Is size the only criterion for reliability?

It's not easy to manage a huge corpus and the manager may run out of investment avenues.

FUND BASICS

Vikaas M. Sachdeva

With hundreds of mutual fund schemes to choose from, how do you select the right one for you? For years, financial advisers have debated the pros and cons of investing in a fund that manages more assets vis-à-vis smaller schemes. It is true that large funds normally get recognition among investors, but that does not always mean that schemes with a smaller corpus are not good for you.

A fund having a large corpus indicates investor confidence. A scheme's corpus may possibly grow due to factors such as the fund's investment process and its steady performance. Larger corpus funds have lower costs as expenses are spread over a larger base. As a fund grows, fixed costs become a smaller proportion of the expenses, which improves its effectiveness.

At the same time, a huge corpus may not be simple to manage and a fund manager may run out of investment opportunities to deploy the cash. In this regard, schemes with a small corpus can be more responsive and flexible and can make the best of the changing market scenario by changing the composition of securities held.

The size of assets under management of a fund house should not be the only influencing factor in an investor's choice of a fund. Instead, one should also go by the track record of the fund and its manager. It is more important to see the fund's performance and whether it is sticking to the stated mandate, since a consistent fund is expected to help you realise your wealth creation objectives.

FACTORS TO BE CONSIDERED

There are a number of other factors that you should consider which choosing your investment.

Fund performance: Compare the mutual fund's performance with that of similar funds. While there is no assurance that the fund will repeat the previous year's performance, you can get a fair idea of the fund and the manager's strategy.

Risk: Risk is measured by the standard deviation of the fund, which indicates the degree of risk the fund manager has taken with investors' money. Analysing this parameter helps match the risk profile of the fund with your own risk appetite.

Risk-adjusted returns: This parameter is normally measured by the Sharpe ratio, which shows the returns a fund has delivered vis-à-vis the risk taken. Higher the ratio, better the fund's performance.

A fund with a higher Sharpe ratio delivers higher returns for a unit of risk that you undertake. It thus helps you evaluate whether a fund's high returns are a result of good investment decisions or higher risk.

Other factors such as liquidity, average maturity, turnover rates, low expense ratio and load structure should also be taken into account before you select a mutual fund scheme. Schemes with higher liquidity, lower average maturity and low turnover rate are typically favoured.

If you are not an active investor it is also more prudent to select a scheme with a well-diversified portfolio rather than a concentrated one, as the former carries a lower risk. Portfolios can be reviewed on the basis of a company and sector/industry focus.

Keeping these factors in mind, an investor can reduce risk and invest in quality funds systematically over the long term. There are thus more aspects to deciding the choice of funds than mere size of assets under management.

(The author is chief executive officer of Edelweiss Asset Management Ltd. Views expressed are personal.)