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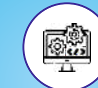
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From the
Editor's Desk

The equity markets will never have a linear growth trajectory and it is the volatility that enables higher returns. From each low the markets have risen to new highs. History is replete with events where in times of correction, anxiety has come to fore again and again. Nobody, in the wildest of dreams would have ever imagined that equity markets would reach today's levels at the time when those events occurred. Despite all these problems the Sensex has given a CAGR of more than 15%.

Having said so, is direct equity investment best form of investment? For the uninitiated, I would say a firm "NO". Equity Mutual Funds have emerged as one the best form of investment instrument for all categories of investors. In this issue of Punji Times, it is our endeavor to bring out all nuances of Mutual Funds.

Investor should have patience and a high level of conviction in the fundamentals and a belief that any setbacks are temporary and markets will always continue to give superior returns.

Best,

Team Meri Punji

Punji (*noun/Hindi*) **- Capital** *meaning, wealth in the form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing.*

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Saving Vs Investment

Savings and Investments though appear as synonyms but are vastly different. The table highlights the differences between the two along with their Pros & Cons.

BASIS FOR COMPARISON	SAVINGS	INVESTMENT
Meaning	Passive & Uninvolved Activity Surplus income not being used is put in safe financial Instruments	Active & Involved Activity Defined process of putting funds In assets generating higher returns.
Purpose	To meet short term or unforeseen urgent requirements	To meet long term defined goals and create wealth
Risk & Returns	Low Risk Low Returns Unlikely erosion of Capital	Higher Risk & Much higher Returns
Instruments	Bank Deposits, Government Bonds Guaranteed Income Insurance Policies	Mutual Funds, Equities, & PMS Insurances Loss of Capital a possibility in short term
Liquidity	Highly liquid	Less liquid

In conclusion, investing is the way to create wealth and reach financial goals with an element of risk attached that needs to be managed strategically.

BASICS OF INVESTING

A majority of people consider investing a complex matter that requires in-depth knowledge. However, contrary to this belief, investing is quite a simple process that requires only discipline and patience.

The reason for this misconception stems basically from human psychology.

1 What do people want from their investments? Undoubtedly maximum returns. But very few consider the risk to return ratio.

2 Riskier investment does give higher returns but the journey can be very volatile.

3 Fear and Greed are the two worst enemies of long-term investing.

- Fear sets in when markets are falling. Investors exit their investments thereby incurring losses.
- Greed and Euphoria overtake caution in a rising market. People tend to increase their investments in an already overvalued market.
- This cycle of fear and greed results in investing at high price and withdrawing at low price. This completely annhilates the returns, resulting in anxiety and disillusionment.
- Once bitten twice shy. Such investors shun investments and retreat to the safe haven of saving in the banks.

Investing is not a demon or difficult creature to tame. Adhere to some basic rules.

Define your goal with time horizon

Instead of following the traditional approach of first creating an investment portfolio and then using the returns from it to meet goals as they arise, it is more effective to first identify your goals at different stages of your life and to then invest for each goal separately based on the time horizon and risk profile.

Understand you risk appetite.

Ask your self would be your reaction in a situation where in short term returns are dwindling with partial erosion of capital.

Select investment products that are

- Simple to understand.
- Meets your risk quotient
- Does not necessitate constant monitoring

Invest regularly

Be disciplined and make it a habit.

Have patience

Let money work for you. Get the benefits of compounding returns.

> "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it."
>
> Albert Einstein

The equity markets will never have linear growth trajectory and it is the volatility that enables higher returns.

This rapid highs or lows of the market can rattle every kind of investor.

History is replete with events where in times of correction, anxiety has come to fore again and again.

1990 Gulf War, worst market decline in 16 years.

1998 "Tiger Economies"of Asia Financial Crisis

2001 Dot Com bubble burst, Recession, 9/11 WTC Attack.

2003 War in Iraq.

2005 Record high of oil & gas prices.

2008 Sub-prime mortgage, Lehman Brothers crisis. Indian GDP at 3.3%

2012 European Debt crisis (Greece, Portugal, Ireland & Spain).

2013 Indian GDP growth rate falls to 5.5%.

2019 US-China Trade War, India GDP growth rate at 5 %

2020 Covid -19 Pandemic

2022 Russo-Ukraine War & Very high inflation

2023 Middle East Crisis (Israel-Hamas Conflict)

Nobody, in the wildest of dreams would have ever imagined that equity markets would reach such levels at the time when the above events occurred. Despite all these issues the Sensex has given a CAGR of more than 15%.

Negative stories create fear and always weigh down heavily on investor's mind.

Investor should have patience and a high level of conviction in the fundamentals and a belief that such setbacks are temporary.

Mutual Funds

An Overview

In today's investment environment, Mutual Funds have emerged as one of the simplest and a high return investment Instrument. Mutual Fund investing is less of a science or art, it is more of a process of patience and discipline, due to which an investor can enjoy the benefits of compounding returns.

What are Mutual Funds

A mutual fund is a pool of money managed by a professional Fund Manager. It is a trust that collects money from a number of investors who share a common investment objective. The Fund manager invests these funds into various financial instruments such as stocks and bonds. The income / gains generated from this collective investment is distributed proportionately amongst the investors after deducting applicable expenses and levies.

All investors desire

"Highest Returns at Lowest Risk"

Mutual Funds help in managing these competing demands in a manner that would enable higher returns within the risk capacity of the investors.

BENEFITS

1 Diversification

Unlike stocks, mutual funds invest across asset classes and shares of several companies, thereby providing you with the benefit of diversification. This reduces the concentration risk to a great extent.

2 Liquidity

Unlike stocks, mutual funds invest across asset classes and shares of several companies, thereby providing you with the benefit of diversification. This reduces the concentration risk to a great extent.

3 Investment Managed by Experts (Fund Managers)

Fund managers are finance professionals who have an excellent track record of managing investment portfolios. Furthermore, fund managers are backed by a team of analysts and experts who pick the best-performing stocks and assets that have the potential to provide excellent returns for investors in the long run.

4 Low Cost

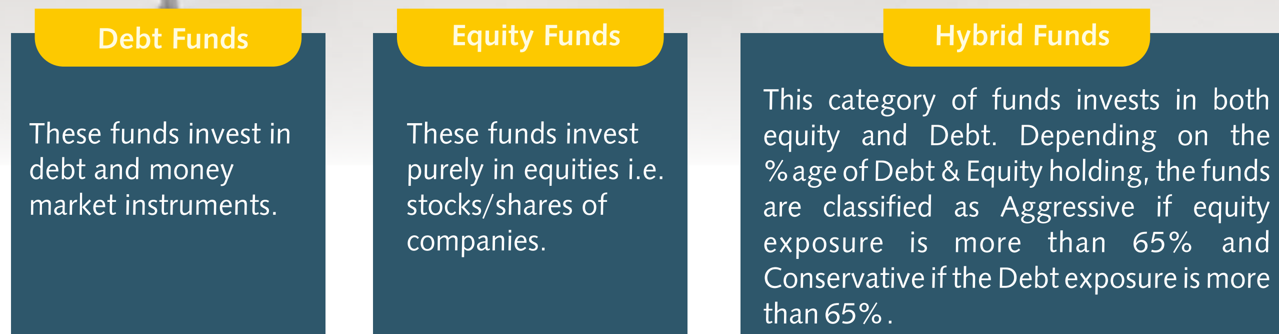
Investing in mutual funds comes at a low cost, and thereby making it suitable for small investors. Mutual fund houses or asset management companies (AMCs) levy a small amount referred to as the expense ratio on investors to manage their investments. It generally ranges between 0.5% to 1.5% of the total amount invested.

5 Tax-Efficiency

Gains in Mutual Funds are treated as capital gains and therefore unless withdrawn they are not taxable. Whereas in Bank FDs, interest earned is treated as income and is taxed every year whether it is withdrawn or not. Further the tax rate is much lower on gains earned through mutual Funds.

Types of Mutual Funds

Mutual Funds can be basically divided into 3 categories on the basis of type of asset classes in which they invest:



Debt Funds

Primarily the investment in debt funds is made by risk averse investors who are willing to accept lower returns but higher safety. Debt Funds, however, also have some risk attached which are: -

- Credit Risk or what can also be termed as default risk. Credit risk is measured by "Credit ratings"., which is assigned by professional credit rating agencies. In terms of safety GOI bonds are highest rated and thereafter safety rating varies from AAA being the next best and going down the ladder as AA, A & D.
- Duration Risk or what can also be called as interest risk. The interest rates keep changing with time. Bond prices and interest rates are inversely related. Longer the maturity, greater the degree of price volatility.

So as a thumb rule, while investing in debt funds one should avoid both credit & duration risk. This strategy limits the option to funds that have in their portfolio

- To reduce credit risk - 80-90% of papers should be a combination of GOI bonds or AAA rated papers.
- To reduce Duration risk- Average maturity period of the papers should be around 2 to 2.5 years.

The above criteria is not **"OR" but "AND"**. This would narrow down the options to

1. Ultra-short
2. Low Duration Funds
3. Short term Funds
4. Corporate Bond Funds
5. Banking & PSU Debt Funds

Equity Funds

Equity fund space there are 20 types of Funds: Here also the investor should cut out the noise and clutter. In the stock market the equities are basically classified as Large Cap, Midcap and Small. Cap. To simplify investor should aligns their invests with this classification. For diversification there are Multicap and Flexi Cap funds that invest across market capitalizations,

Large-cap funds - Invest only in top 100 large blue-chip companies in terms of market capitalization. These companies are considered safe to invest because they are market leaders and have good corporate governance. These funds offer modest returns but are less volatile and therefore carry relatively less risk.

Midcap funds- invest mostly in medium-sized companies. These companies can be risky as they may or may not realize their full potential. However, if they succeed, they will become large companies and investors will be rewarded handsomely. Investors with high-risk appetite should put their money in these funds.

Small cap funds- invest in small companies. These companies can be extremely risky, as there will be very little information about them available in the public domain. However, they can also offer phenomenal return. They are suitable only for investors with a very high-risk appetite.

Flexi cap- Invest across market capitalizations and therefore they are less risky than mid- and small-cap funds, but a little riskier than large cap funds. However, over a period all Flexi cap funds have large cap bias with very little exposure to Mid cap or Small Cap stocks. Due to this investment approach these fund returns are just a shade better than large cap funds.

Equity Linked Savings Schemes or tax planning mutual funds are suitable for investors looking to save taxes under Section 80 C of the Income Tax Act. These funds follow the Flex cap strategy but have lock-in period of three years. Due to this lock in period, the fund manager has the flexibility to take longer duration call and therefore generate higher returns.

Focused Equity Funds – This category also follows Flexi cap strategy but restricts to 20-30 stocks. They can be loosely classified as very aggressive Flexi cap and they have very high volatility.

Multi cap Funds - Invest across market capitalizations but are mandated to invest minimum 25% each in large, mid & small cap stocks. The balance 25% is at the discretion of the Fund Managers, however they stick to large caps. These funds bring in truly a good diversification. The mid & small caps provide the alpha in generating higher returns and the large caps bring in the stability in volatile markets.

These funds are less volatile than pure mid and small-cap fund. They are suitable for investors with higher risk appetite.

Hybrid Funds

Invest in a mix of Equity and Fixed Income Products. The percentage of mix between Equity and Debt varies and depending on the mix they can be classified as

- **Hybrid Conservative –** In this category the debt instruments percentage is above 80%, so the Equity percentage never exceeds 20%.
- **Equity Savings Funds –** In this category pure equity varies between 20-35%. To reduce the risk quotient of these funds but to keep the equity taxation, these funds invest about 30-45% in arbitrage. Balance is made by Debt instruments. The tradeoff here is that of little lower returns as compared to Hybrid Aggressive Funds.
- **Hybrid Aggressive -** In this category the equity percentage varies between 65-80%, so the debt percentage can never exceed 35%.
- **Balanced Advantage Funds –** These funds dynamically manage the ratio between Debt and Equity. The Equity %age can vary between 30-80%. So when the markets are at high these funds substantially reduce their equity exposure and visa versa. The advantage of these funds is that as an investor is not burdened with the decision making as to when to shift in or out of Equity. The tradeoff here is that of little lower returns as compared to pure Equity Funds.
- **Multi Asset Allocation Funds –** These Funds are hybrid funds that must invest a minimum of 10% in at least 3 asset classes. These funds typically have a combination of equity, debt, and one more asset class like gold, real estate, etc. Nearly all funds in this category limit their exposure to Gold/ real estate to 10%.

Sectoral and Thematic funds

Sector or a theme are cyclic in nature and the returns of these funds vary with the cycle. An investor has to be monitoring the cycle to plan his/her exit or entry at the right time for high returns. An investor should keep following in mind while investing in these funds:

- Fund manager of such funds is constrained in their flexibility to choose stocks as they have to stick to a sector or theme.
- A sector or a theme follows cyclic growth pattern and the funds in this category generally mirror this pattern.
- A fund manager of a normal multi-cap/ flexi cap fund would also see the opportunity in specific theme or sector and can easily shift to such sector. However, he has the flexibility to shift out when that sector is witnessing a downside.
- A specific sectoral or thematic fund cannot shift out during downside.
- There are proven pedigreed multi-cap funds available with long and good track record both in terms of scheme and fund manager performance.

Investing in New Fund Offer

An Investor should weigh the pros & cons of investing in NFOs

- What attracts investors to a NFO is that they would get units at par NAV value.
- A common misconception - lower NAV does not imply better returns.
- If a fund holds same stocks and in same ratio than irrespective of the NAV the returns of the two funds would be same.
- NFO has no track record of performance.
- NFO has small fund size, so initially the Fund Management Charges can be high.

Portfolio Diversification

Diversification in a portfolio does not necessarily mean having large number of schemes. It can be achieved by adhering to few simple steps

- **Asset Allocation -** That is Debt, Equity, Gold and other financial instruments.
- **Category Allocation -** That is Large Cap, Mid Cap and Small Cap.
- **Style of Investment by Fund Managers:** Traditional or Quant.
- **Avoiding underlying Equity Stocks holding overlap -** Schemes with nearly same asset allocation or category allocation or nearly same stock holding leads to duplication rather than diversification.

Simple points to be considered while Selecting Funds

- **Trailing Returns** have a recent performance bias and returns are specific to a period in consideration.
- **Rolling Returns** on the other hand measures the fund's absolute performance across complete time periods, without bias and provide a robust analytical tool for evaluating the performance. In addition, we also take into account
  - Calendar year returns to assess the year-on-year basis performance volatility of the scheme.
  - Fund's Portfolio of stocks
  - Fund House & Fund Manager's Profile.

Fund Category Selection Based on Investment Horizon

- Equity Mutual Funds provide great returns but they can be very volatile in short term.
- In Debt funds the maturity period of underlying instruments should match one's investment horizon. The trading value of bonds can vary in the interim period. This can result in underperformance of the scheme if there is mismatch between the time horizon of investment and maturity period of the underlying instruments in debt fund.
- It is very important to keep the time horizon of investment in mind while selecting funds. (These broad guidelines and can very for individuals base on their risk quotient)

Up to One year: Ultra Short/ Low Duration Debt Funds
Between 1-3 Years: Short Duration/ Corporate Bond Funds/ Banking & PSU funds
Hybrid and Equity Funds should only be considered if the Investment Horizon is 2 Years and more
Above 2 Years: Hybrid Equity Funds
Above 3 Years: Large Cap, Flexi Cap, Multi Cap Funds
Above 5 Years: Mid Cap & Small cap.

Data shows that Mid/ Small Cap mutual funds have the potential to double the investment in 12-18 months but on the other hand during the same period they can erode capital by 50%. The probability of either of the outcome is nearly the same. However, over 6-7 years period these categories of funds have rewarded patient investors handsomely.

INVESTING STRATEGIES in Mutual Funds

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Every individual is unique and so are his or her investment needs. Investment planning must always be aligned with one's goals. Hence, our approach is to help you chalk out an investment strategy that is best fit for 'you'.

We see ourselves as educators rather than advisors. Our endeavor is to build awareness about the various kinds of investment products in the market. After all, an informed decision is always a better decision.

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