Things To Remember While Investing In Mutual Funds

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If you are looking to start investing in mutual funds, the current market level shouldn't be a deterrent. Equity markets tend to go up and down, but in the long run, they help you earn better returns than other asset classes provided you stay disciplined and invest with a clearly defined time horizon.

Mutual funds are a simple, yet effective investment vehicle. However, investing in them may not always be an easy task for an investor since there are hundreds of schemes to choose from. No wonder, investors often err by choosing funds that don't match their needs and/or by ignoring the need to balance risk and reward. That's the reason why identifying the right level of risk tolerance and choosing the right funds should be the key focus areas while building your mutual fund portfolio.

Plan your Investments — It's always a good idea to plan your mutual fund investments rather than investing haphazardly in every fund that comes your way. When you make investment decisions based on the short-term performance of funds, you could either end up making your portfolio very aggressive or very conservative. Remember, creating a roadmap before beginning to invest not only ensures that you follow the right process but also keeps your investments on track to achieve your goals. While asset allocation helps you maintain a balance between risk and reward, investing in an option like mutual funds provides you the flexibility to make changes, when required, for different reasons.

Don't Over-React to the Current Market Level — The market's dizzy heights can evoke a mixed response from investors. On the one hand, some face the dilemma of whether to book some profits or not and on the other, some wonder whether it is safe to start investing at these levels. In reality, if you are someone who is looking to start investing in mutual funds, the current market level shouldn't be a deterrent. Remember, equity markets have a tendency to go up and down but in the long run, they help you earn better returns than other asset classes provided you stay disciplined and invest with a clearly defined time horizon.

In a rising market, investors often get tempted to invest in aggressive categories of equity funds like sector and thematic funds. If you are not well-versed with the attendant risks and how to time entry and exit, you must stay away from these funds and rely on well-diversified funds to build your portfolio. You can reasonably be sure that if the fund managers see potential in any sector and/or theme, they will surely make you participate in them to an extent through diversified funds.

Allocate to Different Market Segments Carefully — While allocation to equities is important to earn a positive real rate of return over the longer term, you must keep an eye on allocation to different segments of the market. Since equity is an aggressive asset class, the attempt should be to avoid making the portfolio very aggressive by keeping a bias towards the large caps in the portfolio. Of course, the mid-cap and small-cap segments have an important role to play in enhancing the overall portfolio returns and hence, healthy exposure to both these segments must be there in the portfolio. Considering that stocks in these two segments tend to be more volatile than their large-cap counterparts, investing in a disciplined manner and having a long-term view can help minimise the impact of volatility in the short and medium term.

Thankfully, investors can track exposure to different market segments in their portfolio through the information available in the factsheets published by the fund houses. Besides, many portals as well as distributors' websites carry a detailed analysis on this aspect. Remember, the allocation to a particular segment should be the sum total of exposure to that segment through funds investing exclusively in it and also through other categories of equity funds like flexi-cap, large-cap, mid-cap and multi-cap funds.