Go for mix of short- and long-term debt funds to get optimal returns

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Fund managers and investment advisors suggest that debt investors hold a mix of short-term and long-term funds for their fixed income portfolio. Such a strategy will help them optimise returns and earn capital appreciation with the Reserve Bank of India expected to reduce rates by another half a percentage point later this year, after the quarter-percentage-point cut, the first in about five years, announced on Friday. Bond prices go up when interest rate falls.

"Investors could allocate two-thirds of their (debt) portfolios to short-term funds with the balance to long-tenure funds to take advantage of the falling rates," said Vishal Dhawan, founder of Plan Ahead Wealth Advisors.

Despite the RBI reducing the repo rate from 6.5% to 6.25%, bond yields did not react positively. The 10-year-benchmark moved up by 5 basis points to 6.70% as fund managers believe there were no incremental liquidity measures. Bond investors are also worried about the future trajectory of inflation and further rate cuts, on account of global uncertainties, an outflow of foreign investor money and a depreciating rupee, all of which cumulatively have complicated the RBI's task. Hence fund managers do not want investors to go all out and put their entire money in long-dated government securities.

"The RBI has cut rates in a bid to support growth and in anticipation of inflation coming down. However, with future outlook for inflation uncertain due to global factors and currency volatility, investors would do well to stay invested in short-term funds or money market funds," said Trust Mutual Fund CEO Sandeep Bagla.

Short-term funds or corporate bond funds, with a six-month to two-year maturity, could give investors a return of 7.25-7.50% over the next six months and provide a cushion of safety, in case the RBI does not cut rates further. However, aggressive investors looking to enhance returns on fixed income could make some allocation to Gilt funds, given that there could be two more rate cuts later this year.