VIEWPOINT

Investors should capitalise on volatility

Debt mutual funds are ideal in a phase of declining interest rates

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A FLURRY of key policy initiatives announced by the Indian government recently has been favourable for the Indian economy. With fiscal consolidation becoming imperative, steps such as the hike in diesel price, allowing FDI in retail and aviation and disinvestment in state-owned companies were crucial decisions taken by the government. With this hike, the risk of a credit rating downgrade is mitigated. The biggest positive is in the fact that RBI now has the headroom to reduce interest rates gradually. Also, the pick-up in monsoons added to the market sentiment. Additionally, the US Federal Reserve has also announced its quantitative easing measures. All these factors will help provide the much-needed fillip to the economy.

On the Indian equity market front, sentiments have been significantly boosted by progressive government action. This is clearly reflecting in the recent market rally. With the recent rally, investors ponder over if it is the right time to invest and seek to time the market. In the bargain there is a loss of opportunity. Also, domestic retail investors have been completely underweight in bequities in the last four years.

However, inspite of the rally, the markets continue to be at fair value. There further exists a dichotomy of valuations whereby there are stocks that are trading at very high valuations and vice-versa, across sectors and market caps. With valuations being fair and fundamentals better than earlier, equity continues to hold value. Further, the volatility in equity markets that has become the new norm provides investment opportunities for investors. In such a scenario of volatility, investing in mutual fund through a systematic approach helps to capitalise on volatility and is ideal than direct investments into equity markets. The current scenario of volatility therefore brings along an opportunity to benefit from products that are structured with the intent to benefit from volatility. In a range-bound market, volatility provides opportunity as has been the case over the last few years. Investors today have the platform and opportunity to capitalise in this trend of expected volatility by investing in relevant funds. Today there are products like flexi cap dynamic fund that are structured to tide volatility.

While equity continues to be an important asset class requiring continued participation by retail investors, debt mutual fund also holds tremendous potential. However, even after several years of introduction and innovation, investing in fixed income mutual fund products is largely a bastion of institutional investors in India. Retail investor participation in this asset class through mutual funds is negligible given its potential. This is counter-intuitive considering the vast amount of savings that the Indian investors have in bank fixed deposits. From an asset allocation perspective, investors should also invest in debt mutual funds. This is vital to ensuring that even if one asset class languishes the other can add value to the investor's portfolio. In the current context with interest rates headed downwards, we continue to believe that the one-three year space in the short end of the yield curve is attractive in terms of risk-adjusted returns. Retail investors should therefore invest in funds like the short-term and retail-focused regular savings funds.

Finally India is a structural growth story with favourable demographics, strong domestic consumption and strong balance sheets across banks and corporates. As the Indian economy is not leveraged there is no risk of credit bubble to impair its long-term growth potential as against Europe and other emerging economies like China.

However, there exist challenges like the infrastructure bottleneck. The fast growth of the country's economy in recent years has placed increasing stress on its physical infrastructure such as electricity, railways, roads, ports, airports, irrigation, urban and rural water supply and sanitation. However, the positive is in the fact that the government recognises the fact that sustained core infrastructure investment will fuel growth in all spheres of the economy. With government biting the bullet on reforms and setting the stage for the next echelon of growth, India is poised on the right track.

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