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# Maintain allocation to international funds

## Investors who had not rebalanced their portfolios at the end of the previous year, as mid- and small-caps were still rallying, should do so now

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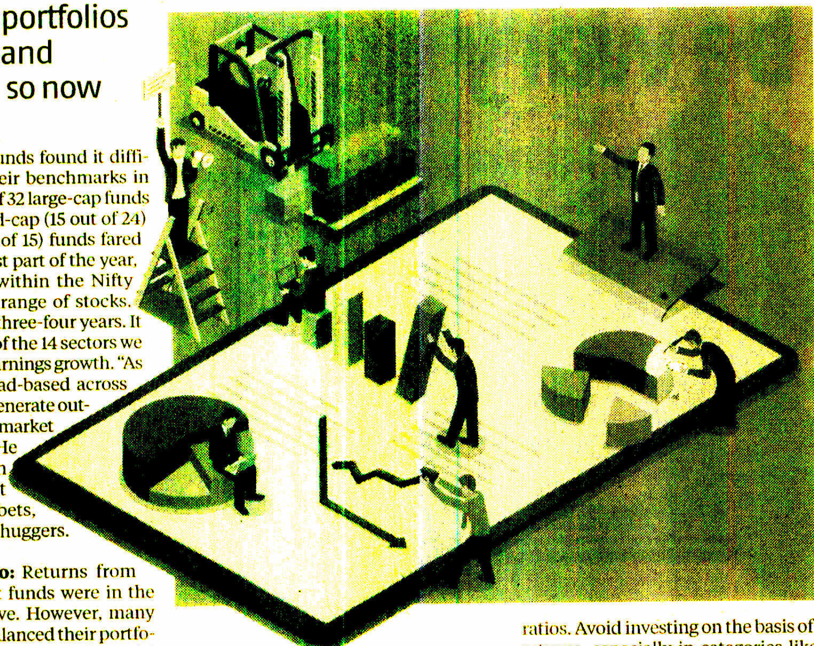
The end of one financial year and the start of another is a good time to assess your investment portfolio and make it ship-shape for the coming year. Your insurance portfolio, too, may require changes due to altered circumstances. It is also a good idea to get started on your tax-saving investments right from the beginning of the year.

**Tepid returns from mutual funds:** Average returns from all categories of diversified equity funds were in the single-digit during 2018-19. Large-cap funds performed better than mid- and small-cap funds (*see table*). "Large-caps were more rationally priced at the start of the year and were also seeing earnings recovery. Large-caps include quality businesses, with better long-term operating history, scale and stability, which tend to perform better during periods of volatility," says Sailesh Raj Bhan, deputy-CIO, equity investments, Reliance Mutual Fund.

Explaining the underperformance of mid- and small-cap funds, Shreyas Devalkar, senior fund manager-equity, Axis Mutual Fund says: "The mid- and small-cap segment had rallied in a big way from 2013 till the start of 2018. Since then we have witnessed a phase of consolidation." This period of consolidation, he says, coincided with the interest-rate hikes in the US.

"Around the end of 2018 or the start of 2019, there were indications that the rate hike cycle in the US was coming to an end. Since then mid- and small-cap funds have started doing well again," adds Devalkar.

Large-cap equity funds found it difficult to outperform their benchmarks in 2018-19. Only two out of 32 large-cap funds managed to do so. Mid-cap (15 out of 24) and small-cap (13 out of 15) funds fared better. "During the first part of the year, most of the returns within the Nifty came from a narrow range of stocks. This happens once in three-four years. It is changing now. Ten of the 14 sectors we track are now seeing earnings growth. "As earnings become broad-based across sectors, the ability to generate outperformance from the market improve," says Bhan. He suggests investing in large-cap funds that take independent bets, rather than in index huggers.



**Rebalance portfolio:** Returns from both equity and debt funds were in the single digit or negative. However, many investors had not rebalanced their portfolios at the end of the previous financial year, as they were reluctant to book gains in mid- and small-cap funds, which were rallying then. "If investors did not rebalance at the end of the previous financial year, they would still be overweight on equities, especially in the mid- and small-cap segment, and hence should rebalance now," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

**Beware of credit risk:** On the debt side, shorter-duration funds did well for the greater part of the year, but longer-duration funds have rallied in recent months. The IL&FS crisis and the subsequent liquidity crunch in the debt market brought credit risk to the fore. "It highlighted the need to invest in well-diversified debt fund portfolios so that even if there is a downgrade or default the damage is minimised," says Mahendra Jajoo, head of fixed income, Mirae Asset Global Investments.

Many investors had invested heavily in credit risk funds based on past returns. They should move out of this category now if it does not align with their risk profile. About 75-80 per cent of their debt fund portfolio should be in funds that are low both on credit and duration risk (average duration should not exceed two-three years). Select funds with lower expense ratios. Avoid investing on the basis of past returns, especially in categories like gilt funds, as this will result in investing at the wrong end of the rate cycle.

The past year year also highlighted the difficulty of trying to predict interest-rate movements. During the first nine months of 2018-19, the view was that interest rates were going to rise, but the opposite happened during the last three months. To avoid interest-rate risk, investors should ladder their fixed-income investments (fixed deposits, non-convertible debentures and tax-saving bonds) so that they mature at different points of time.

**Stay invested in international funds and gold:** Average return from US funds, the most widely recommended category of international funds for Indian investors, has been a stellar 13.35 per cent over the past year. Investors who were internationally diversified fared better than those who were invested only in the domestic market, underlining the importance of having international exposure.

Gold's return was weak at 3.54 per cent. It has given up some of its gains in recent months due to the rupee gaining strength. Maintain a 5-10 per cent allocation to it despite its tepid recent performance, especially as a global slowdown is expected.

**Reassess your insurance needs:** During your annual portfolio review, assess if your life insurance needs have changed. If your risk level, or your family's dependence on you has risen, say, due to the purchase of a house or the birth of a child, you should enhance your term cover. On the other hand, if you have, say, paid off your home loan, you may reduce your term cover.

If you have invested in traditional or unit-linked insurance plans (Ulips), evaluate whether it makes sense to exit such expensive investments. "While it's best to surrender traditional plans and exit them altogether, many are reluctant to do it for fear of losing a major chunk of their investments. In such cases we advise individuals to make it a paid-up policy," says Suresh Sadagopan, founder of Ladder 7 Financial Advisories. In Ulips, the costs are higher in the initial years. If you have a Ulip for four-five years, look at the fund performance and then take a call on whether to exit or stay.

Your need for health insurance may also have changed with rising affluence. Earlier, you may have been content to stay in a shared room and get treated at a mid-level hospital, but may now want a single room in the best hospital in the city. This will call for enhancing your health coverage. If you plan to shift from a job to your own venture, that would also call for augmenting your cover.

**Make an early start to tax savers:** Start your systematic investment plans in ELSS funds early so that the entire burden of investment does not fall on you during the fourth quarter of the financial year. If you contribute to the Public Provident Fund (PPF), invest now so that your money earns interest during the entire year. "Starting early will give you the comfort of making an investment that suits your overall portfolio. If your portfolio is already heavy on debt, for example, investing in ELSS would be a better option than in PPF," says Malhar Majumder, partner and consultant at Positive Vibes Consulting & Advisory.

### LARGE-CAPS OUTPERFORMED MID- AND SMALL-CAP FUNDS

| Equity funds | Category average returns (%) 1-year | 3-year | 5-year |
|---|---|---|---|
| Large-cap | 8.1 | 13.6 | 13.1 |
| Multi-cap | 5.7 | 14.3 | 15.0 |
| Large- and mid-cap | 4.2 | 15.2 | 16.5 |
| Mid-cap | -1.0 | 14.2 | 18.0 |
| Small-cap | -7.2 | 13.9 | 19.2 |

### THE YEAR BELONGED TO SHORTER DURATION FUNDS

| Debt funds | Category average returns (%) 1-year | 3-year | 5-year |
|---|---|---|---|
| Low duration | 7.5 | 7.6 | 7.9 |
| Liquid funds | 6.9 | 6.9 | 7.5 |
| Short duration | 6.7 | 7.3 | 7.8 |
| Corporate bond | 6.7 | 7.2 | 7.9 |
| Ultra short duration | 6.4 | 7.0 | 7.7 |
| Dynamic bond | 6.2 | 7.1 | 8.4 |
| Medium duration | 5.7 | 7.6 | 8.5 |
| Credit risk | 5.0 | 7.3 | 8.3 |

Source: Ace Mutual Fund