A DIY Investor's guide to profitable portfolios

The practical approach to build and maintain portfolios that work for you - from PrimeInvestor.

TABLE OF CONTENTS

1. Authors
2. Introduction
3. 5 Principles for long-term investments
4. How many funds should you have in your portfolio
5. What fund categories suit a portfolio?
6. Fixing your returns expectations
7. Why you can't just buy and hold one equity fund for years
8. Reviewing your mutual fund portfolio
9. How to rebalance your portfolio
10. Moving out of equity
11. FAQs on portfolios and funds
12. About PrimeInvestor - What we do and why we are different

Authors

Vidya Bala

Vidya helped build one of the country's earliest robo-advisory solutions in the country in her earlier role at FundsIndia. Vidya was the head of mutual fund research at FundsIndia where she did some path-breaking work in analysing funds and offering researched portfolios. Her recommendations had a sound track record of beating markets and showcasing consistency. They were followed widely by investors, advisors and media.

A Chartered Accountant by qualification, Vidya began her career as a Senior Internal Auditor for Ashok Leyland. She then went on to work for The Hindu Business Line's Research Bureau, tracking mutual funds, stock markets, sectors and the macro economy for eight years. She has more than 18 years of experience, of which over 15 were spent analyzing the markets.

Vidya is known in the media for her straight talk and, calling out bad products.

Bhavana Acharya

Bhavana was Deputy head of research at FundsIndia and was instrumental in converting many of the research outputs to products on the platform. She is a management graduate in finance with over 11 years of experience. 4 years were at FundsIndia, 7 years with The Hindu Business Line as research analyst.

Bhavana is an expert at analyzing stocks, sectors, and funds and creating portfolio products for investors. Bhavana's ability to simplify complex analysis into simple, well-written, actionable commentaries has won the praise of many investors.

Bhavana is a management graduate from BIM.

Executive Summary

There are three stages to portfolio building – setting asset allocation, setting category allocation, and fund selection. But your job doesn't stop here. Maintaining that portfolio over the course of your timeframe is equally, if not more, important.

This book aims to help you do both. There is no one-size-fits-all in a portfolio. There are no hard-and-fast rules on allocations or funds. It's all about guiding and finding the best fit for you – because each of you is different in what you're saving for, in what risk you can take, in what you want from your investment.

So instead of giving you information you can't really use, this book will be the practical guide you can use to make the right portfolio decisions. In this book, you will know

- how many funds to have in your portfolio
- what mutual fund categories you need, how to use them, and what to ignore
- how you can set return expectations
- what goes into reviewing your funds
- how to rebalance your portfolio to keep it within your requirements
- when you need to start moving to safer options as you near your goal
- ...and other useful tips

There's no jargon-filled explanations, no complex calculators, no requirement on your part to be a finance whiz. It's, very simply, just what you need to know to be successful and profitable in your investments.

> *The stock market is a device for transferring money from the impatient to the patient.*
>
> \- Warren Buffett

CHAPTER 1

5 principles for long-term investments

Your investment timeframe could be long-term or short-term. Your goal could be to go on that vacation, to buy that car, to buy that home, educate your children in the best colleges, to live a peaceful retired life.

Short-term portfolios, by their very nature, don't leave too much space to juggle the funds you invest in or worry about the effects of lower return. Portfolio building, maintaining that portfolio, and reaching your goal is more difficult in long-term portfolios as it gives you a long rope to constantly try to get the best from your investments.

Do these questions seem familiar to you? "When should I reallocate?" "When should I move out of equity?" "I am investing for the long term. But are there portfolios that will give me some tactical exposure?" Well, you're not alone!

The good thing about all these questions is that most are investing for the long term and that's where true wealth-building happens. The not-so-good thing is the multiple layers of complexity they added to investing.

So when you invest for the long term, there are 5 broad points you need to get in place and continue practicing. And these are:

- Save and invest regularly
- Know what you are saving for and a ballpark figure of how much you need to save
- Track your goals separately. Different strokes for different goals
- Stay with good products
- Rebalance

Save and invest regularly

This is non-negotiable. When I say save regularly, I don't mean you do only through SIPs. You can invest lumpsums too. However, if you do lumpsum investing without an idea of how much you need to save for your future goals, you have a problem. Regular saving and investing makes it easier to track goals by breaking down your plan of action into capsules that also help you fine tune as you go.

For example, suppose you have a goal of, Rs 30 lakh in 10 years for your child's undergrad. Now if you had a return expectation of say 10% annualized, you could say you need to invest Rs 11.5 lakh today to reach Rs 30 lakh or invest Rs 15,000 a month for the same goal and same return expectation.

The latter (regular investing) is simpler for a few reasons: It seems less daunting when the amount is broken down into monthly savings. It avoids wrong timing of market. You have a higher chance of regularly tracking and upping savings gradually (not invest and forget). But remember, if you aspire big, your escape route is not tweaking your return expectation to 20-30% in your calculator. It doesn't work that way. You must up your savings!

Next**,** when we say invest regularly, we need to be sure which investment vehicles lend themselves well to this. For example, regular investing or SIPs directly in stocks can be a hard and even risky proposition. It can get very stressful to use them as vehicles to build for goals less than 15 years.

It is only when you build a sizeable portfolio of stocks that it becomes more predictable to assign them to specific goals such as retirement or leaving an inheritance etc. That way, mutual funds (and ETFs) and simple fixed income products such as deposits are most amenable to practicing disciplined investing.

The quick check tip: Investing regularly and in a disciplined way does not guarantee your achieving the goal. Midway, you may realize your returns are turning out to be lower than what you expected. The only antidote to lower returns from the market is saving more. If you want a high-sounding name to this, it is called **value averaging** (not SIP). Value averaging makes you invest more when your returns are lower than your expectations and vice versa. But make sure your return expectations are not outlandish and in line with the nominal GDP growth rate.

You don't need any specific tool to do value averaging or try to time the market. Here's how: On an annual basis, check your portfolio returns. If you see it more than 4-5 percentage points lower than your expected return, deploy some surplus in addition to the SIP running.

This is because when your returns are lower (assuming that your funds are quality ones), it means the market is underperforming. So, by deploying more, what you are indirectly doing is investing more when markets are lower. The beauty here is that you need not know where the market is! You simply need to know where your portfolio stands vis-à-vis expectations. Now, if your next question is whether to sell and exit some amount if your returns are higher, please don't. We will discuss this in the rebalancing section below.

Know how much to save If you save without knowing how much to save and for what you are saving, then there is a very high chance you don't meet your aspiration. All you need for this is some basic excel calculation (or calculators) to get a ballpark figure on how much you need in the future.

I am not talking of the 10-page financial planning reports here! You can get such reports done if they give you some comfort. But frankly, with at least half a dozen assumptions and caveats, they are not cast in stone. They keep changing. Hence, don't get too fixated on coming up with a super-plan. Simply know what you are saving towards and how much money you need to commit to that.

The quick check tip: Go back to the section above on quick check tip to make sure you add more if your savings seem inadequate.

Portfolios for different goals

An investor told me that he had 6 different goals and his planner advised him to maintain just one portfolio. While this may have been said to avoid fund duplication, it will not help build/track portfolios optimally for each goal.

Having a single portfolio has other limitations as well. Asset allocation will vary for different goals with different time frames. The strategy/risk profile and therefore the category of funds or ETFs that each portfolio needs will vary. Let me give an example: a value fund is ideally avoided for a 3-5-year portfolio while it has a better chance to deliver in a 7-year portfolio.

This does not mean you need all unique funds for different portfolios. While some funds may be used across goals, it is better to maintain them as separate folios (for each goal) as most online platforms, unfortunately, don't have the option to invest portfolio-wise. This way, you will have a dedicated corpus running for each goal. The same goes with deposits too, whether you are doing it with a bank or outside.

The quick check tip: The tricky part is to get the right combination of investments/ strategies for the different goals. If you find it difficult or want to take cues, check Prime Portfolios to get an idea of how to mix strategies for a given timeframe or goal. Or you could save yourself the trouble and pick the one closest to your requirement. Follow this portfolio to remain updated (we review every quarter to ensure it's still got quality funds!)

Stay with good products

Planning and knowing how much to save and choosing the right channels to save is just a fourth of a job done. The rest comes from choosing the right products and more importantly staying with the right products. Yes, it is not an easy job and this is where most of you need help. Unless you stay on top of whether your fund continues to be a consistent performer, you may well lose out.

Had you invested in large/multi-cap/ELSS funds 15 years ago, there is just a 47% chance that the fund you held beat the Nifty 100 index TRI! (Or even worse if one took the entry load then). So just identifying good funds at the start isn't good enough. Staying with good funds is more important to ensure your portfolio doesn't go out of whack.

You can ensure you stay with right products in two ways; one is staying passive with some index funds and liquid funds because choosing the right products is never easy. This is fine if you don't regret the additional returns lost by not choosing to invest in good active funds.

The other is to have a mix of both – some passive funds to make sure you ride the market and some quality active funds (especially in segments where outperformance is evident) to get that additional 2-5 percentage point return that can buttress your wealth.

The quick check tip: For quality funds with minimal overlap in strategies, you can look at Prime Funds. Then use our MF Review Tool to run a periodic quality check on whether your funds are worth holding. We also ensure that we don't rush into exits at the merest drop in performance. We observe steady deterioration as much as we watch for steady improvements and then take a call. Please note that our ratings are not our recommendation; our review tool is. You can add ETFs too from our recommended list for passive investing strategies.

Rebalancing

Periodically, checking the performance of your investments and exiting or stopping SIPs with slipping performers is a review. Rebalancing is about reducing exposure to inflated assets and adding to undervalued assets. This will be a practical solution to many of your queries on selling when market is high and investing when it is low.

You can't time the market. But rebalancing acts as a good proxy. The best part? You don't need to know market levels to do this! We have covered rebalancing in detail in Chapter 7.

Know that reducing equity exposure and gradually moving to debt is a risk-mitigation strategy. It is not rebalancing. While it also plays with asset allocation, it does not consider whether your equity is inflated or not. It simply preserves all that you have built till then. This question of when to move out of equity as you near your goal is covered in Chapter 8.

CHAPTER 2

How many funds should you have in your portfolio?

To be a little annoying – there's no straight answer to this question. But what we can tell you for sure is this:

1. It's not just the number of funds in your portfolio that is important but the mixing of styles and strategies for each goal that you have. In other words, one goal – one portfolio – sufficient diversification.
2. Once you build a portfolio focused towards a goal, then mixing styles and therefore keeping number of funds optimal become easy.
3. It is perfectly fine to use same fund for multiple goals.
4. The style or strategy that needs to be mixed depends on the time frame of your goal.
5. The quantum of money you plan to invest will decide how many funds you need.
6. Excessive exposure to a single fund is best avoided in high risk categories that have liquidity, default or high volatility risk. This is specifically true in debt.

You can apply these broad guidelines to keep your portfolio in shape and yet not too concentrated and not too diversified.

How many funds for beginners?

How many funds to hold is not a question that should bother you as a newbie. If you are beginner investor, with say a total of say Rs 5,000-10,000 of SIPs, or less than Rs 50,000 lumpsum **you don't need more than 2-4 funds.** This is because you likely know very little about the fund risk, the fund strategy and how to mix them.

But when I say have just 2 funds, you can't pick one high-risk equity and one high-risk debt. We have seen first time investors hold one midcap fund and small cap fund or an all-aggressive portfolio. You definitely need to go with index funds or diversified equity funds and a low-risk debt fund. How do you do this?

Consider this portfolio below, which we built for a 1-3 year timeframe:

Fund	Fund category	Allocation
ICICI Prudential Balanced Advantage Fund	Balanced Advantage	30%
Aditya Birla Sun Life Floating Rate Fund	Floating rate – debt	15%
Axis Treasury Advantage	Low duration – debt	25%
HDFC Short Term Debt Fund	Short duration - debt	30%

Here, you will see that we did not try to add equity funds directly and instead make do with a hybrid fund, keeping the rest in a mix of low-risk debt. We did 3 things here: **one,** by having a hybrid fund, we would reduce the number of funds that were needed for asset allocation. **Two,** we ensured that given the time frame, the portfolio is not hit hard by any equity fall. The hybrid fund we chose is meant to cushion downsides. **Three,** we diversified debt funds and not equity, as the former has higher AMC-related liquidity risk.

You might ask whether holding 2-3 funds would mean high single fund exposure. Yes, it does. However, what you need to remember is that the quantum of wealth is what determines how much a hit hurts you. A Rs 10,000 lost in a credit risk fund versus Rs 10 lakh lost in the same fund makes a huge difference to your wealth and your psyche – even if, in both the cases, the fund accounts for, say, 20% of the portfolio.

Need more styles not number of funds

As your portfolio grows, you need to add some funds. The number of funds can be **in the range of 6 to 12 funds.** If you have more debt, there is a need to add more funds across AMCs. Again, this is just a number, not a rule. Having 6-12 funds, for example, would mean individual funds would be 8-17% of your portfolio – which serves as a good limit. This will also give it leeway to grow to say 20-25%, which can be an outer limit.

When we say 6-12 funds, we mean all your goals put together. You may have same funds across different portfolios. Adding equity funds should be based on the differentiated investment styles rather than based on just categories. For example, there is no real need to add one large cap, one multi-cap one large & midcap and so on – from each category. You will only end up holding portfolios with 50-70% duplication in stocks. Chapter 3 outlines what categories to have and what to avoid, and how you can use them.

Keep the following points in mind:

- What is more important than choosing multiple categories, is **mixing styles** – growth, value, blended growth-and-value, focused, cash holding, or hedging strategy and so on. For example, in the 2018-2020 period, only a narrow set of stocks outperformed, focused/concentrated portfolios did better than diversified ones. Mixing such style as part of your portfolio would have helped. And remember, a fund can be focused even without being in the focused fund category. So go by your fund's strategy, more than just category.
- **What goes wrong is when you up your exposure to one style, because you see it outperforming and add funds there.** For example, as value starts performing now, you will likely be adding 2-3 value-biased funds. You are doing two mistakes here: one, you are unnecessarily adding more funds and two, you are tilting your portfolio to one style. When this style goes out of fashion, you will be sitting on a fully underperforming portfolio. This is true of many portfolios that we have seen – some with 3-4 midcap funds or small cap funds; some with 3 banking sector funds (believing it is diversification) and some with 3 international funds or 2 gold funds. This is not just duplication. It also ends up harming your portfolio when market trends turn.

- **Adding different styles does not mean you need one from each style for all goals.** For long-term portfolios, mixing styles can become important so that at all points, at least one strategy performs when the other does not. But this leeway is not available in shorter duration portfolios. For example, a value-style fund will not fit in a medium term portfolio. But in an aggressive 7-10 year and longer portfolio, it can well find a place.
- **Some amount of mixing styles is now possible with index funds** as well given the range across value to low volatility to midcap and small cap styles. When your portfolio is predominantly in index funds, you don't need to hold, say, 2 Nifty 50 funds or 2 Next 50 funds from different fund houses. Just choose one good index fund with low tracking error.

Debt needs more care

While mixing styles and strategies is easier to implement in equity, it is not so easy in debt. For example, even if you hold a short-term debt portfolio, we would not recommend that you stick with one ultra-short or 1 low duration fund, given the hidden risks that these categories can mask and that situations can change very quickly. Hence, you should have a few additional funds, duplication notwithstanding – just so you can diversify across fund houses. This is the key to lowering liquidity risks in debt.

This approach is more essential for short-term money. When it comes to long-term investment, the rules explained earlier on avoiding duplication will apply depending on what type of fund you have.

For example, if you have highly liquid and high credit quality categories such as dynamic bond funds gilt funds or even corporate bonds funds, you don't need to hold multiple schemes in each category. This is because, liquidity related risks are lower in these, leaving you only with too many funds with no differentiating performance.

For example, we have seen investors holding 3 or 4 dynamic bond funds for diversification. This doesn't really help. Instead, mixing this with an accrual fund (from short or medium duration) would be better diversification without duplication.

When you end up adding more funds

In our experience, the biggest reason for investors adding more funds (I have seen portfolios with 25-60 funds of investors moving their portfolios from banks) is a new fund offer suggested by a bank relationship manager or simply one more better performing fund is suddenly proposed. When you are approached with this offer, you need to ask the following questions.

- Is the NFO unique in any way? How is it going to complement your existing portfolio? If there is no clear answer or the only answer is that it is managed by an already successful fund manager, you really don't need that fund.
- When you are suggested an additional fund, because its performance is looking better, you need to ask your relationship manager to identify – **one**, whether it means that your current funds are not doing well and if so, should you exit any underperformer in place of the new one. **Two,** if not, whether adding this fund will complement your portfolio in any way.

Let me give you an example: if you are given a US-based index fund because you do not hold any international diversification, it is a good strategy. But if you are given a top performing multicap fund, your question should be which fund should you be substituting it with or what this fund can do for your portfolio that other funds cannot. Nine out of 10 times, you will not get a proper response for this. Why? Because the idea is to expect you to invest more; not just switch between funds.

When you do plan to invest more for an already existing goal, a good advisor who has built an optimal strategy will try to allocate the money in existing funds – perhaps changing one or adding another to go well with the current or upcoming market condition or for the goal profile.

Why it's important not to hold too many funds

An unwieldy portfolio can cause the following harm:

- One, it will not allow you to track your portfolio well and you will be unable to stay on top of performance and strategy of each fund.
- Two, the diluted state would mean the performance of a few laggards will pull down the winners' effort and keep your portfolio return mediocre.
- Three, the duplication would mean your portfolio is tilted towards a style or market cap – for example, excessive large caps or midcaps or value funds and may result in a bulk of your portfolio going down at once, when one of them fall out of favour.
- Above all, there is a very low chance you will consolidate them later, fearing high tax outgo. I have put in effort to consolidate many a portfolio (no, we don't do that in our present form) only to realize that the investor does not want to proceed as he/she is reluctant to pay the taxes to exit.

A quick summary

For small investments/beginners	2-4 funds is a good starting point. This should not be in extreme risk funds in equity or debt
As your portfolio grows	6-12 funds with diversifying strategies is good.
When you wish to add more funds	ask yourself whether the new funds will complement your present portfolio.
For short-term debt	diversify across AMCs, even if that means duplication
With long-term debt	when you are holding high-quality low credit risk categories like gilt, dynamic bond or corporate bond - avoid duplicating.

CHAPTER 3

Which fund categories suit your portfolio?

You don't need a fund from every mutual fund category there is. You don't need to stick doggedly to the fund category rule book, either.

The defined category is not important – what the fund does and what its portfolio looks like are. One, there are overlaps in SEBI-defined categories. Second, there are different ways in which you can get stable low-risk exposure, moderate-risk exposure, and high-risk exposure in your portfolio. A category can be used in different ways depending on the kind of investor you are, and what you need that category to do in your portfolio.

So in this chapter, we will look at each fund category across equity, debt, and hybrid and tell you how (and if) you can use that category.

Equity funds

To have equity in your portfolio, you need a medium to long-term holding. Here, you need:

Some moderate-risk exposure, through large-cap-oriented funds. For the most part, the categories below will meet this requirement.

CATEGORY	CONSERVATIVE INVESTOR	MODERATE INVESTOR	AGGRESSIVE INVESTOR	COMMENT
LARGE-CAP	OPTIONAL	OPTIONAL	OPTIONAL	Most large-cap funds trail the Nifty 100 index. Difficult to identify the few good and consistent funds. **Invest in Nifty 50/ Nifty 100/ Sensex index funds instead.**
INDEX	CAN INVEST	CAN INVEST	CAN INVEST	Large-cap indices (other than Nifty Next 50) good for large-cap substitutes. Use other indices where they challenge active funds or provide portfolio differentiation. **Prime Funds** has such a list.
MULTI-CAP	CAN INVEST	CAN INVEST	CAN INVEST	**Funds with stable large-cap holding & less aggressive strategy can be used in the place of large-cap funds.** Can be paired with index funds; conservative investors should use this mix. Other more aggressive funds can be used to boost portfolio's returns.
FOCUSED	OPTIONAL	CAN INVEST	CAN INVEST	If large-cap based, can use along with multi-cap & index funds for large-cap exposure by moderate to aggressive investors. **Good fit to boost returns.** Keep allocations low, for conservative investors. Compare with similar-strategy multi-cap funds.

Some high-risk exposure, through mid-caps and small-caps and other aggressive strategies to give returns a boost so that you are not stuck with low returns throughout your portfolio tenure. This, only if you are looking for that extra returns. the categories that fit this requirement are below. Please note that you can use multi-cap funds as well for higher returns as explained above.

CATEGORY	CONSERVATIVE INVESTOR	MODERATE INVESTOR	AGGRESSIVE INVESTOR	COMMENT
LARGE-AND-MIDCAP	CAN INVEST WITH LIMITED EXPOSURE	CAN INVEST	CAN INVEST	Large-mid blend helps deliver better returns, without pure mid-cap risk. Can be mid-cap substitute for conservative/ moderate investors. High-risk investors can allocate here instead of upping mid-cap/small-cap exposure too much.
MID-CAP	CAN AVOID	OPTIONAL	CAN INVEST	Fits only 5-7+ year portfolios. **Moderate risk investors** - keep allocation low, and/or go for more aggressive strategy funds. **High-risk investors - cap total mid-cap + small-cap exposure at 30-35%**
SMALL-CAP	CAN AVOID	CAN AVOID/ KEEP EXPOSURE TO <10%	CAN INVEST	Fits only 5-7+ year portfolios. Limit total mid-cap + small-cap exposure at 30-35%
CONTRA/ VALUE	OPTIONAL	OPTIONAL	CAN INVEST	Fit only 6-7+ year portfolios. Compare with multi-cap funds that follow value strategy. **Conservative investors** - go for value-growth blended funds instead of pure value.
DIVIDEND YIELD	CAN AVOID	CAN AVOID	CAN AVOID	Wide variation in high dividend yield definitions between funds. Poor performance for several years now.

Other than the categories above, there are those that can be used depending on your need and risk level. These are explained below.

CATEGORY	CONSERVATIVE INVESTOR	MODERATE INVESTOR	AGGRESSIVE INVESTOR	COMMENT
ELSS	CAN INVEST	CAN INVEST	CAN INVEST	Use only for tax-saving purposes. Don't invest in too many funds as it leads to duplication.
SECTOR/ THEMATIC	CAN AVOID	CAN AVOID	CAN INVEST	Use sparingly if aware of which sector to enter and when to exit. Use thematic funds instead of sector funds where possible as they can provide a broader scope.
INTERNATIONAL	OPTIONAL	OPTIONAL	CAN INVEST	Avoid thematic international funds and those markets which are similar to our own. Use in long-term portfolios, and keep allocation within 15%.

Debt funds

In debt funds, going by your investment timeframe is the best way to figuring out which category to use. There are several categories with overlapping strategies, and more than one category will fit a requirement.

Categories that fit ALL investors		
TIMEFRAME	**CATEGORIES TO USE**	**HOW TO USE**
< 6 MONTHS	Overnight, Liquid	These funds earn more than savings bank accounts. They can also be used for STPs and SWPs
6 MONTHS TO 1 YEAR	Liquid, Ultra-short, Low Duration, Money Market, Floating Rate	Other than liquid funds, others may have holding in low-rated papers. Such funds are unsuitable for this timeframe and need to be avoided. Use our **Prime Funds** for lower risk options here.
1 YEAR TO 3 YEARS	Short Duration, Banking & PSU, Ultra-short, Low Duration, Money Market, Floating Rate	Depending on amount invested, mix different categories. Else, simply go for short duration or banking & PSU funds. **Avoid funds with** more than 15% exposure to low-rated papers.
3 - 5 YEARS	Short Duration, Banking & PSU, Corporate Bond, Medium Duration **with no credit risk**	Depending on amount invested, mix different categories. Can otherwise just use corporate bond funds. **Very conservative investors** can use short duration or banking & PSU funds
ABOVE 5 YEARS	Gilt with constant maturity, gilt, corporate bond, medium duration, short duration, banking & PSU **(all with no credit risk)**	Depending on amount invested, **mix different categories**. Else, use corporate bond or medium duration funds. For debt component of long-term portfolios, can also just use constant maturity gilt. Gilt funds can be volatile, so it needs the ability to weather volatility.

Do remember that funds can have credit risks across categories (except corporate bond) as SEBI's definitions mostly pertain to the average maturity of the fund's portfolio and not the quality of its papers. So ensure that you are not inadvertently taking on risk. The categories above will fit every requirement you may have and there is no particular need to go for any other type of fund. But if you are of the more adventurous kind, you can go for the categories mentioned below.

Categories that fit ONLY MODERATE to HIGH RISK investors		
TIMEFRAME	**CATEGORIES TO USE**	**COMMENT**
ABOVE 5 YEARS	Dynamic bond, medium duration or short duration funds with credit risk	Risk comes from active juggling of debt strategy based on rate cycles. Missteps here can subdue returns for a long time. For funds with credit risk, go only for those where low credit exposure is less than 35%
Categories that fit ONLY HIGH RISK investors		
TIMEFRAME	**CATEGORIES TO USE**	**COMMENT**
ABOVE 5 YEARS	Credit risk	Be prepared for losses in these funds, and ensure that there is some back-up in the event of losses. **Don't use these funds as the majority or only debt allocation.**
TACTICAL CALLS	Gilt, gilt or PSU debt index funds	Timing in both entry and exit is important. Going only by past 1-year returns can be misleading.

Hybrid funds

In most portfolios, you can manage with pure debt or pure equity funds. Some hybrid fund categories fit particular needs while others can simply be skipped, as explained below.

CATEGORY	CAN IT BE USED	WHEN AND HOW TO USE
ARBITRAGE	OPTIONAL	Use only if you are in the high tax brackets, and holding period is at least 3 months. **Do not use for STPs or SWPs.**
EQUITY SAVINGS	CAN INVEST	Use for a timeframe of 1.5 years and over. **Can help tax-efficiency in timeframes of less than 3 years**, without compromising on return. For <3 year period, pair along with relevant debt funds
BALANCED ADVANTAGE/ DYNAMIC ASSET ALLOCATION	CAN INVEST	Use for timeframes of minimum 1.5 years. Use as a lower-risk route to equity in longer-term portfolios. Check for the fund's tax status.
CONSERVATIVE HYBRID	CAN AVOID	Inconsistent returns with risks on debt strategy often unclear. **Can instead use categories above, or pure debt funds.**
AGGRESSIVE HYBRID	OPTIONAL	**Use sparingly**, only if a lower-volatile route to equity is desired. Best suited for new investors who do not have large sums to invest, which makes asset allocation difficult to achieve.
MULTI-ASSET ALLOCATION	CAN AVOID	At this time, **effectiveness of allocation strategy unclear**. Asset allocation can also be achieved with pure debt, equity, or gold funds; this also brings more control over own portfolio.
PENSION FUNDS, RETIREMENT FUNDS, CHILDREN'S GIFT FUNDS	CAN AVOID	**Long lock-in and exit loads detracts from attractiveness.** Can instead use pure debt and equity funds for same goal. For tax saving, ELSS funds can be used.

CHAPTER 4

Fixing your return expectations

How do you form your return expectation? It's one of the keys to knowing how much to save. I posed this question to friends. Their responses can be broadly categorised in two groups. One, they either read or were told that equity markets can deliver 15-20% returns. Two, at some point in the past, some of the stocks they held had delivered this return and it naturally became the 'best return to expect'. Neither is good.

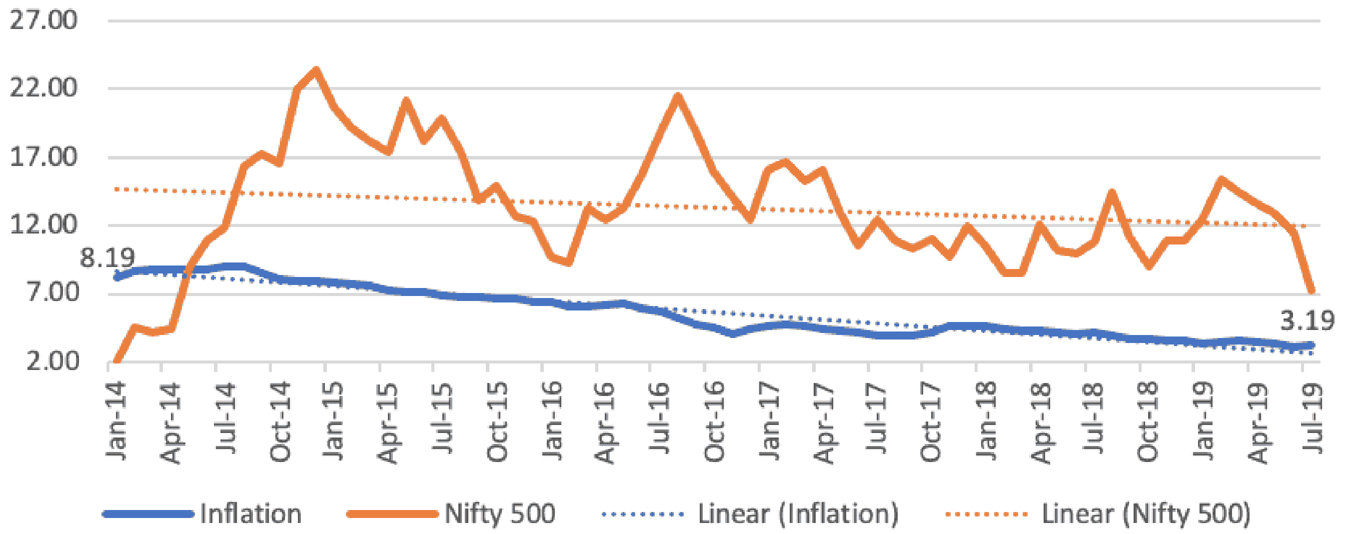
So in this chapter, you will know how to set your equity return expectation – that's your portfolio's mainstay.

Equity returns – low may not actually be bad!

In 2016, former Reserve Bank governor Raghuram Rajan said that he wanted real returns of 1.5-2 percentage points for savers. Real return is the return adjusting for price rise (inflation) in the economy. He wanted the RBI to monitor and keep inflation under check and protect savers. So we can take cues from this.

Mr Rajan wanted a fixed income product to deliver 1.5-2 percentage points over inflation so that an investor's savings don't shrink as a result of price rise. If that is for a fixed income product, a market-linked product like equity should obviously beat inflation and by a higher margin given the higher risk.

So, the first point is that you should be linking your return expectation to inflation, rather than an arbitrary number.



The rolling 3-year returns graph in Chart 1 will tell you that:

1. The market (represented by the Nifty 500 index) has beaten the consumer price inflation (CPI) almost all times for any 3-year period between 2011-2019; barring a short period until May 2014 when markets returned lower than inflation.
2. Inflation over this period reduced from 8.2% to 3.2% – a good 5 percentage point reduction. Why is this important? Because it means **you do not have to earn as high a return as earlier to stay ahead of price rise.**

In other words, your return expectations must moderate compared with 4 years ago as inflation is on a clearly downward trajectory.

The chart also shows that the margin by which the market has delivered returns over inflation has varied. This is partly to do with inflation and the growth of the economy.

While a very high inflation is not conducive (see Table 1 - 3 years ending January 2014) for the economy and stock markets to outperform, a very low inflation (see Table 1 - 3 years ending July 2019) doesn't help either. The margin of outperformance by the market has steadily come down post 2015 with inflation moving south.

3-year returns rolled monthly in...	Avg. 3-year CPI (%)	Avg. 3-year Nifty 500 returns (%)	Real market returns (%)
2014	8.5	11.8	3.3
2015	7.1	17.0	9.9
2016	5.5	14.6	9.1
2017	4.4	12.8	8.4
2018	4.1	10.6	6.5

The shrinking outperformance of the equity market is attributable to the lower growth in the economy. While lower inflation is one of the reasons, other internal and external factors (starting from demonetization to new bank code to a new tax regime and external trade wars) also contributed to the economy's slowdown.

What does this mean? **While you want 'inflation + X' as returns, this 'X' can vary based on how the economy is performing.**

So, set your expectations right.

Your current return expectations must be tapered down in line with lower inflation as you do not need a 'high return' to beat 'low inflation'.

- A high market return is also not possible in a steadily low inflation and lowering economic growth scenario. To this extent too, be prepared for lower margin of outperformance.
- Periods of no double digit returns in equity market does not necessarily mean that equity as an asset class is not performing.

There is a low chance of India hitting the high inflation phases experienced pre-2013 as the RBI is now constantly monitoring and managing it with monetary tools, and is tasked with keeping inflation at around 4%, +/- two percentage points.

And therefore, **an inflation of 3-5% plus the real growth of the economy can be your expectation over 3-5-year periods or more.** Note that individual stocks may continue to outperform well beyond these expectations. But as a portfolio, they cannot be totally cut off from the averages of the market. To this extent, a diversified basket of stocks will largely reflect market returns plus or minus some points based on the fund manager's ability.

Why return expectation is important

One, wrong expectations would primarily mean setting your financial goals and savings wrong. High return expectations will lead you to save a smaller amount which will leave you short when markets return lower.

Second, when your high expectations are not met, you lose faith in equities and move to FD for good. You miss the fact that equity would still be better than an FD rate or other fixed income options. This may lead to a sub-optimal wealth building strategy.

CHAPTER 5

Why you can't just buy and hold one equity fund for years

“All you need to do is pick the right funds and just hold them. In the long term, since all fund performances tend to move to the mean, there is no real case for reviewing fund performance.” True?

We don’t think so. We think one needs to redefine buy and hold. Buy and hold is a great quality to have when you invest in equity funds. But patience does not mean putting up with prolonged underperformance. **Buy and hold equity; but which funds to hold is a call to be taken.** And that needs periodic review and some judgement. This chapter explains why reviewing is needed, with some data. In the next chapter, we’ll look at the practical approach to weeding out under-performers from your portfolio.

Point of no return

We took the 5-year rolling returns of equity funds for 10 years ending September 2019. That essentially means we took a 15-year period for this exercise. We split this 5-year rolling returns calendar-wise and ranked them every year.

When we did this, one-third of the total universe of funds that were all in quartile one and two in rankings in 2009/2010, had moved to the bottom two quartiles by 2019. The reverse was also true. Those in the last 2 quartiles had moved up. Effectively, a ‘good’ fund did not always stay good and a bad fund found the ability to improve and deliver.

Great to gone

Aditya Birla Sun Life Dividend Yield (ABSL Dividend), Reliance Vision, L&T Equity, SBI Contra, Templeton India Equity Income, UTI Dividend Yield are some other instances of yesteryear top performers now struggling to make a comeback.

ABSL Dividend, among the popular funds pre-2008 is a classic case of slipping due to prolonged underperformance of the dividend yield strategy (a strategy in which a fund manager invests in stocks where dividend as a proportion of stock price is high).

Some like IDFC Focused Equity saw a change in strategy and slipped. Others such as L&T Equity saw significant change in fund management, from Fidelity; while Reliance Vision saw a sharp spurt in inflows leading to challenges in pursuing its strategy.

On the other hand, funds such as ICICI Pru Multicap, Canara Robeco Emerging Equities, Principal Multicap, Aditya Birla Sun Life Advantage, that you would never have picked 8-10 years ago have been consistently in the top quartile of performance chart in the past 4-5 years.

When it matters

So what if some funds underperform? Should it matter? Two factors determine whether you should bother.

- One, what is your exposure to the fund that has been underperforming.
- Two, whether the fund fits your portfolio given your time frame.

Let us look at the first point. If you had, say, a 25% exposure to dividend yield or value funds (where fund managers buy quality stocks with depressed valuations) in the last few years, it would definitely hit your returns hard. But not if it accounts for, say, 5%. If a chunk of your portfolio is underperforming, it needs review and change, regardless of fund strategy or its suitability for you.

Let us understand the quantum of the impact with a simple example of ABSL Dividend. If you had been investing Rs 10,000 per month in this fund from September 2011 (when it was ranked in top quartile), you would have Rs 12.6 lakh by end of September 2019; a return (IRR) of 6.4%. What if you had changed course say in 2015, when the fund was already languishing and switched to emerging performers such as Mirae Asset Large Cap? Your returns would have been double at 13.1%. And in terms of wealth created, you would have Rs 17.2 lakh, a good 36% more than the wealth built with the other fund.

If you're wondering if this is mere hindsight bias – it isn't, really. Simple performance metrics would have shown you that ABSL Dividend was steadily underperforming while the Mirae fund was steadily coming up. Of course, this would have been possible only if you review, at least once a year.

Now take the second point on underperformance of a strategy. In the ABSL Dividend example, one can argue that the dividend yield strategy did not pay off and hence the underperformance. The question is – how long would you wait for the strategy to bounce back?

This is best answered with your own time frame. If you had, say, a 5-year time frame, and a value or dividend yield did not work for 3 years, then it needs to make a tremendous comeback in the next 2 years to deliver. The equation changes if you had a 10- or 20-year time frame.

In short, strategy underperformance should not give you a false sense of comfort. **Remember you do not hold a strategy because you 'like it'. You hold it expecting it to deliver better than the market over time.** And if you choose funds that don't fit your time frame, the best thing is to correct it whenever you realise it.

Review a must

So, let us summarise the various reasons for underperformance and where you need to act:

- first, the classic case of strategy underperformance.
- second, funds that may have garnered too much assets too quickly and are struggling to keep up the nimble performance they managed earlier.
- third, change in fund house, fund management or change in styles that upset the fund's performance rhythm.
- four, simply wrong calls by fund managers resulting in losses that are hard to recoup.

In the first reason, you need to take a very informed call on whether to continue or exit considering your overall exposure and time frame. All the other cases call for an exit after you wait for 3-4 quarters to see signs of pick up – either over benchmark or peers.

Continuing with underperforming funds compounds risks. There is an opportunity loss. More importantly: when you invest for a specific goal, making market return assumptions, severe underperformance can throw your goals out of whack unless you identify the dip and course correct.

So - buy and hold equity funds but be open to changing them when you must. How? Well, go to the next chapter.

CHAPTER 6

Reviewing your mutual fund portfolio

Every time you need to review your portfolio, no doubt your mind is flooded with questions.

“My fund is underperforming. Should I sell it or not?”.

“How to go about selling it – in one shot or in a staggered manner?”

“How long should I hold an underperformer?

“If I hold a mediocre fund but start SIPs in a fresh one, over time, the number of funds in my portfolio goes up. What to do?”

Before we move on to discussing these questions, to the extent we can, let’s first talk about the review process per se.

When and how to review

In our view, **it is sufficient to do a yearly review of any portfolio** and especially for very long-term portfolios (10 years and over). If you have the time and inclination and if your time frame is 3-10 years, you can consider a half-yearly review.

If your time frame is less than 3 years – honestly, there isn’t much time to course correct except when a fund turns out to be high risk (sudden credit risk event) and you need to exit it. Of course, if you are constantly looking at tactical opportunities, the field is all yours. We are not that equipped to advise you on that.

Next, when it comes to identifying underperformers, you can use our MF Review Tool. Please note that this tool uses the fund’s performance relative to its category, and other qualitative metrics to decide whether it is buy, hold, or sell. And therefore, what the tool throws up may be different from what the fund has returned for you in your portfolio.

So when should you act and how?

Identifying underperformers and acting

- First, your fund need not be an underperformer if it delivered say 5% or 6% in 2-3 years. It may be that the market too delivered the same. Not your fund's fault.
- If your fund has been steadily behind the benchmark for 3 or more quarters (our experience tells us this is a good period) by 3-6 percentage points or more, it is indeed underperforming.
- Next, you need to see if this is to do with the theme/strategy itself – for example, a value fund may be underperforming the Nifty 50 but it is likely that other value funds are, too. In that case, compare with peers to know if your fund is a poor one among the other underdogs. It is a different call if you choose to exit a strategy. That is more about your portfolio requirement and less to do with the performance of the fund. Refer to Chapter 5 where we discuss this point.
- If your fund has been underperforming its benchmark and peers, your first step can be to stop SIPs. Then start the SIP in similar funds in your portfolio or choose a better one.
- If you simply stop with the above, it is likely that over a period, you will be left with an unwieldy portfolio.
- It is necessary for you to review such 'hold' funds during your next review and see if their underperformance has worsened (or simply put, have they moved to a 'sell' in our MF Review tool. This will be discussed more in our section on - how long to hold 'hold funds'.

Selling a fund

When a fund has been worsening in its performance in your portfolio or is a simple 'sell' in our MF Review tool, it essentially means you stop all SIPs and sell the fund.

Remember there is an opportunity cost in holding a bad fund. Let's take a simple example of ABSL Dividend Yield fund which was a sell in our Review tool in December 2019. Assume you had invested Rs 10 lakh 5 years ago in this fund. You continued to hold it instead of moving to an alternate value-tilted fund from our Prime Funds, when you saw a 'sell' call in the fund. Today, the amount lost by not switching would be around Rs 1.46 lakh (in just 6 months, yes!). Of course, this can vary with time and the nature of market and funds. What you have to do is weigh this opportunity cost against the cost of taxes and exit loads.

The issues you are confronted with while acting on this is broadly 2-fold: exit load and taxes. You have another dimension of how much the fund accounts for in your portfolio. Use the pointers below to deal with it:

If your equity funds are less than a year old or you have been running SIPs on the fund in the past 12 months, then there is a high likelihood of exit load and short-term capital gains tax (if you have profits). In those cases, you MAY choose to wait to sell the entire units a year later or sell those units that have crossed a year. If tax and costs don't bother you, you should simply sell and move to the next fund.

If your debt funds are less than 3 years old, the same short-term capital gain tax issue, as above, will crop up. But here, it is important for you to take the call on whether you are holding a high-quality debt fund (no risk and at best low returns) or a high-credit risk debt fund. High risk and short residual period of holding (if your time frame is less than say 2 years) is a bad combination and you cannot decide only based on taxes. The risk of capital loss should outweigh all other reasons.

If some of you do tax planning, then you may want to set off capital gains and capital losses and time your redemptions accordingly (subject to the above risk in debt funds). This is best done consulting your tax consultant/auditor unless you are well-versed in this.

If you have **an extremely high proportion of holding (say over 25%) in a single fund**, you usually hesitate to do a single shift at a time. Now, technically, when you simply move from one equity fund to another, there is no element of market timing (unless you are out of the market and re-enter after some time) and hence no cause for worry. However, incurring large taxes in one shot may bother you. **In such cases, phased exits will help.** Otherwise, this is not something that calls for a SIP or STP simply because you continue to remain invested in the same asset class – just that it is another fund now.

If your holding in the underperforming fund is small, then you should not bother about all the above and simply exit.

How long to hold 'hold' funds?

We stated earlier that you simply stop SIPs in your 'hold' funds and wait. If a fund remains a middle order performer and is not terrible, there is no real cause to sell it. However, if you keep doing this over a 15-20-year period, the number of funds in your portfolio will likely swell. In such cases, use the following pointers to exit some of your 'hold' funds.

When you are rebalancing and you have multiple funds from the same category or style, exit or reduce the 'hold' ones first, if there are no 'sells'.

When you do your annual review and the number of funds you have is unwieldly (read Chapter 2) then exit some of the 'holds'. Reinvest in like-funds in your portfolio or if there are none, the nearest fund in terms of risk profile. For example, if you had a large & midcap fund and you would rather exit it to consolidate, you can well consider a multi-cap fund in your portfolio to shift into. It may be marginally less aggressive but there's no point adding a new fund since your aim is to consolidate. Else, split it between a multicap fund and midcap fund that you already hold. Refer to Chapter 3 on how to mix fund categories.

When you need some money for emergencies and need to necessarily draw from your long-term portfolio, the 'sell' and 'hold' funds can be your first choice. Many of you use the argument that you will book profit in the performing fund first. But you need to remember that MFs are not stocks. A stock that has gone up becomes expensive. A mutual fund that has returned well, may continue to return well as it rejigs its portfolio to find newer opportunities. Track record of consistent performance is more important. The exception to this is sector/theme funds.

And of course, if you are with all top-quality funds, **then you can always reduce the risky funds (mid and small cap) when you rebalance.** But we are talking of 'hold' calls here and not about how to rebalance. For that, move on to Chapter 7.

CHAPTER 7

How to rebalance your portfolio

Rebalancing helps you achieve two objectives.

- One, you will ensure that you stick to your asset allocation and thereby keep your portfolio risk even
- Second, you will periodically be booking profits in an inflated asset (overvalued asset class) and redeploying in a deflated one (undervalued one). Indirectly, you will be selling high and buying low, without having to watch the market level every time.

Rebalancing is most relatable to mutual fund portfolios. But you can apply the principles to any combination of products – as long as the focus is on asset allocation.

What is rebalancing

Many of you may be using the term rebalancing interchangeably with reviewing. While that is not entirely wrong, I'd like to establish some clear definitions of what I mean:

Rebalancing: Rebalancing is essentially re-aligning the asset allocation weights in your portfolio to bring them back to your original level or the desired level you fixed. For example, if you started out with a 60:40 portfolio of equity and debt and it becomes 70:30, then selling equity and redeploying in debt to bring it back to 60:40 is called rebalancing.

Reviewing/Changing funds is not rebalancing – Many of you use the term 'rebalancing' to denote review of your funds. That is, you want to know whether to sell a fund that is not performing and invest in a better fund. We call that 'review'. However, while rebalancing, you can definitely weed out bad performers as part of the rebalancing process. Chapter 6 discussed portfolio review.

Reallocation: When you decide to change or shuffle your asset allocation to make it riskier or to reduce the risk in your portfolio, we call it reallocation. For example, let's assume you had a 70:30 portfolio. By the time you are, say, 56, you want to slowly reduce the equity component and move to income earning options or lower risk debt options. In this case, you are re-allocating your portfolio – i.e. shifting from equity to debt, either gradually or in one shot. **This topic is covered in Chapter 8.**

The act of rebalancing

All of you wish to be sounded off when the market is at a peak so that you can book profits. You also wish to know when to invest more, when the market falls. Since this is not an easy task, rebalancing is often a good proxy to fulfil this wish. But that is not the primary job of rebalancing.

When to use

Rebalancing seeks to reduce massive swings (falls) in your portfolio and as a side-effect will also curtail some amount of growth in a prolonged rallying market. This is something you need to be aware of.

Therefore, it is our view that rebalancing has a larger role to play in portfolios with goals less than 10 years. This is because over a longer period, there is a higher chance that your portfolio reacts less to market swings. Over shorter time frames there isn't much time to recover from deep shocks.

Of course, you might want to practice rebalancing as a hygiene, irrespective of what time frame you have, but know the limitation that we mentioned in terms of curtailing some growth. Our illustration further down will make that clear.

Now, let us get into the act of rebalancing:

1. **Check your portfolio annually** to see whether it needs rebalancing. Take calendar beginning or end or even a fiscal year end but stick to it consistently every year.
2. **A minimal deviation** in each asset class does not call for rebalancing. It will lead to unnecessary tax impacts and exit loads.
3. **Keep a thumb rule of over 5 percentage points** deviation in any of the asset class to trigger a rebalancing on your side. There is nothing very scientific about this. Starting this level of deviation, your portfolio would actually begin to seem inflated in an asset class (say equity) and therefore hint that it is overvalued.
4. **If your portfolio has not crossed this threshold** but is on the verge of crossing it, you can still do a rebalancing if you see that market is rallying sharply (like 2007 end in our illustration later).
5. Once you identify that your portfolio needs rebalancing, **review your funds next.** At PrimeInvestor, we have designed a review tool that gives buy/sell/hold calls on funds. You can use this MF Review tool to exit underperformers – depending on whether your portfolio requires equity or debt to be reduced. Funds that are a sell on our tool can be used to exit or reduce. If there are no sells, the holds can be used to prune.
6. **If your equity has risen** and you have no underperforming funds, based on our MF Review tool, see which category has inflated more (midcap or small cap or large cap) and accordingly reduce.
7. **If your equity has fallen**, like it has in the illustration below (in 2008), then bring back your category allocation in large caps/multi-caps and midcaps to where it was before. If the market correction spooks you, add only index funds multi-caps. This will ensure you don't have to take any call on whether midcaps will come back sooner or languish.
8. **When debt is inflated**, you might often find that it is either from high duration funds (gilt, dynamic bond) or risky funds. Prune those (of course after first applying the rule for underperforming funds).
9. **When you need to add to debt** (reducing equity), do not try to take duration or credit calls. Use a combination of high-quality medium duration funds, short duration funds and even liquid funds in your portfolio. It is better to spread across time duration. That way, you will remain neutral to interest rate risks.

10. **Booking some profits and keeping it in liquid funds** will come in handy to redeploy when the next correction in equity happens. Please note that we cannot put a number to this as much depends on whether you already hold liquid funds or not. In general 5-10% of liquid funds or overnight funds (outside of emergency needs) in your long-term portfolio is good to have, when you book profits in equity.
11. **Make sure the exposure of that individual fund**, in the case of equity, is not in excess of 20-25% of your portfolio in the case of debt, not over 10%-20% when you are increasing exposure to an existing fund. Introduce a new fund, if you have an already concentrated portfolio. Please note that this is subject to individual limits you might have for midcaps or say high-risk debt funds (not over 10%) and so on.

The illustration below gives a simple example of how rebalancing helped. This is based on lumpsum investments. With SIPs, rebalancing may be a further rare occurrence, since you are averaging already.

Please note that this does not also consider taxes. It simply tries to illustrate how your wealth may grow slower in years like 2007, because you rebalanced. But it also tells you how you would have tackled the fall much better in 2008 and also because of averaging, your returns when the uptick happened in 2009 would still look better.

Portfolio without Rebalancing

	Nifty 50 TRI	Gilt fund	Gold	Total
Dec-05	6,00,000	3,00,000	1,00,000	**10,00,000**
Allocation	60%	30%	10%	
Dec-06	8,51,584	3,13,305	1,19,948	**12,84,836**
Allocation	66%	25%	9%	
Dec-07	13,35,324	3,35,124	1,38,730	**18,09,178**
Allocation	74%	18%	8%	
Dec-08	6,50,684	3,97,317	1,76,097	**12,24,098**
Allocation	53%	32%	14%	
Dec-09	11,55,555	3,43,246	2,18,795	**17,17,595**

Does not include taxation impact

Portfolio with Rebalancing

	Nifty 50 TRI	Gilt fund	Gold	Total
Dec-05	6,00,000	3,00,000	1,00,000	10,00,000
Allocation	60%	30%	10%	
Dec-06	8,51,584	3,13,305	1,19,948	12,84,836
Allocation	66%	25%	9%	
Dec-06 (post rebalancing)	**7,70,901**	**3,85,451**	**1,28,484**	**12,84,836**
Allocation	60%	30%	10%	
Dec-07	12,08,811	4,12,295	1,48,602	17,69,708
Allocation	68%	23%	9%	
Dec-07(post rebalancing)	**10,61,825**	**5,30,912**	**1,76,971**	**17,69,708**
Dec-08	5,17,412	6,29,439	2,24,639	13,71,490
Allocation	38%	46%	16%	
Dec-08 (post rebalancing)	**8,22,894**	**4,11,447**	**1,37,149**	**13,71,490**
Allocation	60%	30%	10%	
Dec-09	14,51,396	3,56,116	1,70,011	19,77,523

Does not include taxation impact

Selling funds

Many of you ask us whether the tax impact will not be very high when you do rebalancing. What you need to keep in mind is that the threshold of 5 percentage points (over original level) we have given will very rarely occur in a space of 1 year. It is only in years such as 2007 that you will see a rebalancing called for within a short span. So, you will most likely be holding funds which have fully or partly (if SIP is running) crossed both exit load and STCG periods. You will not have much to worry on this count.

If you have additional money to invest, instead of adjusting within your portfolio, deploy afresh in the undervalued asset class instead of selling in the over-valued asset. This will assuage your concerns on tax implication. But note the following:

- If you are investing fresh sums (and not rebalancing with existing money), we would prefer fresh investment for equity alone (where equity has fallen).
- When equity falls, you know you are value averaging. However, in most cases when debt falls, it is because equity is inflated and not because debt is significantly undervalued.
- There will be rare instances of debt undervaluation due to fall in your gilt funds or dynamic bond funds (high rate scenario). But these are hard for you to identify. Your debt might even have fallen because of some high-risk funds seeing sharp NAV falls. Hence, it can be risky to think debt is undervalued and pump in more fresh money. This is why we earlier suggested that you stick to safe funds, without duration or credit calls when you re-deploy in debt.

Please note that there will be many other smaller issues you will face when you try to do rebalancing. I have seen very meticulously drawn spreadsheets by financial planners on this and also seen individual investors finding it too complex and giving it up.

But it is my personal belief that it is not necessary to be very accurate nor be correct to the last level of detail.

All you need to ask yourself is this: "Has my equity or debt or gold swelled beyond a limit that I set myself initially. If so, let me put it back in order".

CHAPTER 8

Moving out of equity

How close to your goal should you start moving out of equity? This is at the top of your mind, as you look at stock markets swing. In this chapter, you will know how to approach this question.

Know one thing first - there's no one single answer that will fit everyone. The solution depends on your personal situation and the external markets. This chapter breaks it down into different situations and you can use this to understand what you should do.

Exit on reaching portfolio goal early

The easiest and the toughest decision is to make the shift from risky assets or categories when you have hit or exceeded your portfolio goal early. This could be because you benefitted from a bull market or you saved a lot more than you initially planned. When I say early, it could be 3 years or even 5 years ahead! It does not matter. If something served your purpose, fold it, and move on. But you can do so in a more phased manner.

Ideally, shift out of equity, and even credit risk funds or other high-risk or high volatile debt funds to the extent of your goal amount. The remaining (if you have exceeded your goal amount) can continue to stay in equity. Most investors fail to do this simply because it is hard to have the discipline to exit when all you see is more money on the table.

Use the STP or SWP route to do this shift if you strongly feel you don't want to miss further up-moves. But do this shift over 6 months to 1 year and not any longer, as there is always a risk of falling into the grip of a deep bear market, especially when you are in a prolonged rally!

If your goal is retirement, then the strategy can be slightly different. Remove the corpus needed for the first 5 years of your post-retirement period, and allow the rest to grow until your original time frame. But do not forget to do your annual rebalancing check for the remaining corpus.

When you actually retire, you will have to overhaul your entire investment and redeploy it into different instruments or products to fund your retirement.

1 or 3 years ahead?

Most of you want a time frame – the number of years before the goal – to begin an exit. So, let us first try to see if that can be figured.

As analysts, we like to quantify. So, if I told you that Nifty 50's 3-year rolling returns were negative 16% of the times over the last 30 years, it prima facie suggests there is a 16% probability that your corpus may fall 3 years from now.

In other words, if your goal is coming up 3 years from now, it means there is a 16% chance that your corpus may be eroded by 15% from today's value (See table), going by past data.

But this is far from a golden rule! Why? Because this proportion changes too. For example, if you take the 2010-20 period, the Nifty 50 returned negative just 4.4% of the times over 3-year periods! That may embolden you to think that you can afford to wait till the last minute.

Over 1-year and 3-year periods, the average fall was more or less the same. But the difference was that the instances of fall were higher in 1-year periods. Going by past data, there is a one in three chance of your corpus being lower in a year's time, irrespective of how long you had remained invested.

	% of times returns were negative	Avg. absolute fall	Worst fall
Rolling 1-year returns	32%	-15%	-56%
Rolling 3-year returns	16%	-15%	-42%

The above table tells us the average falls are not too scary. What is important is that in the 1-year bucket, the frequency of such dips is high. Therefore, taking stock just a year ahead of goal can be risky.

The loss probabilities are hard to guess in future. But what we know for a fact is doing a check just a year ahead, for vital, non-negotiable goals is a big risk. So don't wait until 1 year before your goal. Do a check on where your corpus stands vis-à-vis your target amount 3 years before your goal date.

Taking stock of where you are 3 years ahead of your goal will help you decide:

- Whether you can shift out 3 years ahead when the going is good, and continue in safe options such as FD or RD and still reach your goal.
- Whether you can wait it out and if the market does fall before you reach your goal, whether your goal can be pushed by a year or so to allow your corpus to climb back.
- If you are far away from your goal amount, what you should do.

Know your shortfall and decide

I'm taking a simple example to explain this. Suppose you had a goal of reaching Rs 1 crore for your child's education in 15 years and have been investing Rs 25,000 a month assuming a 10% return on your portfolio. Now in the end of the 12th year, there are the following possibilities.

1. Your money has exceeded your return expectations at 12% and you have a Rs 80 lakh corpus.
2. Your money grew as anticipated at 10%, leaving Rs 70 lakh in 12 years.
3. Your money grew lower than expected, building just Rs 60 lakh at the end of the 12th year at 8%.

Let us suppose you decide to exit from equity at this point and move to debt and continue Rs 25,000 in a 6% recurring deposit. See the table. If your portfolio had exceeded your return expectation at the end of the 12th year or is close to that, you will have little shortfall. Of course, the tax paid would bring in some 4-6% of some impact if it is an FD.

Can you afford to shift to lower risk options?

12th year corpus (Rs)	Corpus @6% p.a for next 3 years	Rs 25,000 p.m for next 3 years @ 6%	Amount at the end of 15th year	Shortfall
80 lakh (@12%)	9,528,128	983,403	10,511,531	Nil
70 lakh (@10%)	8,337,112	983,403	9,320,515	-7%
60 lakh (@8%)	7,146,096	983,403	8,129,499	-19%

So before you decide to shift to low risk options, take stock of the following:

For goals more than 15 years: Run a status check 3 years ahead of your goal. Do the above simple calculation of what happens if you pushed the entire corpus into safe investments.

If your corpus in such a calculation is closer to your target: you CAN AFFORD to exit earlier, continue investing in RDs or low risk debt funds and stay safe and still reach your goal. You must do this if your goal is non-negotiable (like education).

If your portfolio has not done well and you are, say, 30-40% away from your goal:

- You simply have to ramp up savings as you can't make it up in low-risk options like FD.
- If you can increase savings, then you may move to low risk options entirely and lock into the gains made so far.
- If you have no other source to make it up, reduce your equity exposure to reduce the impact of any potential market fall and lock into gains already made. The continued equity investment can help grow your corpus to reduce the shortfall.
- If the goal is negotiable, then even this need not be done. In this case, you can again do a status check a year ahead of the goal.
- For goals like retirement, if you have not exceeded your target, continue investing but by reducing equity by 5% every year for the next 3 years. There is no hard-and-fast rule to this. We are simply re-allocating slowly so that you give your portfolio a better chance to grow but at the same time reduce the chance of hits.

For goals of less than 15 years: Regular rebalancing is the best you can do. If you are lucky to spot that you are close to your goal in advance, reduce your equity (or other high risk component) by half. The vital points here would be to keep return expectations modest and increase savings as much as possible, whenever you can. There can be no other antidote to shocks in shorter tenure goals.

Return expectation is the key

What if you decide not to do anything and are suddenly confronted by a fall? Just look at the graph below where a 15-year SIP from 1997-2011 nosedived in 2008. In one of the worst periods like 2008-09, had you continued your SIP, your peak corpus would have been in January 2008 and you would have come back to those levels only in October 2010!

But the beauty here is that your IRR was still 12% in that period. That means, had you originally built this portfolio with lower expectations, your portfolio may not have made the best of the 2003-07 rally, but it would still have survived and delivered the desired result. If you had invested with a 15-20% return expectation in those periods, you would have ended with a shortfall!

Nifty SIP of Rs 25,000 a month

SIP data from 1997-2011

Bottomline

- Regular rebalancing during your investing years will ensure falls are not too painful. Chapter 7 dealt with rebalancing.
- Keeping return expectations moderate is the key. This will also automatically ensure you plan for higher savings. Chapter 4 covered how to set return expectations.
- If you are confronted with a goal year where the market sharply falls – wait it out if the goal is negotiable by a year or so. Else, exit in a phased manner giving some opportunity for portfolio to recover. Remember, this could have been dealt better by doing a check 3 years ahead of your goal.

CHAPTER 9

FAQs on portfolios and funds

Should you worry about fund manager changes?

A fund manager change is not a prompt to immediately exit a fund. A new manager does not mean the fund's performance is going to dip. The best course of action is to watch performance for 3-4 quarters. If performance holds up, you need to take no action. If the performance falters, switch to a better option. If the fund's strategy or portfolio changes, take a call based on the nature of change. Understand more about fund manager changes and AMC changes in this article.

Should you worry when expense ratio changes in a fund?

You need to be conscious of expense ratios, specifically in debt funds. You need not worry about the regular AMC mails updating you of a few basis points of increase or decrease. That is merely a compliance mail from AMCs as required by SEBI. Small changes in expense ratios are perfectly fine as on a month-to-month basis, it alters based on the fund's activity and costs and the city in which it gathers assets. If the ratio is suddenly hiked by a large margin (say 0.3-0.5%) or more, then watch the fund's performance, especially if it is a debt fund. If performance slips, then consider exiting and moving to a better fund. If you hold the regular plan of a scheme, then check the expense ratio of the direct plan. A big increase in the regular plan while the direct plan has a minor or no increase is a red flag.

Should you have gold as part of your portfolio?

Longer periods returns (5 and 10 years) of gold has been up to 10%. Very high returns are not common with gold. More, gold can be flat and non-performing for years in a row. It takes a global equity market risk aversion to send gold returns soaring. One strong year of returns (like 2020) can pull up years' worth of poor performance. But this is hard to predict. In shorter periods, gold can be as volatile as equity. Therefore, because gold returns have low correlation with equity, it is best used as a portfolio hedge for long-term portfolios only. You can allocate up to 10% here, if you wish to hold gold. Debt alone should also suffice as a hedge for very long period portfolios. Please read this article to understand in detail.

Can you have a passive-only portfolio?

Yes. Index funds and ETFs today cover large-cap, mid-cap, and small-cap indices. They also cover the broad-market indices (Nifty 500 and BSE 500), as well as some others (Nifty Next 50, Sensex Next 50). So mixing these with different allocations based on your timeframe and risk can give you a diversified portfolio. In the ETF space, there are also more differentiated factor-based and sector/theme-based indices which you can use to give your portfolio better returns and style differentiation. However, ensure that you pick funds/ETFs with low tracking error. Several ETFs also have poor trading volumes. Read this article to understand how to build a passive-only portfolio and the differentials between index funds and ETFs.

Can you use EPF/PPF as the debt component of a long-term portfolio?

You can, because it is a debt instrument. However, you need to be aware that you cannot achieve some of the portfolio management techniques such as rebalancing using PPF. For example, you cannot shift from your debt to equity when your equity allocation falls as a result of a market correction. This is because they are illiquid. This apart, debt funds do have the potential to deliver better returns, though they may not score as much on the tax front. Hence, for rebalancing purposes at least some allocation to liquid debt products like debt funds will help.

How can you calculate how much you need to save?

Getting your savings right is the first step to building wealth for your goal – you really don't want to save lesser than you should. You will find a variety of calculators on our platform, so use them to work out your investment requirements.

Should you go for direct or regular mutual funds?

Direct plans are, obviously, the better returning of the two when it comes to saving costs and thereby getting higher returns. However, if you wish to go that way, you have to get one of these two right: one, have a good fee-based advisor and pay the right price for them to manage your portfolio. Two, put in a lot of effort yourself in learning and taking the support of pure research platforms like PrimeInvestor. You can use our service, where we tell you which investments are worth your investment, sound you off on what to avoid and give you alerts when you need to take action. With this, you can be confident that you're on the right track with your investments. You can read this article for an argument on direct versus regular.

Otherwise go with regular plans, provided you know advisor/distributor has your best interests at heart and providing the portfolio management support you need. Ensure that you get reasonable explanations for the recommendations and changes your advisor suggests. Here again, you can use PrimeInvestor's varied tools including MF review tool and recommended funds to cross verify whether your agent is giving the advice in your best interest.

Should you invest in NFOs?

In most cases, no. An NFO needs to offer a differentiation to your portfolio. It needs to be unique in some way compared to funds that already are available. And its strategy should be such that it can be invested in right away, and not require a watch to see how returns pan out (like quant-based funds or funds which dynamically change asset allocations or strategies based on markets). In all other cases, give NFOs a miss. This goes for both active and passive fund NFOs.

Should you invest through SIP or lump sum?

There's no hard-and-fast rule. You can do either. We touched upon this in Chapter 1. You can do lump-sum investments, provided you don't invest just one time and entirely miss investing after that. You also need to make lump-sum investments at different points over market cycles to ensure that you don't suffer from bad timing.

SIPs are just a very easy, convenient way to invest. Its primary benefit is that it makes saving disciplined - you don't miss saving or find that you have spent all your income in a month and have nothing left to save. It allows everyone to build wealth gradually even with small sums. The other plus point is that it helps you invest across market cycles which reduces timing risks.

You can always have an SIP and top it up with tactical lump-sum investments from time to time.

Can I hold funds of a single AMC?

No. Diversify across AMCs, especially in debt funds. AMCs often take exposure to a company's debt instruments across funds in varying proportions. If there is an issue with that company's credit quality, it will disproportionately impact your portfolio. In equity funds, the AMC's core investment philosophy will run through most of its equity funds. The fund itself may have its own strategy, but can still be built on the core philosophy. If this basic strategy underperforms in a market cycle, it will reflect across its funds. So exposure to multiple funds from the same AMC will mean a big part of your portfolio gets pulled down.

CHAPTER 10

About PrimeInvestor - What we do and why we are different

PrimeInvestor **is a platform that delivers researched investment solutions to individual investors.** We sift through the hundreds of personal finance investment products out there across and filter them using exhaustive quantitative and qualitative metrics.

We distil this extensive research into a list of good, investment-worthy products for you, for every goal that you may have whether you're a novice investor or an experienced one.

Why we're different

Here's why we stand out from distributors or your brokerages from whom you receive research reports and advice:

- We do not earn any commissions, kickbacks or advertisements from any of the product manufacturers. Our structure (we are Research Analysts registered under SEBI) ensures we remain independent and unbiased.
- We do not earn brokerage by trying to churn your portfolio. You are free to execute where you want and we ensure you simply get best-in-class unbiased research solutions from us.
- We earn our revenue through a flat subscription from you. This ensures we remain loyal to you, our customer, at all times leaving no room for bias.

What we offer

Our researched solutions are outlined below. Do note that we track, review, and update all research products on a quarterly basis and keep you informed of changes.

- Prime Ratings**:** Our mutual fund rating that uses different metrics for each fund category. Use this to **know where a fund stands in performance** in comparison to peers.
- Prime Review**:** We add a layer of qualitative analysis and other quantitative measures to the Prime Ratings, in our mutual fund review tool. Use this tool to **know if your funds are a buy, sell, or hold in our view**.
- Prime Funds**:** We have clear recommendations on funds we think are worthy of your investment, across categories. Each fund in this list is unique in strategy and will help you **build a style-diversified portfolio with ease**.
- Prime ETFs**:** Our list of recommended ETFs. We believe this is an emerging space and there are already **options here which are not to be found in the mutual fund space** as yet.
- Prime Deposits**:** Our **list of deposits filtered for quality** so that you get the best of available fixed-income options with minimal to no risk.
- Prime Portfolios**:** Using Prime Funds, Prime Deposits, and Prime ETFs, we have **readymade portfolios built for different needs and timeframes**. You can follow portfolios and be informed of changes when we make them.
- Prime Term Insurance Ranking**:** And because insurance is an integral part of your financial needs, we have the **first-of-its-kind ranking for term plans so you know which one scores on all metrics**. Or use the Term Insurance DIY Selection Tool to do your own analysis.
- Insights & alerts**:** And finally, we regularly publish **insights, strategies, investment alerts, recommendations, opinions** and more, multiple times a week.

PrimeInvestor

From Redwood Research

Join Us

Join PrimeInvestor to learn, engage, and profit.

Invest with Confidence!

Register and Subscribe