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GOLINOPINION

Don’t invest in balanced funds for regular dividends

Those who are in need of regular income should shift their money to short-term debt funds

CHIRAG MADIA

Not just equity funds, even balanced funds have seen massive participation from retail investors over the past one year as equity markets touched new highs. The data from the Association of Mutual Funds in India (Amfi) shows balanced funds saw net inflows of over ₹840 billion in 2017. But now with the market environment changing, investors should watch out for the risks in these funds.

Balanced funds are a gateway for first-time investors stepping into equities. Since they have a debt component of 30-35 per cent, investors get some protection from the volatility of pure equities. Over the past one year, balanced funds have given an average return of 22.95 per cent. Longer-term returns of these funds are also attractive: The five-year annualised category average return stands at 15.13 per cent (source: Ace MF).

Balanced funds are also tax-efficient. Any fund that invests more than 65 per cent money in stocks is treated as an equity fund for tax purposes. Balanced funds maintain at least 65 per cent of their money in equities, hence long-term gains from them are tax-exempt. The key advantage for investors is that even the debt portion of these funds gets equity-like treatment.

Fund houses say this category will continue to grow. “Balanced funds offer many advantages like automatic rebalancing. They also have a track record of delivering decent returns over a longer time horizon. I think the momentum should continue in these funds,” says Neelesh Surana, chief investment officer-equity, Mirae Asset Global Investments (India).

HIGH RETURNS OVER PAST YEAR

Category returns (%)

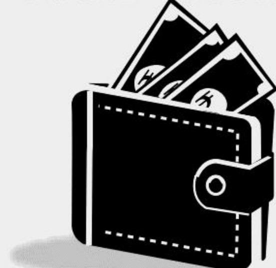
	1-year	3-year	5-year	10-year
Minimum	6.86	5.42	7.40	-2.36
Maximum	48.78	16.10	18.60	14.25
Average	22.95	10.54	15.13	8.76

Source: Ace MF

Many experts, however, expect the returns from balanced funds to be more muted in the future. With equity markets trading at above-average valuations, this asset class could take a breather until earnings improve. Returns were also high in 2017 because the debt portion of balanced funds did well owing to the downward movement in interest rates. But with interest rates within the economy having hardened over the past quarter, returns from the debt portion of these funds are also likely to be lower.

A lot of retail money moved into balanced funds due to the declining returns from traditional fixed-income products. Money that used to go into fixed deposits (FDs) and other fixed-income instruments went into balanced funds because returns from traditional debt products fell. But experts warn that investors should not move from FDs to balanced funds. “The two product classes are not comparable as balanced funds carry a certain level of risk. Nonetheless, there has been a clear shift of money from fixed-income instruments to equity-oriented instruments purely because of the returns,” says Suresh Sadagopan, founder, Ladder7 Financial Advisors.

YOUR MONEY



In recent times, many asset management companies (AMCs) have pushed the dividend option of balanced funds, especially for new investors who were moving from bank FDs to mutual funds for the first time. “Balanced funds are pitched as an income option by way of a regular dividend. I do not think it is right to do so,” says Vidya Bala, head-mutual fund research at FundsIndia.

Investors should also look at the equity component of their balanced funds. In some cases, the equity component could be above 80 per cent. Some funds may also have high midcap exposure. If equities correct, these funds will be hit hard. Another risk to watch out for is that the fund manager could have taken high-duration exposure in the debt component. Again, if interest rates keep rising, such funds could take a hit in their debt portion.

Analysts also warn that investors should not invest blindly in balanced funds just for dividends. Equity funds are under no obligation to pay dividends regularly. In case the markets correct, they could stop dividend payments. If investors are looking for a regular income, they should put money in short-term debt plans and do a systematic withdrawal plan (SWP). This is one way in which they can generate regular returns.