

What is XIRR in mutual funds, and why is it important?

Remember the parent-teacher meetings at school when you would find out how you had fared at the end of the year? The report card had a breakdown of your result from each class test, half-yearly, and final year-end exam. Mutual funds in India also have a similar report card or returns analysis that can help you understand their performance across the tenure. Figures like XIRR can help you make sense of how your money is being compounded for every investment or redemption. Let's find out how this works.

What is XIRR in mutual funds?

Extended Internal Rate of Return or XIRR calculates the actual rate of return when there are multiple investments or redemptions. All mutual fund types, including active or passive equity funds, debt funds, <u>hybrid funds</u>, etc., offer the option of investing through a Systematic Investment Plan (SIP). An SIP helps you invest your money in small but regular instalments over time. However, understanding returns for all instalments made across periods is tricky. But XIRR enables you to calculate your returns from multiple transactions.

Thanks to the inbuilt XIRR function in Microsoft Excel, you can easily calculate XIRR. You can enter the date of each SIP along with the corresponding amount and get the result.

XIRR can be used whenever you have multiple transactions like SIPs, <u>Systematic Withdrawal Plans (SWPs)</u>, multiple redemptions, dividends, as well as lump sum investments with additional purchases during the tenure.

Importance of XIRR in Mutual Fund

As you now know, XIRR is a commonly used metric to measure the performance of mutual funds. The meaning of XIRR in mutual fund can be derived from the fact that it is a calculation that takes into account the time value of money, and provides an accurate representation of the annualized rate of return of an investment over a certain period.

XIRR in mutual fund is an important concept. One of the important aspects which gives XIRR meaning in mutual fund analysis is that it takes into account the impact of cash inflows and outflows on the investment. This is particularly important for mutual funds, as investors often make regular investments or withdrawals from their investments in the fund. XIRR accounts for these cash flows and provides a more accurate measure of the fund's performance.

The XIRR's meaning in mutual fund is also derived from the fact that it provides a single metric to compare the performance of mutual funds across different time periods, which is a useful way of tracking the performance of their investments over time, and comparing

the performance of different mutual funds.

XIRR can also be leveraged for calculating the returns of mutual funds when you have irregular investment patterns. For example, if you undertake multiple investments in a fund over time, XIRR can be used to calculate the annualized return on the total investment. This is particularly useful for mutual funds that have a lump sum investment option as well as a Systematic Investment Plan (SIP) option.

Investors should also note that XIRR takes into account any fees or charges associated with the mutual fund investment. This is important as it provides a more accurate measure of the actual returns earned by the investor after deducting any expenses related to the investment.

XIRR is an important metric for investors to consider when evaluating mutual funds because it provides an accurate measure of the performance of the fund, taking into account cash flows and fees. By using XIRR as the metric, you can make more informed investment decisions and potentially earn higher returns on your investments.

Reasons XIRR is more helpful than IRR while estimating SIP returns

The Internal Rate of Return (IRR) is another method to calculate returns from a mutual fund scheme. It is used to assess the profitability of future investments. However, it uses a uniform period between each instalment. This implies that the calculation assumes that all investments, redemptions, or dividends are made during equal intervals. However, in reality, there can be differences between periods.

For instance, if you invest on the 1st of February, your next investment will be after 28 days on the 1st of March. After this, your next investment in April will be after 31 days. Months have different number of days, so assuming a fixed timeframe can lead to inaccurate results. If your SIP falls on a holiday, it will be pushed to the next day. Likewise, dividends may also be released at different times during the tenure. So, the idea of a fixed period does not sit well with the IRR method.

XIRR is a step above IRR as it accounts for the difference in intervals and understands that transactions cannot be evenly spaced out. With XIRR, you can add the date against each transaction and get an accurate result. This lets you plan your financial goals when you are investing through SIPs and if you have multiple redemptions.

Conclusion

There are several benefits of SIPs, because of which people are drawn to it. It promotes financial discipline, breaks down the investment into smaller instalments, and allows you to benefit from the power of compounding. However, understanding the returns therefrom can be a bit confusing. Methods like XIRR can simplify this and help. Besides, you can also <u>use anSIP calculator</u> to make better investment decisions with SIPs.

An investor education initiative by Edelweiss Mutual Fund

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