

Liquid Funds - Way Forward

Current Market Scenario

Over the last few months various events have kept the fixed income markets volatile. Moreover covid-19 coupled with Franklin debt crisis have compelled RBI to cut rates aggressively, while keeping liquidity abundant in the banking system. All of the above factors have put downward pressure on the short term rates. Short term rates are trading below the repo rate (as seen in the graph).



Regulatory Changes

Effective 20th October 2019 - Liquid funds are subject to graded exit load

Effective 30th June 2020 - Liquid funds shall hold at least 20% of its net assets in liquid assets -

YTM ↓ Returns ↓

Amortization based valuation shall be dispensed with irrespective of residual maturity i.e 100% MTM - Hence Volatility ↑

Effective 1st July 2020 - Stamp duty applicable on all securities. When an investor buys MF units, he/ she will be charged on the buy leg of the transaction - Returns ↓

Investment Recommendations

As a consequence, it is recommended that investors in liquid fund have a horizon aligned with maturity profile of the fund. Moreover, investors with longer investment horizon are recommended to make investment in following categories of Mutual Fund schemes having high credit quality -

- Money Market Funds - 2 to 4 Months
- Ultra Short Duration Funds - 4 to 6 Months
- Low Duration Funds - 6 to 12 Months

Investors with horizon between 1 and 3 years can also look at Corporate Bond and PSU Banking Funds.

