5 Things To Consider Before Investing In Top Mutual Funds In 2022

Pushpita Dey |09 FEB 2022 8:04 AM

With more investors from different age groups and income levels investing in mutual funds, it is important to keep a few things in mind to ensure maximum benefit

There has been a growing trend of investing in mutual funds (MF), and it seems to have become one of the most preferred investments choices even among novice investors. As per data released by the Association of Mutual Funds in India (Amfi), the assets under management (AUM) rose by 24 per cent to an all-time high of Rs 38.45 lakh crore in 2021 by November-end itself, as compared to Rs 31 lakh crore at the end of December 2020. In addition to that, data published during the winter session of Parliament shows that people from the low- and mid-income groups have invested the most in MFs. Read more about who is investing in MFs

While MFs continue to be the preferred choice for several investors, one needs to keep in mind a few things before investing in them, especially for the long term.

Any investor needs to track and monitor their portfolio regularly, suggest experts. Monitoring helps to check a few things: first, is the MF is performing as per the expectation of the investor, and second, is there risk in the portfolio. If the fund is not acting as per expectations, investors need to check if the risk is higher than expected. Based on this, one needs to decide to retain or remove the fund from the portfolio.

"If you cannot give the attention that investing deserves, then it is better to work with a qualified advisor who has the knowledge, experience and time to do this for you," advises Anup Bansal, chief investment officer, Scripbox, a digital wealth management service firm. Although it is advisable to keep track of a portfolio, doing it too frequently is not useful. "Avoid looking at your portfolio too often, especially for the first 3-5 years, as your effective holding period is only one-and-a-half or two-and-a-half years for a SIP (systematic investment plan)," says Vishal Dhawan, founder of Plan Ahead Wealth Advisors, a financial services firm.

Understand Sharpe Ratios, Rolling Returns

Often, investors invest in MFs without proper knowledge of the product and yet have the hope of gaining fast profit. Before you jump into any investment, you need to have a clear idea about how the fund's risk level and performance are to be measured. And for that, an investor needs to understand what Sharpe Ratio is.

Sharpe Ratio is a measurement of the return on investment compared to its risk. It is directly proportional to the risks associated and the returns. So, a high Sharpe Ratio indicates more returns but also high underlying risks for that investment.

"Typically, most mutual fund fact sheets now have this data and a Sharpe Ratio will enable the client to compare the same," says Dhawan. Getting an idea of the Sharpe Ratio is particularly helpful when investors are confused between dividend and growth. Getting dividends periodically (say, quarterly or annually) is often perceived as growth. Investors feel that just because they are getting dividends, the MF must be growing too. That may not be the case. Sharpe Ratio helps to understand the overall growth as it considers the risks too.

Rolling returns give a wholesome idea of the fund's performance. It is the average of the annual returns of a fund of a certain frequency (daily/weekly/monthly) calculated from the beginning till the last day of the investment period. Thus, it helps in evaluating the performance of the MF over some time at regular intervals. Rolling returns are considered more accurate as they are not biased towards any period. In comparison, trailing returns show a point-to-point performance, say, between certain dates. To check long-term consistency in the fund's track record, rolling returns are better than trailing returns.

Also, look at risk ratios to identify the risk-adjusted returns.

Check Performance And Cost

Often, investors don't know if they should continue with the fund if its cost (price per unit) is getting high. In such cases, "we would suggest to let current investments be as is but avoid doing fresh SIPs as costs are controllable for the investor, but the performance of the scheme may change and is, therefore, an uncontrollable variable," says Dhawan. Securities and Exchange Board of India (Sebi) has set limits on how much investors can be charged, and these rules are designed to give the investor a fair result.

"However, historical data suggests that over time, if funds are unable to generate more than market returns, then it is better to invest in a fund that has a lower cost structure," says Bansal.

Follow A Suitable Investment Pattern

The way a novice investor would invest will not be the same as an aggressive investor. "New investors may want to look at more active options in scheme selection while regular investors are more attuned to using a mix of active and passive funds," says Dhawan. New investors should avoid thematic schemes as these concentrate on particular industries, sectors or themes that the investors may not be familiar with. Aggressive investors can look at thematic/sectoral schemes in addition to other active schemes. "However, they should track the thematic/sectoral exposure carefully as these can go out of favour," cautions Dhawan.

Have An Emergency Back-up

Experts always caution investors against investing their savings to such an extent that no emergency funds are left. Despite having ample investments with good return benefits, one needs to have the back-up corpus for emergencies such as sudden illness, job loss or demise of another earning individual in a family. With the hope of getting higher returns or multiplying the money, often people end up investing a significant portion of their earnings in a risk-associated investment like MFs, a move that can be counter-productive.

Investment experts stress maintaining an emergency fund, irrespective of all other types of investments. "Emergency funds take care of the day-to-day living expenses in case of an unforeseen emergency. Overnight and liquid funds may be used for this purpose," adds Bansal.

It is also essential to have backup funds required for short-term goals that are less than three years away.

****