Liquid Mutual Funds

If low risk and high liquidity work best for you

Higher returns as against a, say, savings account interest rate, easy and fast redemption of invested money, devoid of lock-in period – there is a lot to recommend liquid mutual funds. Overall it's a good place to park your surplus money for a short period of time. With all of the good feedback, though, it is prudent still to be fully aware of the cons, if any, and the factors that need to be considered by investors before taking the plunge, so to say. After all, liquid funds are not wholly risk-free and among other things, you will need to see which fund house your money should be headed to. The following report also assesses specific liquid mutual funds on basic parameters.

Subas Tiwari & Gopal Ravi Kumar

We chose 12 liquid mutual funds based on product offer and consumer feedback, with the criterion being restricted to 5 star and 4 star ratings. The parameters on which we have compared them include returns, net assets, minimum investment, minimum additional investment, fund grading, fund performance and expense ratio. We gave the highest weightage (20 points) to consumer feedback, which also helped in determining the most important and beneficial variables. These variables have a direct bearing on the product structure.

How Liquid Are They?

- Liquid mutual funds take short positions in the MF market with shorter maturities.
- Redemption proceeds, the amount which an investor wants to get back in his/her bank account, are usually paid within one working day

Characteristics of Liquid Funds

- Liquid funds have no restrictions of a lock-in period and are therefore considered to be low- to average-risk funds.
- Withdrawals (funds redemption) are processed within a day of the request.
- Units are allotted on investment on the previous day's net asset value (NAV).
- Liquid funds have the lowest interest risk associated with all the classes of debt funds.
- Liquid funds are primarily invested in fixed-income maturities with short maturity.
- There are no entry/exit load ratios (hence minimal expenses to pay).
- NAVs are calculated for 365 days (unlike other debt mutual funds where NAV is computed for business days only).

Liquid funds fall in the category of debt mutual funds that invest their corpus in financial instruments such as treasury bills (TB), bills re-discounting, commercial paper (CP), bank fixed deposits (corporate deposits) and other debt securities with maturities up to 90 days.

What does the mutual fund market say about liquid funds?

- As of March 2018, the assets under management (AUM) of mutual funds were Rs 21.35 lakh crores, out of which liquid and money market schemes constituted Rs 3.36 lakh crores—that is, about 16.00 per cent of the overall AUM (AMFI data).
- The share of retail investors (investors who invest less than Rs 500,000) in the liquid funds scheme is less than 3.00 per cent.

LIQUID MUTUAL FUNDS:

CV Weightage Points (100)			10	10
Name of fund	Launch date	NAV (growth) (Rs)	Fund grading *	Net assets (Rs, in crore)
L&T Liquid Fund – Direct Plan	01-01-2013	2,467.793	4 (5)	16,424 (5)
Baroda Pioneer Liquid Fund – Direct Plan	01-01-2013	2,070.771	5 (10)	9,530 (2)
Axis Liquid Fund	09-10-2009	1,988.513	5 (10)	30,065 (7)
UTI Liquid Cash Fund – Regular Plan	10-12-2003	2,936.664	4 (5)	45,537 (10)
Tata Liquid Fund – Regular Plan	01-09-2004	2,822.910	4 (5)	24,458 (7)
HSBC Cash Fund	01-06-2004	1,787.874	4 (5)	7,508 (2)
Indiabulls Liquid Fund	25-10-2011	1,748.822	4 (5)	6,725 (2)
DHFL Pramerica Insta Cash Fund	05-09-2007	232.961	4 (5)	14,288 (5)
Reliance Liquid Fund	09-12-2003	4,372.491	4 (5)	51,486 (10)
Invesco India Liquid Fund	17-11-2006	2,468.856	4 (5)	15,284 (5)
Aditya Birla Sun Life Liquid Fund	29-03-2004	287.956	4 (5)	59,099 (10)
Franklin India Liquid Fund – Super Institutional Plan	02-09-2005	2,683.033	4 (5)	6,955 (2)

Notes:

a) NAV of the funds is as of 27 September 2018

b) The fund grading (four stars/five stars) is based on Value Research website.

c) We have chosen funds with four-star and five-star ratings for this study.

d) We have selected only those liquid funds that have net asset value of more than Rs 5,000 crore.

e) Information given here has been sourced from the companies' websites/Value Research website.

f) NS – not specified

CV RECOMMENDATIONS

Best Buy

L&T Liquid Fund (Direct Plan)

Good Buy

Baroda Pioneer Liquid Fund (Direct Plan)

Fair Buy

Axis Liquid Fund

A COMPARATIVE CHART

	10	5	15	10	10	10	20	Grand total (100)
	Minimum investment (Rs)	Minimum additional investment (Rs)	Returns (since launch) (%)	3-month fund performance (%)	1-year fund performance (%)	Expense ratio (%)	Consumer feedback	
	10000 (3)	1,000 (3)	8.13 (15)	1.82 (10)	7.17 (10)	0.10 (10)	18	79
	5000 (7)	1,000 (3)	8.22 (15)	1.85 (10)	7.24 (10)	0.15 (10)	11	78
	500 (10)	500 (5)	7.96 (10)	1.82 (10)	7.14 (5)	0.15 (10)	9	76
	500 (10)	NS (0)	7.39 (5)	1.81 (10)	7.10 (5)	0.18 (5)	16	66
	5000 (7)	1,000 (3)	7.65 (10)	1.81 (10)	7.09 (2)	0.14 (10)	10	64
	5000 (7)	1,000 (3)	8.09 (15)	1.83 (10)	7.12 (5)	0.14 (10)	6	63
	500 (10)	500 (5)	8.40 (15)	1.78 (5)	7.06 (2)	0.17 (5)	10	59
	100 (10)	100 (5)	7.94 (10)	1.82 (10)	7.10 (5)	0.18 (5)	3	58
	100 (10)	100 (5)	7.39 (5)	1.81 (10)	7.10 (5)	0.23 (2)	4	56
	5000 (7)	1,000 (3)	7.91 (10)	1.82 (10)	7.10 (5)	0.22 (2)	8	55
	1000 (7)	1,000 (3)	7.56 (10)	1.79 (5)	7.10 (5)	0.22 (2)	8	55
	10000 (3)	1,000 (3)	7.84 (10)	1.82 (10)	7.09 (2)	0.18 (5)	6	46

Limitations

- Liquid mutual funds are not very popular among brokers and fund advisors because the rate of brokerage/commission paid to them is lower than in other investment products. Therefore, first-time investors do not get to know about this fund option, a factor that affects its growth.
- Due to the modest rate of return (as compared to other MFs), this type of fund has very few large investors in the market.
- This fund does not have the 'systematic investment plan' (SIP) tag as it is a liquid fund and does not insist on a minimum period of investment. Hence, any investor can exit at any time and get returns for the period of holding. This holds backs growth as well as possible higher returns. This also discourages those who are investing for 'saving' purposes.
- There is a perceptible hesitancy in the investors' mind because of the 'minimum investment' rider, which also acts a dampener while taking investment decisions. Some feel that the minimum investment can be brought down to Rs 1,000 to enable widening of the net to attract small and retail investors.

Taxation Laws on Liquid Fund Investment Returns

- **Short-term capital gains tax (STCGT)**

This is applicable to liquid funds held for a period of 36 months or less. STCGT is calculated as per the income-tax slab as applicable to the retail investor (5%–20%–30% of the amount of gain).

- **Long-term capital gains tax**

This is applicable to debt mutual funds held for a period of 36 months or more. LTCGT is calculated at the rate of 20 per cent, with cost indexation on the amount of gain. Indexation is the adjustment of the purchase price with respect to the effect of inflation on the economy (helps in lower taxes on the capital gains).

Liquid Mutual Funds	Bank Fixed Deposits
Risks are lower in this type of fund due to higher liquidity.	Bank deposits are totally risk-free.
Returns are 'decent' (7% to 9% on an average between 3 months and 1 year).	Bank deposits held for a similar period earn a maximum of 6.50%.
Liquid funds do not suffer entry/exit load.	Premature withdrawals by demanding the contracted amount earlier than held will attract payment of penalty for breaking the contract.
NAV of liquid funds is not volatile as the only change in their NAV is mostly as a result of the interest income that accrues. In other words, given their short-term maturities, these instruments are hardly traded in the market. They are held until maturity. Hence, their NAV only sees a change to the extent of interest income accrued everyday including weekends.	Deposit rate, once contracted at the time of deposit, is to be paid till the maturity period. However, at the end of the maturity period, the prevailing rate of interest will be contracted (maybe more/less).
Liquid funds are charged dividend distribution tax (DDT) of 28.84% (deducted at the AMC end, including surcharge and cess).	Tax deducted at source @ 10% is payable beyond a certain specified amount on the interest earned on the deposit.
The liquid fund invested has no guarantee against its erosion.	Bank deposits up to a specified amount are guaranteed by deposit insurance.
Liquid fund returns by way of dividend do not enjoy any 'guarantee' as they are dependent upon play of market forces.	Bank deposits interest is almost 'guaranteed' as it is mandatory for the bank to pay irrespective of market forces.

Consider These

- **NAV**

NAV volatility is minimal but sudden market fluctuations cannot be prevented. Liquid funds are therefore least risky but not completely risk-free. Hence this factor needs to be taken into account.

- **Returns**

Historically, liquid funds have been generating returns that are much higher than those from bank fixed deposits and savings accounts. This needs to be factored in while weighing investing options.

- **Fund history**

The history of the fund becomes an important criterion in fund selection. It goes without saying that a fund house with a consistent track record is always to be preferred.

- **Cost of funds**

Liquid funds charge a fee (expense ratio) to manage the investment (SEBI has mandated the cap at 2.5 per cent).

- **Net assets**

A fund house with a large corpus fund will be able to ‘absorb’ market fluctuations and may not pass on ‘small losses’ suffered in the market to the investor. Small fund houses may not be able to do this.

Takeaways

a) Consider investing in liquid funds as a viable additional investment option.

b) Park your idle funds (lump-sum funds like bonus, incentive and increment) for a short-term period—say up to 90 days (3 months) initially.

c) Choose a fund house with a consistent fund history/performance/return record for the last 5 to 10 years.

d) Analyse least expense ratio with consistent fund returns.

Think Liquid Mutual Funds if You

- want to create a dedicated fund for emergencies
- have idle money to invest
- are looking to earn better than what you do from bank deposits, keeping in mind the fact that both are highly liquid in nature
- prefer short-term exposure
- prefer highest liquidity with the least risk