What investors should do: Make the most of debt opportunity

On Thursday, the Reserve Bank of India decided to sell Rs 22,000 crore of cash management bills every week to drain out liquidity from the system. Over the last one month RBI has implemented a series of liquidity tightening measures to address the decline in rupee against the dollar. While the impact it had is subject to debate, the measures have resulted in rise in interest rates and also a sharp decline in returns generated by debt funds over the one and three-month period. The returns for majority of debt funds for that period stand in the negative territory and the drop in returns saw investors pulling out a net of Rs 45,296 crore from liquid/money market products in July and a net of Rs 2,657 crore from income funds.

However, since the measures are not expected to last for long as has been communicated by RBI and a reversal in the stance is expected once rupee stabilises, while the medium to long-term debt investors should stay put with their investments and not press the panic button, those looking to make an entry should latch on the opportunity being offered by the spike in interest rates.

What should existing investors do?

As of now the the average one month return on medium to long-term gilt funds is (-)3.14 per cent and that for income fund and short-term income fund stands at (-)1.83 and (-) 0.99 per cent respectively. Even as the returns have turned negative, “Stay put unless you need the money in the short-term” advises, Surya Bhatia, a Delhi-based financial planner.

The losses are only mark to market losses as the rates went up after RBI implemented liquidity tightening measures resulting into money market moving up from 8.25 to 10.25 per cent and the long-term yields going up by 50-60 basis points. However, if the investors entered the market with 18-24 month perspective they will see their losses recover once the RBI stance reverses.

“If the interest rates don’t go up further and RBI withdraws its measures in a couple of months then the returns would recover and therefore you should remain invested rather than book losses unless you are overweight and took aggressive bets on debt,” said Vishal Dhawan, a Mumbai-based financial planner.

Mutual fund players agree that they have taken mark to market hit. “Mutual fund portfolio will take MTM hit because we are sitting on an invested portfolio and yields have gone up and our portfolios are MTM,” said Nand Kumar Surti, MD & CEO, JP Morgan AMC.

Should you invest now?

While RBI continues to take fresh steps to contain further depreciation in rupee there is uncertainty in the market on how the rates will move. Experts feel that in the medium term, rates should come down as high interest rate is not good for the economy and RBI too has stated that it will reverse its measures once rupee stabilises.

In such an environment with interest rates ruling high, investors can look to benefit from the high interest rate regime.

"As compared to a month ago, all fixed income products look attractive for investment and since the the short term rates are higher than the long term rates, investors can look to invest in short term income funds for good returns over the next one year," said Dhawan.

There are others who vouch for only longer term investment as the short-term remains uncertain on the kind of actions that RBI can take to contain rupee fall.

"There can be short-term pain and the environment looks uncertain but for 18-24 months it is a very good time to enter," said Bhatia.

July 15: RBI hiked short-term rates by raising Marginal Standing Facility rate by 200 bps to 10.25%, restricting the overall access by way of repos under LAF to Rs 75,000 crore and conducting open market sales of government securities of Rs 2500 crore on July 18

July 22: It rationalised import of gold by making it incumbent on all nominated banks/entities to ensure that at least one fifth of imported gold is exclusively made available for exports

July 23: The central bank modified the liquidity tightening measures by regulating access to LAF by way of repos at each individual bank level and restricting it to 0.5% of the bank's own NDTL

August 8: To bring stability in the currency market, the RBI decided to sell Rs 22,000 crore of Cash Management Bills every week to drain out liquidity from the system.

IMPACT: The rupee has failed to strengthen and continued to remain volatile despite various RBI measures. It plunged to an intra-day low of 61.80 earlier in the week and closed at an all-time closing low of 61.30 on Wednesday amid huge demand for dollar. The RBI has been selling dollars to prop up the rupee but the currency has remained weak.

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