How to Choose Best Long Term Mutual Funds for Investment

Investing over the long term not only helps generate attractive returns, but also significantly reduces risk. This is especially true in case of investments in equity. The ideal way to invest for the long term (whether in equity funds, debt funds or hybrid funds) is through mutual funds.

Long-term and short-term Mutual Funds

Mutual Funds can be classified as long-term and short-term funds:

Long-term mutual funds: These are funds which can help you create wealth over a long period of time so that you can easily meet your financial goals. Usually they are equity-oriented funds. This is because equities can help you generate the returns required to build the kitty required for your goals. Such funds may be volatile over brief periods. However, over the long term, they have the potential to outperform all other modes of investment.

Short-term mutual funds: Short-term funds are those comparable to fixed deposits. They are less volatile than equities. Usually they are Liquid Funds or Short Term Debt Funds which invest in debt papers of below six months. Ideally such funds may be used for parking your liquid money before it is deployed for a specific purpose.

How to choose long-term mutual funds

Investing in equity-oriented funds for the long term (5 years and above) has the potential to offer attractive returns. Besides, the longer you stay invested, lower is the investment risk. The key to successful long term investing in selecting the right equity-oriented funds and remaining invested for a long period of time. Here are some pointers for picking long-term mutual funds:

- Consider Index Funds: Index funds emulate a stock market index such as the BSE Sensex, NSE Nifty, etc. and usually provide returns almost identical to that of the underlying Index. The advantage of an index fund is that the expenses charged to the fund are very low.
- Benefits of Actively Managed Funds: Fund managers of such schemes try to beat the index by selecting stocks based on in-depth research. While there is no guarantee that such funds would actually manage to outperform their benchmark index consistently, in general, over the long-term, a majority of actively managed funds have outperformed their underlying indices in India.
- Look up the Track Record: While selecting actively managed funds, it is best to check-out the track record of the funds, particularly for 5-year and 10-year periods. This is publicly available information on various websites which track and rank mutual funds.
- Risks of Smaller Companies: Large-cap funds (they invest in large companies) and Multi-cap funds (which have a mix of large and smaller companies in their portfolio) carry lower risk as they are less volatile compared to Mid-cap and Small-cap funds.
- Diversification is important: It may be best to invest in at least two or three funds rather than put all eggs in one basket. Controlling your risk is as important as going after returns.

How to become a long-term investor

In order to be a successful long-term investor, it is very important to maintain the discipline of investing irrespective of market conditions. The day-to-day news flows makes investors nervous and they tend to pull out of equities. Such investors miss out on the long-term benefits of equity investing.