Mirae Asset Knowledge Academy

Profit from Knowledge

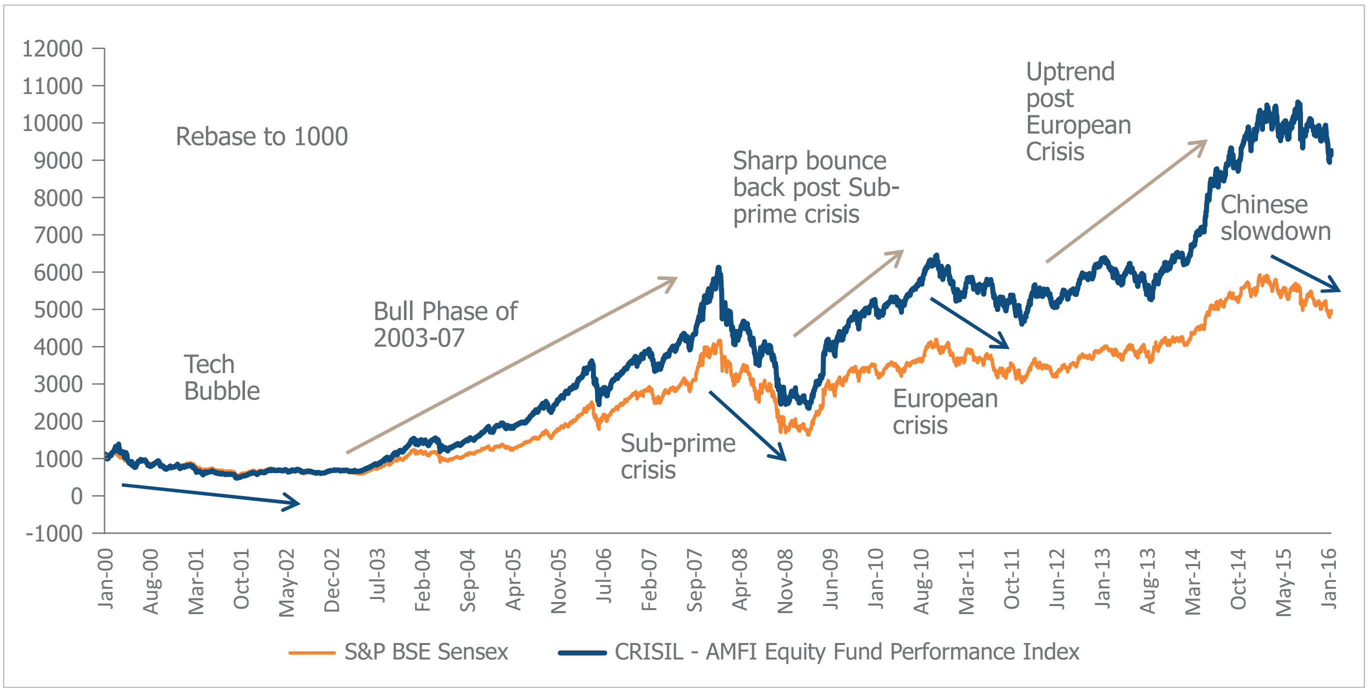
Combat volatility with long-term SIP

A volatile market can shake the best of equity investors. Guided by the intrinsic emotions of greed and fear, we invest when the market rises, sometimes even at premium valuation, and sell when the market falls, sometimes even at a loss. One needs to behave rationally to beat the emotional conundrum while investing. Consider systematic investment plans (SIP) to beat volatility. They are not new to mutual fund investors. We are aware of their benefits - rupee cost averaging, disciplined approach and negating the need of market timing. This article attempts to build a case for SIP as a weapon to combat volatility and explains how it helps create wealth in the long term.

Remember, volatility is but for a moment

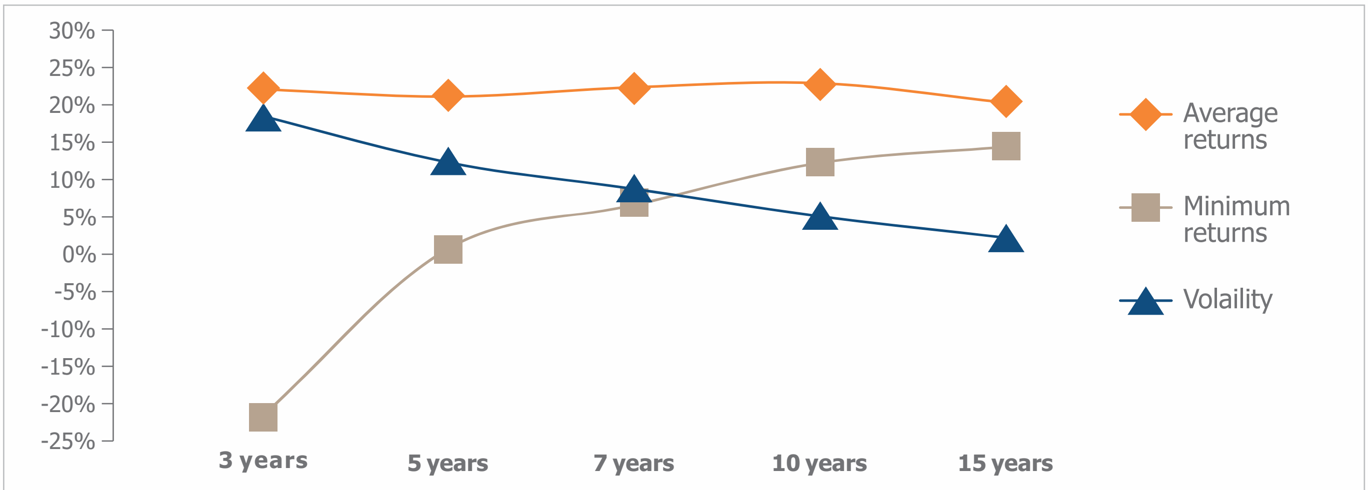
History has proven time and again that the equity market is highly volatile in the short term, but always moves up in the long term. Further, it should be noted that equity investments via mutual funds have fared better than direct equity investments thanks to professional management.

Chart 1: Cyclical movements of the equity market



So, what is a relatively safe long-term horizon? Performance of equity mutual funds (represented by CRISIL- AMFI Equity Fund Performance Index) shows that minimum returns from equity investments increase and concurrently volatility decreases over a wider time span of typically 10-15 years (highlighted in Chart 2).

Chart 2: Returns and volatility



Past Performance may or may not sustain in future. Average rolling returns for various periods since April 1997. Volatility represented by standard deviation.

Take a long-term SIP

Investing regularly is the best way to endure the unpredictable behaviour of the equity asset class. One can do so via SIP in mutual funds. It enables rupee cost averaging which helps iron out short-term volatility as the investor is invested both at high and low points of the market. SIPs in equity mutual funds have returned over 18% for 15 years ended January 29, 2016 as shown in that table below.

Table 1: SIP performance

	Total Amount Invested	CRISIL - AMFI Equity Fund Performance Index		CRISIL - AMFI Large Cap Fund Performance Index		CRISIL - AMFI Small & Midcap Fund Performance Index		CRISIL - AMFI Diversified Equity Fund Performance Index		S&P BSE Sensex	
SIP period	Value (₹)	Value (₹)	Returns (%)	Value (₹)	Returns (%)	Value (₹)	Returns (%)	Value (₹)	Returns (%)	Value (₹)	Returns (%)
5 years	60,000	84,154	13.52	78,026	10.46	1,00,600	20.82	82,244	12.59	71,813	7.13
7 years	84,000	1,34,311	13.19	1,23,322	10.80	1,68,529	19.56	1,30,231	12.32	1,10,874	7.81
10 years	1,20,000	2,25,260	12.11	2,06,476	10.47	2,78,691	16.09	2,18,543	11.54	1,78,297	7.69
15 years	1,80,000	8,33,510	18.45	7,31,871	16.97	NA	NA	8,54,668	18.73	5,29,867	13.25

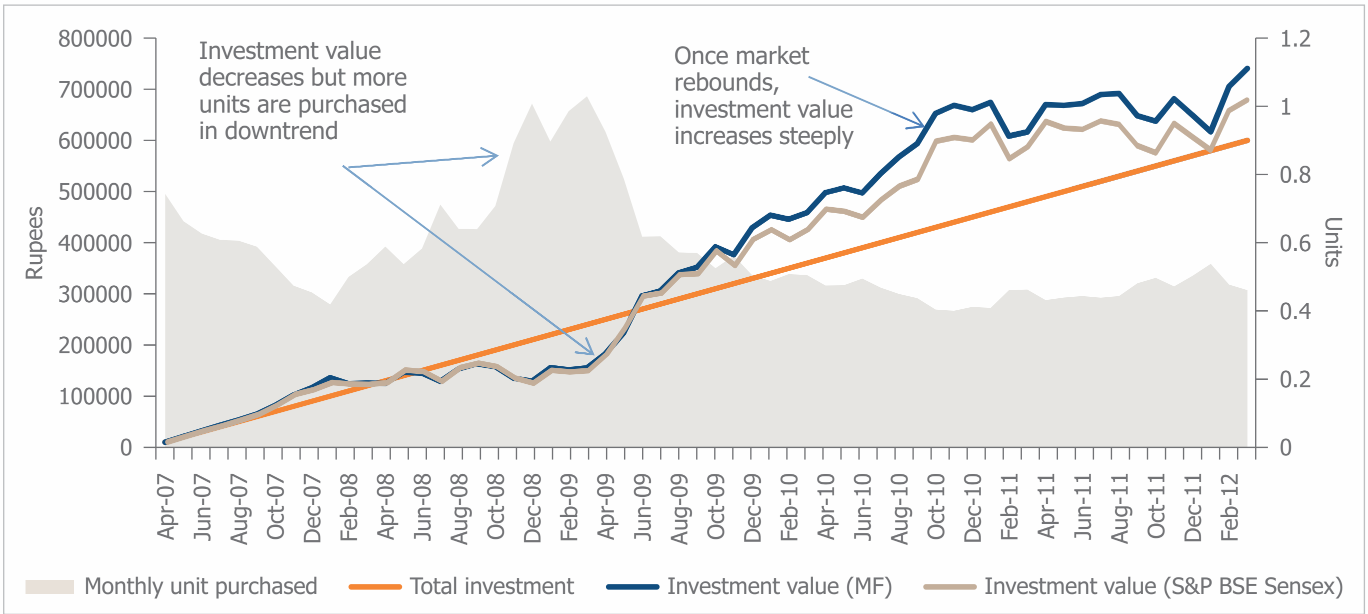
The SIP returns are calculated by XIRR approach assuming investment of ₹ 1000/- on the 1st working day of every month.

SIP can be started any time

Sure, buying low and selling high is a winning strategy. But, can lay investors always position themselves advantageously and predict the future course of the market? That is why SIP makes sense - it helps investors to be a part of both the bull and bear phases of the market. In a downtrend, even though one's investment value goes down, one can accumulate more units. Don't forget, the market has the ability to rebound on positive cues and reward investors commensurately in the long term. This holds true in most cases even if we start the SIP when the market is at its peak.

Let's consider a scenario where an investor started five-year monthly SIP of Rs 10,000 at the peak (say April 2007) of the bull phase of 2003-07. Due to the sub-prime crisis, which followed later, the investor witnessed value erosion in January 2008 - March 2009, but was also able to accrue more units due to regular investments (Chart 3).

Chart 3: Five-year SIP performance onset at peak level of bull phase



The SIP returns are calculated by XIRR approach assuming investment of ₹ 10,000/- on the 1st working day of every month.

Outcome - Once the market bounced back after the sub-prime crisis, investment value increased. The investment of Rs 6 lakh was valued at Rs 7.4 lakh by investing to Crisil AMFI Equity Fund Performance index and Rs 6.84 lakh by investing in S&P BSE Sensex. Hence, despite starting SIP at peak levels, the investor survived the downtrend and even managed to gain once the market rebounded.

Do not stop SIP

Investors, often, cede to the fear of losing money when the market bottoms and end up terminating their plans or putting them on hold. This could negatively impact one's financial planning in the long run.

Case study

Let's assume Ajay, Suresh and Vinay started monthly SIPs of Rs 5,000 each in equity mutual funds in January 2005.

- Citing the 2008 financial crisis, Suresh discontinued his SIP in December 2008 and channeled his savings and the monthly investments then after into a bank fixed deposit.
- Ajay continued his Rs 5,000 SIP.
- Vinay, on the other hand, adopted a strategy of investing more during the downtrends. He doubled his investments to Rs 10,000 whenever the net asset value (NAV) fell more than 10% in a one-month period and went back to the original investment amount (Rs 5,000) only when the NAV surpassed the level before it fell 10%.

Table 2: Demerits of stopping SIP

	Total amount Invested (₹ lakh)	Current investment Value (₹ lakh)	Total returns (%)
Vinay	9.70	20.71	13.02
Ajay	6.65	14.13	12.93
Suresh	2.40 (in equity until Dec 2008) 4.25 (in debt post Dec 2008)	9.41	6.07

Equity mutual funds represented by CRISIL- AMFI Equity Fund Performance Index. Bank fixed deposit returns assumed at 8% per annum.
Data ended January 29, 2016. The SIP returns are calculated by XIRR approach assuming investment of ₹ 5,000/- on the 1st working day of every month.

Outcome - Vinay's decision to increase the investment amount via SIP helped him grow his wealth at higher returns (Table 2) vis-à-vis Ajay and Suresh because of the power of compounding and higher market returns during the upturns.

Summing up

Investors should resist the temptation (ignited by fear of value erosion) to stop SIP during market downturns as falling markets are the best time to adopt an accumulation strategy. Staying invested over the long term via SIPs helps to even out the short-term market fluctuations.

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