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FUND RADAR

A distant target

Having tasted success with target-maturity funds, fund houses are launching their longer-duration versions. Should you invest in them?

Spurred by the success of five-to seven-year target-maturity funds, AMC's are introducing even longer-duration target-maturity funds. Take for instance Edelweiss Mutual Fund, which launched the country's first such fund with a 15-year maturity this September. SBI and Mirae Asset have been similarly nimble, rolling out target-maturity funds that will mature in 2036 and 2033, respectively. Last heard, HDFC is set to float a target-maturity fund maturing in 2051, while IDFC's will last until 2062 to "give Indian investors a long-term fixed-income option...(and) milestone-based savings like retirement", as per Sirshendu Basu, Head - Products, IDFC AMC. Both these AMC's have filed offer documents with SEBI.

But the question is: will longer-duration target-maturity funds be a good addition to our portfolio?

The rise of target-maturity funds

Let's first understand why investors are in love with target-maturity funds. Since target-maturity funds – a type of passive debt mutual fund – buy and hold bonds with a similar maturity period, they offer higher predictability of returns. So, you can expect a specific rate of return on this investment if you hold the fund till the end.

The charm of these funds also lies in their safety, as they typically invest in higher-rated debt instruments such as AAA rated securities, government bonds and high-quality

papers of top-rated PSUs. Given their relative predictability and security, it's not surprising that target-maturity funds are making waves and giving bank FDs a run for their money – a trend confirmed by Anand Vardarajan, Business Head – Banking, Alternate Products & Product Strategy, Tata Asset Management. He also compared target-maturity funds with fixed-maturity plans, "They (target-maturity funds) offer liquidity as they are open-ended in nature," which means investors have the flexibility to buy and sell these at any given point.

The risks of longer-duration target-maturity funds

That target-maturity funds are open-end can be a double-edged sword. It's true these funds have a higher predictability of returns but only if you stay invested until maturity. On the other hand, if you decide to withdraw before time, you may face the wrath of interest-rate risk. For instance, if you plan to exit a target-maturity fund prematurely when interest rates are climbing, you can incur mark-to-market losses. That's because, in a rising-rate environment, the freshly issued bonds offer higher

yields, making the existing bonds (the ones you are planning to sell) unattractive and difficult to sell.

Reinvestment risk is real too. Sandeep Yadav, Head - Fixed Income at DSP Investment Managers, explains clearly. "If interest rates are lower, the reinvestment will also happen at lower rates, impacting the net return of the investor. Conversely, if the rates increase, reinvestment will happen at higher rates, but then investors will have some knocks on the net asset value (NAV)."

Liquidity is another problem, as buying and selling bonds is not very common in India, and even high-quality papers are not immune. Since even relatively shorter-duration bonds face liquidity risks, think of the debt instruments bought by target-maturity funds that will mature in 15–30 years.

What should you do?

Value Research has held a favourable view of target-maturity funds in the four- to six-year range, which have a pre-tax yield of 7.22 per cent.

However, longer-duration target-maturity funds are a different meat altogether. We believe if you have a 15- to 30-year investment window, it makes sense to invest a certain portion of your money in equities. This holds true for the most conservative investors, as equities have historically outperformed debt in the long run. ☒

