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Is it wise to ignore long duration debt mutual funds because of volatility?

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Most debt mutual fund investors know that long duration bond funds and gilt funds benefit the most in a falling interest rate scenario. Both these categories have been topping the return chart with higher double-digit returns in the last six months. However, most debt mutual fund investors may have missed the rare opportunity to earn the supernormal returns if they were listening to their mutual fund advisors and debt fund managers.

Mutual fund advisors and debt mutual fund managers have been asking investors to stick to short to medium duration schemes in the last one/two year/s since the RBI started easing policy rates. They were of the view that most debt mutual fund investors would not be able to tolerate the volatility in long duration schemes and gilt schemes. So, investors are better off without these schemes.

Is that so? What about debt mutual fund investors who do not want to miss the rare opportunity to earn high double-digit returns? Should they ignore such cautious advice and invest in long term bond funds and gilt funds if they have a long investment horizon and higher risk appetite?

"The trouble with long duration funds is that the signals can change any moment. Even the largest banks of the world wait for data to take calls on what to do. So, when the calls are so difficult, you cannot possibly take tactical allocations in these schemes," says Vishal Dhawan, Founder, Plan Ahead Wealth Advisors.

Radhika Gupta, CEO, Edelweiss AMC, also points out that there is a lot of risk and volatility involved in investing in long duration bond fund that many debt investors would find scary.

The point, once again, what if an investor wants to pocket the extraordinary returns these schemes can offer in anticipation of a falling interest rate scenario? "If you want to invest for a long term and stay invested, go ahead and do it," says Dhawan. Radhika Gupta also agrees; "If investors are investing in long duration or gilt, knowing the risk, then it is fine. If you want to hold a gilt fund for 10 years and you know your reasons well, do it."

However, the trouble is that if you wait for consensus on the easy rate regime to invest in long duration schemes and gilt schemes, you might be disappointed. For example, these schemes have already offered higher returns in anticipation on the expectations of rate cuts by RBI and they are unlikely to offer similar returns in the coming months.

"The market reacts in anticipation of rate cuts, not to rate cuts," said R Sivakumar, head-fixed income, Axis Mutual Fund, recently in an interview to **ETMutualFunds.com**. That means if you are waiting for firm cues to invest in these schemes and pocket higher returns, you might be disappointed.

Probably, the dilemma explains why many mutual fund advisors ask most of their clients to stay away from long term bond funds and gilt funds. They recommend dynamic bond funds to clients who insist on benefiting from falling rates. However, after many dynamic bond fund managers got their call wrong on interest rate cuts two years ago, even these schemes are not favoured by many mutual funds anymore.

Vishal Dhawan says investors who want to commit their money for more than seven years and have a stomach for volatility, can go ahead and invest in long duration funds. He lays down the following conditions: "You should know the risk involved. You should keep in mind that these schemes can go into the negative territory also," he says. His parting shot: don't expect RBI to keep cutting rates for more than a year.