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Fund picks for short-term parking

RISK & REWARD. Overnight, liquid, money market, short-term & arbitrage funds offer bank FD alternatives for up to 3 years

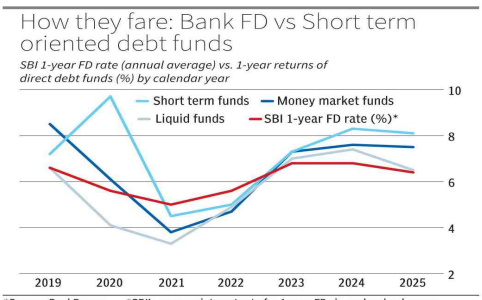
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For investors looking to park money for a few months to three years, debt mutual funds offer alternatives to bank fixed deposits (FDs), with potentially greater liquidity and flexibility, but their returns are market-linked and carry some risk. Bank FDs remain the default choice for Indian savers because they offer certainty of returns and capital stability. Debt funds may suit investors willing to accept some fluctuations in value in pursuit of potentially better returns.

Unlike bank deposits, mutual fund returns are not guaranteed as their performance is influenced by interest rates, portfolio maturity and credit quality. The suitability of a debt fund depends on an investor's time horizon and ability to tolerate fluctuations in value. Investors need to assess the risk-return trade-off of each category while investing.



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*Source: BankBazaar *SBI's average interest rate for 1-year FDs in each calendar year
2026 is excluded as the comparison requires full-year 1-year returns for funds, although SBI's 1-year FD rate for 2026 is available

How selected funds compare

Scheme Name	Category	Based on 1-year rolling return* Maximum	Minimum	Average	YTM (%)	Base expense ratio (%)
Aditya Birla SL Liquid	Liquid	7.5	3.3	5.7	6.6	0.21
SBI Liquid		7.4	3.2	5.6	6.5	0.20
HDFC Liquid		7.4	3.2	5.6	6.5	0.20
Nippon India Ultra Short to Short Term	Ultra Short to Short Term	8.9	3.9	6.7	7.5	0.28
Kotak Ultra Short to Short Term		9.5	3.4	6.8	7.5	0.41
HDFC Ultra Short to Short Term		9.2	3.5	6.8	7.4	0.46
Tata Money Market	Money Market	8.6	3.7	6.5	6.9	0.18
DSP Money Market		8.1	3.0	6.0	7.1	0.18
Aditya Birla SL Money Market		8.5	3.6	6.4	7.0	0.22
PGIM India Overnight	Overnight Fund	6.8	3.1	5.1	5.4	0.16
Edelweiss Overnight		6.8	3.1	5.1	5.3	0.11
Axis Overnight		6.8	3.0	5.2	5.3	0.09
SBI Short Term	Short Term	10.7	2.7	6.7	7.6	0.35
ICICI Pru Short Term		12.0	3.0	7.6	7.7	0.45
Nippon India Short Term		10.9	2.8	7.2	7.6	0.39
Tata Arbitrage	Arbitrage Fund	8.8	3.8	6.4	7.0	1.71
Aditya Birla SL Arbitrage		8.7	3.5	6.2	6.9	1.25
Edelweiss Arbitrage		8.9	3.5	6.4	6.6	1.76

Direct plans are considered *Rolling returns were calculated from the last seven years NAV history Return value as of Sep 3, 2026 Source: ACEMF

HOW THEY COMPARE

The biggest advantage of an FD is certainty: investors know the interest rate upfront, and returns remain unaffected if the deposit is held to maturity. Debt funds work differently, with their NAV fluctuating with the market value of underlying securities. Interest-rate movements, credit quality and market conditions can affect returns.

FD investors are insulated from falling rates once they lock in a deposit, but may miss out when rates rise unless they break the existing FD and reinvest. Debt funds, by contrast, can gain or lose from rate movements depending on their maturity profile and the direction of rates.

Liquidity is another key difference. Premature FD withdrawals may involve a penalty. Debt funds generally allow redemption on business days, though exit loads can reduce proceeds, particularly over shorter holding periods. Exit loads range from nil to 1 per cent. Some overnight and liquid funds also offer an instant redemption facility.

RISK

FDs remain superior for investors who cannot tolerate fluctuations in value. Deposits with scheduled banks offer a high degree of safety and are protected by deposit insurance of up to ₹5 lakh per depositor, per bank. Debt funds carry varying degrees of interest-rate and credit risk.

Overnight funds are among the safest, as their securities mature in a day, leaving virtually no interest-rate risk. Liquid and money market funds are also relatively low-risk, while medium- and long-term funds carry higher volatility because of their longer maturity profiles.

TAXATION

Debt mutual funds purchased on or after April 1, 2023, no longer enjoy the earlier long-term capital gains benefit or indexation, with gains generally taxed at the investor's slab rate. The key difference is when tax is paid: FD interest is taxable as it accrues, whether withdrawn or reinvested, whereas debt-fund gains are taxed when units are redeemed.

SHORT-TERM OPTIONS

Here, we explain MF categories suited to investors looking to park money for a shorter tenure. Relevant categories include overnight, liquid, money market, ultra-short to short-term funds, short-term and arbitrage funds. Each differs in maturity, interest-rate sensitivity, credit risk, liquidity and return potential.

One simple way to choose a debt fund is to match your investment horizon with its maturity and duration profile. For instance, money market funds, which invest in debt and money-market instruments maturing within a year, may suit investors with a similar horizon.

You can also consider the scheme's yield-to-maturity (YTM), which indicates the yield of its current portfolio if the securities are held to maturity. Comparing the YTM with prevailing bank FD rates for a similar tenure can help assess relative attractiveness. YTM is not a guaranteed return and should be considered alongside the fund's expense ratio, duration and credit quality. For 1-3-year deposits below ₹3 crore, HDFC Bank offers 6.45 per cent to the general public, while SBI offers 6.4-6.45 per cent.

LIQUID & OVERNIGHT FUNDS

Overnight funds are suitable for parking money for a few days to months, while liquid funds may be preferred for investment horizons of up to around a year. Many of them offer instant redemption, allowing withdrawal of up to ₹50,000 or 90 per cent of the folio value, whichever is lower, with the money credited through IMPS.

Liquid funds invest in short-term money-market instruments such as treasury bills, commercial papers and certificates of deposit maturing within 91 days. Their returns broadly track short-term interest rates. Based on one-year rolling returns of direct plans over the past seven years, the category delivered an average 5.7 per cent.

Overnight funds invest in securities maturing in a day, making them subject to very low interest-rate risk and relatively low credit risk. Over the past seven years, direct plans delivered an average one-year rolling return of 5.4 per cent. As of July 2026, portfolio YTM ranged from 5.6 per cent to 6.6 per cent for liquid funds and 4.9 per cent to 5.4 per cent for overnight funds. Overnight funds have no exit load, while liquid funds charge an exit load if redeemed within the first six days.

MONEY MARKET FUNDS

Money market funds invest in high-quality money-market instruments, including treasury bills, commercial papers and certificates of deposit, with maturities of up to one year.

One-year rolling returns of direct plans over the past five years averaged 6.6 per cent. Exit loads are generally nil, according to ACEMF data. As of July 2026, portfolio YTM ranged from 6.4 per cent to 7.1 per cent.

ULTRA-SHORT TO SHORT-TERM FUNDS

Ultra-short to short-term funds, formerly low-duration funds, invest in instruments with a Macaulay duration of six to 12 months and may suit investors with a 12-18-month horizon. Macaulay duration, simply put, indicates the average time taken to recover the money invested.

They invest across corporate bonds, government securities and money-market instruments. One-year rolling returns of direct plans over the past seven years averaged 6.7 per cent, with individual schemes ranging from 2.5 per cent to 9.5 per cent. Exit loads are generally nil, according to ACEMF data. Investors should closely monitor portfolio quality as some funds also invest a smaller portion in non-AAA rated papers. As of July 2026, portfolio YTM ranged from 6.6 per cent to 7.5 per cent.

SHORT-TERM FUNDS

Short-term funds invest in debt securities with Macaulay duration of one to three years and are suitable for a horizon of around three years. They seek to balance higher yields than liquid categories with lower interest-rate risk than long-term funds. Their shorter maturity profile limits volatility from changing interest rates, while portfolio turnover allows managers to gradually reinvest in higher-yielding securities when rates rise.

Fund managers can invest a portion in AA-rated debt, making portfolio quality important. One-year rolling returns of direct plans over the past seven years averaged 6.9 per cent. As of July 2026, portfolio YTM ranged from 6.3 per cent to 7.8 per cent.

ARBITRAGE FUNDS

Arbitrage funds, a hybrid category, exploit price differences between cash and futures markets by buying stocks and simultaneously selling futures, locking in the spread. As positions are hedged, directional equity risk is limited, while returns depend on arbitrage spreads and short-term interest rates.

With over 65 per cent equity exposure through hedged positions, they are taxed as equity funds; gains held for more than a year qualify for long-term capital gains taxation. One-year rolling returns averaged 6.4 per cent, though returns can vary as spreads compress. They can suit investors looking to park money for around 12 months.