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ORIGINAL ARTICLE

MUTUAL FUNDS VS FIXED DEPOSITS: COMPARE WHICH IS BETTER

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Abstract:

Mutual fund industry has experienced a drastic growth in the past two decades. Increase in the number of schemes with increased mobilization of funds in the past few years notes the importance of Indian mutual funds industry. To fulfill the expectations of millions of retail investors, the mutual funds are required to function as successful institutional investors. Proper assessment of various fund performance and their comparison with other funds helps retail investors for making investment decisions.
The main aim of this paper is to evaluate the performance of mutual fund and compare these returns with domestic term deposit rates. Considering the interest of retail investors simple statistical techniques like averages and rate of returns are used.

KEYWORDS:

Mutual Funds, Fixed Deposits, Rate Of Return, Liquidity.

OBJECTIVES

To analyze the returns of mutual fund schemes. To compare the average returns of selected Mutual fund schemes with SBI domestic term deposit rates. To have a comparative analysis of various categories of Mutual fund schemes.

ABBREVIATIONS

MF---- Mutual Funds, FD---- Fixed Deposits, NAV----Net Asset Value, TDS----Tax Deducted at Source

INTRODUCTION

Comparison between mutual funds and fixed deposits is a long debate, especially when it comes to a comparison between fixed deposits and debt mutual funds. Even a few years ago, any conservative and risk averse investor would think investing in bank fixed deposits is better than mutual funds (debt or otherwise). Nevertheless, the market scenario has changed a lot in the recent years, and many a mutual funds family has come up with interest debt mutual fund schemes with guaranteed returns alongside capital appreciations.

This makes the comparison between debt mutual funds versus fixed deposits more complex, and even the most risk averse investor (count my father!) is led to think twice. That being said, whether you should invest in bank fixed deposits or debt mutual funds is no more a simple question as it used to be five-six years back, and needs a detailed examination and explanation. And, we at Mutual Funds Manager are here again to help you with a neutral comparison between fixed deposits and mutual funds.

While only you can finally decide whether mutual funds or fixed deposit where to invest — depending on your risk taking abilities, return expectations, and investment horizons — let us try to analyse some key factors one by one and chalk out a comparison between bank FD and mutual funds.

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BANK DEPOSITS Vs DEBT FUNDS

Bank deposits cater to a segment of the investor class that looks for safety and accepts a relatively lower return. Equity Funds cannot clearly be compared with the bank deposits, as investors can expect higher returns from equity funds on only at the risk of losing part of the capital also. Given the risks, Indian investors are currently investing heavily in debt funds.

A bank deposit is guaranteed by the bank for repayment of principal and interest. Any risks associated with investment of the investors' funds have to be borne by the bank. The depositor has a contractual commitment from the bank to pay. A mutual fund, on the other hand, invests at the risk of the investor. Hence, there is no contractual guarantee for repayment of principal or interest to the investor.

The bank depositor does not directly hold the bank portfolio of investments, as he does in case of a fund. The investor needs to assess the risk in terms of the credit rating of the bank, which provides an indication of the financial soundness of the bank.

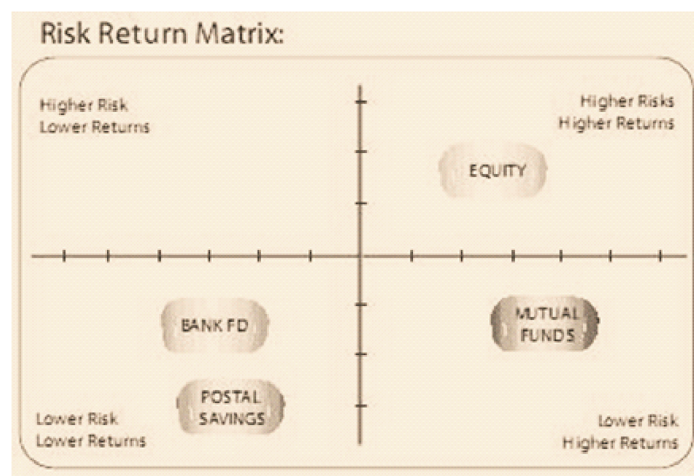
In case of investments, in debt funds, however, only a few debt funds in India are rated by a Credit Rating Agency. Where a fund rating is available, it is a useful guide for the investor to know the risk level of the fund. In all other cases of unrated funds, the investor has to assess the risk on the portfolio held by the fund. The investor needs to know whether the fund invests in high quality assets or lower rated debt. Unlike in case of bank deposits, therefore, the investor needs to know his own investment objective and risk appetite before investing in debt fund. The expected returns will be commensurate with the level of risk assumed by the fund.

It can be seen that the bank deposits are not totally free from risk, while generally giving lower returns. A conservative debt fund can give better returns than a bank deposit, even if there is no contractual guarantee as in case of a bank deposit. Investor seeking higher returns from the capital market securities, a diversified debt portfolio while still investing small amounts, and a portfolio that matches his objective and risk appetite is well advised to consider part of his investment in debt funds.

Return on investments vary for mutual funds, but not bank deposits

Needless to repeat, bank deposits offer you a fixed percentage of return, as would be agreed upon by the investor and the bank at the time of the investment. For example, if you put 50 thousand rupees in FD for 5 years and the agreed interest rate is 8% per annum, you will continue to enjoy the same interest rate throughout the tenure. On the other hand, debt mutual funds have no assured rate, and the return on investment for debt mutual funds depend completely on the market and the performance of the fund. Fluctuations in the money market impact the NAV of the fund, thereby altering returns. Thus, a great advantage of bank fixed deposits is that, you will continue to earn the same interest rates even if the market goes down.

Nevertheless, this very advantage of fixed deposits over mutual funds can actually turn out to be their great disadvantage. If the market goes up mutual funds will give more returns accordingly, but your FD will continue to yield in the same old rate. So, the actual question becomes, whether there is any chance of the Indian market going up in near future, especially following the recent recession? Yes, there is. At least, we think so. Market researches and predictions indicate that the Indian money market will go up in 2013, may get stagnant for a while in 2014, then taking another upward curve.



	BANKS	MUTUAL FUNDS
Returns	Low	Better
Administrative exp.	High	Low
Risk	Low	Moderate
Investment options	Less	More
Liquidity	At a cost	Better
Quality of assets	Not transparent	Transparent

Comparison between mutual funds & fixed deposits: Inflation adjustment

Inflation adjustment is a very important point while comparing mutual funds and fixed deposits. FDs don't come with inflation adjustment guarantees, and if the interest rate is lower than the inflation rate, you actually end up losing the value of your money. In the FY 2011-12, the inflation rate in India was 7%, while the interest rate for around 1 year tenure was something around 7% as well [6.5% for ICICI and HDFC banks, 6.75% for Citibank and HSBC, 7.10% for Axis and Yes Bank and so on. Higher rates are there, but for lump-sum investments like 1 crore. Thus, if you have invested in bank FDs for the last FY, you either failed to beat inflation or ended up with minimal inflation adjusted positive returns. On the other hand, at least half a dozen mutual funds yielded returns greater than 8% (some as high as 12-14%), thereby giving you handsome inflation adjusted returns. Usually, mutual funds outrun inflation and always give positive, real returns.

Mutual funds and fixed deposits: Capital appreciation

When it come to capital appreciation, mutual funds are better than fixed deposits, because of the equity investment. In longer time periods, market changes result in increasing interest rates. And, your mutual funds manager is there with all the expertise and professionalism to ensure a better capital appreciation.

Mutual funds or fixed deposits, which one is more liquid?

In terms of liquidity, these days both fixed deposits and mutual funds are almost same. Fixed deposits are actually meant for long lock in periods, but most banks allow premature withdrawals with a nominal penalty (usually 1%). The interest rate calculation for bank fixed deposit withdrawals is done on how long the money was parked. Mutual funds are equally liquid; you can take out any number of units within a couple of days. The return for premature withdrawal of mutual funds units is done on the prevalent NAV of the fund. Usually, there is an exit load of 1% for premature withdrawals before 1 year.

Risk factor of mutual funds and fixed deposits

The only reason why most investors prefer fixed deposits to debt mutual funds is the assured return of the capital. On the other hands, returns from investments in mutual funds are subject to the volatility of the market, and may result in low or even negative returns. An investor should be wise enough to judge the quality of the investment instrument and thereby minimizing risk factors. Do take a look at the Beta Ratio of your mutual fund.

Cost of investments in mutual funds and bank fixed deposits

Investing in bank fixed deposits costs nothing. On the other hand, there is a minimum charge for mutual funds investments management and fund distribution, borne by the investor irrespective of returns. In other words, no matter whether your return on mutual funds investments is positive or negative, you have to bear an expense as the fees of fund management. Sometimes, entry loads are there as well, but quite rarely.

Tax benefits of debt mutual funds and bank fixed deposits

Fixed deposits interests are considered incomes and come under income taxes (if you are taxable, of course). Moreover, there is a TDS (Tax Deducted at Source) at the rate of 10.3% p.a. if your total cumulative interest on all FD is more than Rs. 10,000 in any financial year. Similarly, short term capital gains of debt funds are considered income and are accordingly taxable. For long term capital gains, tax is 10% without indexation or 20% with indexation. However, dividends received on debt mutual funds are tax free.

RESEARCH METHODOLOGY

Source of Data

The data for this study is mainly collected from Secondary Sources like Books, Journals, Magazines, and various websites like www.nseindia.com, www.amfiindia.com, www.mutual fundsindia.com, www.sebi.gov.in and www.moneycontrol.com.

Statistical Tools

The simple statistical techniques like averages and rate of returns are used. Considering the interest of the retail investors the study has been made simple and average rate of return of mutual fund schemes compared domestic term deposit rates.

LIMITATIONS OF THE STUDY

Mutual fund schemes are considered for the period of 2008-2013. Hence, the findings of the study may not be generalized upon the other mutual fund schemes and for the same schemes for different periods. The performance of a scheme can be evaluated on various parameters, but to make the study simple and understandable by a retail investor only average return of the schemes has been calculated. Income tax aspects are not considered in this study.

CONCLUSION:

So, should you invest in mutual funds or fixed deposits? This decision is yours. If you are young and come from the average middle and upper middle class (at least), you can supposedly take more risk and should go for investing in mutual funds. On the other hand, elderly people and low-income persons cannot take much risk; securing the capital matters most to them. Such people should opt for bank fixed deposits instead of debt funds. After all, it is your money, and none knows yourself better than you. Only you, therefore, can make a final decision.