

Fixed Maturity Plans

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FMP a case for investment...

Fixed maturity plans are close-ended investment schemes floated by mutual funds with a maturity period ranging from three months to five years. These plans are predominantly debt-oriented. The objective of such a scheme is to generate steady returns over a fixed-maturity period by holding security till maturity and immunising the investor from market fluctuations.

Features of FMP

- A fixed maturity plan generates stable income or capital appreciation by investing in a wide range of debt and money market instruments
- Investments are made in a portfolio of securities with a maturity profile similar to the plan
- Generally invests in certificate of deposits, commercial papers and corporate debentures
- Credit rating of the instruments depends on the objective and strategy of the fund but generally investments are made primarily in AAA rated papers. It is safe to assume low credit risk

Why FMP?

- **Higher yield:** FMPs offer higher yield than fixed deposits and investors may expect a 50-100 bps return over and above bank fixed deposits
- **Capital protection:** Even though credit risk exists under FMP it is very less due to diversification and allocation to higher rated papers
- **Tax advantage:** FMPs are debt-based scheme and, therefore, dividends are tax free in the hands of investors though fund house has to pay dividend distribution tax, while bank fixed deposits interest is fully taxable in the investor's hands. Also, more than one year tenure FMP provides indexation benefit and are, therefore, tax advantageous as compared to FDs

...one year pre tax FD return is at 6-6.5% while post tax its around 4.50% while similar tenure FMP may be expected to yield 50-100bps more depending upon portfolio composition..

Recommendation

- FMPs are better investment options than bank fixed deposits as they offer higher after tax returns with minimal risk
- Debt funds are exposed to interest rate, liquidity and credit risk while FMPs are exposed to credit risk only that is taken care by investing in high quality papers
- Interest rate movement is difficult to predict but the trend is definitely upwards. However, because of lower yields in shorter duration debt securities it makes more sense to invest part of the portfolio under higher yielding medium tenure fixed maturity plans (FMP)
- Even though the trend in interest rates is upward and we may see higher yielding debt issuances in the next six months but because of lower yields in shorter maturity debt funds it is better to allocate some portion of the portfolio in FMPs for 12-18 months

...lower returns of shorter duration debt securities makes the case for FMPs stronger due to higher yield...

For ongoing FMPs please visit Mutual Fund Section...

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