Direct plans of MFs: Only for the aware and systematic investor

You need to align your investments with your goals, as otherwise the intended financial target may not be achieved

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Twenty-eight-year-old Sushant Gawade, a process manager with an e-commerce portal based in Mumbai, decided to route his investments through a mutual fund distributor after earlier doing so on his own, in direct plans, for two years. For him, mutual fund investments meant earning high returns, and not an alignment of schemes in order to reach his financial goals. "Two years back I had invested in various schemes based on their historical performance and with inputs from friends. Most of my investments were in small-cap funds and, after witnessing losses of around 20 per cent, I have now decided to opt for professional hand-holding," said Sushant.

Many investors decided to take the do-it-yourself route to investments to save on commissions paid to distributors and thereby derive extra returns on these funds. The journey was smooth when markets were on a rallying mode and the net asset value (NAV) of the mutual fund schemes were rising. The sentiment changed when the stock markets turned volatile and the shares of most small and mid-sized companies were hammered.

The shift

The portfolio of both the regular and direct plans is the same. But in the case of regular plans, there is a distributor commission payable and to that extent returns are lower compared to those of direct plans. The difference could be as high as one percentage point in the case of equity funds. In the case of bond funds, the difference could sometimes be as low as 20 basis points. If the investors is willing to do the legwork – identification of the mutual fund scheme in which he should be investing, operational issues such as compliance to know-your-client norms and form-filling, among other things, then they can opt for direct plans. Online platforms and websites of mutual funds make investing in direct plans less cumbersome.

Around 18 per cent of the investments done in mutual funds came through the direct route in the April-June 2019 period.

Direct plans were introduced in January 2013 by the Securities and Exchange Board of India (SEBI), the regulator of mutual funds.

Investments in direct plans have risen steadily over the years. However, not all investors are cut out for direct plans. Many are now willing to take the services of a distributor or a financial planner.

Gain understanding first

Direct plans work for the matured investors who are keen to invest in line with their financial goals. "You must understand both the underlying markets and the product. If you lack understanding of either of these, you may suffer. You cannot just pick a fund based on past performance and expect success," says Pankaj Mathpal, founder and CEO of Optima Money Managers. The basic tenets of investing must be clear to you. For example, you need not understand how to pick stocks, but you should be well prepared to face the volatility offered by the stock markets. You may not have a good grounding on which bonds to pick for your fixed income portfolio; however, you should have a clear understanding of why gilt funds deliver double-digit returns in a particular year followed by tepid returns.

Behavioural issues

Investing is more than just numbers. Many times, the best of the ideas cannot be executed just because the human mind cannot handle the pressure. "In the short term, there would be volatility. Investors need to be prepared for it," says Harsh Jain, chief operating officer of Groww, a mutual fund transaction platform. An investor who initially intends to stay put for 10 years in an equity fund, gets worked up when she sees negative returns over six months. For example, many investors came to stock markets towards the end of the bull-run in early part of calendar year 2008. However, after markets fell more than 50 per cent in that year, many sold off. An advisor at this stage may be of some help. "Investors, especially new investors, need some counselling and some handholding as markets may remain volatile for longer time periods than expected. A 'do-it-yourself' investor may not have such an option and that may lead to incorrect decision making such as selling in distress," says Mathpal.

Handling greed and fear in the real life is a serious task. Vishal Dhawan, founder and chief financial planner of Mumbai based Plan Ahead Wealth Advisors says, "A do-it-yourself investor will harm himself if he is unable to buy when the markets are volatile just because his mind does not allow him to take risk. Advice from a professional can help you gather conviction and go ahead with your investments even when the markets are volatile."

Investment recommendation meant for one person may not work for another. If you go direct assuming that someone else's plan can be executed in a cost-effective manner, you may be in for a shock later on. "The way a diet plan meant for one individual does not necessarily work for another individual, the financial plan prepared for one individual does not work for other," points out Vishal. Our needs, risk-profile, cash flows and mind-set differ.

But direct works

You must check a few boxes if you are to make direct plans work for you. The first and foremost would be – understanding of the market functioning and macroeconomic situation. You may also consider going direct if you take the services of a SEBI-registered investment advisor (RIA). Since December 2015, RIAs have been getting access to their clients' investment details. This can be used by RIAs to monitor their clients' investments.

"Before investing, the investor should understand his/her own risk appetite and must take decisions accordingly. In case of any doubts, the investor should get in touch with a professional (investment advisor) to help create her portfolio," says Ashish Nanda, EVP, Kotak Securities.

Vishal says that investors using simple products such as index funds and liquid funds too can go direct. These products are easy to understand and once you get the asset allocation right, there isn't much scope to make big mistakes.

Operational aspects

Investing in direct plans of mutual funds isn't too easy. You are expected to track your own investments. If you invest by creating a login in many individual fund houses' websites, it is likely to be a cumbersome task. In that case you may have to create a portfolio to efficiently track your progress. One such option would be to track it through this web portal.

You also have the option of investing through third-party portals and apps. There are a few transaction platforms such as Groww and Coin that do not charge you for investing in direct plans of mutual funds. Then there are others such as Kotak Securities that allow you to invest in direct schemes of mutual funds for a fixed yearly fee. Kotak Securities charges an annual fee of Rs 999. For advisory, if the client opts for it, apart from the annual fee, there is no charge for liquid funds, while for debt and arbitrage funds 25 basis points (on average quarterly AUM) is charged. For equity and hybrid funds the firm charges 50 basis points (on average quarterly AUM).

MF utility (MFU) is also a platform investors can use to transact in mutual funds. It issues a common account number (CAN) to investors and allows them to transact in mutual fund schemes of their choice among those available on MFU.

Direct mutual funds transaction platforms make the process of investing much easier and more importantly let investors track their investments on the go. However, do check if the platform chosen by you allows you to transact in all mutual funds of your choice. Also, you must understand that you need to align your investment