Removal of debt tax benefit is fuelling equity market rally: Trust Mutual Fund's Sandeep Bagla

The CEO of Trust Mutual Fund says interest rates will not rise dramatically or fall in the near term. However, a rate cut is likely somewhere at the start of FY25

Sandeep Bagla, Chief Executive Officer, Trust Mutual Fund

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After being a debt focussed mutual fund house since its launch in 2018, the Rs 1,185-crore Trust Mutual Fund – India's 38th largest – is ready to launch equity funds.

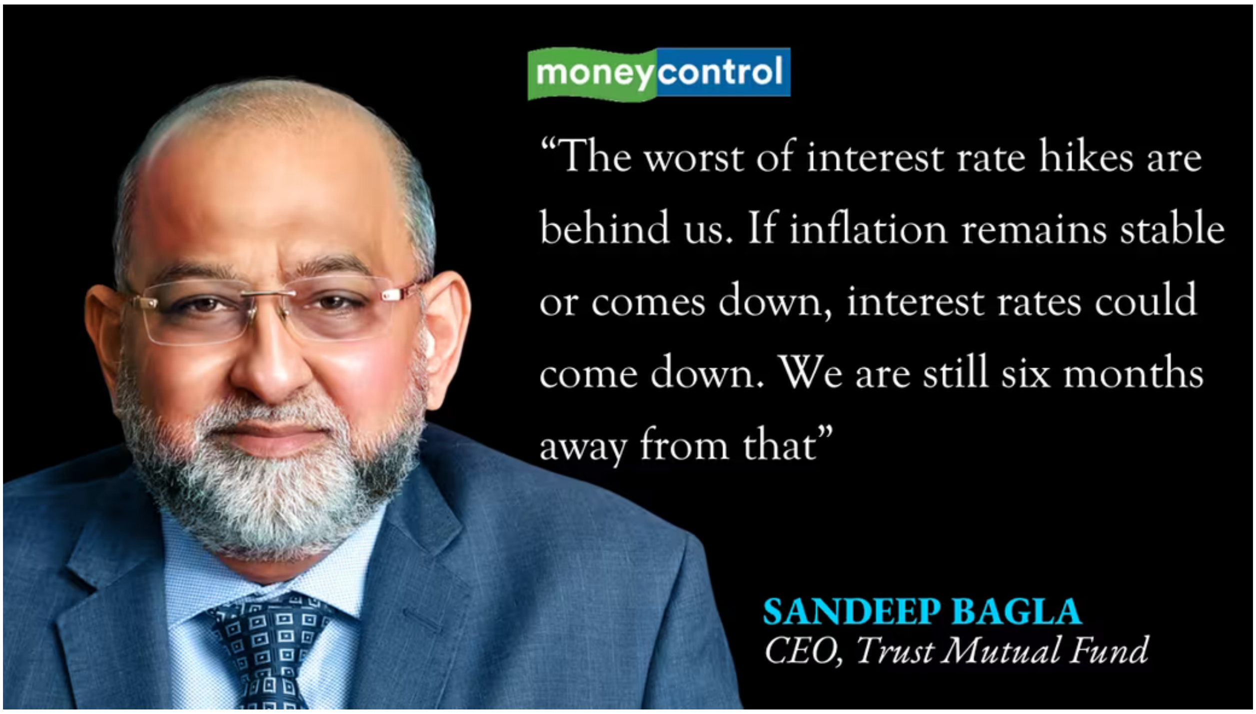
In October, it hired Mihir Vora as its Chief Investment Officer (CIO) and recently applied to the Securities and Exchange Board of India (SEBI) for its first equity fund, in the flexi-cap category. Vora was Senior Director and CIO at Max Life Insurance before joining Trust. He had also worked at HSBC India Mutual Fund between 2006 and 2009.

Sandeep Bagla, Chief Executive Officer, Trust Mutual Fund, in an interview to *Moneycontrol* shared his views on the interest rates scenario, impact of the debt taxation changes in the Budget, how to invest in the current market situation and the fund's plans to expand product offerings.

Edited Excerpts:

Interest rates in India have been high for quite some time now. Has the time come for interest rates to be cut?

If one looks at our current inflation reading, the headline numbers are just about in the RBI's comfort zone of two to six percent. On a sustainable basis, we are likely to remain much higher than the four percent target of the RBI. While the momentum of inflation could be coming down and it is quite likely that we may not have any more interest rate hikes in the US or in India, we are still some time away from talking of a rate cut. I think all the central bankers have been talking about is that we need to have higher rates for longer.



High interest rates can lead to some moderation in demand and the slowdown is already visible in a few sectors in the US, data shows.

Most US-based analysts are expecting rate cuts there by May-June of 2024. And probably in line with that, our inflation is also projected to be close to four percent in the second quarter FY25. So, in anticipation of that, probably RBI would also reverse its current tight stance and probably ease liquidity and cut interest rates.

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We are still six-nine months away from an interest rate cut.

Given this scenario, in terms of high interest rates, where are the opportunities for investors and fund managers?

It's a good time to lock in three-year yields from corporate bonds that are on offer these days. These securities yield around 7.75 percent. Expected inflation is anywhere between four percent and

4.5 percent in a year's time; investors will get a real return of about 300-350 basis points higher than expected inflation.

It is quite reasonable to expect that in six to nine months, interest rates governed by RBI would be probably lower than where they are today, especially if inflation goes down to 4-4.5 percent on a sustainable basis.

Once interest rates soften, you will generate some capital gains in corporate bonds, in government securities of longer duration. It would be a simple corollary that you should invest larger parts of your funds in fixed income products which are not very interest rate sensitive, but also gives you a high carry income and can generate potential capital gains, which will add to your returns. So, I think it's a fairly good investment option or opportunity for investors to invest in corporate bonds of let's say three-to-five-year maturity and be patient, hold on for one year, and you could probably generate a holding period return of 9-10 percent if interest rates come down by 50 to 75 basis points.

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If someone has Rs 10 lakh to invest today. How should they split it?

Put 50 percent in equities, assuming you will stay invested for five-seven years and you need little cash in the interim. India is a growth market. Within this, put 30-35 percent in large-caps, 10 percent in mid-caps, maybe 5-10 percent in small-caps.

For the remaining 50 percent to be allocated to fixed-income securities, you can either put them in fixed deposits and/or debt mutual funds.

If you opt for debt funds, put 30 percent in corporate bond funds or long-term funds, 10 percent in liquid funds or money market funds which have low volatility and high liquidity, so you can withdraw at any point of time, and another 10 percent in government securities' (G-sec) funds. Investments in g-sec funds can give you a kicker if interest rates were to come down sharply.

What kind of impact have you seen in terms of inflows into debt funds after the taxation amendments in the Budget 2024?

The taxation amendment in the budget has mostly impacted allocations from high net worth individual (HNI) investors or corporates who have extremely long-term surpluses.

The allocation has gone partly into fixed deposits, because unlike mutual funds, bank FDs are able to give you a distinct return and promise the return on the back of the capital which they have. So, some amount of money has gone out to those where the coupon is guaranteed and to some to the Non-Banking Financial Company (NBFC) deposits or bonds, corporate bonds of lower rating as well.

I suspect that some of the money has also gone into small-cap and mid-caps. So, indirectly the removal of this tax benefit is fuelling the equity market rally that you're seeing right now.

Do you want the government to revisit this decision in the upcoming budget?

Of course. In my understanding, the removal of the tax benefits to debt funds was in response to some of the target maturity funds which were buying single government securities. The authorities might have felt that debt mutual funds have got the tax benefits because we take interest rate risk, credit risk and liquidity risk.

If a fund is investing only in a certain government security, then they do not really require any kind of tax benefit.

I agree with the regulators on that. Maybe the tax benefit can be reinstated for open-ended funds, which are managing all the key risks. The fixed tenure plans or target maturity funds, as they are called, could be removed from the basket of mutual funds which have any tax benefits.

This has been a case where the baby has been thrown away with the bathwater. So it's time for us to get the baby back.

Are equity markets worried about the 2024 general elections?

Markets don't like any kind of uncertainty. So, if markets get a sense that there is some uncertainty on the horizon, they will try to price in scenarios where that uncertainty could percolate down to the corporate sector, earnings sector and your P/E (price-to-earnings) multiples as well, discounting factors.

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I am not an expert in politics, so I do not have a view on what is going to happen. But markets like continuity and markets like removal of any uncertainty.

Trust MF has just hired Mihir Vora as head of equities. Are you finally ready to launch equity funds?

We are planning to launch our first equity fund in the coming months. We have filed the draft offer document of our upcoming Flexi-Cap fund with the Securities and Exchange Board of India (SEBI; the capital market regulator).

If all goes well, in the first quarter of the next calendar year, we will come out with our maiden offering in equity funds.

We plan to be a mainstream regular mutual fund, which will have equity funds, fixed income funds and hybrid funds. Hopefully in the next two to three years, we will extend our product suite which any normal mutual funds are offering and we will become as regular a mutual fund as any other fund house. We will launch actively-managed funds.

Apart from Vora, how are you beefing up your team on the equity side?

We have made multiple offers to equity analysts and fund managers, and already have an equity dealer in place and we hope that in the next two months' time, our equity team will be fully on board.

Are you looking at growing through the organic route or will you go for acquisitions?

As of now, we are planning to grow in an organic way. But one never knows. If some good opportunity comes our way, one never knows what can happen.

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You will be a newcomer in the equity segment. There are existing fund houses with string equity teams in place and we are getting new fund houses. How would you look to separate yourself from the competition?

The whole idea is to build a team, which can deliver consistently over different timeframes in different market conditions across a variety of products. So, we will concentrate on building that team and taking the products to investors and distributors. We will concentrate on research, on understanding markets, sharing our thought process with the investors and distributors, and managing funds.