

Money market funds outshine liquid & overnight funds in May. Time to rethink emergency fund strategy?

By Surbhi Khanna, Published on June 18, 2025



In May, mutual fund investors showed a shift in their preference within the short-term categories as liquid and overnight funds experienced net outflows whereas money market funds attracted fresh inflows.

According to the latest data by Association of Mutual Funds in India (AMFI), money market funds attracted the second highest inflows within 16-sub categories in debt mutual funds and attracted an inflow of Rs 11,223 crore in May.

On the other hand, liquid funds witnessed the largest outflows of Rs 40,205 crore and overnight funds saw an outflow of Rs 8,120 crore in the same period. An expert attributes this shift to strong macroeconomic environment and stability in repo rates as in the last policy meet, the apex bank did a 50 basis point cut in the repo rate and changed its stance from accommodative to neutral.

In the post-meeting conference the RBI governor clearly mentioned that the change in stance shows the RBI's approach of taking decisions based on the data that will come regarding growth and inflation and there was also a change in stance that indicated that we may well be currently at the end of the rate-cutting cycle, the expert said.

“Given the strong macroeconomic environment and stability in repo rates, going ahead, investors will focus more on high yields. Currently, the top Money market funds on average are providing 25 bps to 70 bps higher yields than liquid and overnight funds, respectively. Since these funds are categorized as park money for the short term, the higher yields provided by Money market funds make them more attractive,” Vishal Dhawan, CEO, Plan Ahead Wealth Advisors, a wealth management firm in Mumbai shared with ETMutualFunds.

Investors generally consider overnight and liquid funds as an option for parking idle savings outside the world of banking. For a savings account alternative, safety and liquidity must take priority over anything else and liquid funds and overnight funds come closest to satisfying these conditions.

In liquid and overnight funds, if an investor redeems money on a Friday, even as they will get their money on Monday, the net asset value (NAV) applicable will be of Sunday which is because in liquid and overnight funds, NAV is declared for every day, including holidays.

Now with the given flow, the important thing to know is should one review the emergency fund parked in liquid or overnight funds? In response to this, the expert firmly says that Yes, reviewing these funds on a periodic basis is necessary, given the changes in the macro environment and personal events of the investor as certain important factors like investors' cash flow, interest rate cycle, and short-term requirements are vital for reviewing these funds.

“If investors are expected to have a consistent cash inflow with no ultra short-term cash requirement and an overfunded emergency fund in a stable interest rate environment, they can tactically plan to change the allocation of funds from low-yielding liquid or overnight funds to money market funds. However, if their emergency funds are not funded enough, liquid or overnight funds are preferred,” Dhawan told ETMutualFunds.

RBI Governor in his policy statement mentioned that inflation has softened significantly over the last six months from above the tolerance band in October 2024 to well below the target with signs of a broad-based moderation.

“The near-term and medium-term outlook now gives us the confidence of not only a durable alignment of headline inflation with the target of 4 per cent, as exuded in the last meeting but also the belief that during the year, it is likely to undershoot the target at the margin,” the governor added.

Now with RBI estimating its inflation expectation for FY26 to be less than its target of 4%, the current interest rate cut and tax benefits provided in the union budget should support growth, unless there are some significant global events that slow growth or increase inflation, Dhawan said.

“Given, we may be at the end of the interest rate cut cycle, we can expect a stable interest rate environment going ahead. Money Market Funds do provide healthier yields than liquid and overnight funds at the current juncture. Hence, money market funds can be looked upon by investors who want to park excess funds for the short term, as they provide a good real return with lower credit risk,” Dhawan advised the investors.

And with such category level shifts in inflows and outflows, reviewing debt fund allocation between once a quarter and half year should be good enough for investors, Dhawan further added.

According to the Sebi mandate, overnight funds invest in overnight securities having maturity of one day and liquid funds invest in debt and money market securities with maturity of upto 91 days only. On the other hand, money market funds invest in money market instruments having maturity up to one year.

One should always invest based on their risk appetite, investment horizon, and goals.