Sharp outflows from debt funds a normal phenomenon; money will return in new quarter: Marzban Irani, CIO – Fixed Income, LIC MF

India debt market: The development of capital markets is a significant step to boost the economy in general. However, the biggest challenge continues to be credit risk and liquidity risk, says the debt fund manager.

Marzban Irani, Chief Investment Officer – Fixed Income, LIC Mutual Fund

The inclusion of Indian bonds into JP Morgan's emerging market debt index will not only lead to the diversification of the investor base for government bonds but also bring in valuable US dollar flows. With a new large investor base, rates are expected to cool off as and when these flows hit the domestic economy, freeing up capital to be fueled in the much-starved credit markets, says Marzban Irani, Chief Investment Officer – Fixed Income, LIC Mutual Fund, in an exclusive interaction with Zee Business' Swati Verma.

Marzban Irani has 22 years of experience in Fixed Income. Mr Irani is a PGDBM - Chetana's Institute of Management & Research, Mumbai. B.Com – Mumbai University. Irani manages five debt schemes of the fund house, with assets under management (AUM) of Rs 12,002 crore.

Edited excerpts:

Last month, JP Morgan announced it would include India in its emerging market debt index. There are expectations that other global indices may also follow suit in the near future. The development is touted as a game-changer for Indian markets. What should a layman know about its implications? Please explain.

As far as index inclusion is concerned, it was long awaited. The government and the Reserve Bank of India (RBI) have been on the front foot for a decade now. With the JP inclusion deemed to be the beginning of opening Indian sovereign markets to index investors, we expect other indices to follow suit. The current inclusion alone is expected to lead to inflows of close to $25 billion purely from passive fund managers. This not only leads to the diversification of the investor base for government bonds but also brings in valuable US dollar flows. With a new large investor base, rates are expected to cool off as and when these flows hit the domestic economy, freeing up capital to be fueled in the much-starved credit markets.

Debt funds saw heavy outflows in September. What is your view on it?

This is a normal business cycle, which I observed and experienced in September. Banks generally redeem their investments owing to higher capital weightage, whereas corporates and other institutions withdraw owing to tax payments and other outflows. This money is expected to return at the beginning of the new quarter, and this cycle is a normal quarter-end phenomenon.

A recent IMF report says that the corporate bond market in India has grown significantly in the last decade, with total outstanding debt volumes increasing from Rs 9 trillion in 2011 to almost Rs 40 trillion now. What are the challenges and opportunities?

The development of capital markets is a significant step to boost the economy in general, and the current trend is a step in the right direction. However, the biggest challenge continues to be credit risk and liquidity risk. Investors should be wary of misselling and understand the credit risks underlying their investments. Given the current high-interest rate regime across the globe, the probability of default, especially by the lower-rated entities, rises. Globally, credit default swap (CDS) spreads have risen, and it has become essential for investors to price in such risks. Each investor should understand the risk appetite and investment horizon before entering such investments.

A quick glance at the three-year data shows that LIC's debt funds have given returns between 3.8 per cent and 4.53 per cent during the window. What has been the investors' trend in the past three years?

Three years ago, there was immense liquidity in the system. All over the world, central banks had infused liquidity. The same was done by our central bank. Hence, the yields dropped and the spreads compressed. Durations across funds were reduced to hedge against a turn in the interest rate cycle. And the cycle turned very sharply in 2022.

Tell us about your investment strategy.

I adhere to the SLR Process.

The investment philosophy for the debt segment focuses on safety and capital preservation while optimising returns. All investments are subject to the SLR process, where:

S stands for Safety of Investment

L stands for Liquidity of the portfolio and

R stands for Returns of the portfolio

For any debt instrument, first I consider and look at the safety of the investments, then at the liquidity of the instrument, and finally at the returns of the portfolio. The security selection is dependent on parameters like yields, relative valuation, maturity, duration, exposure ceiling, liquidity need, issuer's financial ratios, track record, etc. After a thorough analysis of the variables that impact the investment climate, I arrive at the final investment decision.

What advice would you like to give to retail investors looking to invest in bonds?

Retail investors may diversify their investment base, and bonds are one of the mediums to achieve this objective. If an investor is savvy enough to understand the underlying risks, they may choose the direct route to invest; however, buying a few bonds may not lead to diversification and, on the contrary, may increase the risk. We recommend investors go through the mutual fund route if they don't have the right expertise in understanding the bond markets. The transparency and disclosures in the mutual fund industry are second to none.