



What are Gilt Funds – Meaning, Features, Risk & Returns

Introduction

If you are looking for low-risk mutual funds that can offer you benefits like growth, diversification, etc., you have plenty of room for choice. There are 16 types of debt funds as per the Securities and Exchange Board of India (SEBI) guidelines on the categorisation and rationalisation of schemes. Out of these, gilt funds can be ideal for conservative investors looking for a safe and reliable way to invest money. In this article, let's take a closer look at what gilt funds are, how they work, and the potential benefits of investing in them.

What are gilt funds, and how do they work?

Gilt funds are mutual funds that invest primarily in government securities (G-secs) or bonds, which are considered to be very low risk. They are open-ended schemes and do not invest in corporate bonds.

To understand how gilt funds work, it is essential to know that when the Government of India needs money, it borrows money from the Reserve Bank of India (RBI). The RBI further borrows money from other entities such as insurance companies and banks. In return, the RBI issues G-secs with fixed tenures. Gilt funds subscribe to these securities. At maturity, the gilt fund returns the G-secs and gets money in return.

There are two types of gilt funds. The first, known as gilt funds, invest at least 80% of their total assets in government securities. The second type, known as gilt funds with a ten-year constant maturity, invest 80% of their total assets in G-secs for ten years.

Now that you know a bit about gilt funds, find out the benefits of investing in them

Benefits of investing in gilt funds

- **Stable returns:** Gilt funds have the potential to provide steady returns when interest rates are low.
- **Opportunity to invest in G-secs:** Gilt funds offer exposure to G-secs that is not possible otherwise. You can invest in G-secs through these funds and diversify your portfolio.
- **Low risk:** G-secs carry minimal credit risk as they are backed by the government. As a result, the gilt funds carry low risk.

Gilt funds offer many benefits. However, when investing in them, several essential factors must be considered so that you can make an informed investment decision.

Things to consider when investing in gilt funds

- **Interest rates:** As gilt funds primarily invest in G-secs, they are sensitive to interest rates. When interest rates rise, the value of the bonds held by the fund falls, which can lead to a decline in the fund's NAV. On the other hand, when interest rates fall, the fund's NAV rises.
- **Expense ratio:** Gilt mutual funds charge an expense ratio to cover their operational expenses. It is important to compare the expense ratios of different gilt funds because they may differ across funds.
- **Investment horizon:** Gilt funds are typically recommended for investors with a medium- to long-term investment horizon.
- **Taxation:** Profits from gilt funds are subjected to long- and short-term capital gains tax depending on their holding period. Gains from funds held for more than three years are taxed at 20% plus indexation, whereas gains from funds held for less than three years are added to your taxable income and taxed accordingly.

Note: Indexation adjusts the cost of an asset for inflation to reflect its actual value over time. This lowers the tax liability as you pay tax on the gains you make after adjusting your investment cost for inflation.

Conclusion

Being a type of debt mutual fund, gilt funds can be suitable for conservative investors looking for low-risk investments that offer stable returns. You can also consider other low-risk options like passive debt funds, long-duration funds, etc. Just remember to understand the pros and cons of all options and research well before picking a fund.