Retail participation in Fixed Income through mutual funds–Past, Present, Future

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Retail follows where the advice is. That's no proverb. But it certainly has truth in it. There has long been a trend that equities were retail dominated while fixed income was largely driven by institutional investor class. For that reason, the mutual fund product, services and communications were addressed with this specific pre-conceived notion in mind while designing that strategy. But that is changing. Rapidly!

Three major events were the triggering factors for this change in retail investors' behaviour - the 2008 market fall; the 2013 QE3 tantrum; and the post demonetisation effect. The 2008 market fall and global crisis saw policy makers slash rates drastically. This led to a major rally in the duration based funds and the early leg of informed retail investors switched into this asset class at that time. 2013 QE3 market tantrum saw the yields spike suddenly and that time too the market opened up to the opportunistic retail buyers. This was also the time that credit funds started attracting investor attention.

But the rally in duration in 2016, especially post demonetisation saw three things happen. First, the inflow of idle cash into the banking system saw the decline in interest rates. At the same time, the forced reset saw a portion of savings move into the mutual funds. And at that, the need for relative stability in yields saw the retail segment begin to view the fixed income funds with a longer term horizon.

There were nearly 3.75 lakh retail folios which were predominantly investing in debt and liquid funds. Most of these investments were obtained primarily from T30 (top 30 location) distributors. It is evident that the retail participation is led primarily by distributors' confidence in mutual funds. This confidence needs to be continuously built and strengthened.

Interest amongst retail investors about fixed income funds is also rising majorly due to the investor awareness campaign being run by AMFI and the mutual fund industry. For a perspective, the cumulative effect and word of mouth strategy will see a compounding growth as the popularity spreads amongst the masses. We are of the view that as the penetration and the financial literacy expands, retail interest in debt MF too will rise.

Natural grain of Indian investing pattern is towards fixed income. The high penetration of traditional fixed income products with the retail segment is a testimony to that. Investors for long have been accruing sub-optimal post-tax 'real returns' (net of inflation). Low levels of financial literacy, financial awareness and very low risk appetite were the key reasons for such investing behaviour during this period.

Mutual funds are changing that. It is a real and tangible alternative to traditional investments. The mutual funds product suite is relevant to almost all kinds of fixed income investors. An investor with an appetite to make a possibly higher return over a savings account can look at it (via-liquid, money market funds).Or an investor seeking to develop a corpus without much volatility too can approach fixed income market (through credit risk funds). Not just that, an investor with an acumen for riding the rate cycle can also look at making reasonable capital gains from time to time through durations funds. One key point to note here is that no mutual fund can assure returns! Return generation is a function of the underlying securities and of course the interest rate movement in the economy.

Then of course there are many funds for unique investor requirements. So we have a low duration fund for investors seeking very low interest risk exposure but with a desire for a slightly higher liquid plus return. Then there are funds for such investors who don't want duration risk. Or for those who don't want a high credit risk. The point is, mutual funds can provide an all-enveloping possibility, provided the investor is aware of his/her requirements.

In the current market, the credit risk fund strategy is attracting higher attention. It is because such portfolios typically are high on yields and lower on duration risk. There is a reason for this rising appetite for such credit risk/corporate bond funds. Firstly, the high crude oil prices and high rising inflation are posing a risk to the growth in the near term. To mitigate that, the RBI has started to hike interest rates. Already a 25 bps hike has been made. An additional 25 bps hike seems possible in the next few months. Thus the duration funds, despite offering value at the current juncture, could remain volatile and may be still off the stability seeking retail investors' radar.

Going forward, as the penetration and financial awareness rises, the nature of fixed income products too will change. We may see FMPs (fixed maturity plans) gain traction with the marginal investors and savers. We

may see that the liquid and money market funds may increasingly be a part of a monthly investing strategy of the regular urban investor.

The fixed income segment of mutual funds may have to develop unique investment products with varying features to cater to the rural/semi urban clientele. The distribution strategy will need to be adopted accordingly. Not just that, there are many segments within the urban pockets that are beyond the pale of formal investing network. This segment too can find growth possibilities in money market and short duration product categories.

In summation, the retail participation in the fixed income mutual funds is expected to rise. While the equities will be the primary point of attraction with a growth bias in mind, debt funds too will play a catch up game in the investors' asset allocation. But the mutual funds have a long way to go before there is any rest. In our country of over 130 crore people, there are nearly 75 crore bank accounts. There are around 35 crore people with insurance policies. There are nearly 29 crore PAN card holders but unique mutual fund investors are only around 1.6 crore. This needs to change!