Home » Money

During volatile markets, asset allocation is your best friend

Planners recommend multiple asset classes so that if one falls, others can balance it

Last Published: Mon, Oct 15 2018. 09 03 AM IST

Kayezad E. Adajania

Photo: iStock

As television anchors took us through the near 1,000- point drop in the Sensex index, early Thursday morning, following the sharp fall in the US markets, Mumbai-based Vishal Shah, 41, was gleeful. He saw an opportunity. He called up his financial planner Kalpesh Ashar to invest a fat amount of money—he didn't tell us how much but made it sound it was a chunk—in equity funds. Shah had booked profits from equity funds and sold some of his equity shares in 2017 as he couldn't justify the (high levels in) market. The booked profits were parked in some ultra short-term and short-term funds. Although Shah comes from a family that swears by equity investments, Ashar introduced him to liquid and ultra short-term funds as a means to bring down the risk levels in the portfolio.

The year 2018 has been volatile, to say the least. Although equity markets have risen by a mere 0.3%, debt funds have been rocked by rising interest rates and fears of deterioration in credit ratings in the wake of downgrades in Infrastructure Leasing & Financial Services Ltd (IL&FS) and some of its subsidiaries. Whichever way the investor looks at, it's volatility everywhere. Should you just sit on the fence and wait for the volatility to get over or should you continue with your investments and systematic investment plans (SIP) as if nothing happened? The short answer is: nurture your asset allocation.

The importance of asset allocation

We've always told you to not put all your eggs in one basket. As clichéd as that sounds, here's proof. In the last one month, while equity funds fell by 8%, government securities funds (a good proxy for debt markets) rose marginally by 0.27%. International gold prices fell by 0.74%, but the S&P 500 index based in US marginally rose by 0.43%. In 2017, while government securities funds rose by just 2%, Indian equity funds had risen by 33%, and gold went up by 13%. The S&P 500 index had risen by 19%.

“People, in general, have forgotten about gold. But gold as an asset class has begun to go up,” said Vishal Dhawan, founder and CEO of Mumbai-based Plan Ahead Wealth Advisors.

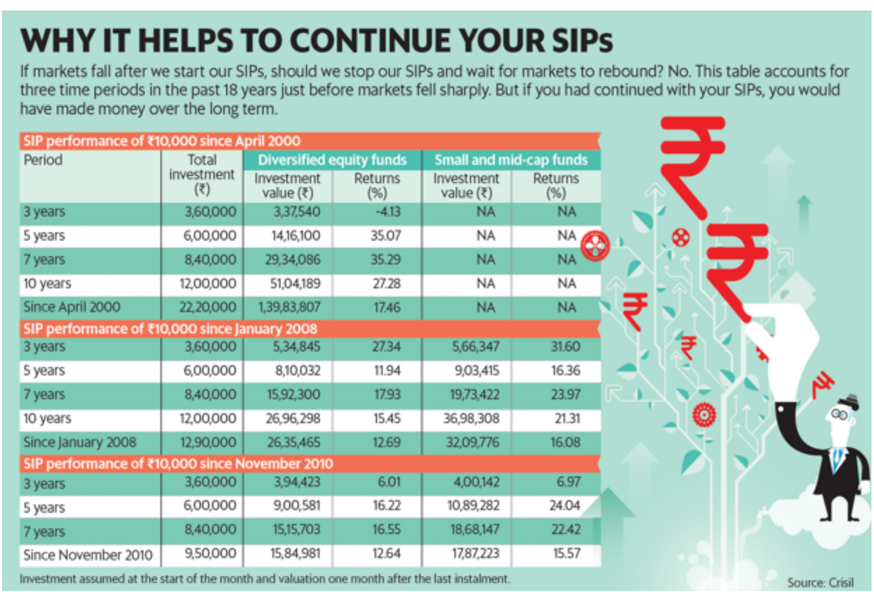
Importance of asset allocation. Source: Mint Research, Value Express
photo

Broadly, financial planners recommend multiple asset classes so that if one asset falls, another or few others don’t fall as much. In fact, some may just as well go up and that helps your overall portfolio.

Mint saw the returns through broadly four asset classes—equity (through large- and multi-cap funds), debt (through government securities funds), gold (in US prices) and S&P 500 index as a proxy for the US markets. Between 2000 and 2017, equity outperformed all other asset classes nine times, debt markets five times, gold three times and the US markets once. “Typically, on days when markets fall, many investors want to remove all their equity holdings. But when markets are at their peak, investors want to invest everything into equities. Asset allocation tells you ideally how much you should have of what asset class,” said Shyam Sunder, managing director, PeakAlpha Investment Services Pvt. Ltd.

Patience pays

SIPs have been getting truckloads of customers into the mutual funds industry. In September 2018, ₹7,727 crore worth of inflows came into MFs through SIPs, up from ₹6,644 in January 2018 and ₹4,095 in January 2017. But what happens if the markets crash after you start your SIP?



WHY IT HELPS TO CONTINUE YOUR SIPs

If markets fall after we start our SIPs, should we stop our SIPs and wait for markets to rebound? No. This table accounts for three time periods in the past 18 years just before markets fell sharply. But if you had continued with your SIPs, you would have made money over the long term.

Period	Total investment (₹)	Diversified equity funds: Investment value (₹)	Diversified equity funds: Returns (%)	Small and mid-cap funds: Investment value (₹)	Small and mid-cap funds: Returns (%)
SIP performance of ₹10,000 since April 2000					
3 years	3,60,000	3,37,540	-4.13	NA	NA
5 years	6,00,000	14,16,100	35.07	NA	NA
7 years	8,40,000	29,34,086	35.29	NA	NA
10 years	12,00,000	51,04,189	27.28	NA	NA
Since April 2000	22,20,000	1,39,83,807	17.46	NA	NA
SIP performance of ₹10,000 since January 2008					
3 years	3,60,000	5,34,845	27.34	5,66,347	31.60
5 years	6,00,000	8,10,032	11.94	9,03,415	16.36
7 years	8,40,000	15,92,300	17.93	19,73,422	23.97
10 years	12,00,000	26,96,298	15.45	36,98,308	21.31
Since January 2008	12,90,000	26,35,465	12.69	32,09,776	16.08
SIP performance of ₹10,000 since November 2010					
3 years	3,60,000	3,94,423	6.01	4,00,142	6.97
5 years	6,00,000	9,00,581	16.22	10,89,282	24.04
7 years	8,40,000	15,15,703	16.55	18,68,147	22.42
Since November 2010	9,50,000	15,84,981	12.64	17,87,223	15.57

Investment assumed at the start of the month and valuation one month after the last instalment.

Source: Crisil

Evidence shows that even if markets slide after your SIP starts, patience pays and you have a high chance of making money in the long run. If you had started your SIP in April 2000 or January 2008 or November 2010 just before equity markets had started to fall, you'd still have made money (see graph).

Should you invest?

Experts recommend that your investments must always go on, no matter where the markets are. The question is: how much?

Your asset allocation should be the starting point. Broadly, financial planners recommend that you should divide your assets between equities, fixed income, gold and international equities. Real estate is also an asset, though it's best not counted here if you don't already have one. But if you have real estate, then that becomes the fifth asset in your portfolio, till the time you decide to trim it or remove it altogether.

Vinod Jain, principal adviser, Jain Investment Planner Pvt. Ltd, has a slightly different approach. He tracks equity and debt markets with a hawk-eye and determines the most likely equity and debt split his customers should have. Then, depending on their risk profile and how much fall an investor can tolerate, the asset allocation deviates, albeit marginally, from his firm's stated equity and debt split. On Wednesday, when Mint spoke to him, he said that if he'd be investing in the US markets, he'd be putting in much less money there than before, based on his reading of the indicators he typically tracks, to decide on equity investments. When India woke up on Thursday morning, the US markets had already fallen sharply. The S&P 500 ended with a loss of 3.29%, Nasdaq Composite 4.08%, while the Dow Jones shed 2.2%.

But as Jain reiterates, it is important to invest in at least two asset classes, namely equity and debt. "It is simple. Equity and debt markets are negatively co-related. Most of the times, if equities go up, debt markets go down and vice-versa. If you have money invested in both, you are cushioned," he said.

Last year, when Leo Pereira, 66 walked into Jain's office to invest his retirement corpus, Jain's firm was running an asset allocation of 54% in equity and 46% in debt investments. But since he had not invested in equities much before his retirement, except a single SIP, Jain put 60% of Pereira's corpus in equity and the rest in debt funds. Pereira wanted a post-retirement income of close to ₹50,000 every month. Today, Jain's firm recommends an asset allocation of around 65% in equities and the rest in debt funds because of the correction in equity markets. But he has not yet tinkered with Pereira's asset allocation. "Asset allocation may change frequently because of market conditions, but once an allocation is decided for investors, they should not make changes for at least 3-4 years; otherwise, they'll end up churning the portfolios frequently," said Jain.

Meanwhile, on Friday, the day after the market turmoil, the S&P BSE Sensex closed 732 points or 2.15% higher. If your asset allocation were in place, your portfolio would not have suffered.

First Published: Mon, Oct 15 2018. 08 57 AM IST