MIRAE ASSET
Mutual Fund

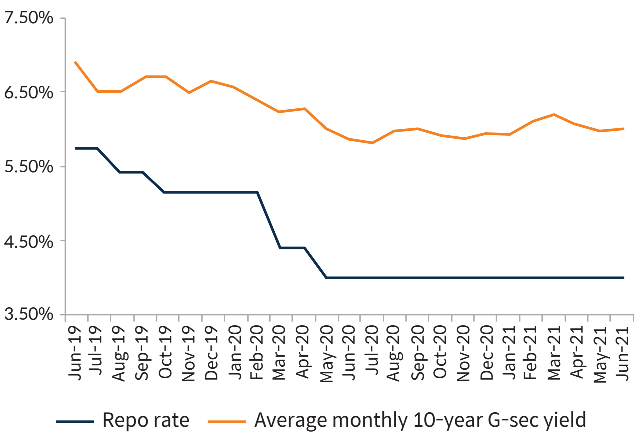
Low Duration Funds may shine despite low interest rates

Low Duration Funds are debt Mutual Fund Schemes which as per the SEBI categorisation circular should invest in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 6 months- 12 months.

Short maturity debt funds such as Low Duration Funds offered by domestic mutual funds have emerged as one of the go-to avenues even as the low-interest regime takes the sheen off traditional instruments and other short-term fund categories.

Interest rates have hit historic lows with the Reserve Bank of India (RBI) slashing policy rates to boost domestic economic growth amid the pandemic. The repo rate, the central bank's principal financing rate, has been at a record low of 4% for more than a year.

Interest rates on a downward trajectory



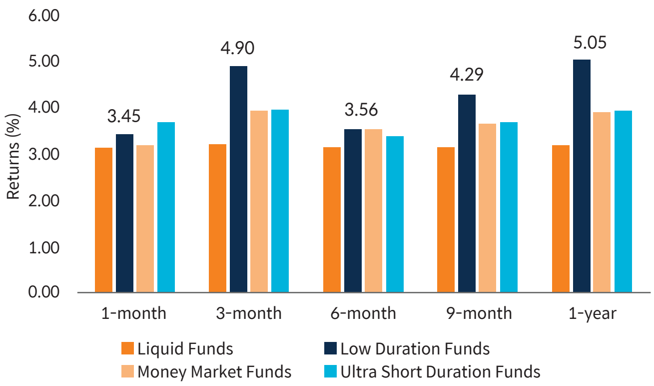
Source: RBI, CRISIL , as on 30th June 2021

The low policy rate regime has, in turn, beaten down interest rates in the economy. Interest rates on bank savings accounts, for one, are at less than 3%*.

Investors with short-term investment horizon can look at short maturity debt funds for investment purposes. Within the broad category of short maturity debt funds, categories such as Low Duration Funds have given as high as 5% return in some return periods.

*SBI interest rates for savings bank deposits

Performance of short maturity debt funds



Source: CRISIL Research

Annualised returns computed by weighted average index of underlying CRISIL-ranked funds of the respective category for the period ended June 18, 2021. Past Performance may or may not sustain in future. The returns shown are the average returns of the Mutual Fund category and does not in any way indicate the returns of a particular scheme of mutual fund.

Performance could pick up if interest rates rise

Short maturity debt funds such as Low Duration Funds tend to do well in times of rising interest rates. Our market phase analysis for the period January-December 2018 when interest rates (repo) were hiked by 50 bps corroborates this view.

Performance of the low duration fund during rising interest rates (January-December 2018)

Categories	1-month (%)	3-month (%)	6-month (%)	9-month (%)	1-year (%)
Low duration fund	9.47	8.81	7.63	6.91	7.06
Money market fund	8.95	6.56	6.60	6.66	6.84
Ultra short duration fund	8.06	8.16	7.25	6.97	7.07
Liquid fund	7.38	7.50	7.41	7.39	7.39

Annualised returns computed at the end of the interest rate rising period ended December 31, 2018.

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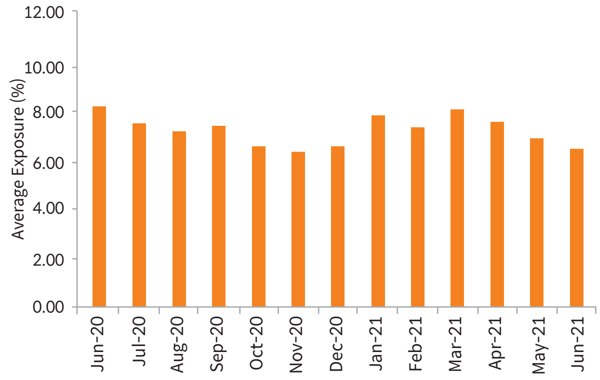
The recent surge in inflation on both the wholesale and retail levels amid supply-side disruptions in the wake of the Covid-19 crisis is fanning expectations of a possible change in stance by the RBI in the near future. On the global front, high inflation expectations have already come alive, with the US Federal Reserve indicating at least two rate hikes in 2023. These factors could bode well for short-term funds such as Low Duration Funds.

Factors to consider while picking Low Duration Funds

Ability to take higher risk

A low duration fund can invest in instruments across the credit rating spectrum, i.e., it does not face restrictions of investing in instruments of a particular rating. Hence, investors need to map the risk-return profile of the underlying securities with their own preference before investing.

Average exposure of lower-rated instruments in the Low Duration Fund



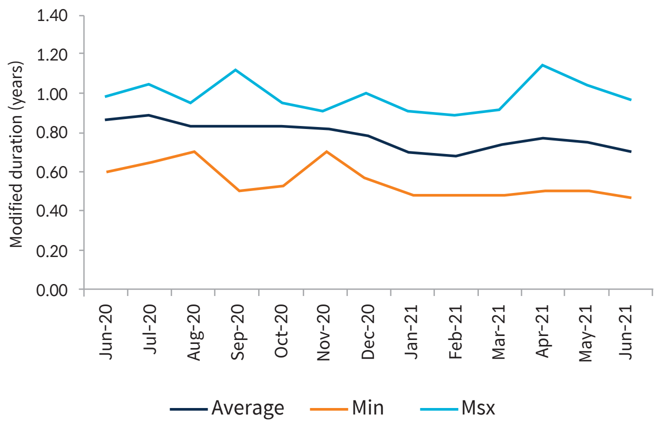
Note: CRISIL-ranked funds for the quarter ended March 2021 used for analysis. Portfolio as of June 2021. Lower-rated instruments include securities rated AA+ and below in case of long term, and A1 and below in case of short term

Source: CRISIL Research

Analysis of the funds' underlying maturity profiles

These fund categories invest in instruments with Macaulay Duration of 6-12 months. One should analyse the funds' underlying maturity profiles, especially check whether the funds are holding high maturity papers, before taking any investment decision. For instance, the low duration fund had an average modified duration of about 0.8 years, while its minimum and maximum duration was about 0.5 years and 1.15 years, respectively, for the one-year period ended May 2021.

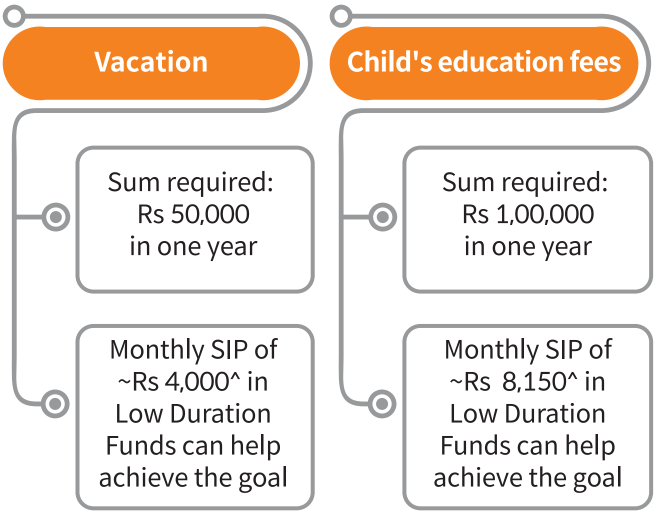
How modified duration of Low Duration Funds has trended



Source: CRISIL Research, as on 30th June 2021

Invest systematically

Low Duration Funds are an attractive investment option to achieve short-term (typically ranging from nine months to one year) financial goals/ needs such as paying for a child's education fees or funding a small vacation. As is the case with other mutual fund categories, disciplined investment, such as through Systematic Investment Plans (SIPs), is needed to realise these goals. The following illustration shows how.



For illustrative purpose only.
^1-year point-to-point return (5%) of Low Duration Funds used for the analysis

Summing Up

Low Duration Funds can be a value addition to investors' portfolio, especially to meet their short-term financial needs. Investors should conduct proper due diligence and consult their financial advisor before investing in these funds, in keeping with their risk appetite.

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An investor education initiative by Mirae Asset Mutual Fund.

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