SWATANTRA

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Risk Averse Investors Could Look At Investing In Debt Fund

Returns on these funds depend on interest rate decisions, credit rating & inflation in the economy

Partha Sinha | TNN

Most Indians, when it comes to investing, are risk averse. This is one of the main reasons why Indians prefer to keep a large sum of money in bank fixed deposits (FDs), even though there are alternative investment products which can give higher returns on a post-tax basis when kept for more than three years, better liquidity but come with just a bit of higher risks. One of such alternative investments is fixed income funds, also called debt funds, by mutual fund houses.

WHAT ARE DEBT FUNDS?

Debt funds are those mutual fund schemes that invest most of their money in fixed income instruments like treasury bills, government and corporate bonds, certificates of deposit, commercial papers etc. These instruments pay a fixed rate of return either at regular intervals or at the end of their term. While instruments issued by the government are almost risk free, there are various levels of risk, from very low to very high, in case of fixed income instruments issued by corporates.

Since debt funds invest in fixed income instruments which show lesser amount of volatility compared to equities over the long period of time, the returns from these funds are also relatively more predictable than equity funds. (See graphics below)

ILLUSTRATIONS: SACHIN VARADKAR

TYPES OF DEBT FUNDS

There are various types of debt schemes. The most popular ones are, according to the duration of instruments they predominantly invest in, are categorised as liquid funds, ultra short-term funds, short term bond funds, medium term bond funds and long term bond funds.

Liquid funds are those schemes in which investors can keep money which they would probably need within a month or two from investing. Usually there are no exit loads for investing in these schemes.

Ultra-short term funds: Investors who are looking to invest their surplus money for between two months and one year, and wants some better returns from bank FDs of similar durations, can look at these funds.

Short-term bond funds: Investors who have some surplus money to invest for between a year and three years should consider investing in these funds. If you can keep the money even for a day more than three years, you can enjoy even better post-tax return because in that case you can enjoy indexation benefits which will help you realise even higher post-tax return.

Medium-term bond funds: Investors who are looking to invest money for between three and five years should consider these funds. Returns from these funds qualify for indexation benefits, hence your post-tax returns will get an automatic boost.

Long-term bond funds: If you are looking to invest money for more than seven years and your are scared to take risks associated with stocks, then you should consider these funds. Here also you can boost your post-tax returns by taking advantage of indexation benefits.

POINTS TO REMEMBER

Like in every investment, while investing in debt funds one should remember a few points.

- **Mind the exit loads:** If you redeem your investments during the exit load period, your total returns will be reduced by that much.
- **Duration risk:** If you are investing in these funds for more than a year or so, in case the rate of interest in the economy rises, a part of your return may be negated by fall in market price of the debt instruments.
- **Credit risk:** A part of your returns may also suffer due to rating downgrade(s) of some of the bonds/papers in the portfolio of the scheme you have invested.

GURU SPEAK

The wisest rule in investment is: When others are selling, buy. When others are buying, sell. Usually, of course, we do the opposite. When everyone else is buying, we assume they know something we don't, so we buy. Then people start selling, panic sets in, and we sell too'

Jonathan Sacks
philosopher and religious scholar (from BrainyQuotes)

'Willingness to course correction is a big positive'

CASE STUDY **I am a single mother, 50 years old and have one daughter. My monthly net take home is Rs 1.75 lakh. I have a credit card outstanding of Rs 64,000 which I will pay off in two months, after which my total monthly expenses will be Rs 1.1 lakh. My current investments are worth about Rs 44 lakh and have a PF of about Rs 10 lakh. I have one family floater mediclaim of Rs 10 lakh and a life cover of about Rs 40 lakh. I have bought a flat for Rs 42 lakh on loan. I need to save for my daughter's higher education who wants to pursue fashion designing at one of the top 10 institute in Europe, but only if she gets scholarship and education loan. Retirement corpus required after 10 years is Rs 2.5 crore. Let me know how and where I should invest to maximise my savings.**

(Name withheld on request)

Your current state of investments and finances have a few risky areas...

- Your risk coverage is very low especially as you are a single parent,
- Your health coverage seems to be on the lower side in today's scenario,
- Revolving credit card payments, and
- No investments

...and a few positives:

- House
- Some liquid investments of about Rs 44 lakh, and
- The biggest plus you are open to course correction.

Steps to be taken:

Immediately pay off your credit card outstanding as credit card companies charge a compounded interest of around 2.5% per month which translates to an annual interest rate of above 35%. This is probably the costliest loan. If you have revolving credit then you don't get free credit period in your future purchases till you have cleared all dues.

For your daughter's education, my suggestion is to take education loan in the country where she studies as all the top institutes have tie-up with local lenders. Education loans are cheaper in USA and Europe with rates of around 2-3% per annum and in most cases no guarantor is needed. If needed, your current investments can be used to cover the incidental costs.

The critical part of your retirement plan is to start an SIP of around Rs 50,000-75,000 per month till you retire.

You will be able to save more because of two reasons: 1) Reduction of outflow after you clear your credit card dues, and 2) No expenses for your daughter's studies going forward.

I also suggest you take a term policy of about Rs 1.5 crore more and a critical illness policy of about Rs 50 lakh. At your age these should cost you around Rs 75, 000 per annum. Please take these policies online which will be cheaper and disclose all material information. This will cover your family of any eventuality. I believe taking these steps will ensure you meet your desired goals.

Sharad Tandon is chief financial planner at Invest At Ease Consultants

INDICATIVE RETIREMENT CORPUS YOU CAN CREATE FOR YOURSELF:

Value of SIP in 10 years

Indicative Yearly Return	8%	12%	15%	20%
Monthly SIP				
Rs 10,000	Rs 18.1 lakh	Rs 22.4 lakh	Rs 26.3 lakh	Rs 34.4 lakh
Rs 25,000	Rs 45.3 lakh	Rs 56 lakh	Rs 65.8 lakh	Rs 86.1 lakh
Rs 50,000	Rs 90.6 lakh	Rs 1.1 crore	Rs 1.3 crore	Rs 1.7 crore
Rs 1,00,000	Rs 1.8 crore	Rs 2.2 crore	Rs 2.6 crore	Rs 3.4 crore

INVESTOR QUERY

I AM A RETIRED PERSON BUT HAVE NO PENSION. MY DAUGHTER IS STUDYING WHO REQUIRES RS 2 LAKH PER ANNUM FOR TUITION AND HOSTEL. I HAVE RS 40 LAKH OF FIXED DEPOSITS IN BANKS. I WILL SELL A FLAT AND WILL GET RS 34 LAKH. WHERE SHALL I INVEST TO EARN MAXIMUM DIVIDENDS?

Umashankar Mukherjee, by email

Dhiraj Mittal and Sunit Jhamb replies

Subject to the assumption of no income and assets other than those listed in the query, you have a net worth of Rs 74 lakh to support the three non-negotiable financial goals: Daughter's education, her marriage and an independent retired life. The two critical pillars of your financial plan are maximising 'post tax returns' on investments and arriving at sustainable 'withdrawal rate' through your golden period.

From the sale proceed of the flat, invest Rs 6.60 lakh in the growth option of short term debt mutual funds. From this you can withdraw Rs 2 lakh a year for the next four years (assumed) for your daughter's education.

You can continue with your bank FDs. You could also invest up to Rs 1.5 lakh in ELSS schemes of mutual funds to save tax on the taxable bank interest. This will improve your post-tax returns from the bank FD.

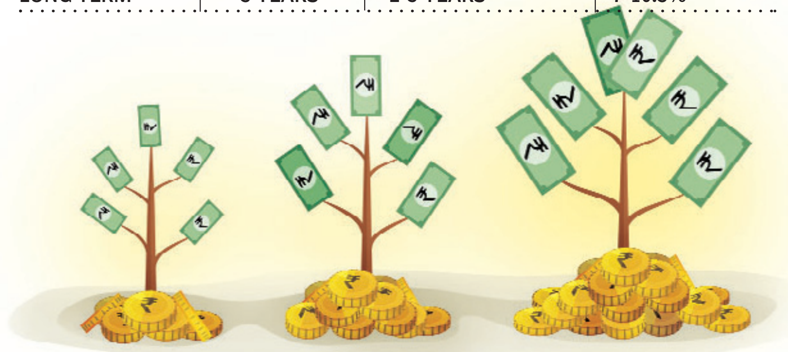
The remaining amount of the sale consideration of flat may be invested in pure debt accrual fund. If the bank interest isn't enough for your living expenses, the same may be met through monthly SWP (systematic withdrawal plan). These plans allow withdrawal of earnings at specific time intervals which may be at monthly intervals. A big advantage which investors can derive by opting for mutual fund SWP is that they are tax efficient. No tax is deducted on these withdrawals. Additionally the actual tax liability is also very minimal. These funds can deliver annual post-tax returns of over 8%. Though the investor may be able to earn better returns by investing in equities, given the limited corpus available to you and the financial goals, it is better you avoid that.

Dhiraj Mittal and Sunit Jhamb are with Prime Capital Services, New Delhi

DEBT FUNDS BY INVESTMENT DURATION & EXPECTED RETURNS

Here's a table that will help you decide what type of debt fund you should consider given your investment horizon

FUND CATEGORY	SUGGESTED INVESTMENT DURATION	CHANCE OF NEGATIVE RETURN (MAXIMUM PERIOD)	INDICATIVE RETURN (PER YEAR)
LIQUID	5 DAY – 2 MONTHS	2-3 DAYS	7-7.5%
ULTRA-SHORT TERM	2 MONTHS – 1 YEAR	3-4 WEEKS	8-8.5%
SHORT-TERM	1-3 YEARS	2-3 MONTHS	7-9.5%
MEDIUM-TERM	3-5 YEARS	< 1 YEAR	8-10%
LONG-TERM	> 5 YEARS	2-3 YEARS	7-10.5%



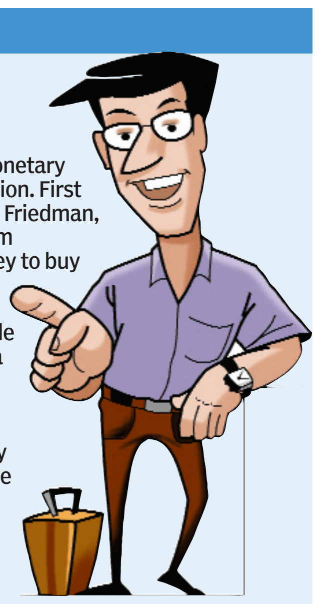
NEXT EDITION

In our next edition we will discuss about the common investing mistakes that investors make

DEMYSTIFIER

WHAT IS HELICOPTER MONEY IN MONETARY POLICY?

Swatantra Kumar explains: It's a hypothetical monetary policy tool that can get an economy out of recession. First ideated by Nobel prize winning economist Milton Friedman, it propose dropping money among the crowd from helicopters assuming people will spend the money to buy goods which will in turn help the economy emerge out of recession. In recent times, Ben Bernanke, a former US Federal Reserve chief made the term famous when he mentioned about it in a speech in early 2000s. Although Bernanke never used such a policy, he used the authority of the US central bank to print money to buy assets which eventually got the world's largest economy out of the 2008-2009 recession, the worst since the great depression of 1930. Of late several central bankers have also started mentioning about helicopter money, in reference to the current global economic slowdown.



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Mutual Fund investments are subject to market risks, read all scheme-related documents carefully