

A money market fund chased an extra half-percent. In 2008 it broke the buck

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Maxim: *Understand the risk before you chase the return.* — Monika Halan, in substance

Every extra percentage point of return is paid for with some kind of risk. The investor's job is to find out which kind before signing up, not after.

If a fund pays more than its peers, the first question is not how much more, but what it is doing to earn it.

The Reserve Primary Fund was one of the most trusted names in American savings. Founded in 1970 by Bruce Bent and Henry Brown, it is often described as the original money market fund, a place for cash that was meant to be as safe as a bank account and pay a little more. At its peak it held more than \$60 billion, according to [Wikipedia's account](#).

For decades the fund stuck to the safest paper. Then, in 2006, it changed its prospectus to allow it to buy commercial paper, short-term IOUs issued by companies. Princeton economist Markus Brunnermeier's [lecture notes](#) on the episode record how quickly that changed the portfolio: commercial paper went from 0.9% of assets in May 2007 to 54% a year later. The fund's returns edged ahead of its peers, by 25 to 50 basis points.

Among that paper was debt issued by Lehman Brothers. When Lehman filed for bankruptcy on 15 September 2008, the fund was holding \$785 million of it, about 1.2% of its assets, according to a [Federal Reserve Bank of Boston paper](#). On 16 September it "broke the buck": its share value fell below one dollar, to 97 cents. Withdrawal requests reached a quarter of its assets within an afternoon and more than half the next day. The fund was liquidated. Investors eventually got back about 99 cents on the dollar, but only after years of waiting.

No investor in the Reserve Primary Fund was trying to take a big risk. They were taking a small, invisible one, in exchange for a small, visible reward. That is the most common way risk is bought.

The Indian version

Indian investors learnt the same lesson in debt funds. Credit risk funds, which deliberately buy lower-rated bonds for a higher yield, grew popular in the years when their returns stood out. As defaults and downgrades spread after 2018, the category came under strain, and after Franklin Templeton wound up six debt schemes in April 2020, investors left in a rush. Credit risk fund assets fell to ₹29,423 crore by June 2020, 53% below their level at the end of December 2019, [Business Standard reported](#) from AMFI data, with ₹19,238 crore pulled out in April alone.

A fund bought for its return tends to be sold in a hurry when the return disappears. The time to ask what kinds of companies the extra yield was coming from, and what would happen if they could not repay, was before investing, not during a rush for the exit. The return was the headline; the risk was in the portfolio footnotes.

The lesson Monika Halan has pressed for years in her personal finance writing and broadcasts is simple: understand where a return comes from before you chase it. A mutual fund is not a fixed

deposit, and her show's advice to investors anxious about short-term needs was blunt: do not put that money in mutual funds at all.

Where returns come from

In investing, extra return almost always comes from one of a handful of risks. Knowing which one you are taking is half the job:

1. **Credit risk.** Lending to weaker borrowers pays more because some of them will not pay back. Check the ratings of the bonds a debt fund holds, not just its name.
2. **Interest-rate risk.** Longer-term bonds pay more but fall harder when rates rise. Look at the fund's duration.
3. **Liquidity risk.** Assets that are hard to sell pay a premium until everyone wants to sell at once. Lock-ins and thinly traded holdings belong here.
4. **Concentration risk.** A few big bets can lift returns and sink them. Look at the top holdings and how much they make up.
5. **Equity and leverage risk.** Higher expected returns from shares or borrowed money come with deeper falls along the way.

Sebi has made part of this easier for debt funds. Since its [June 2021 circular](#), every debt scheme must declare a Potential Risk Class: a grid showing the maximum interest-rate risk and credit risk it may take, as [Business Standard explained](#) at the time. "The fund manager will have to state upfront the maximum risk she will take," one fund executive said.

A simple decision rule. Whenever a fund or product offers noticeably more than its peers, write down which of the five risks it is taking to earn the difference, and check the factsheet or Potential Risk Class to confirm it. If you cannot name the risk, do not invest. If you can name it, ask whether you could live with the bad outcome of that risk, not the average one. Money you may need within a year or two belongs in the plainest, safest options, whatever they pay.

The Reserve Primary Fund's investors did not lose much in the end, a cent on the dollar and a long wait. India's credit-risk investors fared worse in some funds and better in others. In both cases the shock came from the same place: a return that looked like a reward for nothing. In finance, a reward for nothing is usually a reward for a risk you have not yet noticed. Find it first, then decide whether the extra return is worth it.

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