HAPPY DAYS ARE HERE AGAIN!

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The Reserve Bank of India (RBI) over the last six months has revised repo rate from 4% to 6.25%, i.e. by 225 bps. This step has brought tremendous relief to investors who wished to invest in traditional fixed income options like fixed deposit as deposit rates got revised higher to 7% and higher from the prevailing 5% and higher which existed for the last two years. Similarly, when it comes to debt mutual funds, the yields which were hovering at 4-4.5% has now improved to 6% and higher per annum depending on the duration of the product. Among the various offerings in debt mutual fund landscape, the current yield structure has made products like the Target Maturity Fund (TMF) very attractive.

What is a Target Maturity Fund?

TMF are passive debt funds benchmarked against the underlying bond index having a fixed maturity date. TMF invests into Government Bonds, State Development Loans or PSU Bonds which are either sovereign or quasi-sovereign in nature. The typical yield of these bonds currently is in range of 7.25% to 7.50% thus offering a chance to lock in returns at higher yields.

As indicated by the nomenclature, target maturity funds come with a pre-decided maturity date, making it easier for you to choose funds which align with your investment horizon. Target maturity funds can be of two types – exchange-traded funds and index funds. They can be a great option for you to earn high, tax-efficient returns, in a relatively safe manner, because they invest only in instruments which are either sovereign or quasi-sovereign in nature.

What makes TMF attractive is that once an investor locks in an investment at a certain interest rate, the investor can sit back and relax as target maturity funds are not affected by interest rate volatility.

Why invest in Target Maturity Fund?

The salient features of TMF are enumerated below:

TMF is an ideal investment product for investors who are in the 20% + tax bracket and looking to invest for a period of 3-5 yrs period and earn risk free returns.

SALIENT FEATURES		
PARTICULARS	**FIXED DEPOSIT**	**CRISIL GILT/SDL INDEX FUND**
UNDERLINE ASSETS	18 lakhs	34.6 lakhs
RISK	24 lakhs	59 lakhs
TENURE	20 lakhs	95 lakhs
LIQUIDITY	Liquid. Premature penalty applicable.	Liquid. One-day withdrawal. Mark To Market loss possible.
INTEREST RATE RISK	No	Yes. Mark To Market possible in short duration, if held till maturity, target return will be achieved.
INDEXATION BENEFIT	No	No

Tax Advantage

A distinct advantage when it comes to TMF is taxation. Long Term Capital Gain in debt funds are taxed at flat 20% post indexation, if an investor remains invested for a minimum of three years. Thus, an investor can earn virtually risk free return of 7% p.a. which post tax will be approximately 6.5% returns if an investor remains invested till the maturity of the scheme.

Should You Choose Target Maturity Fund?

Given these strong positives, it is worth considering these funds as long as your investment horizon is medium to long-term in nature. Such an offering typically tends to deliver better returns over the long term, given the twin benefits of high interest rate and compounding which will play out over the years. Furthermore, since the portfolio comprises of papers of sovereign and quasi-sovereign debt papers (high credit rating), the presence of TMF can help your portfolio offset the volatility it faces from equity market. Diversification is the name of the game when it comes to ensuring optimal returns and, thanks to its high interest bearing yet safe nature, TMF could make for an exceptional addition to your basket of securities. Furthermore, these are low-cost products as it is passive in nature.

Lastly, target maturity funds can also be a suitable way for debt allocation in your journey to create your nest egg. Your retirement fund needs to be both safe and capable of earning robust returns and TMF is an offering which has these attributes. So, act now and lock-in high returns while the timing is perfect.