

# Bank on fixed income deposits for benefits

EACH DAY, the story reads the same: “ Indian equity markets soar on the back of record foreign flows”. With stock markets continuing to move higher on the back of strong international inflows and analysts predicting another \$5 billion dollars flowing into the Indian markets over the next few months, there are clearly two sets of investors.

One set of investors are those who have preferred the comfort of being in fixed income over the last couple of years on concerns of a double dip recession and are probably feeling a little left out. On the other side are investors who have stayed invested in equity markets over the last three years, who continued to invest over this period and are today seeing their portfolios generate returns that are far in excess of what a fixed income strategy has generated. With risk appetite suddenly seems to have increased and real interest rates on fixed income options continuing to be in negative zone as inflation exceeds rates of returns on fixed income instruments, it is not an easy investment decision for investors to make at this point. Whilst asset allocation strategies and financial goals should continue to determine the investment entry and exit decisions of investors, we believe that it may be time for investors to start the process of paring down their equity exposures gradually and moving a part of their gains to fixed income.

Even for investors who have not participated in the rally on equity markets, it



may not be prudent to become very aggressive at this stage. They will need to look at equity exposures being built over a period and invest larger portions of their corpus in fixed income options. The moot question is :

## What are the fixed income options?

■ **Bank Deposits** — Whilst this has always been the preferred investment strategy for most investors, we think that there are innovations in this space that could be interesting for investors to consider. One of them is a floating rate deposit that will be linked to the base rate of the bank. With interest rates already moving upwards and a large number of banks moving their base rates upwards last week, we think that these products could help investors take advantage of rising interest rates. In case an investor prefers a vanilla fixed deposit, we would recommend that the deposit be placed for a shorter maturity so that the reinvestment on maturity can be done at higher rates. However do keep in mind that a bank deposit strategy may not be the most tax efficient strategy for investors in the highest tax brackets.

■ **Corporate Deposits** — With corporates also expecting interest rates to

move up, they are trying to raise funds at this point from investors. Since corporate deposits are of an unsecured nature, it would be prudent to evaluate the ratings, repayment history and profitability of the corporate raising the money rather than chasing the highest return alone. It would also be critical to build a diversified portfolio of deposits to reduce overall risk.

■ **Bonds** — Investors can consider purchasing non convertible debentures and corporate bonds from the secondary market, or from the primary market as and when they are available. However, it would be prudent to remember that ratings of these bonds need to be considered and investors may need to adopt a hold to maturity strategy on these instruments in a rising interest rate environment.

■ **Mutual Funds** — Today, in excess of two third of all monies with mutual funds are in fixed income instruments. We believe individual investors need to evaluate building fixed income exposures to their portfolio through mutual funds, especially for investors in the highest tax bracket due to the tax arbitrage that they offer. Short term bond funds and fixed maturity plans could be good options to consider at this point, with a smaller allocation to long term bond funds for more aggressive returns.

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