What is an asset allocation fund?

Isn't it nice when brands combine your favourite products into one, so you get to enjoy the best of both worlds? Healthy *atta* noodles combine taste and health, pizza burgers are essentially burgers but with pizza fillings, *naanza*, a *naan* with pizza toppings, and what not! These hybrid products can give you your money's worth by offering you innovative and valuable choices. Wouldn't it be great if mutual funds could also do the same? We're here to tell you that with an asset allocation fund, you can enjoy hybrid options and invest in more than one asset class with the same scheme. Let's find out more.

What is an asset allocation fund?

An asset allocation fund invests in a mix of asset classes like equity, debt, equity derivatives, gold, commodities, real estate, etc. The fund offers you exposure to more than one asset class to minimise risk and optimise returns. The fund manager decides the asset allocation. As a result, such funds are actively managed, and the manager keeps rebalancing the portfolio according to prevailing market conditions, the economy, and the fund's objective.

Types of asset allocation funds

Dynamic asset allocation funds or balanced advantage funds: These funds dynamically manage the asset allocation based on market conditions. If an asset class is expected to do well, the fund manager increases its allocation and vice versa. The allocation in a particular asset class can range from 0% to 100%, depending on the market performance.

Multi asset allocation fund: These funds invest at least 10% in at least three different asset classes. Mostly the asset classes chosen are equity, debt and gold.

Static allocation funds: The percentage allocated to every asset class is fixed in these schemes. The portion for each is generally set at the beginning and remains the same for the entire length of the investment.

Target date funds: Also known as life cycle funds, these invest in different asset classes that have a high risk-reward concentration. However, the risk is gradually lowered towards maturity. They are most commonly used in retirement planning to suit the progressively reducing risk appetite of investors approaching retirement.

Pros of Investing in an asset allocation fund

There are several benefits of mutual funds in general. Asset allocation funds, in particular, can offer the following advantages:

Diversification: An asset allocation fund lets you invest in multiple asset classes with a single investment. You get exposure to various securities that help you lower risk and maximise returns across market conditions.

Enhanced returns: By lowering risk with diversification, these funds also optimise returns. Fund managers actively manage the allocation to cash in on the right opportunities. Asset allocation funds swiftly shift from one asset class to another to improve returns.

Cushion against market volatility: Asset classes may react differently to different market conditions. If one class performs better one year, it may suffer losses the next. By investing in a diversified asset allocation fund with several securities, you gain a cushion against these fluctuations in the market.

To sum it up

Now that you know how asset allocation funds work, you can consider adding them to your portfolio through a systematic investment plan or investing in them in a lump sum as per your needs. However, as with any mutual fund scheme, make sure to pick a fund with a reputed AMC in India after careful evaluation of factors like costs, past performance, fund manager's track record, etc.