Mirae Asset Knowledge Academy

Profit from Knowledge

Balanced Funds

Diversify Across Asset Classes

Balanced funds can help cautious investors diversify across asset classes

If you have a moderate risk appetite and a long-term investment horizon, then balanced funds could suit your profile and purpose. Asset allocation or diversification forms the core of investment philosophy. In this context, balanced funds invest in both equity and debt asset classes (majority being equity). The higher equity component enables you to seek capital appreciation and wealth creation opportunities, while the debt portion acts as a buffer from volatility and ensures stability. Likewise, having a long-term horizon will widen the scope for optimum returns and create a strong corpus towards major financial goals in an investor's lifespan. The only caveat being that these funds do not guarantee capital protection.

Merits of balanced funds

1. **Diversification -**
   Spreading investments across asset classes shields investors from market risk and moderates the impact of performance of a single asset class on portfolio value.

2. **Automatic and tactical asset allocation -**
   If an investor was to manage separate portfolios for his equity and debt investments, he would not only find it tedious, but also bring in an additional churning cost and tax implications. Further, he may not be able to adjust his equity investments tactically or time the market appropriately. On the other hand, fund managers have the requisite expertise to take strategic calls, driven by market movements.

3. **Tax benefits -**
   Most balanced funds usually invest 65% of their portfolio in equities, due to which their tax structure is similar to equity funds. These funds enjoy tax-free returns if the holding period exceeds one year; conversely, they are subject to short-term capital gains tax, except for the dividend option. Dividends paid and received are tax-free, irrespective of the holding period.

Balanced funds are becoming more popular among investors, also reflected in the impressive growth in assets under management (AUM). Their AUM rose 18% (annualized) to Rs 39,104 crore for the decade ended February 2016 vis-à-vis 16% growth recorded by pure-equity funds.

Superior performance

Balanced funds (represented by the CRISIL – AMFI Balance Fund Performance Index) have consistently out performed their benchmark and the equity market benchmark (Nifty 50) across time periods analysed. They even outperformed most pure equity-oriented funds, especially over the decade ending February 2016.

Table 1 – Analysis across market phases

Category/ Benchmarks	3 years (%)	5 years (%)	7 years (%)	10 years (%)
CRISIL – AMFI Balance Fund Performance Index	12.94	10.25	18.42	12.00
CRISIL – AMFI Large Cap Fund Performance Index	9.98	7.97	16.64	10.32
CRISIL – AMFI Diversified Equity Fund Performance Index	11.97	8.76	18.07	10.81
CRISIL – AMFI Small & Midcap Fund Performance Index	20.42	15.78	26.38	12.14
CRISIL Balanced Fund Index	7.86	6.91	12.22	8.72
Nifty 50	7.06	5.54	14.15	8.55

Annualised returns as on 28th February 2016

Debt exposure act as cushion in downtrend

Analysis across various market phases (see Table 2) shows that balanced funds have outperformed pure equity funds by a considerable margin during downturns. This could be attributed to the debt exposure, which offers stable returns and helps offset losses arising from equities, to an extent.

Table 2 – Analysis across market phases

Period	From Date	To Date	Annualized Returns (%)				
			CRISIL - AMFI Balance Fund Performance Index	CRISIL - AMFI Large Cap Fund Performance Index	CRISIL- AMFI Diversified Fund Performance Index	CRISIL - AMFI Small & Midcap Fund Performance Index	Nifty 50
Tech Bubble	1-Apr-00	30-Sep-01	-33.80	-38.08	-49.24	-	-29.05
Bull Phase of 2003-07	1-Apr-03	31-Dec-07	42.11	56.00	63.47	-	46.97
Sub-prime crisis	1-Jan-08	31-Mar-09	-35.93	-43.21	-47.33	-58.48	-43.42
Sharp bounce back post Sub-prime crisis	1-Apr-09	31-Dec-10	51.67	52.92	58.57	76.77	49.87
European crisis	1-Jan-11	28-Jun-13	0.30	-1.07	-3.32	-1.13	-3.30
Post European Crisis	1-Jul-13	28-Feb-15	34.31	33.99	40.56	54.06	28.27
Chinese Slowdown	1-Mar-15	29-Feb-16	-11.49	-18.65	-18.84	-12.82	-21.46

Portfolio inclined towards safe bets

Balanced funds'' portfolios are more inclined towards safer bets. An analysis of CRISIL-ranked balanced funds (as of December 2015 rankings) indicates that the equity portfolio is more skewed towards large-cap stocks (chart 1), which are usually less volatile and more liquid than small and mid-cap stocks. Similarly, on the debt front too, the funds have maximum exposure to higher-rated (sovereign papers, 'AAA' and P1+ rated) debt instruments and cash equivalents (chart 2), thus ensuring lower credit and liquidity risk.

Chart 1 - Market capitalization analysis of equity portfolio

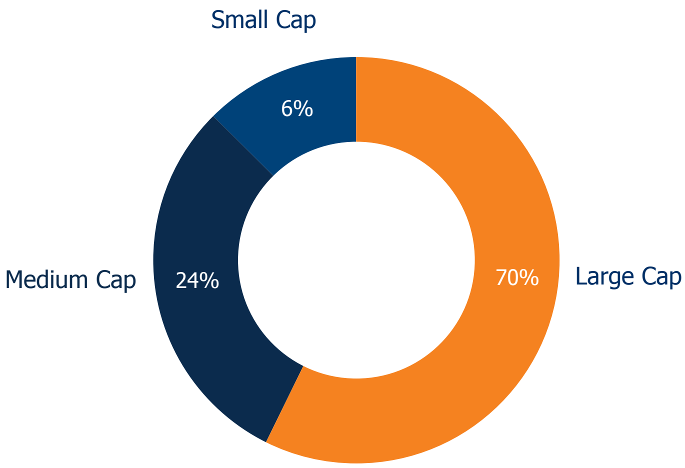
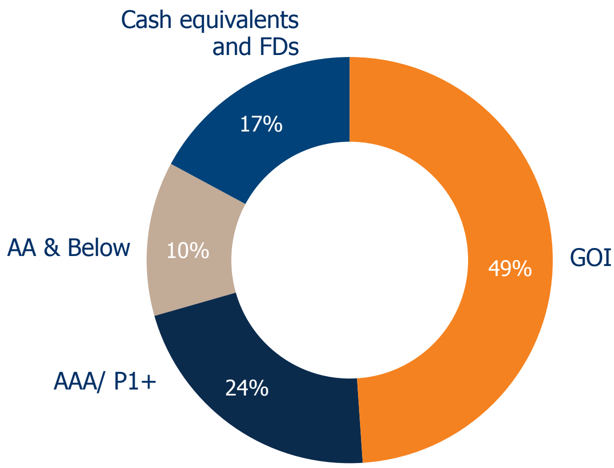


Chart 2 - Credit quality analysis of debt portfolio



Portfolio data as of January 2016

Map long term goals with the fund category

To generate optimum returns, it is advisable that investors maintain a longer time horizon – five years and above. This also helps them to tide over short-term volatility in equities and build a larger kitty. In this manner, investors can use balanced funds as a medium to earmark their investments for their long-term financial goals - in the form of children's education or marriages, down-payment for a home loan, foreign vacations or a retirement corpus.

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