EDELWEISS MUTUAL FUND

# What are target maturity funds?

American author and journalist Ron Chernow once said, “Mutual funds have historically offered safety and diversification. And they spare you the responsibility of picking individual stocks.” The quote does not merely apply to stocks but also to debt market instruments such as bonds and state development loans. The saying is exceptionally true in India, a land filled with multiple growth opportunities and people keen on grabbing these opportunities with open hands. If you are keen on starting your investing journey with mutual funds, and have heard of different types of mutual funds, then you should take a look at target maturity funds and understand how they work to offer you strong returns on investment.

**What are target maturity funds?**

If you are wondering what the term target maturity fund means, here is the answer. The term refers to passive debt funds which track the underlying benchmark bond index. In this manner, they are quite similar to passive index funds, which invest in stocks listed on different exchanges. While there are many open ended mutual fund schemes, target maturity mutual funds always come with a built-in maturity date. So, if you have invested in a target maturity fund, then you will automatically receive your principal amount and the accrued interest, at the end of the maturity period. Given their passive nature, target maturity funds can belong to two categories – exchange traded funds and index funds. Now, let us understand how these funds work and why you should consider including them in your portfolio.

**How do target maturity funds work?**

According to the regulations of the Securities and Exchange Board of India, target maturity funds can only invest in government bonds, SDLs, and PSU bonds which mirror the pre-decided bond index. This is one reason why target maturity funds are exceptionally safe – all these debt assets enjoy sovereign or quasi-sovereign status and, therefore, have superlative credit quality. These funds purchase and hold the above-mentioned bonds till maturity and roll it down as the years pass. Therefore, a year after the purchase of a 5-year PSU bond, its maturity will get rolled down to 4. This momentum helps lower the interest rate risk of the bonds in the fund's portfolio while also offering optimal yield or return on investment, making target maturity funds a suitable option for risk-averse investors. Further, such funds tend to perform well in the current high interest rate environment, making them a great opportunity for you. You can also enjoy the benefit of compounding if you choose the SIP investment route.

**Advantages of target maturity funds**

There are several advantages associated with target maturity funds. Some of the key advantages include:

1. TMFs provide a great deal of safety relative to many other investment options.

2. TMF offers the benefit of being an open-ended scheme, which allows you to sell or redeem units at any time, unlike fixed maturity plans.
3. Investments in TMF are liquid, allowing you to earn potentially good returns while also enjoying the freedom to withdraw your money when you need it.
4. TMF also allows you to lock-in current yields over the maturity period of the fund, as long as your investment horizon is aligned with the maturity date. This means that you can continue receiving higher interest or returns, even when the rates drop in the future so you should invest in TMF during high interest regimes.
5. Finally, TMF offers you the benefit of long term capital gains tax, provided your target maturity date is more than 3 years from the date of investment.

**Disadvantages of target maturity funds**

If you invest in a TMF during a low interest rate regime, you will be at a disadvantage as you will continue to receive lower returns even when the economy moves higher. This is a point you should always keep in mind. Other than this, TMF also has certain disadvantages, just like equity index funds, which is limited control by fund managers in volatile situations and the possibility of a tracking error eating into your returns.

In conclusion, while it is well known that every investment opportunity has both pros and cons, target maturity funds have more advantages than negatives to offer, especially if you are keen on a low risk investment style. Further, with the currently high interest rates, which are likely to head downwards once inflation eases over the near term, investing in a TMF now will help you lock down high returns for the duration of your investment, making it a great option for medium and long term portfolios.