The right formula to build a robust debt portfolio

How can you build a debt portfolio that can generate better returns without putting the capital on risk? Here's a way.

Abhishek Kumar|Jun 22, 2022

Be it equity or debt, investors need the right mix of funds to generate optimum returns at a lower risk through a well-built portfolio.
In debt, experts advice a three-layer portfolio with the first being cash allocation. Having a part of the allocation in a high safety and high liquidity product is important as it can come handy during emergency situations. Liquid funds are the most preferred choice for cash allocation. The investment amount should ideally be worth 3-6 months' expenses.

Then comes core allocation. Here the idea is to look for better returns without compromising too much on safety. Suitable fund categories include low duration, short term, medium term, corporate bond and banking & PSU funds.
A small but significant part can be invested in options that have the potential to generate even better returns like dynamic bond and gilt funds.

At the Cafe mutual Confluence Investment Marathon 2021 (CCIM 21), Vidya Bala, Founding Partner & Head, Research and Product, Prime Investor shared a set of model allocations based on different time frames. Investors can consider adopting these model allocations to build their debt portfolios.

Category	Min. time frame	Nature of risk
Overnight & liquid	1 month and over	Insignificant
Ultra short/low duration/ floating rate	3 months and over	Low to moderate credit risk and liquidity risk
Short duration/banking and PSU	2 years and over	Moderate to high for short duration. Low for banking & PSU debt
Medium duration	3 years and over	Credit risk
Corporate bond	3 years and over	Low duration risk at times
Gilt	3 years and over	Duration risk
Credit risk	5 years and over	Credit and liquidity risk

What is the best mix for the present situation?
Investment choices differ from situation to situation. At a time when interest rates are about to rise, some of above mentioned allocation models may not be suitable right now. We spoke to MFDs and RIAs to understand what they are recommending right now. Here's what they had to say.

Vishal Dhawan, Founder & CEO, Plan Ahead Wealth Advisors
In the current interest rate environment, where both inflation and interest rates are beginning to trend upwards, two-third of the corpus could go towards target maturity funds. The rest can be put into short-term debt funds. This portfolio is apt for investors with a horizon of 3-4 years. If the horizon is lower, one can look at a combination of ultra-short-term and short-term funds. We continue to believe that investors should avoid credit risk funds and invest in funds having exposure to high rated debt instruments.

Shifali Satsangee, CEO, Funds Ve'daa
It is better to avoid long duration funds right now. There will be a lot of volatility in fixed income funds if there is a rate hike. A combination of target maturity and liquid funds is a good option right now. To get better returns, investors should make sure that their investment horizon is aligned with the maturity of the fund.
However, investors shouldn't have very high return expectations from debt funds, given the prevalent low interest rate scenario and the imminent rate hikes in the future.

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