Struggling to Invest? Learn more about ‘Systematic Mutual Fund Investment Plan’ in India and Thank us later for that.

WORK SAMPLE FOR FINANCE NICHE

Gone are the days when we used to get 8-10% returns in FD, which helped beat inflation. Today, FD returns are average 4-5%, which is not enough to beat inflation. Also, there is a 10-15% increase in education and health-related expenses every year.It is certain that we can’t pour all our savings into FD and RD blindly and have a smooth ride over inflation, because there is a risk of losing money to inflation and our purchasing power.

Although FD and other debt products are relatively safe, there is an element of loss/risk involved even in Fixed Deposits. So, what is the solution? We often hear about soaring equity markets, some fancy IPO, and cryptocurrency, but going directly to equity and fancy asset classes from FD is too much to ask for and is often risky..

Understanding Equity Mutual Fund

Unlike FD, there are several types of Mutual Funds (Debt, Equity, Balanced/Hybrid, etc.). There are several categories of funds for each type of equity fund. This makes it a bit complicated for a new investor to arrive at the final 2-3 funds for investment. For simplicity, we will focus only on equity funds today. The popular categories in Equity Funds are Large Cap, Mid Cap, Small Cap, and Flexi Cap.

Understanding Equity Mutual Fund
- Large Cap
- Mid Cap
- Small Cap
- Flexi Cap

As the name suggests, the category is based on the market capitalization of the stocks. Large Cap would invest in larger companies, and Small Cap in smaller companies. Large Cap is defined as the 1st to 100th company in the Indian stock exchanges per Market capitalization, Mid Cap as the 101 to 250th company, and Small Cap starts from the 251st ranked company.

Other categories include Value fund, Contra fund, Focused fund, Thematic fund, ELSS, etc. These are more specialized categories and may carry a larger risk. Therefore, one should invest in these only after gaining more knowledge on Mutual Funds and spending some time as a Mutual Fund investor. For now, let us focus on the popular and simple categories

Historical returns of several mutual fund categories:

Mutual Fund Category	Trailing returns of Top five mutual funds – 5 years	Trailing returns of Top five mutual funds – 9 years
Large Cap	18.5%	16.5%
Mid Cap	22.0%	21.0%
Small Cap	23.5%	24.0%
Flexi Cap	21.0%	17.5%

Source: www.moneyworksforme.com ; https://www.valueresearchonline.com/

From the above table, the returns of these categories range from 17% to 24%, which isan excellentt return by all standards, beating inflation comfortably and even can make you rich. If you think these returns are historic and appear higher, let us just consider a 15% return compounded for 10 years, which is quite conservative with respect to the historic returns.

A 15% compounded return can give you approximately 4 times your initial investment in 10 years and 8 times in 15 years. So roughly 1 lac of investment will turn four lacs in 10 years and eight lacs in 15 years. Now, if we consider a 20% return, 1 lac will turn into 6 lacs in 10 years and more than 15 lacs in 15 years. A person diligently investing each month their 50% savings in a mutual fund can make a fortune by the end of 20 years with returns of even 15%. Although past performance doesn't indicate future returns, it does give us some idea of the investment product's performance. Returns alone shouldn't be the criterion for investing in equity; rather, they should be balanced by the risk involved.

What Fund is right for you?

While Small Cap may seem attractive based on the historic returns, the smaller companies the Fund invests in may be more vulnerable to the economic headwinds and price volatility, which will be reflected in the fund's NAV (Net Asset Value). The volatility can be extreme; in the short term, like one year, it can be down by even more than 50%. Therefore, one should choose the fund based on one's risk appetite.

If you can bear the volatility and continue your investment for 5 to 10 years, you may invest in Small Cap. Large Cap can be relatively less risky, followed by Mid Cap; however, that doesn't mean it doesn't carry risk.

Even a large-cap fund can lose 30-40% in an extreme situation within a year. Therefore, another thing one should ponder is the duration of the investment. One may choose equity mutual funds only if the time horizon is over 5 years and can withstand the volatility. Therefore, a person with a lower risk appetite should go majorly by Large Cap or Index funds (Sensex or Nifty50 or next Nifty50) and a bit of Mid Cap. With a larger risk appetite, one can also subscribe to Small Cap.

Another way is to choose Flexi Cap, where the Fund has the option of Large Cap, Mid Cap, and Small Cap in any proportion. Some of the Flexi funds also invest in other countries' listed stocks, which helps them gain exposure to foreign equity markets.

After one has fixed on the type of fund, to arrive at exact fund one can check the returns of top funds in that category for last 5 years or 10 years and choose from the top 5 funds. One can refer to multiple sources in doing this exercise. One should be careful on not just getting carried away by returns of last one year, the fund should have a good track record for longer time frame. There are several instances where best performer of a year doesn't even appear in top funds next year. You may use any website for this analysis including Moneycontrol, Valueresearch, Moneyworksforme etc.

How much should you invest and by which route SIP(Systematic Investment Plan) /Bulk?

It depends on an individual's income and risk appetite.
However, for a new investor who has just started his job or few years into the job, he or she may invest 50% of his savings in equities through mutual fund but only after he or she has put aside emergency money in an FD (6 months to one year of expense). As we age, we can decrease the allocation.
However, as a thumb rule one should not put money in equities which one may require in next 5 years. Conservative allocation will help ride the volatility smoothly and there will be less urge to liquidate in emergency situation and market fluctuations.

Now comes the common question on whether should we invest in bulk or SIP?

During the initial phase of the career, one should start SIP as one may not have a lot of savings. Even if one has money in bulk and wants to invest in equity mutual fund, one can do it in 5-6 tranches over a period of may be 1-2 years. This would absorb the market volatility.
Although most people say we shouldn't time the market however if you invest with the above rule, in few years you would have good savings in FD (as you were investing 40-50% in debt products). When market corrects 10% or more you can invest a tranche from your savings/FD.

However, this one should be tried after having experience investing in mutual funds for a few years and accumulating additional money in FD or other debt products. As a thumb rule, one should not deploy emergency funds into equities.

Final Thoughts

As India continues to grow economically, the leading companies must grow more than the GDP. And as the companies grow, mutual funds invested in them have the potential to return much more than an FD. However, it is not a linelinear patha volatility will exist. Therefore, either invest or do an SIP in the long term. There is nospecno speno specifiches, and there is no shortcut to it, as long as we are fortunate enough about it. Data indicates people who trusted equity for the long term and didn't bother about volatility in the market were rewarded with high returns.

100% efficiency has always been technically impossible. However, one thing is that equity provides a high probability of beating inflation and has an edge on debt products in the long term. It has also been proven in the last several decades.

Therefore, it is wise to deploy some of your savings in mutual funds for the long term and enjoy the returns. Who knows, maybe after 10-15 years, you may be smiling over high returns and substantial money and thanking yourself for making the right decision?