

# HOW TO SELECT MUTUAL FUNDS: MUTUAL FUND SELECTION GUIDE

Chapter 11

## A BEGINNER'S GUIDE TO MUTUAL FUNDS



Investing is an art that is personal to each individual. Just like every person's artistic inclination varies depending on their tastes and influences, investment choices also differ based on goals and risk capacities. Novice investors tend to gravitate towards safer investments, like traditional savings instruments but a balanced portfolio demands diversification. Although equity investments can generate reasonable returns, not all investors may have the requisite knowledge or time to invest in the stock market. This is where mutual funds come in.

### Understanding the mutual funds

A mutual fund combines funds coming in from different investors in diversified securities like equities, money-market instruments, government securities and even bonds to generate returns. A professional fund manager calls the shots, so investors do not have to dedicate time and effort to monitor the market. Generally, a well-managed fund yields relatively better returns than fixed-income securities.

### Types of Mutual funds

There are a multitude of mutual fund types in the market. For new investors, it is imperative to understand the distinction among them. Funds differ based on structure, asset class, risk levels, investment goals, investment horizons or fund specialty.

For instance, equity mutual funds invest in company stocks. The returns on these funds relatively tend to be better than others, but they could also be riskier than others. Debt mutual funds invest in fixed-income instruments, providing relatively stable but lower returns. Hybrid mutual funds seeks to combine the best of both worlds by investing in both equities and debt instruments.

Mutual funds can also be tax savers. Equity-linked savings schemes or ELSS funds are eligible for tax deductions under Section 80C of the Income Tax Act, 1961. However, they have a lock-in period of three years.

Understanding the differences among various fund types can help you choose the right mutual fund to invest.

## How to choose a mutual fund

India has over 44 registered fund houses, offering about 2,000 schemes. Although this provides more options for investors, the paradox of choice may confuse many. Mutual fund investments (any investment for that matter) are not a game of trial and error. A poor decision can cost you your hard-earned savings.

How then can you pick the right mutual fund? Sometimes, investors rely on ongoing market trends or take advice from friends or relatives. This may not be a wise move. Instead, you need to identify a fund that meets your needs.

Before you choose a mutual fund to invest in, ask yourself these three questions:

### 1. What is the goal?

Define your financial target. Clearly-defined goals make investment and consequent tracking easier. Your goal may be to go on an exotic vacation, save for retirement, or buy a house. Estimate the amount you will need to reach your goal and begin investing accordingly.

### 2. How much time do you have?

Retirement savings are usually long term. A longer investment horizon means you can take more risks. Equity mutual funds can be a good long-term investment option. If you have lesser time, say three to five years, then your risk capacity will be lower. Debt or hybrid mutual funds can be a better bet for shorter durations.

### 3. Is your goal negotiable?

Some goals are not strictly time-bound. For instance, you may be able to push back buying a house by a few years. However, a child's education cannot be compromised with. If your goal is non-negotiable, you can consider investing in a low-risk fund.

## How to invest in mutual funds?

Once you have narrowed down on your financial goal, risk capacity and the investment horizon, you will also be able to decide on the type of fund you want to invest. You can then compare the different schemes available.

One way to choose a mutual fund scheme is to check its historical achievements. Even though past performance does not guarantee future returns, it can be a good indicator. Compare the returns over different investment horizons. You can look for one with the consistent returns as it is likely to give you similar yields in future. You can also check how various rating agencies and independent research houses have ranked the scheme.

After you have decided which fund you want to invest in, you can transact offline or log into Franklin Templeton's website for online services.

To open an account offline, locate an investor service centre closest to you. Our executives will guide you with the paper-based application.

If you are looking for online services, you can transact with us through our website to

- a. Buy a mutual fund

- b. Redeem
- c. Switch
- d. Start a SIP
- e. Renew a SIP

or avail similar services via text or calling our contact centre.

In summary

Mutual funds are convenient and effective investment vehicles that can satisfy a number of financial goals. The key to making the right choice is to understand your individual needs and make a decision accordingly.

**NEXT TO COME: SELECTING THE RIGHT MUTUAL FUND**