How to Choose Right Debt Fund for Your Portfolio?

Pallavi had her first child at the age of 30 and wanted to set up a safe investment for her daughter, Ananya. This investment would come in handy when Ananya turned 18 and decided on her career path. With the asset in hand, she would be able to choose education abroad, if she so desired. With this aim in mind, Pallavi began considering the best investment options for her requirements. Accordingly, she found herself thinking of investing in mutual funds and started wondering how to choose debt funds. She zeroed in on debt funds because of the stable returns offered by the asset, in addition to its comparatively safe nature. This was the exact combination she was looking for – an investment avenue that would not put her principal at risk, while still giving her returns higher than bank fixed deposits. Additionally, she would also be able to invest through systematic investment plans, without stressing out her finances.

Different types of debt funds

While considering the best debt fund for her child, Pallavi went through all her options. She found that debt funds could be categorised according to their duration, as well as their composition. If she wanted a debt fund for short-term investment, she could consider a liquid mutual fund or a short-term debt fund with a maturity of upto three years. Alternatively, she could also invest in medium and long term funds ranging from 5 to 10 years in duration. In terms of composition, Pallavi could choose from sovereign bond funds, which invested in safe government bonds and offered stable returns, or corporate bond funds, which parked their corpus in bonds issued by companies. If she chose a fund investing in corporate bonds rated AA or lower, she would stand to earn higher returns but, since she wanted a relatively safe option, she decided to go with a AAA rated bond fund with a duration of 10 years. She would then reinvest the corpus in another fund, for the next eight years, ensuring that the money would be available when Ananya was ready for college.

Choosing the right fund

As we saw from Pallavi's example, you should choose the fund which is just right for you. To understand which debt fund would offer you the best outcome, you should consider your personal investment profile in detail. Assess aspects such as your risk appetite, return requirements, financial goals and time horizon. For instance, if you need a debt fund to invest your emergency money in, then you should pick a liquid fund as you can redeem your units at any time. Separately, if you have a long-term goal, like Pallavi, you can invest in funds with a maturity of seven years or more. You can also pick from sovereign bond or corporate bond funds, according to your risk appetite. Finally, you can also choose how you want to invest – through lumpsum or SIP. If you have a certain amount of money saved up, you can go for a lumpsum investment. Otherwise, you can invest regularly and enjoy the benefits of compounding through the SIP route.

Factors to consider

The first factor you should consider is the historical performance of the fund house and the debt scheme of your preference. Once you are sure about these aspects, take a look at the fine print and understand the expense ratio you will be required to pay. This shows you how much money you are paying the fund house, for managing your investment. Also pay attention to the credit quality of the assets your scheme invests in, to ensure that you are not caught unawares at a later date.

Now that you know how to choose debt funds, all you have to do is start your journey and enjoy stable returns.

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