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Choose MF with a mix of asset classes

FUNDLINE

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THERE are a lot of mutual fund (MF) schemes that have a mixture of various asset classes. When choosing to invest in these MFs, certain factors have to be kept in mind.

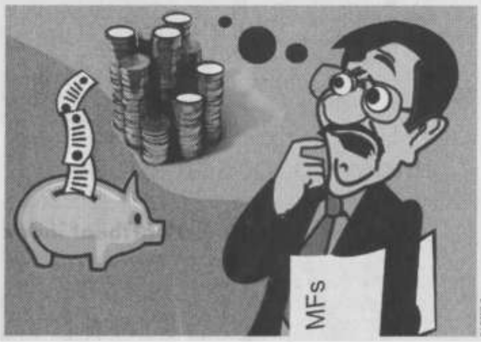
In recent times, several funds have entered the market that invest in a mixture of debt, equity and gold. These funds have several distinguishing features and hence the investors must be able to take a clear decision. Here are a few factors that investors can consider while making a decision.

Nature of fund: The nature of the funds, which invest in debt, equity and gold, seeks to achieve several objectives for investors. Majority of the investments in these funds are in debt, which defines the basic nature of the fund to provide a steady stream of earnings for the investor. In addition, there is a small part that is allocated to equity for the purpose of increasing returns for the funds. This is similar to several monthly income plans that are present, but the major distinguishing factor is that there is also a small allocation that is made for gold. This adds a third dimension to the entire investment and hence, gives a different nature to the fund.

Manner of fund allocation: The first thing that an investor has to decide is the route that they take while making the investment. The first route involves putting money in a particular fund where the fund manager chooses asset allocation.

In this case, the investor relies on the manager for the purpose of making the call on the proportion in each asset class and also when to remain in cash and when a change is desired.

The other option is to decide on asset allocation themselves by choosing funds that invest in a single asset class. What the investor does is select pure equity or pure debt funds and then allocate the required percentage of their portfolio to these funds. So an investor who also wants gold exposure, will select a gold exchange-traded fund (ETF) for investment.



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The difference from the earlier case is that there is not a single fund where a mixture will be involved. The benefit here is that the investor can select a specific nature of the fund for each asset class.

Investment objective: The investor also needs to be clear about what they actually want to achieve when they are investing in a fund that has several asset classes.

The nature in which the portfolio of the fund is constructed will determine the returns generated. For example, when it comes to the question of the fund with the three asset classes of debt, equity and gold, there is a clear demarcation.

The debt will provide stability, while equity will provide higher returns and gold will act as a hedge against inflation. However, one needs to look at the actual situation and determine whether this is correct and if the objectives can be achieved.

A careful study will show that in the past few years, the behaviour of gold has been different from what was witnessed earlier and due to this reason, there is a varied manner in which the entire portfolio will behave.

This needs to be taken into consideration because this will be the determining factor about the nature of the investment. An investor, who expects gold and equity to behave in an inverse manner, might realise that they are actually moving similarly requiring them to change their decision.

Finally, the investor also has to realise that mixing far too many asset classes together might result in difficulty in understanding what is actually happening.

Gold exposure: The working of monthly income plans and how equities and debt interact to provide returns is well known to investors due to their past experience with these funds.

There are different types of impact depending upon the nature of exposure of equity in the portfolio. The investor needs to look at the exposure that will be allowed to gold and then ask questions about its effectiveness.

Some of these would relate to the extent of gold exposure in the portfolio and then looking at whether this has a meaningful impact on overall returns. For example, what is the maximum exposure to gold that the fund will have is important.

A very low exposure might be insignificant in the overall scheme of things. In addition, the fact as to whether there will be a permanent exposure to gold or whether this will vary depending upon the viewpoint of the manager is important.

This happens because in the latter case, it could be that for a long time period, there is no gold exposure whereby the scheme then resembles a monthly income plan that is what the investor might not have wanted in the first place.

(The writer is a CA and Certified Financial Planner.)