

# RBI status quo, likely dampener for long-duration fund investors

**WRONG CALL.** Advisors sold long-duration funds to investors anticipating a fall in interest rates

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The likelihood of the Reserve Bank of India (RBI) holding rates steady for much of this fiscal could be a dampener for investors in long-duration funds. Distributors and advisors sold long-duration funds to investors in the past year anticipating a fall in interest rates.

Fund managers — many of whom have increased the duration of their debt funds in the past few months — have also been caught on the wrong foot. For example, several medium-duration funds of three-four years are running at four years; medium-to-long duration funds of four-seven years are closer to seven years and so on.

"It's difficult to time the entry into such funds," said Dhaval Kapadia, Director, Head, Products, Ambit Wealth. "The growth-inflation dynamics is such that it may not warrant a rate cut in

the near future by the RBI."

Duration funds that include long-duration funds, gilt funds and medium-to-long duration funds have seen inflows of over ₹8,000 crore in FY24 and have returned anywhere between 6.25 per cent and 7.7 per cent in the past year.

## ACCRUAL YIELDS

"The yields have not reversed meaningfully. And to that extent, investors have not taken a big hit on their portfolios. Many fund managers are still sitting on fairly long-duration and maturities," said Kapadia. "The kicker that investors were expecting from interest rates coming down, however, has been delayed."

Bond prices and interest rates move inversely. The amount of appreciation and capital gains is the highest with longer-duration securities.

Let's say an investor is investing for one year in a long-duration bond fund that has

## Performance of debt categories

	FY24 flows (₹ cr)	One-year return (%)
Corporate bond	5,758	6.64
Gilt	3,729	6.59
Long duration	2,996	7.70
Medium to long duration	798	6.25
Gilt with 10-yr constant duration	621	6.85
Dynamic bond	-146	6.49
Medium duration	-3,091	6.48

Source: Value Research/primemfdatabase.com

a duration of seven years, giving a yield of 7 per cent. If the yield rises 20 bps during this period, the returns will reduce by 1.4 per cent (20 bps \* 7 years) to 5.6 per cent, assuming there is no retracement of yields.

"We always maintained that rates cuts would happen in the second half of 2024. We do not know the quantum, but when the first rate cut happens the market will discount a series of rate cuts. That itself may result in higher capital gains than the expectations built in at that point in time," said

Dwijendra Srivastava, Chief Investment Officer - Fixed Income, Sundaram Mutual Fund.

Srivastava believes that investors with a long-term horizon who do not want to time the market and are okay with duration volatility can stay invested. That's because the accrual yield at 7-7.15 per cent is still decent from a long-term perspective. Investors who came in, may be a year ago and want to exit within three-five months, may face a challenge if there's a *status quo* on rate cuts. These investors, he

said, may not get the benefit of capital appreciation.

## GOING FORWARD

"With policy rates remaining incrementally stable, we remain long duration across our portfolios. The path of fiscal consolidation, demand-supply dynamics in G-secs, and expectations of falling interest rates in the US, Europe and in India make an interesting theme for a long-duration stance for investors," Axis MF said in a note this month.

In March, Bandhan MF launched its long-duration fund with a portfolio duration of beyond seven years. The long duration of the fund may result in higher volatility than other debt funds, it said.

Morgan Stanley analysts said this week that the RBI is unlikely to lower interest rates in the ongoing financial year, given India's robust economic growth and changes in the US Federal Reserve's policy direction.