Why you need to promptly rebalance your portfolio

September 23, 2016 08:25 IST

With stock prices at elevated levels, investors must cut valuation risks in their portfolio

Valuations in the equity markets have become stretched. While the over-valuation in large-caps is not too high, the mid- and small-cap indices have turned exorbitantly expensive compared to their long-term averages.

IDFC Mutual Fund runs a valuation meter on its website that tells investors whether it is safe to invest in equities now.

That indicator is flashing red. Some time ago, DSP BlackRock Mutual Fund curtailed investment in its Micro-cap Fund, a clear pointer that the fund manager was finding it difficult to deploy money at current levels.

Dynamic funds, which decide on their allocation between equity and debt based on trailing

P/E (price-earnings) ratio, have cut down equity exposure to about 30-50 per cent of their portfolio. Clearly it is time you too took steps to pare valuation risk in your portfolio.

Cut exposure, don't quit

While equities have turned expensive, you should not panic and quit this asset class altogether. Fund managers concede that headline indices have turned expensive. But in their view, there is still scope for selectively picking stocks with good growth prospects at reasonable valuations.

According to Harrish Zaveri, senior vice-president and fund manager, DSP BlackRock

5 tips for expensive markets

Stick to your long-term asset allocation. Investors who increase their equity exposure in bullish markets court more risk

Investment Managers, interesting opportunities are still available within the large-cap space.

"Earnings in the last five-six years have been so divergent that there are lots of stocks that are very expensive, but there are also stocks that are fairly cheap. Right now, 25 per cent of the market is still trading below book value. If the economic cycle improves, there are enough companies that can give a decent upside," he says.

If your investment goal is close, say, even three years away, lock in gains from equities and put money into low-risk fixed-income instruments

To rebalance, sell the asset class that has become expensive

Short-term debt funds and non-convertible debentures are instruments you may invest in.

Buy gold if you are underweight in that asset

Investors entering equity funds for the first time should opt for large-cap funds of experienced managers adept at handling volatility

Dynamically managed funds are another option for those who want both equity and debt exposure through one fund

Adds Neelesh Surana, head-equity, Mirae Asset Global Investments (India), who manages the mid-cap Mirae Asset Emerging Bluechip Fund: "The universe of mid-size businesses is larger - almost four-five times that of large-caps. The ability to choose from a wider universe, when combined with the improving trend within the economy, offers decent opportunities in midcaps even at current levels."

Another reason for not exiting equities now is that a market that has become overvalued can remain so for a long time, and move further up. By exiting it entirely, you will miss out on on those gains.

Time to rebalance

To cut down on valuation risk, check how the asset allocation of your portfolio has become askew due to the run up in the market. Look at your overall equity exposure, including equity mutual funds, direct equities and employee stock options. Has it become higher than the allocation your financial planner or you had decided upon originally?

"In upbeat markets, investors tend to tactically increase their exposure to equities instead of sticking to their long-term strategic asset allocation. This should be avoided," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Investors also need to check their risk appetite. "If the markets were to fall by 20 per cent tomorrow, would you be affected by it? If the answer is yes, you should reduce your exposure to equities," says Mumbai-based financial planner Arnav Pandya.

If a particular investment goal is approaching, say, your daughter starts college in two years, take out the money meant for that goal from equities and move it to low-risk fixed-income instruments. You will thus avoid jeopardising that goal due to a possible correction.

If your exposure to equities has become higher, sell a portion of your holdings in this class and reinvest the money in an asset class where you are underweight.

This could be either debt or gold. Don't rebalance your portfolio by stopping your systematic investment plan (SIP), which would take a long time to achieve.

Within equities you may have turned overweight on mid- and small-cap funds. Pare exposure to that category and move money to large-cap funds. Surana suggests maintaining a 25-30 per cent allocation to mid- and small-cap funds in your equity portfolio.

Diversifying your portfolio geographically can make it better equipped to deal with volatility. The US market is a good option, even though it too has turned expensive.

"The Indian market tends to be more volatile than that of the US. If and when a correction happens, the Indian market could correct more," says Dhawan.

If you wish to invest in fixed-income products now, opt for short-term debt funds as the rally in longer-term bonds is already behind us. According to Pandya, non-convertible debentures of highly-rated companies are a good option.

Investors may even invest in gold, if their portfolio is underweight on the yellow metal (8-12 per cent of total portfolio is an ideal allocation).

While gold appears expensive in India, its price in the international market is not too high by historical standards. Prices in India track those in the international markets. Continuing global uncertainty means that gold could appreciate further going forward.

Newcomers need to be cautious

New investors need to be cautious, given the current high valuations. If they wish to invest in one product for both equity and debt exposure, dynamic funds, which rebalance the portfolio on the investor’s behalf, are a good option.

Those who invest in a balanced fund should examine its equity-debt mix and choose one that fits their risk profile.

If you already have fixed-income investments, opt for a large-cap fund.

“Go with a fund whose manager has witnessed several market cycles and has become adept at handling volatility. Whenever global liquidity ebbs, the Indian market is bound to witness volatility,” says Dhawan. Finally, those entering equities now should have an investment horizon of at least five-seven years.

Photograph: Shailesh Andrade/Reuters

Sanjay Kumar Singh

Source: Business Standard

Discussion Board

Write a message

Total **1** message **Pages | 1**

GST will brighten up the Logistics.
by chanakya maurya (View MyPage) on Sep 23, 2016 02:26 PM

So it may be wise to dilute the IT in favour of Logistics.

Reply Forward | Report abuse

Total **1** message **Pages: | 1**

Write a message Terms of use | Disclaimer