# BENEFITS OF INVESTING IN EQUITY MUTUAL FUNDS

Chapter 16

A BEGINNER'S GUIDE TO MUTUAL FUNDS

## Professional management, diversification, small ticket size, regulations, high transparency levels are some advantages of investing in equity mutual funds

There are two ways of investing in equity. One, buy and sell stocks yourself and two, invest through equity mutual funds. However, the two activities have their differences. For the former, one needs to be an expert as well as have a full time involvement but it is exactly the opposite in case of the latter as the management of your money is done by a professional investment manager (Asset Management Company). So, if you are not an expert, it makes sense to invest in equities via mutual funds. Why should you invest through equity mutual funds? Following are some of the key reasons-
Professional Fund Management

An Asset Management Company (AMC) works in a professional set-up with individual functions of research, analysis and trading being carried out by experts. In case of a do-it-yourself (DIY) investor, he will have to do these activities on his own. It is also important to note that an AMC will have a more comprehensive industry perspective and outlook than an individual. For instance, mutual fund experts would visit conferences and interact with companies in which they invest. Besides, a mutual fund also continuously monitors economic, geo-political, sector, asset class and stock level developments at a micro level to gauge possible opportunities going forward.

**Risk Mitigation**
A fund manager follows a set of rules either defined by the regulator and by the asset management company to mitigate various forms of risk. These are well documented as well as monitored regularly. For example, concentration risk is mitigated by having a restriction on the stock or sector level exposure beyond a certain pre-defined limit. There are other risk parameters like stock liquidity, volatility, etc that are looked at by AMCs. It is, however, operationally difficult for an individual to adopt multiple risk mitigation factors like a mutual fund.

**Diversification**

Risk mitigation also ensures that many equity mutual funds are well diversified across stocks and sectors meaning they are not over-exposed to any particular stock or sector. Diversification helps to cushion sudden market shocks that may strike individual stocks or sectors for various reasons. Individuals find it difficult to diversify across stocks / sectors owing to the large amount of capital needed to buy multiple stocks besides the skill-sets needed to choose and monitor the portfolio.

**Small Ticket Size**
If you try to build a diversified portfolio with all types of stocks by buying them directly, you would need relatively large amount of funds – at least several thousands to begin with. In mutual funds, you can start off by owning a well-diversified portfolio for as less as Rs.500 (through a monthly Systematic Investment Plan).

**Convenience**
Buying mutual funds is more convenient than buying multiple stocks as you just need to invest in one equity mutual fund of your choice to own a portfolio while you need to trade multiple times to buy individual stocks and create a similar portfolio. Further, a demat account and a broker account is not a mandatory requirement for mutual fund investments unlike stock investments. One needs to be simply KYC (Know Your Customer) compliant to be a mutual fund investor. There are two broad modes to invest in mutual funds – i) directly through the fund house and ii) through an intermediary like a distributor or an independent financial distributor (IFA). You may also invest online through either of the modes.

**Tax Efficiency**
As per current tax laws, in case an individual buys and sells stocks in his personal portfolio, he would be subject to long or short term capital gains tax for each stock that he buys or sells depending upon his holding period (whether less than or greater than one year). So, if he holds one stock for 6 months and another stock for 18 months, he would be taxed for short term capital gains tax for the first stock and long term capital gains tax for the second stock. However, in case of a mutual fund, this is not the case. The AMC need not pay capital gains tax each time a fund manager buys or sells stocks in any scheme. Capital gains tax would be paid only by the investor based on his

investment period. Thus the difference between the two approaches is that in the first approach one is taxed at the stock level while in the second approach one is taxed only at the scheme or portfolio level.

**Well Regulated**

All mutual funds are closely regulated by SEBI (Securities and Exchange Board of India) which mandates certain level of transparency in the disclosures. All funds disclose their month-end portfolios on their website besides daily NAVs (Net Asset Value) and periodic expense ratios as mandated by SEBI. Many independent research houses track this information and provide performance and portfolio analysis of mutual funds to enable investors and distributors to take informed investment decisions.
All these factors clearly bring out the advantages of investing in equity mutual funds vis-à-vis individually investing in stocks.

## SUMMARY

It is operationally very difficult to invest across various stocks and sectors to have a well-diversified portfolio. In contrast, an equity mutual fund with a diversified portfolio can be bought in a single transaction. Mutual funds are also packed with far more advantages like professional management, risk mitigation, small ticket size, convenience, tax efficiency, regulatory oversight and high transparency of information. Individual stock investing would lack many of these aspects.

**NEXT TO COME: WHAT ARE EQUITY FUNDS & BENEFITS OF INVESTING IN EQUITY FUNDS?**