Debt Mutual Funds

Prelims: Indian Economy| Current events of national and international importance

Why in news?

RBI has recently started a rate-cutting cycle and FD rates declining, which makes investors shifting to debt funds.

- **Debt Mutual Funds** – Investment funds that pool money to buy **fixed-income securities** like government bonds, corporate bonds, treasury bills, etc.
- **Regulated by** – Securities and Exchange Board of India (SEBI).
- **Lower risk** – It generates steady returns with lower risk compared to equities.
- It is popular among risk-averse investors and those looking for diversification.
- **Categories of Debt Funds as per SEBI,**
    - Liquid Funds
    - Ultra-Short Duration Funds
    - Short Duration Funds
    - Gilt Funds
    - Dynamic Bond Funds
    - Credit Risk Funds

Significance of Debt Mutual Funds

- **Stable returns** – It offers more predictable and stable returns compared to equity funds.
- **Diversification for investors –** They provide an opportunity to diversify portfolios, balancing risk especially for conservative investors or those nearing financial goals.
- **Better tax efficiency** – Debt funds that held for more than 3 years can enjoy indexation benefits, reducing the tax liability compared to fixed deposits.
- **Liquidity –** Most debt mutual funds offer higher liquidity than traditional fixed deposits, allowing investors to redeem investments partially or fully.
- **Relationship with interest rates** – The debt fund performance is closely tied to the Monetary Policy stance of the RBI's Monetary Policy Committee (MPC) and is in inverse relationship with interest rates that means,
- When interest rates fall, bond prices rise and Debt fund returns increase.
- When interest rates rise, bond prices fall and Debt fund returns decline.
- **Reason** – Existing bonds offer higher fixed returns than newly issued bonds during falling interest rates, making them more attractive.
- During rising interest rates, new bonds offer better yields, reducing demand and price for existing bonds.

Reference

[The Hindu| Debt Mutual Funds]