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Investors in debt mutual funds may do well to keep horizon short

BY PRASHANT MAHESH, ET BUREAU | OCT 05, 2018, 09:56 AM IST

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Financial planners are advising debt mutual fund investors to stick to liquid funds - a safe bet in uncertain market conditions. This is because bond funds had a volatile year due to a downgrade in IL&FS bonds, rising yields and a depreciating rupee against the US dollar.

In the last one month, a downgrade in bonds of IL&FS from 'AAA' rating to 'D', led some mutual fund companies to mark down these bonds by 25-50% in their portfolio, leading to losses for investors. Over the last one year, the rupee has depreciated by 13.2%, crude prices rose from \$56 a barrel to \$86, while the benchmark 10-year bond has moved from 6.65% to 8.18%.

Data from Value Research showed that investors have lost 0.23% in corporate bond funds and 0.44% in credit risk funds on an average. In a one-year period, investors have made a 3.27% and 4.27% in these categories and lost 0.64% in gilt funds.

"Crude oil prices and dollar rupee both are not stabilising, which are keeping the bond markets jittery," said Lakshmi Iyer, CIO (Debt), Kotak Mutual Fund. She expects the RBI to raise rates by 25 bps in its policy meet.

Globally, too, interest rates are on the rise with the Fed having increased its interest rates for the third time in this calendar year and another rate hike later in December 18 is widely foreseen. This could further result in foreign capital outflows from India and put further pressure on the rupee.

Analysts believe with the sharp rise in crude oil prices, OPEC ruling out increase in production and supply concerns ahead of the US sanctions on Iran, oil prices will continue to move upwards. The depreciating rupee and higher minimum support prices, too, could fuel inflation.



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As current account deficit widens due to higher oil prices, interest rates are expected to move further up. "The 10-year benchmark could trade between 8.20 and 8.35% in the next three months," says Vikram Dalal, managing director, Synergee Capital.

Given this scenario, financial planners believe investors should stay away from long duration funds, and in an uncertain environment, prefer liquid funds. Such funds have the potential to deliver anywhere between 7% and 8% with lower risk. “Till there is clarity on currency and oil, investors would do well to stay with liquid and ultra short- term funds with good quality paper,” said Vishal Dhawan, CFP, Plan Ahead Wealth Advisors.

Yield curve

Category	1-year return (%)
Long Duration	-0.64
Medium Duration	3.47
Short Duration	4.29
Ultra Short Duration	5.69
Liquid	6.62
Dynamic Bond	1.01
Corporate Bond	3.27
Credit Risk	4.17

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