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Remember to keep emotions out with balanced advantage funds

They invest more in equities when markets are down and less when they are up — something most investors fail to do by themselves

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If you wish to invest in equities but are concerned about market volatility, consider investing in balanced advantage funds. These funds shift their allocation to equities and debt dynamically, depending on market valuation. They raise equity allocation when markets are down and reduce it when markets are trading at expensive valuations.

Experts say that balanced advantage funds are a good option for investors who wish to capture the wealth creation opportunities of equities, while benefiting from the stability of debt. "These funds offer a diversified portfolio where the asset allocation across equity and debt is defined by the fund manager. They are suitable for investors with a long investment horizon who wish to mitigate market risk through active asset allocation," says Jason Monteiro, assistant vice president, mutual fund research & content, Prabhudas Lilladher.

These funds are also well suited for new investors. "They are especially useful for those who want to avoid volatility, and for investors getting into equities for the first time," says Manish Gunwani, chief investment officer, equity investments, Reliance Mutual Fund.

Balanced advantage funds have predefined valuation models for deciding equity-debt allocation. While each fund uses its own valuation tool, such as price-to earnings, price-to-book, earnings yields, bond yield, and so on, all of them are focussed on buying stocks cheap and selling them dear. They rebalance at the end of the month, depending on change in valuation. "Such allocation arrangement ensures that the investor gets to participate in market upside, while in case of a market correction the presence of the debt component ensures that the downside is protected," says S Naren, executive director & CIO, ICICI Prudential AMC.

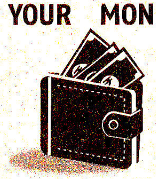
SOUND PERFORMERS

Return (%)

Fund	1-year	3-year	5-year
HDFC Balanced Advantage Fund(G)	0.41	16.33	15.63
Reliance Balanced Advantage Fund(G)	2.10	13.88	13.89
ICICI Pru Balanced Advantage Fund(G)	3.01	11.31	12.45
Aditya Birla SL Balanced Advantage Fund(G)	1.64	12.11	12.47
ICICI Pru Balanced Advantage Fund(G)	3.01	11.31	12.45
Category average	1.69	10.43	12.46

Funds selected on the basis of weighted average return. Source: Ace Mutual Fund

YOUR MONEY



The biggest advantage these funds offer is that they keep emotions out of decision making. "While it is desirable that equity allocation goes up when markets are down, empirically it is seen that flows into funds pick up when markets are up and are negative when market valuations are low and attractive. This is because there is fear when markets are at the bottom and greed when they are at the top. To keep out such emotions, which lead to wrong asset allocation, a rule-based approach that uses valuation as a primary tool is beneficial over the long term," says Gunwani. An investor who is keen on equities but does not know when to adjust his asset allocation will also benefit from these funds. "These funds save investors' time and energy in actively tracking the market and constantly making changes to their asset allocation," says Naren. Over the long term, these funds have the ability to provide sound risk-adjusted returns to investors.

Balanced advantage funds also get the more favourable tax treatment of equity funds. When they reduce equity allocation, they invest in derivatives, so that the sum total of their equity and derivative exposure is always above 65 per cent. For equity funds, gains in excess of ₹1 lakh per financial year are taxed at 10 per cent if investments are held for more than one year. Short-term capital gains are taxed at 15 per cent.

Keep a few points in mind before committing money to balanced advantage funds. Since they are equity-linked, their returns can be volatile and they can deliver negative returns in unfavourable market conditions. Hence, invest with a horizon of at least seven years to be able to ride out market cycles. Conservative investors, who do not wish to see negative returns, should avoid these funds.

Those who have the necessary risk appetite and a long enough investment horizon should, on the other hand, opt for diversified equity funds that maintain an equity allocation of over 90 per cent, suggests Monteiro.