



'Debt likely to outperform equity in 2011'

After burning their fingers in the 2008 crisis, the risk aversion among Indian investors continues to be high, due to which they are choosy. Lower rated corporates may offer higher rates in commercial papers (CPs), but investors would rather be safe than sorry.

Murthy Nagarajan, head of fixed income, Tata Mutual Fund tells **Neelasri Barman** in an interview what investors look for in debt funds. Excerpts:

You have a wide variety of debt funds under Tata Mutual Fund. Which are the most preferred by retail investors? What is your retail portion?

Due to tight liquidity and continuous rate hikes, by the Reserve Bank of India (RBI) to control inflationary pressure, interest rates in the short end of the yield curve have hardened by 250 to 300 basis points (bps). Issuers do not want to lock in at higher rates for a longer period of time, as they expect the inflation trajectory over a one year period to come down going forward. The yield curve has become flat to inverted, with the short-end rates higher than the long-end rates, as issuers are continuously borrowing in the

short end.

As the short-end rates are attractive, fixed maturity plans (FMPs) are attracting a lot of interest from retail investors. Besides that, the Tata Liquid and Tata Floater Fund are two other popular funds with retail investors. In FMPs, we get around 30-35% investment from retail investors. Monthly Income Fund is predominantly retail and in our liquid fund, 10-15% is from retail investors. Retail investors are showing appetite for products that have higher debt portion and limited exposure to equity markets.

What will the scenario be after March, because many are of the view that by then short-term rates will peak out?

The spread between the government securities and certificate of deposits/commercial paper is around 200 to 250 bps. This spread could come down to 150 bps as liquidity improves in the system due to government spending next year. The debt markets would be two contrasting developments, with the government securities yields moving up, but the short-end yields moving down, as liquidity comes back into the system due to increased government spending.

Our view is that over a one-year time frame, returns in equity and debt may remain the same. In fact, there are chances that debt may outperform equity in 2011, because the corporate profitability will get affected due to high interest rates and consumption demand would slow down their purchases. FMP, as a category, could outperform equity. If the economy is expected to grow around 8% level, de-

mand for money would be strong. The chances of ten-year gilt yields coming below 7.75% levels, looks difficult. Returns over one year to two years in duration products should be more of accrual and less of capital appreciation. Investors investing in short-term bonds would get good accrual income and some capital appreciation over a one year time frame, as the short-term rates come down.

Monday Interview

Murthy Nagarajan

What are your expectations from the budget on the government's borrowing programme front?

Next fiscal's borrowing programme will impact you in two ways. Firstly, from April onwards every week you may have gilts auction close to ₹15,000 crore and yields will go up. But because the borrowing programme will be huge, the RBI will not keep the liquidity so tight, due to which banks' borrowings, under liquidity adjustment facility (LAF), will come down.

The revenue of the government is also not robust in the first quarter of the financial year; the government will start spending, due to which there will be inflows. Due to this, the short-term yields will come down, but your long-term rates will move up.

Due to the frontloading of the government borrowing programme, yields will move up, even though there are expectations of inflation coming

Lower rated corporates give higher rates in CPs. But those corporates' financial ratios would come under pressure due to high interest rates and commodity prices. There is a risk associated with investing in their papers. Investors also prefer CDs over CPs. In CPs, they prefer only long term 'AAA' or AA+ rated papers

down due to base effects. The ten year should trade in the band of 8.50-9% levels in the first half of next year, and subsequently trade in the band of 8.25-8.75 in the second half of the year.

What is your outlook on the 10-year gilt yield? And the impact on gilt funds?

It will be hovering in the range of 8.5-9% in FY12, because every week there will be gilt auctions close to ₹15,000 crore. The impact on gilt funds will not be good and that is why we are not recommending gilt funds. We are running a significant portion in cash right now and we would continue even in next fiscal. We are currently carrying 35-40% in cash.

Firms are struggling with their working capital requirements as short-term rates are very high. According to experts, these rates are high because the supply is in plenty, but the demand for the same is lagging? Are fund houses not buying these papers?

That is correct. The migration of risk is going to the banking sector. Mutual funds are investing more into certificate of deposits (CDs) as they are liquid. The credit quality of these banks is high due to government holding and strict norms prescribed by the RBI.

The lower rated corporates give higher rates in CPs. But those corporates' financial ratios would come under pressure due to high interest rates and commodity prices. There is a risk associated with investing in their papers.

Investors also prefer CDs over CPs. In CPs, investors prefer only companies having long term 'AAA' or AA+ rated papers or which belong to reputed groups. Investors are choosy when they are investing in a fund which has lower rated papers. The risk aversion among investors is very high, because investors do not want to end up in the same situation like 2008.

Returns over one year to two years in duration products should be more of accrual and less of capital appreciation. Investors investing in short-term bonds would get good accrual income and some capital appreciation over a one year time frame, as the short-term rates come down