**URL:** <https://www.bajajamc.com/knowledge-centre/liquid-funds-vs-fixed-deposits>

**Meta Title:** Liquid Funds Vs Fixed Deposits: Key Features and Which is Better Option | Bajaj Finserv AMC

**Meta Description:** Compare liquid funds vs fixed deposits to understand their key features, returns, and risks. Discover which is the better investment option for your short-term financial goals.

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# **Liquid funds vs fixed deposits: How to choose a suitable investment avenue?**

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For generations, Fixed Deposits (FDs) have held a position of trust, offering stability and assured returns. With the emergence of mutual funds, however, investors have alternative investment options that offer greater flexibility and similar or better return potential, albeit with some risk.

One such alternative, especially for short-term investments, is a [liquid mutual fund](https://www.bajajamc.com/mutual-fund/debt/bajaj-finserv-liquid-fund). With a low-to-moderate risk profile, liquid funds offer convenient access to money and the potential to earn better returns than FDs of short tenures.

This article will look at the differences between these two instruments and the advantages and disadvantages of each to help you identify which aligns with your financial objectives.

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## **What are liquid funds?**

Liquid funds are a category of [debt mutual funds](https://www.bajajamc.com/mutual-fund/debt) that investors and institutions use to temporarily park their surplus capital. With their focus on high liquidity and limited impact on capital invested, liquid funds provide a relatively stable avenue with modest return potential for short-term investments. These can be used to build emergency funds or money for short-term purchases.

These funds prioritise the relative stability of invested capital over high returns. They invest primarily in high quality debt securities with maturities of up to 91 days. These can include treasury bills, short-term government bonds, commercial papers, and certificates of deposit. The short duration of the debt investments reduces interest rate risk, while the high quality of the papers mitigates credit risk.

Even though liquid funds are among the lower-risk mutual fund options, they are still susceptible to market volatility and thus carry a slightly higher risk profile than FDs. However, they have the potential to outperform FDs in terms of yield over short tenures of a year or so.

## **Key features of liquid funds**

Here are some of the important characteristics of this [mutual funds](https://www.bajajamc.com/mutual-fund) category:

**High liquidity:** Many liquid funds offerredemption within 24 hours, providing easy access to money. Some even offer instant redemption of up to a certain amount.

**Relative stability:** Investments primarily in short-term, high-quality debt securities, ensuring relative stability.

**Modest return potential:** Though not as high as [equity funds](https://www.bajajamc.com/mutual-fund/equity), the return potential of liquid funds is typically higher than that of short-term traditional investments.

**High liquidity:** There is no lock-in period, so you can access your investments whenever you need funds. You can also top-up your investments or redeem only a part of them. This makes them more liquid than FDs.

**Portfolio diversification:** Liquid funds invest in a variety of money market instruments, reducing concentration risk.

## **What are fixed deposits?**

Fixed deposits or FDs are traditional investment options offered by banks and some non-banking financial companies (NBFCs), and the Indian post office. FD returns are fixed and assured, making them popular among risk-averse investors.

FDs function as time-bound commitments, where a lump sum is deposited for a predetermined period, ranging from a few days to several years. In exchange, the depositor earns a fixed interest rate, typically higher than that of a regular savings account. This interest can be disbursed periodically (non-cumulative) or accumulated until maturity (cumulative).

## **Key features of FDs**

**Fixed tenure and interest:** The duration and interest rate are established at the outset, providing predictability.

**Assured returns:** Shielded from market volatility, FDs usually provide safety of invested capital and fixed interest.

**Low risk:** Backed by financial institutions, FDs carry minimal risk.

**Less liquidity:** Early access to funds is possible, often accompanied by penalties or reduced interest.

## **Liquid funds vs fixed deposits**

Both liquid funds and fixed deposits are low-risk/low to moderate risk options for investors. But they cater to distinct financial needs and preferences. Here’s a comprehensive comparison:

**Return potential:** Liquid funds, with their exposure to money market instruments, have the potential to outperform savings accounts and FDs of short durations (around a year). Conversely, FDs, with predetermined interest rates, give fixed returns.

**Liquidity:** Liquid funds permit withdrawals on any business day, making them more suitable than FDs for unforeseen financial needs or for building a cash reserve. You can also add funds to it or redeem a small portion, adding to their flexibility. Some FDs offer premature withdrawal, but usually with penalties. Moreover, part-withdrawal or additional investments are usually not provided.

**Risk profile**: Market fluctuations make liquid funds riskier than FDs. However, they aim to mitigate risks through portfolio diversification, expert investment management and by investing in quality instruments. Additionally, the short maturity of the securities reduces interest rate risk, which is the risk that a change in interest rates in the economy will reduce the market value of the securities.

## **Who should invest in liquid funds?**

Investors with a low to moderate risk appetite can opt for liquid funds. While they do not guarantee returns, they can offer better return potential than fixed deposits with tenures of a year or a year-and-a-half.

This, along with their liquidity, make them a suitable choice for parking surplus cash, saving for a short-term goal or building a liquid reserve for emergencies.

## **Who should invest in fixed deposits?**

Fixed deposits cater to investors seeking fixed and assured returns and security of capital. They can be a reliable long-term investment vehicle for individuals seeking stable returns with minimal risk exposure.

## **How to choose between the two?**

Choosing between liquid funds and fixed deposits requires a careful evaluation of your individual financial circumstances and priorities. Evaluate the following factors:

**Investment horizon:** If you have a long investment horizon of multiple years, FDs may offer higher returns than liquid funds. There are other debt mutual funds, however, that may offer comparable return potential to FDs. Liquid funds usually cater to short-term goals. .

**Risk appetite:** If capital preservation and assured returns are more important than return potential, FDs may be more suitable.

**Liquidity:** Ifyou need easy access to funds or are looking to top up your investments when you have extra money, a liquid fund may be more suitable.

## **Conclusion**

The choice between FDs and liquid funds depends on your investment horizon, risk tolerance, liquidity requirements and financial objectives. For those with a long-term perspective and an emphasis on capital preservation, fixed deposits can be an attractive avenue for steady and predictable returns. Conversely, liquid funds could be suitable for short-term goals or for investors who need liquidity. They offer relative stability and reasonable return potential.

## **FAQs**

**Can a salaried professional invest in liquid funds?**

Anyone can invest in liquid funds. Liquid funds can be suitable for short-term investments, emergency funds and parking bonuses or other lumpsum incomes until they are earmarked for specific goals. The accessibility and relative stability of liquid funds makes them suitable for several types of investors.

**What is the maturity period of liquid funds?**

Liquid funds invest in debt instruments with a maximum maturity of 91 days. This short duration contributes to their high liquidity and relative stability compared to other mutual fund categories. Additionally, your investments don’t have a fixed maturity, as you can redeem units when you need money.

**When does the amount of a fixed deposit mature?**

The maturity date of a fixed deposit depends on the tenure. It can range from a few days to several years, depending on your financial goals and preferences. Upon maturity, the principal amount, along with the accumulated interest, is credited to your linked bank account.

**How do the returns on liquid funds compare to those on fixed deposits?**

Liquid funds can offer slightly higher return potential than fixed deposits for a term of a year or so, particularly in a low-interest-rate environment. However, it's important to remember that liquid fund returns are not guaranteed and can fluctuate based on market conditions. FDs, on the other hand, provide assured returns as per the predetermined interest rate.

**Is a liquid fund better than a savings account?**

Liquid funds offer higher return potential than savings accounts. They are also highly liquid, with some schemes offering instant redemptions. However, unlike savings accounts, liquid funds carry low-to-moderate risk. Capital preservation and returns are not guaranteed due to their exposure to market fluctuations.