation is most important part of investing and is customized based on age, risk appetite, investment horizon and investment goal of individuals. Investment goals of debt funds are meant to preserve the capital and Equity funds are meant to enhance the capital. The widely accepted rule for personal finance is that 100 minus your age as a percentage of one's total saving , should be allocated to equity and rest should be allocated to debt. One should follow proper asset allocation based on above factors for optimum results. Younger the age, higher allocation to equity since one has higher the risk-taking ability and has age by his side to normalize the downsides of equity market.

What important parameters investors can look at before investing in debt mutual funds

Duration of the debt fund and credit quality are the most important factors to look at before investing in a debt fund. Debt funds returns are vulnerable to interest rate movements since price of the bond and interest rates are inversely proportional. The longer the duration of the fund, higher the sensitivity of the fund towards change of interest rate.

Hence in a rising interest rate scenario, one should stay invested in funds with lower duration. Further, debt funds carry credit risk and bad credit quality of investments may cause principal loss to the investors in the event of default by the companies. Hence, it's crucial to check the credit ratings of each portfolio constituents of the debt fund. A portfolio that constitutes fixed income securities that are highly rated is ideal to invest in.

What are the risk you are anticipating in the current times?

Delta variant remains a risk factor going ahead due to its highly contagious nature. Monsoon has been below normal (10%) as per LPA. In addition to this, US taper talks, rising US yields and persistent rise in commodity prices are also added risk factors.

What are the alternatives of FDs in Mutual funds?

Debt funds have suitable alternative for 1,2,3 and 5 year FD with better tax efficiency in offerings. The investors can avail indexation benefit on 3year and above investments, which may improve the post-tax returns.

Debt funds have higher potential to pace with inflation due to market linked returns with higher disclosures. Normally it has better liquidity since no penalty is charged at the time of redemption (however exit load is applicable in debt funds) unlike the pre-mature withdrawal in FDs. Categories like Banking & PSU Debt Fund, Gilt Fund, Dynamic Bond fund can be looked at as an alternative of 3-5 year FD whereas, Short duration & low duration funds are suitable as alternatives for one year period.

What type of funds one can chose for a period of 3 months, 6 months, 12 months.

For 3 months or less time horizon, investors can choose Liquid funds since the maturity of the assets are less than or equal to 91 days. For 6 months' time horizon, Ultrashort fund ideal for investors those who are looking to park their money for 6 months and want to be less susceptible to interest rate risk. Ultra Short term fund offers best proposition due to shorter maturities of underlying assets.

For 12 Months period, Investors can choose Low Duration fund since it holds assets of longer maturity of around one year and better returns than traditional savings due to market linked returns.

Further, the future of the MF Industry are ETFs. G-sec ETFs are one of its kind products which gives the investors an option to participate in interest rate play with low cost. In addition to that, ETFs trade like stocks through the day in secondary market. There is no exit load imposed on ETFs for selling in a short time, thus making them suitable for trading as well

Are debt funds risky?

Risk is an inherent part of investing and debt funds are no exception, there are certain risks specific to debt funds. The investors are expected to analyze their fund selection criteria based on risks associated with debt funds, to avoid negative returns instances in their debt fund investments.

Credit risk is the most detrimental to the performance of Debt fund since it may lead to loss of principal for investor and therefore becomes a very important aspect to look at. Continuous Rating downgrades in the portfolio indicate higher probability of default and may cause permanent loss to the fund. Investors should be watchful of the fact when a fund's instruments are constantly getting downgraded. Investors should further be cognizant of the fact that duration risk also makes the performance of the debt fund volatile. Since it is linked to Interest rate movements which expose debt funds to price volatility. Longer duration funds are more volatile than shorter duration funds and may result into fall of returns in a rising interest rate scenario.

Further, Liquidity risk is posed specifically to debt funds due to illiquid and shallow debt markets and can leave the investors stuck with the investment since fund house due to higher proportion of illiquid securities which may not be saleable to meet the redemptions. Investors can access traded securities data available in exchange platforms to analyze the proportion of illiquid securities in the fund, before choosing it.

What is your view on debt mutual funds going forward

Since we are on the cusp of rising interest rate cycle, existing investors in long duration funds may stay invested for a three-year time horizon with discipline. It is wiser to remain invested which may result in reasonable returns over the long run, even if the portfolio may show losses or lower than expected returns in short term, since returns may normalized with longer time horizon.

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