How To Safeguard Your Mutual Fund Portfolio From 2008-like Scenarios

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If there's one thing that's certain about the Equity markets, it's that they will *rise* and fall. Most of these movements will be minor turbulences, whereas some will be earthshaking. Undoubtedly, a fair degree of risk aversion ensues after every such market cycle, with a number of retail investors 'swearing off' investing in the equity markets (or mutual funds), only to return and repeat the very same mistakes that led to losses in the first place.

Unfortunately, renouncing Mutual Fund investments may prove to be an unwise decision for long term savers, who will miss out on the potential for wealth creation that these products offer. And yet, when you put into perspective that there have been times when even established funds with long term track records have seen values dip by 40-50 per cent in bad *years*, it suddenly becomes apparent why a single such event is enough to scare investors off for a lifetime.

These situations can lead to opportunity losses in the long term. As Suresh Soni, CEO of DHFL Pramerica Mutual Fund puts it - "A falling market can be emotionally challenging and unnerving for investors. Often fear and greed gets the better of us. In 2008 after a sharp sell-off, stocks were available at very attractive valuations but most investors avoided investing, fearing a further fall in the markets."

A case in point is Franklin India Bluechip Fund, considered by many to be a 'bellwether' in the *Indian* Mutual Fund space with a track record spanning close to two and a half decades. The fund has a herculean 'since inception' return in excess of 20 per cent per annum - and yet, its NAV declined more than 35 per cent in a single quarter starting September 2008. In fact, between December 2007 and December 2008, the fund's NAV declined by a weighty 50 per cent plus!

In the 23 years since the inception of Franklin India Bluechip Fund, the Indian markets have witnessed several periods when the SENSEX came under intense pressure. Between 1994 and 1998, the index declined by over 40 per cent. Between 2000 and 2001, we saw a phase when the SENSEX fell by close to 60 per cent, and the famous 2008 meltdown saw the index crashing over 60 per cent. Post March 2015, we've witnessed a bearish phase as well. Undeniably, equity mutual fund investors went through considerable strife during all these phases - and yet, numbers would point to the merit of having held on through them all. Of course, this is easier said than done - when you see your hard earned *money* dropping to half its value, your decisions will likely not be driven by sound logic or patience any longer. Needless to say, a number of retail investors ended up losing a lot of money in Mutual Funds in the crash of 2008.

If you would want to continue participating in the long term growth that can only be afforded by equities, while at the same *time* ensuring that you don't get caught up in a 2008 like scenario, here are some steps you can take.

Invest continuously through SIP's
Retail investors would be taking a wise step by investing in equity markets continuously through SIP's (Systematic Investment Plans) and shutting themselves out from the noise surrounding the markets in general.

SIP's take away the effort of market timing, minimize regretful feelings that may influence even the most poised stock market investor to take unwise decisions, and automatically lead to the purchase of a larger number of units when during market corrections. Investors can afford to be oblivious to market cycles while investing through SIP's, which is great when you consider than any actions taken during seriously bullish or seriously bearish markets usually turn out to be wrong in hindsight.

Carrying on from our previous example of Franklin India Bluechip Fund, a 15 year SIP of Rs. 5,000 per month (an investment of Rs. 9 Lacs) would have growth to Rs. 42 Lacs by June 2016 (a compounded annualized growth rate of close to 19 per cent per annum).

Soni of DHFL Pramerica is a firm believer in the power of SIP's. "An SIP method of investing would spread the investment over *time* by continuing investing even when the market reached bottom, thereby helping lift overall returns when the market finally recovered", he says.

Don't speculate - think long term
Mutual Funds were not devised as a speculative instrument. In the short term, placing bets on sectoral funds may pay off, but these returns are likely to be leveled out in the long run as mean reversion kicks in. Your time horizon will be absolutely critical when it comes to avoiding 2008 like scenarios. Regardless of how tempting the prospect of making a short term profit might be, you must avoid the temptation of placing short term *money* into the equity markets at all cost - all the more when the general noise is indicating that "the markets are going to surge to unprecedented levels" in the next 12-18 months!

When it comes to Mutual Funds, investors would benefit from following the Buffett principle of assuming that the stock markets are closed for 10 *years* after making an investment.

Soni agrees with this viewpoint. "Mutual Funds are essentially meant for investments rather than speculation. Investors will do well to invest for the long-term in reasonably well performing diversified equity funds", he goes on to say.

For the best part, stick with the "Plain Vanilla" funds
Most investors would be better off investing in plain vanilla, diversified equity mutual funds rather than making sectoral or thematic 'plays'. Sectoral funds might provide eye popping returns at times, but bear in mind that this

comes at the cost of increased volatility.

For instance - Reliance Diversified Power Sector Fund delivered close to 140 per cent returns in the 12 months leading up to the 2008 crash, prompting more and more retail investors to invest into the fund. Unfortunately, the NAV ended up falling close to 55 per cent Between January 2008 and January 2009. Most retail investors will not be able to understand or stomach this kind of volatility, and should therefore stick with funds that invest across sectors.

According to Soni, most retail investors are better of avoiding sectoral funds. "Sector funds are for evolved investors who may consider them to reflect their positive view on certain sectors. However considering sector funds are riskier compared to diversified equity funds, investors should monitor them closely and *plan* their exit accordingly", he advises.

Don't get caught up in the euphoria, and don't exit after the markets have fallen
One of the keys to avoiding 2008-like scenarios would be to avoid falling prey to your own emotions and to the noise and excitement that invariably surrounds stock market investing. Forget what your friends may be advising you to do, even the advice of so called market pundits can be hilariously off the mark at times.

There were a number of analysts who predicted NIFTY levels of 10,000 in the 'not so near future', just before the crash of 2008 took the NIFTY from 6,300 all the way down to 2,500. In 2008, Fed Chairman Ben Bernanke said in a statement that he didn't anticipate any 'serious problems' (right before Washington Mutual and Citigroup proved him wrong). There are countless other examples of predictions that have been way off the mark in either direction.

When investing in Mutual Funds, make sure you're entering for the right reasons and with the right time horizon. Do not sell out after the markets have already fallen, and do not be tempted to go in hook, line and sinker after the markets have already gone up. If you must invest into an overheated market, stagger your investments via STP's (Systematic Transfer Plans) instead. And whatever you do, always follow a structured and *logical* asset allocation policy.

Follow an Asset Allocation policy - don't invest based on past returns
Don't forget that debt mutual funds exist too, and many of them have the *potential* to outperform traditional instruments by 200-300 bps after taxes in the long run. Arriving at, and then sticking to your optimal asset allocation (split between equity and debt) is one of the hallmarks of wise Mutual Fund investing. Make debt funds a part of your overall portfolio to balance out risk.

You might want to consider your overall portfolio of liquid (non real-estate) assets while determining your asset allocation. Keep in mind that your asset allocation needs to be determined by your own individual risk tolerance levels, and not what your friends or market experts think. There will be times when a moderate risk investor should be 50 per cent into equities, and other times when this number would be 70 per cent. A qualified Financial Advisor can take into account market indicators and couple them with your unique risk profile to arrive at the figure that suits you best. Once you've worked out that number, stick to it in a disciplined manner and review it periodically to bring it back to your *planned* percentages.

To conclude, Soni offers three wise pointers to continue enjoying the wealth creation possibilities offered by Mutual Funds, while avoiding getting trapped at the peak of a 2008-like bull market. "Firstly, Investors should invest with an objective as well as time horizon in mind. If you have surplus *money* for three to six months, equity funds are best avoided, as they may be volatile in short term. Please consider investing in short-term debt funds. Secondly, consider investing regularly and in a disciplined manner. Lastly, investors should remember that time in the market is more important than timing the market".