

Should you invest in multi-cap funds?



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If you can't decide whether your portfolio should have a large- or a mid- and small-cap tilt, let the fund manager of a multi-cap fund do so for you.



lack of liquidity when the markets tank. When the markets are rising, investors bet aggressively on mid- and small-cap stocks. When the environment turns adverse, liquidity dries up in these stocks. However, multi-cap funds with the right mix of large-caps and mid- and small-caps are not affected as much. **"To meet redemption requests, the fund manager can sell large-cap stocks. He does not have to sell mid- and small-caps at distressed valuations, as happens in portfolios that are heavily loaded with these stocks,"** says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

second decision to an expert, the fund manager."

Points to remember

While investing in multi-cap funds, keep the following points in mind:

Cash allocation: Does the multi-cap fund remain invested in equity at all times or does it take large cash calls? Taking a cash call means that the fund manager moves to cash when he thinks the market may decline, and to equity when he thinks it may move up. Avoid funds that take large cash calls for two reasons. One, taking such calls has an element of market timing, and nobody has ever timed the market right for a considerable period. Two, whether to move to equity or cash is an asset allocation decision that should be taken by the investor or his planner, not the fund manager. If the fund manager takes high cash calls, the asset allocation decision takes place at two levels. Consider an investor, who has a negative view on equity, decides to move 30% of his portfolio to fixed income and leaves 70% in equity. His fund manager also decides to move 30% in cash and has only 70% of the fund portfolio in equity. This means that the investor's effective exposure to equity is now only 49%. If the cash call goes wrong, there is a double impact on his portfolio. Hence, stick to funds that have a less than 5% allocation to cash at all times.

Fund manager's limits: Within the multi-cap category, some fund managers are allowed to go entirely to large caps or entirely to mid- and small-caps. Others are allowed to move to a particular category up to a certain limit. While the former type of funds can earn higher returns, they can also falter badly if their calls go wrong. Choose a fund that matches your risk appetite.

Expectation mismatch: Multi-cap funds hold a mix of large-cap and mid- and small-cap stocks. In most years, they will produce middle-of-the-road performance. In a year when mid- and small-caps have done well, they will lag behind this category, while doing better than large-caps. The reverse could also happen in certain years. So, understand why these funds have fared well or badly, and don't fret about their performance.

How much should you allocate?

When you begin to build a long-term equity portfolio, start with products that offer the least risk and move up the risk ladder. So, 30-40% of your equity portfolio should go to large-cap funds. Next comes the turn of multi-cap funds, which should take up another 30-40%. Mid- and small-cap funds will take up the balance that is left after a 10-20% allocation to international funds. **Explaining the rationale behind a 30-40% allocation to multi-cap funds, Dhawan says, "When you invest in equity, you have to take a couple of decisions: one, how much will you allocate to equity versus fixed income? How much will you allocate to different market segments? By investing a good part of your portfolio in multi-cap funds, you delegate the**

SANJAY KUMAR SINGH

Avantika Singh, a 23-year-old electronics engineer, has just begun investing in equities. Having already put money in a couple of large-cap funds with consistent track records, she now wants to invest in a mid- and small-cap fund. However, her uncle, a financial planner, suggested that she should not overlook the multi-cap category, which has an important role to play in an equity portfolio. Retail investors like Singh need to have an allocation to multi-cap funds for various reasons.

Two, retail investors tend to invest on the basis of recent performance. If, over the past six months, mid-cap stocks have done well, they will tilt their portfolios towards these funds. Fund managers of multi-cap funds are better placed to decide whether to invest more in large-caps or in mid- and small-caps, based on objective criteria like prospects of individual stocks and valuations. They, thus, prevent 'recency bias' from creeping in.

Three, a multi-cap fund is less affected by

A few good options

Here are some of the funds from the multi-cap category that you may choose from.

Fund	RETURNS (%)			Expense ratio (%)
	1-yr	3-yr	5-yr	
L&T India Spl Situations Fund (G)	24.47	9.04	21.46	2.65
Tata Dividend Yield Fund (G)	22.60	7.26	21.99	2.87
Birla SL Equity Fund (G)	30.40	7.10	17.64	2.25
Principal Growth Fund (G)	30.37	9.11	16.30	2.56
DSPBR Equity Fund-Reg (G)	19.53	4.17	17.52	2.33
SBI Contra Fund-Reg (G)	12.63	3.10	12.59	2.10

Funds ranked on the basis of returns, risk and expense ratio. Data as on 16 April 2014. Source: Ace MF

Why invest in multi-cap funds

One reason to opt for this category is that different parts of the stock market tend to do well at different times. The data from 2006 onwards shows that while the large-cap index has done well in a given year, in the next, the mid- and small-cap indices have done the same. "A multi-cap fund, which has exposure to all the categories, can benefit from the outperformance of any of these," says Taher Badshah, senior VP and co-head of equities, Motilal Oswal AMC, which has recently launched Motilal Oswal MOST Focused Multicap 35 Fund.