

Use debt MFs to plan for emergencies

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Life is full of uncertainties, and unexpected emergencies can arise at any time. These emergencies could include medical bills, car repairs, home repairs, or sudden job loss. Having a contingency/emergency fund offers financial security and peace of mind. It acts as a financial cushion that allows individuals or businesses to cover unexpected expenses without relying on credit cards, loans, or other forms of debt. It helps prevent financial stress and the need to make hasty and potentially detrimental financial decisions. A contingency fund provides the necessary funds to address unexpected situations promptly and effectively, without disrupting one's overall financial stability.

There are several ways to create a contingency fund. One of the effective ways to build contingency reserve is to invest in debt mutual funds. For investors wishing to remain prepared for financial crisis, debt mutual funds provide a variety of benefits. Debt mutual funds are perceived as less risky as compared to equity investments due to their lower susceptibility to market movements. The portfolio construction may typically follow certain guidelines and considerations to ensure liquidity. Here are a few Debt mutual funds options one can explore.

Liquid funds: Among the available debt mutual funds, liquid funds are an option to build emergency corpus. These debt funds invest in CDs, CPs and TBills with a maximum maturity period up to 91 days. Liquid funds are low-risk, and you get a chance to earn returns. Liquid funds also don't have a lock-in period and can be held for as long as necessary which makes them a smart choice for creating a contingency reserve. If one invests in liquid funds, investor won't have to pay TDS on redemption, but is subject to short-term capital gains tax on the capital gains. Redemption requests in these Liquid funds are normally processed within one working (T+1) day. Example if investors give redemption request before 2:30 pm on working day, then the money gets credited to his / her bank account on the next working day. The best feature of planning for your contingencies through investing in debt mutual funds is its liquidity.

Redemption in Debt Mutual Funds especially in short term funds like Liquid funds attract no to minimal exit loads. Additionally, investing and redemption can be done online. Some of the mutual funds provide instant redemption feature in liquid funds where in money is credited to bank account within 30 minutes subject to certain conditions.

It's crucial to keep in mind that while liquid funds may not be products that help you build wealth, but they do offer liquidity and returns that may support the development of an adequate emergency fund.

Ultra short-duration funds: The main difference between liquid and ultra-short duration fund is the maturity or duration profile of the two schemes. Liquid funds invest in debt or money market instruments which mature in 91 days, while Macaulay Duration of ultra-short duration funds is 3 to 6 months. Thus, ultra short duration funds are similar to liquid funds, but they may give slightly higher returns than liquid funds due to higher duration. They are also highly liquid as redemption requests in these funds are normally processed within one working (T+1) day with no to minimal exit loads.

To build your emergency fund, you can also choose to opt for monthly systematic investment plan (SIP) in these funds. To build an emergency corpus and to set a target for it, one needs to assess her/his monthly income, other expenses, and existing investments. General thumb rule maybe to have 3 months of salary as an emergency fund.

It is always beneficial to consult a certified financial advisor who can guide you in building emergency corpus by investing in debt mutual funds. A qualified financial advisor can analyse your financial status, develop customised savings plans, track your progress, and motivate you whenever required. By collaborating with such advisors, you may create an emergency fund that will shield you from financial stress and uncertainty by working with him / her. To sum up, debt mutual funds maybe a good option for investors looking to invest in low-risk and liquid securities to be prepared for unforeseen financial circumstances. Disclaimer: This disclaimer informs readers that the views, thoughts, and opinions expressed in the article belong solely to the author, and not necessarily to the author's employer, organization, committee, or other group or individual.

Author is senior fund manager – Fixed Income, LIC Mutual Fund Asset Management Ltd. Views are personal.

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