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Analysis

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NDA
300+

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NDA
272

NDA
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Editor's Keyboard

Manifestos: Between The Substance And The Rhetoric

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US $ 10.15 UK £ 5.05 Sing $ 10.60 Euro € 6.13

Money Market Funds: For A Safe Bet

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Each month, I deposit my salary in my savings bank account and use a portion of this for my monthly expenses. Is there any way in which I can earn higher returns? I may need to withdraw my investments at short notice.

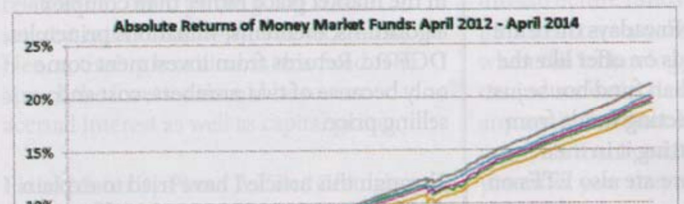
- Kedar Pradhan

Yes there is certainly a way in which you can earn higher returns than the interest you receive on your savings bank account! You could invest in money market mutual funds for higher returns.

Money market funds are considered to be very safe and they carry the lowest risk as compared to other types of open-ended funds. These open-ended debt funds generally invest in fixed income securities such as commercial papers, certificates of deposits, treasury bills and corporate bonds which generally mature within 90 days and hence are very predictable in their returns. Consequently, unlike their longer-duration counterparts, money market funds are not very sensitive to fluctuations in interest rates. Furthermore, money market funds generally invest the majority of their portfolios in highly rated fixed income instruments and hence have low default risk.

These funds usually have no exit loads. Therefore, you can redeem your investments at any time. Generally, when you redeem your investment in a money market fund, you will receive the amount the next day if your request has been submitted before the cut-off time.

At the end of March, the yields offered by money market funds were between 9 per cent and 10 per cent. These funds generally have expense ratios lower than 1 per cent. Even after expenses have been accounted for, the yields offered by money market funds are nearly double the rates on savings bank accounts. The rates on savings accounts at most major banks are only around 4 per cent while a few private sector banks offer rates as high as 6 per cent if your balance exceeds ₹1 lakh.



The NAVs of some money market funds dipped briefly in July 2013 when the RBI imposed emergency liquidity tightening measures to stabilise the currency. These measures led to a spike in short-term yields which dragged down the returns of some money market funds for a couple of days. Nevertheless, as shown in the chart, the NAVs of these funds quickly recovered. This was virtually the only month in the last five years in which this phenomenon occurred.

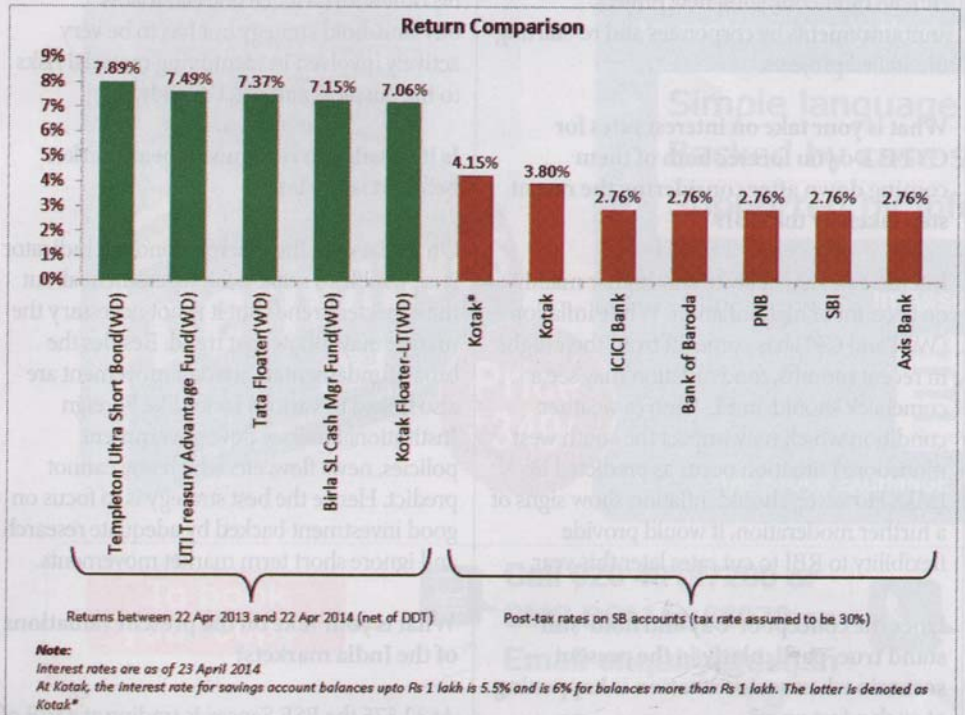
In spite of the marginal setback last July, investors in money market funds eventually benefited from higher accrual returns as carry yields increased. As shown in the table below, the weekly dividend options of some money market funds have generated returns between 7 per cent and 8 per cent during the last year (even after deducting dividend distribution tax).

Annualised Returns as on 22 April 2014							
Scheme Name	1 Week	2 Week	1 Month	3 Months	6 Months	9 Months	1 Year
Birla SL Cash Mgr Fund(WD)	6.80	6.30	7.98	7.50	7.17	7.73	7.15
Kotak Floater-LT(WD)	5.21	6.17	8.15	7.61	7.41	7.68	7.06
Tata Floater(WD)	6.97	5.95	7.03	7.32	7.27	7.82	7.37
Templeton Ultra Short Bond Fund(WD)	7.50	7.38	7.78	7.88	7.84	8.17	7.89
UTI Treasury Advantage Fund(WD)	6.87	6.87	8.48	7.53	7.24	7.79	7.49

Money market funds may also be more tax efficient than savings accounts. If the interest you earn from the money in your savings account is greater than ₹10,000, then this will be taxed according to your tax slab. However, as shown in the table below, if you invest in money market funds, you can save tax by choosing to invest in dividend options if you fall in the highest tax bracket.

Type of Investment	Investment held for 12 months or less	Investment held for more than 12 months
Savings Bank Account	Interest upto Rs 10,000 is exempt from tax. But if the interest you earn is greater than Rs 10,000, then this will be taxed according to your tax slab.	
Money Market Funds (Dividend Option)	Dividends are tax free in the hands of the investor but the mutual fund scheme pays dividend distribution tax at 28.325%.	
Money Market Funds (Growth Option)	Short Term Capital Gains Tax (according to your tax slab)	Long Term Capital Gains Tax Lower of: 10% without indexation or 20% with indexation

If you had invested in the Weekly Dividend options of money market funds during the last year, the post-tax returns on your investment would have varied between 7 per cent and 8 per cent (net of dividend distribution tax or DDT).On the other hand, if you had invested the same amount in a savings bank account, the post-tax returns from your investment in your savings bank deposit would have been significantly lower, as shown in the chart. (Note that the post-tax returns have been calculated on the assumption that you are in the highest tax slab).



Note:
Interest rates are as of 23 April 2014
*At Kotak, the interest rate for savings account balances upto Rs 1 lakh is 5.5% and is 6% for balances more than Rs 1 lakh. The latter is denoted as Kotak**

Consequently, you may be better off by investing a portion of your salary in money market funds each month.

KEY POINTS

Money market funds generally invest the majority of their portfolios in highly rated fixed income instruments and hence have low default risk.

Money market funds may also be more tax efficient than savings accounts.

Money market fund usually have no exit loads. Therefore, you can redeem your investments at any time.

Money market funds are considered to be very safe and they carry the lowest risk as compared to other types of open-ended funds. These open-ended debt funds generally invest in fixed income securities such as commercial papers, certificates of deposits, treasury bills and corporate bonds which generally mature within 90 days and hence are very predictable in their returns.

Disclaimer: Past performance does not guarantee future returns. The mutual funds which have been mentioned are indicative of historical performance only. Please consult your financial advisor before investing in mutual funds.