Should large & mid cap mutual funds form a part of your portfolio?

BY ET CONTRIBUTORS | UPDATED: SEP 12, 2019, 12.01 PM IST

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It has now been over a year since the scheme re-categorisation exercise was carried out by mutual funds. The aim of the exercise was to help investors to understand the various mutual fund categories better, and to make it easier to compare the performances of similar schemes.

Another benefit of this exercise has been the reduction in overlap between schemes doing similar things but appearing to be different from each other. One of the categories though, that still creates confusion in the minds of many investors is the “large & mid cap” category and the “multi cap” category that tend to be, in their mind, very similar to each other and therefore fungible options.

Multi cap schemes are allowed to invest in any mix of large, mid and small cap stocks that the fund manager deems appropriate, as long as at least 65 per cent of the monies are in equities.

Thus, there could be points where the fund manager may believe that a particular segment of the market, for example, mid caps are more attractive than any other segment, and therefore move all the monies into mid caps. Thus, a multi cap scheme is the equivalent of a chameleon that changes its colour depending on the outlook of the fund manager.

Whilst this has its advantages in terms of allowing the maximum flexibility to fund managers, it also means that what investors bought thinking as a mix of large cap, mid cap and small cap could suddenly become a completely large cap or mid cap fund or small cap fund because the manager believed the maximum value is in that part of the market. If the fund manager gets his choice of market caps wrong and the market moves against him, this flexibility could be detrimental to the portfolio.

Large & mid cap schemes, in comparison, need to have a minimum of 35 per cent each in large cap and mid cap stocks, with freedom to invest the remaining 30 per cent as they wish, as long as that is invested in either large caps or mid caps. This category is therefore similar to a frog which can change colour but only to a limited extent. In addition, they cannot invest in small caps at all, and thus one segment of the equity markets is not available to them at all. The advantage of this restriction is that the fund manager will always have a portion of the portfolio in large caps and mid caps, and therefore will limit his market cap based calls to only 30 per cent of the portfolio.

For investors who are happy to delegate the complete decision on which market cap of stocks to buy to a fund manager, they may prefer the flexibility of a multi cap due to its go anywhere approach. For those investors, who wish to provide that flexibility, but only to a limited extent, the large and mid cap category works. Remember though, that works for your friend or neighbor, may not work for you, so consult a professional advisor to make the
appropriate choice for your specific situation.

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