The Mutual Fund Show: Should You Opt For MF Schemes With Insurance Cover?

Financial planners often recommend mutual fund schemes that offer free term-insurance plan as asset managers rush to woo investors amid increasing competition.

But are mutual funds with an insurance cover a viable investment option?

"This is a blessing for mutual fund investors," said Anant Ladha, founder of Invest Aaj for Kal. "Free insurance plan with systematic investment plans and funds will allow investors to remain invested for a long term, generating good returns." Ladha said on BloombergQuint's weekly series The Mutual Fund Show.

Still, not all agree.

Vishal Dhawan, founder and chief executive officer at Plan Wealth Advisors, said the moment investors combine mutual funds with insurance, it may affect their decisions on the performance of the fund.

"If the fund manager is not performing as per your expectations, you cannot exit it due to high exit load. Therefore, having a free-term insurance would keep you latched on to the fund even if it's not the best for you."

We have learned to keep insurance and investment products separate. So, how attractive are term insurance plans with mutual funds?

Anant Ladha: It is a blessing for mutual fund investors, and the industry as a whole. Traditional investment plans were sold by focusing on the insurance part. Now mutual fund SIPs will give you free insurance. Everyone will be very excited to do it. The best part about the free insurance is you have to keep your funds intact for long term. That is any way something you want for a mutual fund investor or an equity investor. It is aligning to two things—one is a long-term part and giving insurance absolutely free. I think people will enjoy it. Investors have to run through it because if mutual fund investors are keeping money for long term then they are bound to make money. If they make money, they will feel happy. Whether they keep it for insurance part or equity part, they are bound to make money. So, it's an added advantage.

Vishal Dhawan: We have seen free insurance happening in the car industry in the past. We have seen that somehow, the side item becomes more important than the core. To us, insurance when you are trying to do investments largely, is the satellite item. The core reason you are investing is that you want your money to grow to certain level so that it can help you meet certain goals and objectives. The moment you combine these together, our view is, it will hold you back when you have to take decisions on the quality of performance of the fund. If you find that your fund manager is not doing his job in the way that you hoped he would against his peer group, and you want to come out, but insurance will hold you back. On normal fund, you have an exit load which is just one year and for some it could be two-three years. You can't get access to all schemes of a fund manager. The reason why the industry works well is because it has open architecture, you can go where you want, you can pick the manager of your choice, if you don't like active funds, you can go passive; You can do all those things and focus on your investment choices and that's what is missing the moment you add term insurance. All of a sudden it becomes a chain for you and it holds you back because you have term insurance.

Suresh Sadagopan: When you want to take term insurance, it is not that you want Rs 8-10 lakh which is coming free. A normal person for whom we offer term insurance, maybe they will give Rs 1-3 crore. There is an insurance which may be free for Rs 8-10 lakh, but we have to keep that going just because it is free, and you have opted for it.It will hold me back as an investor to not get out of fund even if it is not performing relatively well as compared to some other candidates. So, you will latch around that fund and probably that will not be a good thing for an investor.

Should investors put money in the new fund offers opened currently? There are Mirae Asset Focus Fund, Principal Small Cap Fund and ITI Multi Cap Fund, among others, which are open.

Dhawan: You need to look at an NFO when it comes with something unique that exists, which doesn't exist in any of these at all. Unfortunately, all of these are getting added-on funds to categories that they are already part of. You have a lot of names which have strong track records. Mirae has done extremely well on equity side. But there are other focused funds that investors can look at. There are track records. You can track these funds what they did over a period of time. If it is perfectly okay to buy. After a period of time, if you see fund managers perform, take advantage of it. The same thing with Principal. They have some good schemes, but the question is that is this the first small-cap fund in market? The answer is no. So, you need something unique to come in to say that you want to put money in it before you have a track record to go by.

Ladha: Investing in these NFOs would be like hoping rather than investing. They are hoping that these funds will do good in future and you don't have a track record. I will prefer an existing fund. But if I have to put my bet on one out of these four funds, it will be on the ITI Multi Cap Fund. That's because of the track record of fund managers. George has managed ICICI Multi Cap Fund and even long term well. So, does the other fund manager who is ex-Tata. He has done well with Tata Tech Saving Fund, which is pure value fund. So, if I have to choose, I will choose ITI. Otherwise, new investors can avoid these funds.

Would you recommend investing in best performing multi-cap funds of FY19?

Sadagopan: When we analyse the universe of sub-categories as multi cap, we don't look at the performance alone.We look at the short- and long-term performance. We look at risk parameters, return on capital employed, return on assets, besides the expense ratio, and who is the fund manager and for how long has he been there? Then we have a set of quartiles I, II, and III funds. We sort it in such way. Performance is one of the factors and it is not just about that. We cannot go by that this fund has given 17.25 percent and the other has given 16.81 percent and say 17.25 percent is better than 16.81 percent. Past performance is not an indicator of how it will perform in the future. Analysing long-term performance of these funds and by applying all the criteria and parameters, you will come up with credible choices.

Dhawan: It may be a coincidence that there may be a fund which may have done well in the last one year and which also has a great track record. You might pick it by chance. The good news about FY19 is that there are some schemes which have a fantastic long-term track records, which are also appearing on top. At the same time, there are schemes with very good track records which unfortunately are at the bottom. You could make wrong choices if you pick the best and let go of the worst or vice-a-versa. You could say I will never pick best in last one year because they have underperformed, and you could find that the fund has great long-term track record.

What is the top multi-cap fund to invest in right now?

Ladha: The best part of best-performing funds is that they are bound to change every year. We need a consistent performer rather than a best performer. When we talk about consistency, I find two funds very good. First is ICICI Multi Cap Fund. That is because it is fairly on a defensive side. They have good amount of diversification and exposure. They are having good exposure in PSUs and sectors which have not been performing lately. The SBI Multi Cap Fund is good, too. More than asset managers fund, it is analysts' fund. They have eight separate analysts looking at each sector, who would be tracked for their sector and they have to outperform their sector. The best thing about this multi-cap fund is that they have removed the sector risk. We have two kind of risks in every fund—sector risk and selection risk. They have completely copied the benchmark sector. So, they have zero exposure to sector risk, and they are only taking funds call. These two are funds which I would recommend on multi-cap side because they are defensive. They are such funds with which we can map the goals and consistently see them performing well over long term.

Dhawan: HDFC Equity fund, which coincidentally did very well on FY19 rankings, is a good choice and it has done very well over periods of time. So, there are pockets of under-performance along the way. Some of those pockets have been fairly long and sometime investors' patience gets tested along the way. But the reason why it seems to work very well is the willingness of fund manager to make shift across market cap with great conviction and holding on to that conviction. The second is willingness to get concentrated. This is very important because HDFC Equity is a very large fund of over Rs 20,000 crore. It is a general belief that it is hard to outperform if you have a large fund. But if you are holding large businesses and are concentrated, there is an ability to generate alpha provided you stick with your conviction. Third is the fact that a fund manager remains as long as he has. A lot of people have grown up on that fund in the fund industry. So, it is a good fund for investors to look at and that's why sometimes you will find a fund emerging on top which also has a great long-term track record.

Sadagopan: You have Kotak Standard Multi Cap Fund which has been consistently doing well for a reasonable amount of time now. In our composite ranking, it is coming well in the first quartile. That is the fund which I would recommend. Another fund which I recommend which is going into large cap is Mirae India Equity Fund. Once upon a time it was multi-cap fund. They are re-badging that as a large-cap fund. Those are the funds.

With higher spread and tax advantage, what are the opportunities in arbitrage funds? What kind of investors should look at this and what should be the time frame?

Ladha: Arbitrage funds give returns of 50-60 basis points a month. Currently, they might give returns of up to 70 basis points which will turn around to be 8.5 percent for a year and post-tax around 7.5-8 percent. I think this will not last for long. It may last for 1-1.5 months at the most and that, too, at a risk. This is because of rollovers which happened in February-March due to the change in stance in equity market. Feb. 19 was the day when we had a clear outbreak in the equity market due to pre-election rally. This is the reason why we might expect around 70 basis points return in arbitrage fund. But I am not sure that we should bet or not. I am not confident in the coming two-three months.

Dhawan: Arbitrage fund is designed for at least a three-six-month investment horizon. There will be periods along the way where we have seen in last 30 days where returns are disproportionately larger than what they have been traditionally. The past tends to make us more confident about the future. Some of those views can change very quickly. The challenge for arbitrage fund is that when there are no opportunities available in arbitrage fund, they start to behave like liquid products. The moment they start to behave like liquid products, the expense ratio becomes the challenge because they are at higher expense compared to liquid fund or an ultra-short-term fund. If you take a 30-45 days bet, then that category is not the right place to be in. You might be right but that is just speculative in our view. If you want to get advantage of the fact that there is some tax arbitrage available then stay invested there for three-six months, you can see outperformance happen over a liquid ultra-short-term fund, especially for people who are in the highest tax bracket. But be aware of the fact that it will not be linear or straight line and there’s going to be months where one does better than the other. You just ride out the entire period.

Sadagopan: In view of the election, the arbitrage opportunities are normally there when there is going to be volatility. In the next one-two months, there could be a lot of volatility and there will be opportunities for someone investing in arbitrage fund. You cannot bet that there could be opportunities in an arbitrage category. We should look at a 6 percent kind of return. That is a normal kind of return you could expect from an arbitrage fund. People who want to do something for the real short term—which is not 30-45 days and arbitrage fund will not sit in there—but for below one-year, for them arbitrage and ultra-short and liquid along with that one can look at arbitrage fund. Not because of the 8.5 percent return which it is currently giving which can vanish in a blip.

How to deal with the change in KYC norms from June 1?

Ladha: The major change that happened is Aadhaar-based KYC is no longer valid. In short term, distributors might say that it is an issue. But in the long-term, it is very good. Anyway an Aadhaar-based KYC, had upper limits. And we want to make investors put in more money and to earn more money. Sooner or later, we were required to do physical KYCs. If we are doing the same stuff on the very first day, then there is no issue. There is short-term pain for long-term gain.

Dhawan: This is not as much relevant for existing investors but new investors. There was an e-KYC model but it got discontinued in late 2018. It has come back. From whatever we hear from the industry, there are various challenges around the way it is working. Essentially, mutual funds were doing centralised KYC. Unfortunately, the way this KYC system works now is that it goes back to the registrar. Mutual funds are actually asking if we can go back and make it c-KYC complaint so that one KYC works for all instruments. That is what investors want. They are tired of going everywhere with their PAN cards, address proofs, signing documents and photographs. They don’t even know what they are signing. The more we can use technology for this, the better. It is an impediment, but it is not holding people back saying I will not invest because KYC is painful. It is making it easier. Like booking a cab on Uber is easier but it is not like you don’t travel by cab if Uber is not there.

What does the new investor have to do to be KYC-compliant from June 1?

Sadagopan: As far as traditional KYC is concerned, three things are required—PAN card, Aadhaar card and address proof. I don’t think any investor who is interested in mutual fund is going to be put-off by this process. As it is in a million other places, we are already giving these things. This is another place you will be giving it and you will be giving it one time. I don’t think it is a challenge. But I am not supporting this move towards a paper-driven system. We have to take it the rough with the smooth. But I don’t think it is a deal breaker.