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Allocate a large share to short-term debt funds: Kumaresh Ramakrishnan of DHFL Pramerica MF

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The bond yields crossed the seven per cent mark this week due to domestic and international factors. **ET.com Mutual Funds** spoke to **Kumaresh Ramakrishnan** , CIO-Fixed Income, DHFL Pramerica Mutual Fund, to understand the current situation in the debt markets and how it is going to impact the debt mutual fund investors.

Edited Interview:

The 10-year yield is climbing up on fears of higher oil prices and likely government deficit. How do you view the situation?
Revenues for the government in the current fiscal have been under some pressure on two counts. GST was implemented starting July 1. The system is going through some transitional issues as the industry adjusts and absorbs the new indirect tax. Besides, there has been a progressive reclassification of items and easing in operational issues under GST at the monthly meetings. The full impact of revenue loss if any on such reclassification of items is not fully clear. Also on the non-tax revenue front, collections this fiscal will be lower primarily because of lower dividend from RBI which is down almost 50 per cent from the previous year. Direct tax collections have been quite encouraging and growing in line with expectation.

On the external front, oil prices have witnessed some rebound, having hovered around the $50 per barrel for a while. Near term, there has been some escalation in geo-political concerns which are adversely impacting oil prices.

Other factors which have had some impact on local rates include the ongoing tightening by the US fed and the likelihood of a fed rate hike in December. Combination of the above mentioned factors has caused a reversal in yields over the last two to three months.

We believe that absolute benchmark G-sec yields are taking in account all of these factors. This partly explains the reason for spreads in the benchmark 10 year G-sec being in excess of 100 bps over the repo rate. The last time we witnessed spreads in excess of 100 bps for G-secs over repo rate was in 2013 at the height of the currency crisis. The current macro position however is vastly different. As such, we view the current widening in yields, as an opportunity to add selective exposures from a medium-term perspective.

India is going through a painful structural changes after demonetisation, GST, etc. Do you think government is likely to slip on key numbers?
As mentioned earlier, some variability on the indirect tax collection front is expected. This is dependent on the manner in which the system fully absorbs GST in the coming months. We believe that some of the recent changes in GST are aimed at making the system simpler and should lead to better compliance. This should allay fears of a major revenue shortfall on indirect taxes. However, full clarity is still awaited on the revenue numbers for the current fiscal on this count.

Simultaneously, we would like to highlight that this government has exhibited high degree of fiscal discipline by sticking to its targeted fiscal numbers in each of the past three years. We also think that the government has the flexibility to recalibrate some year-end spending, based on expected revenues which will help minimise deviation from the targeted numbers.

There is ample liquidity in the market. Will that keep the yields lower?
Short-term yields continue to remain well anchored given the system surplus position. Overall levels of liquidity in the system have declined in the last few months as a result of liquidity suction conducted by RBI through MSS (Market Stabalisation Schemes) issuances and OMOs. Nevertheless, the system remains adequately in surplus which should cause short-end yields to remain benign.

Rates are going up in the US and Europe. Will India travel in the opposite direction?
Indian benchmark rates have declined by 200 bps in close to three years starting from a cut in January 2015, when repo rates were at 8 per cent. RBI has met five times this year starting from February until October and rates have been cut only once in August 2017 by 25 bps. In all other meetings the MPC has maintained a status quo on rates. Given the ongoing consolidation in macro, expectation of some growth revival and a marginal reversal in inflation, our view has been for a pause in rates. Given this backdrop we are not pencilling in strong rate cuts going ahead.

Do you expect a rate cut in this financial year?
High real interest rates relative to other emerging market economies and weak growth in recent quarters have been factors pushing the argument for rate easing. These factors are however being offset by inflation rising recently and expectation for CPI to inch further in the months ahead. On balance, our expectation is for a 'pause' in rates in the near term.

Should investors stick to ultra short-term and short-term schemes for now?
Ultra short-term and short maturity funds have been all weather products for us in our fixed income basket and have fared well under all market conditions. As such, we believe these products should form the core part of the investment allocation in fixed income for most investors. The ultra short-term fund is a product ideally suited for investors with an investment horizon of 3-6 months. Investors with a slightly longer investment horizon of six months and beyond are encouraged to consider the short maturity funds. Based on their incremental risk appetite select clients can fine tune their allocation to some bias either to duration or accrual strategies.

What about investors in long-term debt funds? What should be their strategy?
Post the sharp reversal in yields, investors with a higher existing allocation to longer products may wait for a tactical rally to re-balance in favour of shorter products. Investors making a fresh allocation are advised to allocate a larger share into short-end products.

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