kotak Mutual Fund

Common Investing Pitfalls

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What are some of the common mistakes people make when choosing mutual funds?

These are some of the common mistakes made when choosing a mutual fund:

a. **Buying based only on past performance** - In any market environment, some funds produce phenomenal returns. However, last year's best performers can be this year's laggards. One must take qualitative considerations into account before investing in a fund.
b. **Having a short-term horizon** – One should enter the equity mutual fund schemes with a long-term vision. Equity fund tends to give good returns over a long period of time. Short-sightedness causes worry and panic.
c. **Risk Tolerance / Goal setting** – One should invest in equity mutual fund schemes only if you have a high risk appetite and ability to tolerate volatility of stock market. Some are ready to take very high risk because they can afford to take the extra risk. However, some others want to take the middle path or moderate risk. This is the reason why mutual fund houses have different categories of equity mutual funds.

   If a conservative investor chooses to invest in small cap mutual fund scheme, the investor tends to panic when the schemes gives negative returns for a year or two. They will either stop their investment or sell their investments. Similarly, an aggressive investor tend to get impatient when he/she sees his investment in a large cap scheme is growing at a slower pace. That is why it is important to consider your risk appetite while selecting funds to achieve your goals.

d. **Behavioral biases** - Behavioral biases affect people's capability to make the right investment decisions. It is important to not let emotions rule over the rational mind when it comes to money matters. Like the stock markets, investors also go through an emotional cycles. This leads to some common investment behavioral biases like Overconfidence bias, Confirmation bias, Loss Aversion bias, Anchoring Bias, Herd mentality, Disposition Effect: etc.

Do Tax Saving / ELSS funds offer tax exemption on the investment amount above the limit of 1.5 lakh?

The ELSS investor gets tax exemption only to the extent of Rs 1.5 lakh per annum. Over and above that, the investor does not get any tax benefit. Each investment in Tax Saving / ELSS fund is locked-in for a period of 3 years. Other than that, nearly all the features and the facilities are similar to diversified equity scheme. Thus, in these type of funds one gets dual benefit of equity growth potential in the long term as well as tax benefits.

Do Mutual funds give guaranteed returns?

Mutual funds don't guarantee you the capital protection or fixed returns but it has the potential for better returns provided one stays invested for a longer period. Moreover, mutual funds are also tax-efficient as compared to traditional products.

It is cheaper to invest in NFO's because initial NAV at 10?

Many investors subscribe to an NFO primarily because its net-asset value (NAV) is priced at Rs 10 per unit, compared to open-end schemes with higher NAVs. The fact is that it doesn't make these schemes cheaper compared to a scheme with an NAV of Rs 100.

Particular	**Fund A (NFO)**	**Fund B**
NAV at time of launch of Fund A	10	100
Units Purchase (Initial Investment of 10000)	1000	100
NAVs at time of redemption from Fund A	12	120
Redemption Value	12000	12000
Rate of Appreciation	20.0%	20.0%

For example, you have 2 choices, 1,000 units of Fund A with a NAV of Rs.10 and 100 units of Fund B with a NAV of Rs. 100. You decide to buy 1,000 units of Fund A. After a year, as both funds have the same portfolio they grow equally at around 20%. The NAV of Fund A would then be Rs. 12 and NAV of Fund B would be Rs.120. Your investment value would then increase to Rs. 12,000, and the return would be the same irrespective of which fund you choose.

Are monthly dividends akin to fixed or guaranteed return?

Monthly dividends does not mean that fund will necessarily pay dividend each month. It only implies fund will strive to potentially pay dividend for the said period. Dividends are paid out of the profits and distributable surplus accumulated by the fund over the years. Dividend is paid out of the profits made by fund investments. One should keep in mind that NAV falls to the extent of the dividend paid out. Dividends are also subjected to 10% dividend distribution tax with effect from April 2018.

I am 60 years of age and still invest significantly in Equity category of Mutual Funds. Is it Right?

Conventional wisdom suggests that as the age of an investor increases, the portfolio should lean more towards relatively low risk investment instruments such as debt. Wealth preservation is more important for someone in the retirement phase of life and thus such persons should have a low to moderate allocation to equity assets. The thumb-rule of investing generally followed by many for allocation % in equity is 100 minus your age. So equity allocation should not be more than 40% for someone who is 60 years old. Although the exact asset allocation is dependent on various other factors and a professional financial advisor can help investors decide an appropriate allocation. Though, equity has the potential to provide high returns but only over a long period of time, and it also involves uncertainty, volatility and risk of loss in capital in short term. In order to reap potential gain from equity exposure, you must stay invested for the long term.

Are SIP's risk free form of investment?

Systematic Investment Plans have been regarded as an optimal mode of investment in mutual funds. It gives you benefit of averaging and compounding. SIPs make sense only if invested regularly for a long period of time. If you get into an SIP only for a short period, the returns generated could be insignificant or volatile. As the investing period goes on increasing, the potential for better returns increases. There is misconception that SIPs will always generate positive returns. SIPs only help average out the costs but there is no assurance of capital protection. SIPs help investors by instilling automatic discipline of investments and thus helps one plan their financial goals better.

Are Largecap Equity funds immune to volatility?

The advantage of having large-cap equity funds in portfolio is the relative stability they can provide. Because large-cap companies have a well-established reputation with consumers and are less likely to come across a business or economic circumstance that renders them insolvent or forces them to stop revenue-producing operations completely. However they are exposed to various types of risks such as Country Risk, Credit Risk, Business Cycles, Currency Risk, Interest rate, Liquidity and market risk etc. which can affect their revenues & profits over a period of time.

What are Debt Funds and how different from Banks Fixed Deposits (FDs)

Debt funds are mutual Fund schemes that mainly invest in a mix of debt or fixed income securities such as Treasury Bills, Corporate Bonds, Government Securities, Money Market instruments and other debt securities of different time horizons. The primary areas of difference could be returns, taxation and liquidity. Debt mutual funds, at fundamental level are just a diversified portfolio of debt securities with additional features. FDs while they give a semblance of security provide little to no liquidity. Other than that, inflation risk from investing in long term FD is high. Debt mutual funds provide liquidity and opportunity to ride interest rate and credit opportunities. As such, debt funds are relatively safe in comparison to equity, but they are not as risk-free in the way you think of bank deposit. And this perception of risk-free FD is largely due to the nature of the bank ownership. It's important to consider the following while choosing an appropriate Debt Mutual Fund Schemes.

a) Investment Horizon

Debt Mutual Fund generally specify an investment horizon, for which investors should consider investing. This is an important parameter that is sometimes overlooked by investors. Figure out your investment horizon and then choose a fund with a matching profile. For example, if you want to park your money for a few days or weeks, choose a liquid fund. If the investment horizon is little longer, say, a few months, you should opt for ultra-short duration scheme and so on.

b) Credit Ratings

Debt instruments in India are rated on the basis of their credit worthiness by various credit rating agencies . Credit ratings for debt instruments in the portfolio of a debt mutual fund scheme can throw some light on the qualitative aspects as it helps you assess the credit risk -- a risk of default on debt that may arise from a borrower failing to make required payments. If the portfolio consists of securities with highest credit rating, it implies that the portfolio is less exposed to default risk. Credit ratings of underlying portfolio is published on the websites and factsheet of mutual funds. Having said that credit rating of the securities and fund may change time to time.

c) Asset Allocation in Fund portfolio

This helps investors understand the investment approach of the fund manager. Debt funds invest in bonds issued by different entities and investors can identify the percentage of the fund's portfolio that is invested in the various debt instruments like government of India bonds, state government bonds, corporate debt, public sector undertaking (PSU) bonds, treasury bills, cash etc.

d) Interest Rates

Interest rates and bond prices share an inverse relationship. When interest rates in the economy move upwards, prices of bonds issued at the rate lower than the new rate fall lower and vice versa. So when you invest, you need to have a fair judgment of where interest rates in the economy are heading to select the right category of debt mutual fund scheme, and whether to invest in long-term or short-term debt funds.

How can one decide asset allocation between equity, debt & other types of mutual funds?

The quantum of investment in debt or equity or hybrid fund is dependent on the asset allocation mix, which in-turn is derived from one investment strategy & goals. An investor should take into account his risk taking capacity, age, and financial position and investment goals to determine the ideal debt and equity investment proportion for them. Different schemes invest in different type of securities as disclosed in the Scheme Information Documents (SID) and offer different return potential and risks. Investors may also consult professional financial advisors to help them in deciding their asset allocation to various types of mutual funds.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

Investors should consult a professional tax advisor for details of taxation on mutual funds.