For MFs, income funds keep their lustre

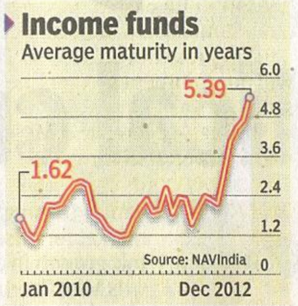
Average duration shoots to 3-year high, talk of a rate cut starts it all

Aswathy Varughese • MUMBAI

Funds with longer maturity like income and gilt funds are enjoying a cozy spot among managers. The talk of a likely reversal in interest rate cycle is believed to have sparked the trend.

Data from Credit Rating and Information Services of India (Crisil) say it all. The average maturity for this category – duration funds – rose to 8.40 years from 5.49 in the December quarter, the highest in the past 3 years. In contrast, for short-term funds, the average duration reads 1.79 years. Duration is the gauge of sensitivity of price of a fixed income instrument to changes in rates and expressed in years.

The asset under management (AUM) for income funds has been on a rising trajectory, the report added, which jumped a whopping 111% to ₹33,563 crore for the quarter to December compared with the previous period. The gain in AUM, to give you a perspective, is at a 2-year peak. Currently, the average 1-year return on income funds stands at 10.40% and the total inflows as of December are at ₹70,131 crore.



"Inflows to duration funds like income and gilt funds are on the rise in anticipation of a reduction in interest rates. Also, investors prefer to stay invested in such funds expecting long-term returns from such funds," said K Ramanathan, CIO, ING Investment Management.

With Reserve Bank of India's monetary policy review due on Tuesday, there is an overwhelming consensus among fund managers for a downward revision in the rate cycle, which many say would lead to long-term funds yielding better returns for investors. "We expect a 25 bps cut in key interest rates, which may come down by 100 bps this calender year," Ramanathan added.

Any action on the rate front sets off a chain reaction. In the event of a softer policy, price of bonds would rise, which would ultimately push up the net asset value (NAV) of long-term funds. These funds are a hit with investors because they are less risky and offer a steady source of income. But interest rates and liquidity risks could be the potential trouble spots for these investment instruments.

Fund managers are clear that investors with a long-term horizon can give this option a try. "When the overall interest rate is at a lower level and inflation in a comfortable zone, investors can opt for it, achieving long-term goals like retirement and so on. More inflows may be seen in this fund type as expectations of rate cuts are all built up. Redemption also seems to be less," said Dwijendra Srivastava, head-fixed income, Sundaram MF.