

## ReturnTracker

# A sombre year for gilt funds

The volatility in the bond market continues to weigh on funds' performance

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After a lacklustre 2017, the performance of gilt funds — schemes that invest primarily in long-duration government bonds — this year is still nothing to write home about. From the beginning of the year, yield on 10-year G-Secs has gone up by about 40 basis points, impacting the performance of gilt funds (yield and price of government bonds are inversely related).

On an average, gilt funds have delivered 2-4 per cent returns year-to-date, lagging short-duration and credit-risk funds that have delivered 5-7 per cent returns. With yield on bonds likely to harden further, performance of gilt funds could remain sombre in the coming months.

### Rising rates

Concerns over inflation, tightening global liquidity and the RBI hiking its key repo rate — at which banks borrow short-term funds from the RBI — are factors that have led to rise in interest rates over the past year. In fact, G-Sec yield peaked at 8.1 per cent in September, and has since come off a bit, ruling at 7.7 per cent currently. The RBI bringing in measures to ease liquidity, coupled with the announcement of several open-market operations (buying of government bonds of ₹36,000 crore for October and ₹40,000 crore for November),



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have soothed the bond market in the past month or so. But while the yield on G-Secs has cooled off, risks persist. Risks to fiscal slippages, global factors and the upside risk to RBI's inflation projection are likely to lead to hardening of yields in the coming months.

### Funds' performance

In light of all this, the performance of gilt funds has been tepid this year. Interest rate movements impact bond prices — if rates move up, bond prices fall, and vice versa. As long-duration bonds are more sensitive to interest rates, fund managers mitigate the rate risk by reducing the maturity of the portfolio when rates rise.

Amid the lacklustre show by gilt funds as a category, there have been a few funds that have managed to cap losses and deliver modest returns. Reliance GSF, ICICI Pru Gilt, IDFC G-Sec, DSP G-Sec and UTI Gilt are some of the top-performing funds this year. Most of these funds significantly reduced their portfolio's average maturity to tide over

market volatility. From 11-14 years, towards the end of 2017, these funds reduced the maturity profile of their holdings to 3-5 years this year. ICICI Pru Gilt Fund has reduced maturity all the way from 10 years to about a year now.

Franklin India G-Sec, Axis Gilt and IDBI Gilt have been laggards, delivering 1-3 per cent year-to-date. Relatively higher maturity has dampened their performance. Franklin India G-Sec's average maturity, for instance, has been 11-13 years through the year.

Over a longer period of 3-5 years, Reliance GSF, ICICI Pru Gilt, UTI Gilt and SBI Magnum Gilt have been consistent performers.

Barring a few funds, including Franklin G-Sec, most funds have brought down their average maturity to 2-4 years as of October, possibly because of expectations of bond yields hardening further in the coming months.

Investors with a low to moderate risk appetite would do well to invest in short-duration funds that carry lower interest rate risk.



### Muted

On an average, gilt funds have delivered 2-4% returns year-to-date, lagging short-duration and credit-risk funds that have delivered 5-7% returns