Move to short-term debt funds: Experts

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Rising bond yields have prompted investors to shift to debt funds of shorter tenure from long-duration products. Wealth managers said advancing crude oil prices have raised worries about a spike in inflation, which could lead to yields remaining firm and losses in funds that invest in long-term government securities.

Yields on the benchmark 10-year government bond have risen 8 basis points so far in November to 6.94 per cent -its highest level seen in May -due to the sharp spike in crude prices. And with oil prices expected to remain firm due to worries over rising political tensions in Saudi Arabia -the biggest oil exporter-bond yields are expected to rise further.

"We expect the 10-year benchmark to rise to 7-7.25 per cent, as inflation could rise from here, and trade deficit could be higher due to a rise in oil prices," said Vikram Dalal, managing director, Synergee Capital.

Bond yields and prices move in opposite direction; when yields rise, prices fall and vice versa. Debt mutual funds that invest in longterm government bonds trade in them to benefit from a rise in prices.

Dalal believes that if yields move up and you are invested in long-tenure gilt funds, you could see a mark-to-market loss of 4 per cent. "Assuming you have a coupon of 7 per cent, you will earn only 3 per cent if you stay invested for a year. Investors should book profits in long-term bonds or gilt funds and move into ultrashort term funds," he said.

Market participants are worried about a slippage in India's fiscal deficit target of 3.2 per cent. Also, a high number of equity IPO offerings in the primary market will drain out liquidity . IPO offerings from insurance companies such as GIC Re, New India Assurance SBI Life, HDFC Standard Life and Bharat 22 ETF are likely to squeeze out as much as Rs 40,000 to Rs 50,000 crore which could cause yields to move up higher.

"A combination of high oil prices, fear of fiscal loosening due to bank recapitalisation bonds, global environment where banks are raising rates implies that interest rates could stop falling from here," says Vishal Dhawan, chief financial planner at Plan Ahead Wealth Advisors.

Dhawan believes that with no visibility on rates cuts, you could move to low-duration short-term funds which have low expense ratios. He recommends investors stay with HDFC Short term Opportunities Fund and IDFC Corporate Bond Fund.