Plan To Be Financially Independent

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Mutual funds are proving to be a great option for investors with varied risk profiles, time horizons and investment goals. However, it can be a bit tricky for investors to make certain important decisions during the process of building the portfolio. In fact, some of these decisions contribute decisively to the final outcome of one's investment process. Here are a few of those and how investors can deal with them.

Direct versus Regular Plan

Most mutual fund investors would have faced this dilemma at some stage. While there is a clear advantage of lower cost in direct plans, the decision should ideally be based on the level of confidence one may have in one's ability to choose the right options as well as monitor the progress of funds in the portfolio. Although mutual funds are a simple investment vehicle, investing in them is not as simple since one has to make several decisions starting from ascertaining asset allocation, choosing the right funds within an asset class and monitoring their performance.

There may also be a need to take corrective measures and keep focus on different goals during the volatile periods. As is evident, direct plans reduce the cost for investors. However, the inability to follow the right process can prove very costly either in the form of taking risks beyond one's capacity or earning below-average returns. And that can compel an investor to compromise on some of the important investment goals.

Diversified versus Focused Funds

There is a place for both diversified and focused funds in the portfolio. While beginners should focus on diversified funds, experienced investors can expand their investment universe through funds that have focused or concentrated portfolios and enhance their returns, albeit with increased volatility.

STP versus SIP

Both a systematic transfer plan (STP) and a systematic investment plan (SIP) propagate a disciplined investment approach. The basic difference is that while opting for STP, one must have a lump sum amount. This amount is invested in an option like a liquid fund with an instruction for the fund to transfer a fixed sum, at a fixed interval, into a pre-decided fund of the same mutual fund. Remember, liquid funds have the potential to generate higher returns than what an investor would usually get from a savings bank account.

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Besides, parking money in a liquid fund can eliminate the possibility of money being utilised for something or the other that may compel an investor to compromise the financial future. On the other hand, investing through SIP requires a commitment to invest a fixed sum at a pre-decided interval – usually every month – directly into the fund chosen for investment. In other words, even if one doesn't have a lump sum, a fixed amount is invested every month out of the monthly income.

Existing Schemes versus New Schemes

The decision of whether to add a new scheme to the portfolio or to invest in an existing fund can be tricky. Ideally, the key factors in making this decision should be the composition of the portfolio, investment goals as well as the time horizon for which one intends to invest additional funds. For example, an investor who has built a portfolio for long-term goals will have to necessarily invest in a new fund if the intent is to park money for a period of 6-12 months.

Generally speaking, investors must remember that over-diversification makes it difficult to monitor the portfolio and doesn't offer any advantage as mutual funds themselves are a diversified vehicle. It can be a good idea to build the portfolio with multi-cap, large-cap, mid-cap and flexi-cap funds as fund managers rebalance the portfolio from time to time without making any dent in an investor's returns by way of taxes.