The Mutual Fund Show: Investors Must Focus On Goals, Time Horizon

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Turbulence and stock markets may go hand in hand, but Roopa Venkatakrishnan advised equity mutual fund investors to stick to their goals.

"The investment could be an SIP (systematic investment plan) or a one-time lumpsum amount," the independent financial advisor said in BloombergQuint's weekly series *The Mutual Fund Show*. "In between, if your goal changes, then you can add more to the SIPs. But it (the investment) has to be goal- and time-based."

The S&P BSE Sensex and the NSE Nifty 50 Index have declined by nearly 9 percent each since their record close on Aug. 28, primarily due to rising crude prices, a weaker rupee and a credit crisis triggered by defaults by IL&FS group companies. "You will see cycles where the markets correct," she said. "The sharp corrections during the period shouldn't be deterrent for your goals."

Gajendra Kothari, managing director and chief executive officer of Etica Wealth Management, agreed. "The foremost thing has to be goal and then you have to fit the products within the goals," he said. "If your horizon is short-term like 2-3 years, then debt products are suitable." If one is invested in equities, then the timeframe, according to Kothari, must be at least five years.

The challenge in India is to find a fund manager who can stick to value, said Vishal Dhawan, founder and chief executive officer of Plan Ahead Wealth Advisors. He said this was why he would suggest the Parag Parikh Long-Term Equity Fund, which has a third of its holding in foreign companies.

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could be an SIP or one-time investment. You will see cycles were the markets correct. In India, we have seen that the bull and bear markets take around 8-10 years to go through those cycles. You should look at 8-10 year period. The sharp corrections during the period should not be deterrent for your goal. You should stick to your goals and investments. In between, if your goal changes then you can add more to the SIPs. But it has to be goal- and time-based.

Should we park money in equity funds or debt funds? Is there an either or case here?

Gajendra Kothari: You want to revisit the question of what your goals are. Products don’t decide which is the right entry level. The foremost thing has to be goal and then you have to fit the products within the goals. If your horizon is short term like 2-3 years, then debt products are suitable, no matter how cheap the equity is at this point. It won’t suit for your 2-year goal because it’s near-sighted. Anything below three years, go for debt products. Within debt products, debt fund is a good way to enter because you are entering at elevated yields. If in two years yields cool off, you make additional capital gains. If you are invested in equities, then you have to come with more than 5-year time frame, whether it is SIP or direct equities.

You have something like strategic asset allocation and tactical. Within tactical asset allocation this might be a good time for more lump sum. I wouldn't say SIP because they are all weather products. You can't time SIPs, but you can time lump sum perhaps. The markets have fallen and may expect another 5-10 percent if there is some money lying in liquid funds. You can switch larger amount into equity funds as and when markets go down. For the tactical part of your portfolio, which may be 20-30 percent, this is a good time to start looking at it very closely.

Which fund did you choose?

Venkatakrishnan: The one which I choose in equity is SBI Focused Fund. If you look at its consistency, then it is a multi-category fund which has 20 percent small cap, 40 percent mid cap and 40 percent large cap. In India, there is a cycle of 8-10 years of bulls and bears. Even the mid and small caps go through the cycle of investments. This fund has weathered through all that in the last 10 years. It is very essential to judge a fund in 8-10 years rather than looking at 3-4 years because even the fund managers have to go through cycles to give returns. In equities, the horizon should be more than 8-10 years. This particular fund has been a quartile in the last 3-5 years and has performed consistently.

You are saying the time horizon should be 10 years. And it might be wise now to put in lump sum money. Why so?

Venkatakrishnan: It could be lump sum or systematic transfer plan. Investment is all about expectation of returns. The most important is goal, time horizon and expectation of returns. From 1986, the BSE Sensex has given 30 percent annualised return. If your expectations of returns are moderate, if it is above inflation, and it gives you sustainable purchasing power, then you should be fair. The concern for most investors is expectation of return. If expectation of returns is reasonable then you are fair enough and for long term you will be able to achieve.

Why are you choosing a UTI Equity Fund?

Kothari: It is a multi cap fund and is diversified. The fund follows growth-style of investing. It has quality names in its portfolio. The fund manager believes that it may not do as good as other funds. But on the downside, it offers a great cushion because of the quality names. It is a great product for most strategic portfolios. The fund size is also manageable which is Rs 8,000 crore. The expense ratio is about 2 percent. So, all boxes are ticked off.

What is the risk associated with it?

Kothari: In bull markets, it will underperform peers or the market at times. So, you need to have patience. If you aren't worried about the downside, then this is a very good product fitting into your portfolio.

Why Parag Parikh Long Term Equity Fund? Why you are going for a fund which has got a third of shareholding in global companies?

Vishal Dhawan: It is one of the reasons why we tend to allocate money there for investors. There is a core reason which is critical. Our belief is a lot of funds in India follow a growth style because India is a growth-oriented market. The challenge is can you find a value manager who has the conviction to stick to value? It is not easy. They are constantly getting tracked, measured against peer group. They (Parag Parikh Long Term Equity Fund) have still been able to do it very well with a value style stuck to that. The international exposure just adds that kicker because it gives access to probable products or opportunities which don't exist in India. If you look at its largest international holding, it's in Alphabet and Google. Similar business doesn't exist in India. If you look at their holding like Suzuki, Maruti has been favorite till a few months ago. You can buy Suzuki more cost efficiently compared to Maruti in India. You will see a blend of smart thinking which has gone in portfolio. As long as investors understand the risks associated with strategy, a blend of 2-3 things, it is a great addition to portfolio.

For the debt category, you are recommending Reliance Liquid Fund. What type of investors should go in with debt category?

Kothari: It is an entry-level fund. Somebody who is coming to the mutual fund industry for the first time, this is the safest bet. It is a liquid fund where your money goes into safest securities. This fund is ideal for people who have idle money lying in bank accounts. All our employees' salary directly gets credited in this fund and then they can withdraw from the app at any point of time. In Diwali, we will give bonus and the bonus will also come in liquid fund. Money is earning 6-7 percent compared to 4 percent in savings account. You can withdraw up to Rs 50,000. So, it is a great way to start investing. Each one of us have Rs 50,000-1 lakh in savings account. Then why not the bulk of money stay in liquid fund. This is one fund which you don't have to worry about. The performance has been good. It has given 7-7.5 percent for a long period. The expense ratio is reasonable at 0.23 percent. The size is big and a lot of big institutions invest in it. A time period of anywhere between a week and 6 months is great to be in this one.

You are recommending Franklin Templeton Short Term Income fund. Why this one?

Venkatakrishnan: When you look at debt, it has to have a time horizon and expectation of returns. Debt funds give you returns at the level of your inflation and you have to be safe with your money. Because taxation-wise all debt funds are more effective, the fund is very consistent, and is not volatile. The fund manager has been able to manage it in the last 6-7 years very consistently without any panic. You have seen a lot of panic in the last 3 months in the debt market. Everything is priced in, and this fund looks good with a view of 3-4 years.

The risk is only in a shorter period of time. The risk can be expectation of returns. If you come with expectations that short term will give you 10 percent, then no. The expectation of return should be 7.5-8 percent. At the end of it, the disappointment in any investment is expectation of return. If you have a reasonable expectation, then the customer gets what he will get at the end of maturity. The volatility is for the shorter period of time. Maybe 6 months down the line when the yields spike, returns might look negative. If you look at 3-4 years period, then you are able to achieve returns and goals.

What is the fund that you are recommending?

Dhawan: Our recommendation is to look at a very safe short-term debt fund. HDFC Short Term Debt Fund would be our choice. There are three drivers to it. One is low duration. We think that there are enough stress points in Indian macro today for investors to worry about not being able to figure out where interest rates will go. Short term debt fund like HDFC, which has a duration of 1-1.25 years or a quarter, are suited to take care of this volatility. Second, several times investors underestimate the impact of cost, especially on debt portfolio, and it is 0.4 percent a year which is low cost. Third, which is critical right now, is portfolio quality. It has got in excess of 90 percent of portfolio sitting in AAA and AA+ papers which is interesting. It takes your yields and subtracts the expense ratio. You can get returns which credit risk funds can deliver, net of expenses very similar to each other. Therefore, you are able to buy high-quality portfolio at low cost, giving you possibly a similar return to a high-credit risk portfolio with higher cost.

Is the timing right to get into a debt fund category, assuming time horizon is three years?

Dhawan: If you look at the history, whenever you have crises you typically find that things settle down in debt market in 6-9 months. The moment you have given yourself three years, you have given more than enough time to be able to tide over any things. The more critical aspect is you have at least a portfolio investment horizon equal to the duration of portfolio. If you have to look at this portfolio for less than a year, then you might see some of these risk playing out. But if you are here for three years, then all of this will get over as long as you don't panic.

What kind of investors should go for the hybrid category and why have you chosen L&T Dynamic Equity Fund?

Venkatakrishnan: Customers often ask is it the right time to invest. This category fund has an asset allocator, internally built in to allocate in equity and debt as per market valuations. The fund itself takes care of it instead of investor trying to time the market. Again, in this particular fund, the time horizon is very important. It needs to have a 2-3-year view when it comes to investments in this fund. But because the asset allocator is built in, customers don't need to ask about the right time to enter. But the returns are not as much as equity funds would give but it could be reasonable and volatility could be much lesser to get returns in 2-3 years.

You have given us two names—Edelweiss Equity Savings Fund and ICICI Balanced Advantage Fund. Why these two funds?

Kothari: A first-timer in equity funds can come through this space where equity exposure is within 25-30 percent and the expectation returns are FD-plus returns over a 3-5-year period. If he likes it, he can move on to the next product which is ICICI Balanced Advantage Fund, a pioneer in its category. They have the most successful fund manager. This fund is an all-weather fund and for this kind of fund you can be a lazy investor because the fund manager is doing your asset allocation. You don't have to track the market level.

If you see the portfolio of the fund right now, it is 40 percent equity and 60 percent is in cash and debt. You don't have to worry about markets. The risk-adjusted return from these kind of funds can be better than pure equity funds. With much less volatility, you can expect 10-12 percent return over a five-year period which is fantastic for most investors because they are getting much better than FD kind of returns and not the volatility which comes in equity product. Many can be direct investors. For them, these kind of funds are having low risk. In this fund, they don't have to panic. These funds will never give you 20-25 percent returns. This are stable funds of 10-13 percent returns.

You are recommending ICICI Prudential Nifty Next 50 Index Fund and Franklin India Feeder US Opportunities Fund. You like betting on funds which have U.S. or international exposures.

Dhawan: There exists a very large home bias across investors. You go to a U.S. investor, he has got all the money in U.S. Europe investors have all the money in Europe. Everyone is comfortable in their own zone. They need to know which companies they bought. But you find that markets and economies don't go up and down together. So, the idea is to move away from having all your money in a single geography. It cannot be that equity, debt and gold become your starting point. It actually has to be India, U.S. and other parts of the world.

Will you recommend this fund even for the one who is starting investing? Or this is for thise who have some years of mutual fund investing and some assets under their portfolio before they go in for geographical diversification?

Dhawan: It is important for everyone. So, the allocation percentage should vary. Someone who is starting off may start with only 5 percent going overseas and 95 percent in domestic because he is trying to build confidence and comfort. As you get more experience, you might go up to 50 percent international. The U.S. has 50 percent of the world market cap. A lot of businesses are global there. So, it is not about whether the U.S. will do well in the next 12 months or 24 months. If you are constructing portfolios for 10 years, would you not have allocation to the largest markets in the world?

Why ICICI Prudential Nifty Next 50 Index Fund and what is the time horizon for it?

Dhawan: Our belief is that active managers in India have started to beat indices. If you look at one-year data, 88 percent of fund managers are underperforming in large caps against indices. If you go to three or 10 years, you will find it is more than 65 percent. All of a sudden something which seems to appear internationally have come to Indian shores. Active managers are struggling to be passive. The clear difference is cost. If you look at active manager today most of them are sitting with 1.5-2 percent of management fees. If you look at index funds, something of this kind can be 0.6 percent. Otherwise a lot of indices are between 0.2 percent and 0.6 percent. You are able to save 1 percent of cost itself just through your strategy and on top of that if the fund manager is going to underperform, you will have an additional kicker. This is the core part of your portfolio. You are doing with the Next 50, which is stock number 51-100, which in today's mutual fund classification is still large cap, though people might believe 75 percent large cap and 25 percent mid cap. But largely a large cap portfolio and good quality names. A lot of them will enter the Nifty over a period of time. So, it is a natural selection and de-selection process. It will happen automatically when the indices change. Low cost, no active fund manager risk and it is a great strategy for long-term investors.

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