

MUTUAL FUNDS

Understanding the rise of hybrid funds in India

When Ashish spoke to his cousin about building an investment portfolio offering robust yet comparatively safe returns, he was advised to consider hybrid funds as a first-time investor. While the mutual fund industry offers a variety of investment avenues, from debt fund to balanced arbitrage funds and equity fund, the advice to invest in a hybrid fund was based on recent happenings, which have propelled hybrid funds to the forefront of the mutual funds investment arena.

In the financial year 2023-24, hybrid funds experienced a remarkable turnaround, witnessing a net inflow of INR 1.45 trillion, a stark comparison to the net outflow of INR 18,813 crore recorded in FY23. This surge in interest was coupled with a notable increase in the investor base, which expanded by 1.4 million, reaching 13.5 million folios by March 2024. Let us evaluate the factors that contributed to this resurgence, and consider the appropriateness of the advice given to Ashish by his financially savvy cousin.

The substantial inflow into hybrid funds propelled the category's assets under management (AUM) to INR 7.2 trillion by March 2024, marking a significant 51% increase from FY23. This surge contributed to the mutual fund industry's overall growth, with the AUM reaching a record high of INR 53.40 trillion by March 2024, reflecting a positive trajectory for the industry as a whole.

Assessing hybrid funds

Hybrid funds represent a blend of investments in equity and debt, sometimes including other assets like gold. Positioned to strike a balance between potential growth from equities and stability from debt instruments, hybrid funds cater to investors with moderate risk tolerance. This segment encompasses seven types of mutual fund categories, with a total of 149 hybrid mutual fund schemes. Among the most popular are dynamic asset allocation, arbitrage funds, and a combined category of balanced and aggressive hybrid funds.

Why are hybrid funds resurging?

Several factors have fuelled the resurgence of hybrid funds, beginning with the change in debt fund taxation. The alteration in tax rules for debt funds implemented in April 2023 played a pivotal role—with the elimination of indexation benefits for debt funds held beyond three years, investors sought alternative avenues, finding hybrid funds increasingly appealing. Further, investors anticipated a potential decline in interest rates in FY24, leading them to explore hybrid funds to capitalise on potentially higher bond yields. Although rate cuts are yet to materialise as expected, the attractiveness of hybrid funds has persisted due to sustained high bond yields. Separately, hybrid funds, which are helmed by experienced fund managers, offer diversification across asset classes, thereby providing a hedge against market volatility. This diversification strategy resonates with investors like Ashish, who are seeking a

balanced approach to growth and stability.

Are hybrid funds right for you?

According to market experts, hybrid funds present an all-encompassing solution for investors, eliminating the need to invest in multiple funds. Once tax-saving requirements are fulfilled, selecting a suitable subtype of hybrid fund and initiating a systematic investment plan (SIP) can streamline the investment process. By committing to a well-suited hybrid fund and adhering to an SIP over the long term, investors can mitigate unnecessary complexity and focus on building resilient and growth-oriented portfolios.

Which hybrid funds should you choose?

The surge in inflows into hybrid funds was particularly notable in certain categories, as mentioned here –

- Arbitrage category: A significant portion of the inflow, amounting to INR 90,846 crore, was directed towards arbitrage funds, which capitalise on short-term profit opportunities through arbitrage strategies.
- Multi-asset allocation: Investments totalling INR 33,000 crore were observed in multi-asset allocation funds, emphasising investors' interest in diversified portfolios.
- Balanced advantage and equity savings funds: Notable inflows were also recorded in balanced advantage and equity savings funds, indicating a preference for strategies that balance risk and return.

The resurgence of hybrid funds underscores investors' growing appetite for balanced investment products that offer a blend of growth potential and stability. With factors such as changes in debt fund taxation, anticipation of interest rate reversal, and the benefits of diversification driving investor interest, hybrid funds have emerged as a compelling option for investors seeking to navigate volatile market conditions and build resilient portfolios. By understanding the unique value proposition of hybrid funds and adopting a disciplined investment approach, investors can harness the benefits of asset allocation and capitalise on the opportunities presented by this dynamic investment category. While Ashish is certain that hybrid funds are his best bet in the current investment atmosphere, will you also be adding these assets to your portfolio in the ongoing financial year, given the potential for robust returns?