Falling rates may be a boon for fixed-income investors

Fixed-income investors are in a fix. The volatility in the money market is making their investment decision very tedious. Bank deposits, company deposits and tax-free bonds are offering higher yields, but many investors are unsure whether they should lock-in their money at current rates.

They also can't make up their mind about their debt mutual funds because of the volatility and uncertainties in the domestic economy.

"In the near term, yields are expected to remain volatile due to factors such as current account deficit, weakening rupee and liquidity tightness. However , over a period of one year, yields should be definitely lower compared to where they are today," says Joydeep Sen, senior vice-president — advisory desk, fixed income at BNP Paribas Wealth Management.

Think Long Term

Funds	Returns (%) One Month	Three Months	Six Months	One Year
Liquid	0.88	2.01	4.18	**8.37**
Ultra Short-term Bond	0.68	1.37	3.78	**7.95**
Short-term Bond	0.16	-1.06	2.17	**6.49**
Income	-0.59	-3.56	0.86	**6.1**
Short-term Gilt	0.47	0.41	3.58	**8.4**
Long-term Gilt	-1.55	-5.98	-0.77	**5.47**

Data as on August 30, 2013 Source: valueresearch

Many market participants subscribe to his view and believe the falling interest rates should reward investors in the long-term instruments if the investors have the time-frame of at least a couple of years.

"Investors should at least invest 40% of money now and the rest of the money can be invested later, as the yields may show a further spike, offering even better opportunity," says Deepak Panjwani, head — debt markets, GEPL Capital.

A Market like Never Before

Many seasoned fixed-income investors claim that they have never seen the bond market this volatile. Bond markets were quick to respond to the sudden drop in liquidity after the Reserve Bank of India came out with a series of measures to support the free-falling rupee. The 10-year benchmark government bond yield shot up to 9.24% on August 19 from 7.11% on May 24.

Even though the benchmark yield has come off the high, it still oscillates between 8.4% and 9%, which is adding to the confusion of investors.

"It is a discount sale going on in the fixed income market. But that does not mean you will make money investing in any instrument. If the volatility continues and you cannot digest marked-to-market losses, you stand to lose your capital," says a fund manager with a mutual fund, who doesn't want to be quoted.

However, an investor can't afford to run away from the market because of volatility . Nor can s/he afford to wait for the right yield to start investing. "Catching the bottom is not easy," says Alok Singh, chief investment officer — fixed income, BoIAXA Mutual Fund.

It makes sense to gradually enter the market, as yields are attractive. A point to note is that many savvy investors treat a yield of above 9% on benchmark bond as an attractive yield in Indian markets. "If your investment time frame is one year or less, stick to liquid funds, ultra short-term bond funds and fixed maturity plans. Long-term bond funds and income funds may remain volatile in the short term," says Alok Singh.

If you have a longer investment time frame, you may consider other products. Says Joydeep Sen: "Conservative investors should go for closed-ended products like fixed maturity plans. If you can digest some volatility, then shortterm bond funds look good. Long-term bond funds are for investors with a bigger appetite for volatility."

Check Tax-free Bonds

Tax-free bonds from some of the reputed government enterprises such as Rural Electrification Corporation (REC) and Power Finance Corporation (PFC) are about to tap the financial markets.

"REC tax-free bonds can be a very good investment option for investors from the high tax bracket," says Panjwani of GEPL Capital. For example, Rural Electrification Corporation offers 8.71% rate of interest on 15-year tax-free bond.

This is equal to pre-tax returns of 12.6% for an individual investor, who falls in the 30.9% tax bracket. This is an AAA-rated bond issued by a government-backed enterprise and you have the option to invest in 10-, 15-and 20-year bonds.

You take home an assured tax-free return and if the yields fall over the next one year, you can sell these bonds on the exchange and pocket long term capital gains, he adds. It is a win-win solution for investors who need some guaranteed return from their fixed income investments and still want to participate in the fall of yields as and when it happens.

Existing tax-free bonds quoting on the stock exchange are offering lower yield to maturity than the new bond, and hence, it makes sense to invest in the new bond issue than to buy the existing bonds in the secondary market. You may keep some money aside to invest in the forthcoming bonds. If you are in the lower-income tax bracket, you can also look at the ongoing AArated secured non-convertible debenture issue of SREI Infrastructure Finance.

The bond offers an annual coupon at the rate of 11.5% and 11.75% for three- and five-year term, respectively. Market participants expect bond issuance from other companies in the next couple of months offering similar returns from them.

You can also consider fixed deposits of reputed companies. Popular recommendations from advisors include AAA-rated fixed deposits from Mahindra and Mahindra Financial Services and Gruh Finance.

"Ongoing rates on these fixed deposits are attractive and it makes sense to lock in your money in fixed deposits now, as the rates may be lowered over the next couple of months," says Anup Bhaiya, MD of Money Honey Financial Services.

(Economic Times)