



Why Debt Funds Might Be Right For You

Mutual funds offer products to meet any life goal based on your risk appetite. Risk-averse investors have the option to invest in Debt Funds, which carry relatively low risk.

Know your Debt Funds

While there are 16 categories of Debt Funds, here are a few broad categories based on the degree of risk:



Overnight Funds invest in overnight securities having a maturity of 1 day. They carry the lowest risk.



Gilt Funds invest in government bonds. They carry relatively low credit risk but carry interest rate risk.



Corporate Bond Funds invest in AA+ and above rated corporate bonds. They carry credit risk.



Credit Risk Funds predominantly invest in AA and below rated corporate bonds. They carry a high degree of risk.

Advantages



Liquidity:

Investments can be redeemed any time in open end debt funds.



Returns:

Can yield higher returns as compared to traditional investments.



Diversification:

Exposure to less risky instruments protects the downside risk in your portfolio during adverse movements in equity markets.



Retirement:

Can be used to get regular income through Systematic Withdrawal Plan (SWP) during retirement.

Things to know before you invest

- Match your investment horizon with average maturity of the fund.
- Compare the expense ratio and quality of the portfolio.
- Check fund manager experience and fund house pedigree.
- Understand Interest Rate Risk, Liquidity Risk and Credit Risk.



Types of risk

Investing in Debt Funds is not completely risk-free. Here are a few risks involved in Debt Funds:



- Interest rate risk arises due to changes in interest rates. Bond prices and interest rates have an inverse relationship. Rise in rates results in fall in bond prices and vice-versa.
- Credit risk arises in case of a financial crisis in any of the companies whose bonds the debt fund has invested in because this makes the payment of interest and principal due on these bonds extremely uncertain.
- Liquidity risk arises in case of debt securities that are not frequently traded and hence the fund may be forced to sell these securities in its portfolio at a loss under unfavourable circumstances.

To sum up, debt mutual funds act as portfolio diversifier and are ideal to save for short term goals.