

Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	64
Circulation:	195,000		

1

MUTUAL FUNDS • **FIXED INCOME**

KEEP
IT
FIXED

IN RECENT YEARS, FPIs HAVE MADE A
BEELINE FOR DEBT FUNDS. WILL THE
FUNDS CONTINUE TO OUTPERFORM ONCE
THE CURRENT VOLATILITY EBBS?

BY **PRINCE TYAGI**

ILLUSTRATION BY **NILANJAN DAS**

Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	65
Circulation:	195,000		



Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	66
Circulation:	195,000		



1

66 |

THE RECENT CORRECTION in the Indian markets has led many mutual fund investors to take cover in safer, fixed-income instruments as they look to tide over the storm. This comes even as the sharp ups and downs in equity and debt markets have spooked foreign portfolio investors (FPIs), who have shifted between risk-on and risk-off sentiment.

Debt funds, which primarily invest in fixed-income securities like government and corporate bonds, offer investors stable returns with lower risk than investments in equity-oriented funds. Though not as popular as equity-oriented funds, they have seen a huge shift in flows in the financial year 2024-25 (FY25), compared with FY24.

Data from the Association of Mutual Funds in India (AMFI) shows that while debt funds saw net outflows of ₹23,097 crore in FY24, the trend has reversed so far in FY25 with an impressive net inflow of ₹3.41 lakh crore inflow till February 2025.

Apart from the correction and the shift to safer investment avenues, this has also been aided by the inclusion of the Indian government's bonds on the JP Morgan Emerging Markets Bond Index Global.

BETTER THAN EQUITY

The performances of Indian equity and debt mutual funds in the three months and one year to March 11 stand in stark contrast.

Data available from Value Research shows that the equity funds saw a steep decline of 14.76% in average returns in the three months to March 11, whereas debt funds delivered an average return of 1.54%. The sharpest drop among equity funds was seen in the small-cap

MUTUAL FUNDS • FIXED INCOME

category, whose returns fell by 21.41%, followed by mid-cap, which fell 18.04%. In contrast, debt funds provided consistent short-term returns, with the Debt: Others category providing 3.36%, followed by credit risk at 2.74%. The Debt: Others category includes fund of funds (FoF) of debt ETFs, and debt arbitrage funds, among others.

In the year to March 11, debt funds outperformed equity funds with average returns of 7.53% compared to equity's modest 0.27%. Here, too, the Debt: Others category gave the highest annual return at 9.79%.

VOLATILE INFLOWS

A significant factor that has shaped recent market movement is the wild fluctuation in foreign portfolio investment (FPI) flows to India over the last few years.

FPIs invested ₹1.01 lakh crore in Indian equities in 2019, per National Securities Depository Limited (NSDL) data, indicating confidence in the country's growth story. The following year, investments surged to ₹1.7 lakh crore, despite a major outflow from Indian debt instruments like government and corporate bonds. Then, in 2021, there was a sharp decline in inflows to ₹25,752 crore, suggesting growing caution.

By 2022, FPIs turned net sellers in Indian equities, pulling out ₹1.21 lakh crore, due to global uncertainties such as rising inflation and geopolitical risks. In 2023, optimism returned, leading to a strong rebound with inflows of ₹1.71 lakh crore. By the next year, the looming global uncertainty became clear as net FPI inflows were a paltry ₹427 crore. That has turned to a full-blown pullback by FPIs so far this financial year as they have withdrawn ₹1.35 lakh crore.

While equity investments saw extreme fluctuations, investments in debt instruments have shown a clear upward trend in recent years after initial jitters. In 2019, FPIs invested ₹25,882 crore in the Indian debt markets. In 2020, there was a major outflow of ₹79,648 crore. The following two years, 2021 and 2022, witnessed minor net flows of ₹22,527 crore and an outflow of ₹12,120 crore, respectively.

A significant shift occurred in 2023, with a strong return to debt markets, as FPIs invested ₹60,214 crore. The trend continued in 2024, which saw the highest-ever surge, with FPIs pouring in ₹1.53 lakh crore. That momentum has continued into 2025, with inflows of ₹28,331 crore so far.

Devang Shah, Head of Fixed Income at Axis Mutual Fund, attributes the surge in debt investments in 2024 to India's inclusion in the JP Morgan Global Bond Index. While FPI flows have also driven bond yields lower, "This has definitely benefited debt funds as long

Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	67
Circulation:	195,000		

GAINING MOMENTUM



While FY24 recorded ₹23,097 crore in net outflows, in FY25 (till Feb 2025), debt funds have seen an impressive ₹3.41 lakh crore inflow

In addition to liquid funds, money market funds and overnight funds have also performed well in FY25, attracting ₹87,883 crore and ₹25,020 crore, respectively

In debt mutual funds, tax is payable on redemption, whereas in FDs, tax is levied annually on accrued interest

Historically, a falling rupee has led to tighter monetary policies, negatively impacting debt funds

If the repo rate falls further by 100 basis points, long-duration funds are expected to generate substantial returns

67

duration bond yields have rallied due to FPI flows,” he notes.

REBOUND OF DEBT FUNDS

The Indian debt mutual fund space has seen a striking reversal in FY25.

The shift highlights growing investor confidence in debt instruments, particularly amid expectations of further rate cuts by the Reserve Bank of India since that could push up yields.

Among debt funds, it is the liquid funds that have emerged as the biggest gainers, with inflows of ₹1.71 lakh crore in FY25. Money market funds and overnight funds have also performed well, attracting ₹87,883 crore and ₹25,020 crore, respectively. Corporate bond funds saw inflows of ₹14,987 crore, while gilt funds, which provide exposure to government securities, saw net inflows of ₹11,190 crore. One notable trend is that short- and medium-duration funds have benefited the most from the expectations of rate

14.76
PER CENT
THE RATE OF DECLINE
IN AVERAGE RETURNS
OF EQUITY FUNDS
IN THE THREE
MONTHS TO MARCH 11

21.41
PER CENT
DROP IN THE SMALL-
CAP CATEGORY OF
EQUITY FUNDS IN THE
THREE MONTHS TO
MARCH 11

cuts, while banking and PSU funds, credit risk funds, and floater funds have continued to see outflows.

RATE OUTLOOK

Interest rate movements have a direct impact on debt fund performance. A bond’s coupon rate (interest rate offered by bonds) is fixed at the time it is issued. If interest rates fall below the bond’s coupon rate, then it becomes more attractive as it provides a higher return than the prevalent market rate. That then increases demand for such bonds and pushes up their prices. Conversely, when interest rates rise, these bonds become unattractive, and their prices fall because of lower demand.

A similar dynamic plays out for fixed-income funds as well. When interest rates rise, and the prices of fixed-income securities fall, there is a commensurate dip in net asset value (NAV) of fixed-income funds that hold the debt securities

Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	68
Circulation:	195,000		

MUTUAL FUNDS • FIXED INCOME

in their portfolio. Conversely, when interest rates fall and prices of fixed-income securities rise, there is an increase in the NAVs of fixed-income funds, providing investors with positive returns. However longer-duration bonds are more sensitive to interest rate changes than shorter-duration bonds.

So, if the RBI cuts the repo rate by 100 basis points in the next one or two years, long-duration funds can generate substantial returns. Shah of Axis Mutual Fund says recent moves by the RBI have helped debt funds. "Since January, the RBI has taken various steps to inject durable banking liquidity along with the rate cut of 25 basis points in Monetary Policy Committee meeting in February." These moves have stabilised rates at the short end and led to a rally in long bond yields by 5-10 bps, which have had a positive impact on debt funds on a mark-to-market basis. Shah expects

the repo rate to be cut by a further 25-50 bps in the next three to six months and additional liquidity measures this calendar year.

Others too expect further cuts by the central bank. With India's GDP growth slowing and inflation aligning closer to the RBI's 4% target, there is room for another 50 bps of rate cuts, believes Kaustubh Gupta, Co-Head of Fixed Income at Aditya Birla Sun Life AMC. The upshot for fixed income investors is potentially good returns. According to Anurag Mittal, Head of Fixed Income at UTI AMC, "A repo rate cut of 100 bps or higher may lead to some capital gains in long duration funds as they are regulatorily required to maintain a minimum Macaulay duration of seven years." These funds are ideal for investors with a long-term horizon who want to capitalise on the interest rate environment, he explains. The Macaulay duration is the time required to fully repay the initial investment of a bond through the internal cash flows.

Murthy Nagarajan, Head of Fixed Income at Tata Asset Management, notes that liquidity infusion by the RBI has helped stabilise market conditions, although the overall stance remains neutral. "We expect further rate cuts in 2025, which may take the ten-year yields into the 6.25 to 6.50% band in the current calendar year", Nagarajan added. The longer end, which is bonds with a duration of five years or more, has already rallied, with the 10-year sovereign yield dropping from 7.2% in January 2024 to 6.7% now. The short to medium-duration segment, that is durations up to five years, looks attractively valued and should benefit from easing rates and improving liquidity.

"Hence, short-term and corporate bond funds are likely to perform better in the current rate cycle," says Mittal. Most central banks cut rates in 2024 and are expected to continue to do so this year. "Despite the volatility marked by early days of US President Donald Trump's tenure, bond yields have eased in the US and in most major markets," says Kaustubh Gupta, Co-Head of Fixed Income at Aditya Birla Sun Life AMC.

RUPEE IMPACT

Another factor influencing debt markets is the depreciation of the Indian rupee over the past six months, triggered by the uncertain global environment. Shah of Axis says a falling rupee has historically led to a tighter monetary policy, negatively impacting bond markets. "However, in 2024, the rupee depreciated by 3-4% compared to other emerging market currencies that fell by 8-10%," Shah says.

Mittal of UTI AMC explains that the rupee depreciated primarily because it was playing "catch up" as

1

68 |



DEVANG SHAH
HEAD—FIXED INCOME,
AXIS MUTUAL FUND

"This (India's inclusion in the JP Morgan Global Bond Index) has definitely benefited debt funds as long duration bond yields have rallied due to FPI flows"



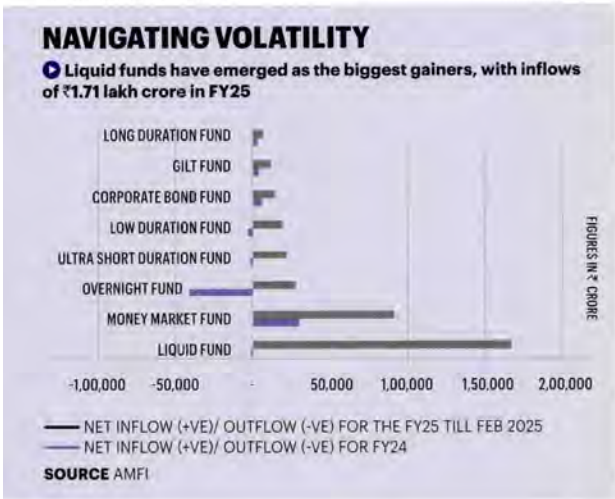
KAUSTUBH GUPTA
CO-HEAD, FIXED INCOME, ADITYA BIRLA SUN LIFE AMC

"Despite the volatility marked by early days of US President Donald Trump's tenure, bond yields have eased in the US and in most major markets"

Published Date:	13 Apr 2025	Publication:	Business Today [National]
Journalist:	Prince Tyagi	Page No:	69
Circulation:	195,000		



1



it did not depreciate despite FPI outflows between October and December 2024, thanks to the RBI's intervention. Besides, the current depreciation is because of the dollar's strengthening. "However, any knee-jerk and significant tariff announcements on China may have an impact on Asian currencies and central banks may want to go slow in times of elevated uncertainty," Mittal says.

TAX ADVANTAGES

Debt funds also come with tax advantages. They are taxed at marginal tax rates, but unlike fixed deposits (FDs), tax is not deducted at source on accumulated capital until it is redeemed, while in FDs tax is deducted based on accrued income. "The benefit is to the extent of tax planning for the individual, as tax is levied at the time of redemption in the fund and no TDS is collected yearly on capital accumulation which is not redeemed. However, TDS is levied on dividend income," notes Nagarajan. Meanwhile, Budget 2025 has introduced tax reforms that favour the salaried, exempting individuals earning up to ₹12 lakh from income tax. This has made debt funds an even more attractive investment option.

The deferred taxation allows investors to manage their tax liabilities more efficiently. Comparing debt mutual funds with equities, Gupta of Aditya Birla Sun Life AMC points out that in the new tax regime, debt mutual funds will get a full tax rebate if the income is less than ₹12 lakh (₹12.75 lakh including standard deduction). "This rebate will not be available in equity investments."

69

DEBT EDGE

Fund managers believe that debt funds will continue to provide stable returns this year, too. With the potential for additional rate cuts and improving liquidity conditions, short-term and corporate bond funds remain the top picks. The potential inclusion of India in indices like Bloomberg's Global Aggregator Index could bring more foreign investment into India's debt market.

Nagarajan of Tata AMC advises investors to focus on duration products like corporate bond funds and short-term bond funds amid expectations of another rate cut. Debt funds also prove attractive alternatives to FDs.

If interest rates continue their downward journey, long-duration debt funds could prove to be a shrewd bet. BT

@PrinceInMedia