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Expecting superior returns from closed ended funds?

May be you should look at one that has some select high-conviction stocks in the portfolio

Times News Network

In general, people refer to open ended funds when they speak about mutual funds. However, there's another type of fund, called closed ended fund, which is a lot different from an open ended fund.

A close-ended fund sells its units to investors only once, when they launch an offer, that is during the new fund offer (NFO). After that these units are listed on the stock exchanges and could be traded just like stocks are traded. In comparison, within an open ended fund structure the fund house is allowed to sell an unlimited number of units to investors. Investors, on the other hand, can sell their units back to the fund house if they need to redeem their investments. In case of open ended funds, the units are not traded on the exchanges but bought and sold by the fund houses themselves.

ILLUSTRATION: SACHIN VARADKAR

Within the closed ended structure, fund managers often settle for a concentrated portfolio where the portfolio usually holds 20-25 stocks and also the top 5-10 stocks usually make up for about 45-55% of the total portfolio. This approached is markedly different from a diversified portfolio strategy where the fund manager would typically hold about 40-50 stocks and no stock would contribute more than 10% of the total portfolio.

Usually concentrated portfolio strategy has stocks on which the fund manager has strong belief about outperformance, fund industry officials say. And a concentrated portfolio within a closed ended structure indicates that the fund manager expects the stocks in his/her portfolio to outperform his/her peers within the timeframe for which the fund is run. Most closed ended funds are launched for a three-year period.

Unlike in a diversified portfolio where to reduce the total risks in the portfolio the fund manager would keep some stocks which constitute a small percentage of the total holding. Such a strategy is usually avoided in a closed ended structure. Under the current Sebi rules, however, usually no fund can invest more than 10% of its portfolio in a single stock.

There is another fund management strategy that also qualify for concentrated portfolio: In case the fund manager buys a large number of stocks from a select few industries and the weight of those industries in the portfolio is very high compared to all other industries.

Fund industry people believe that a concentrated portfolio strategy works well within a closed ended structure. In this case the fund manager buys some of the high-conviction stocks that he/she believes could give high returns over the duration of the fund. Since within this kind of fund structure the fund manager does not need to sell part of his/her portfolio, such concentrated portfolio of high conviction stocks could give returns superior to what could be achieved from a diversified portfolio. However, fund industry people warn that a concentrated portfolio strategy comes with some extra amount of risks as well. On the other hand, a diversified portfolio is built on the principles of risk mitigation.

Fund industry veterans also say that although the units of closed ended funds are listed on the bourses, there is very low liquidity. Hence if an investor is looking to invest in these funds, it is better to invest that fund which the investor may not require during the duration of the fund.

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Scan this QR code know what you must keep in mind when choosing a new fund.

STEPS TO DOWNLOAD AND SCAN A QR CODE
● Download QR code app on your phone ● Run app and scan the QR code ● Your smartphone will read the code & navigate to the destination

GURU SPEAK

In investing, what is comfortable is rarely profitable

— Robert Arnott,
US entrepreneur, investor and writer

CASE STUDY

'Get a term plan, start SIPs & reallocate FDs'

I am 36, employed in a private firm at a monthly salary of Rs 60,000. My expenses total Rs 30,000 (house rent, credit card bills etc). I have a 25-year life insurance policy of Rs 5 lakh with an annual premium of Rs 25,000. Annually I invest Rs 60,000 in PPF, Rs 50,000 in NSC and have bank FDs worth Rs 10 lakh. I would also like to invest in ELSS. My goal is to build a corpus of Rs 5-8 crore in next 15-20 years to take care of emergencies, marriage, buying a house etc.

- Indrajit Dutta

Arjun Rebelo *replies*

It's important to begin with covering risks. A Rs 5-lakh medical insurance cover will cost you under Rs 10,000 annually with tax benefits. Though you are not married and have not specified liabilities or dependents, you can also opt for a term insurance cover. You can stop the current life policy and redirect the premiums towards a basic Rs 1 crore cover which will cost you under Rs 12,000 for a 25-year term, with tax benefits.

You can reduce taxes with investments of Rs 1.5 lakh under section 80C and another Rs 50,000 under NPS under section 80 CCD (1B). The two together could bring down your current annual tax liabilities to around Rs 10,000.

We need to look at allotting your Rs 10 lakh FD and monthly surplus of Rs 30,000 towards your financial goals. You should follow an asset allocation plan, based on your risk appetite. You could continue to allocate Rs 60,000 towards PPF. Alternately if you take an aggressive stance, you could allocate the full amount to monthly SIPs in ELSS. You could allocate the Rs 30,000 monthly surplus as follows:

Rs 11,000 in ELSS, Rs 4,000 in NPS, Rs 10,000 in liquid plus schemes and Rs 5,000 in regular equity mutual fund schemes.

The total amount invested in ELSS and term plans would aggregate Rs 1.44 lakh and we assume that the Rs 6,000 shortfall under section 80C tax benefits would get covered under the company's PF deductions.

You should re-allocate the FDs to more tax efficient investments. Invest Rs 2 lakh (approximately three months' salary) towards a Liquid Plus scheme to build an emergency fund. Allocate Rs 3 lakh into dynamic equity category (equity income funds). These have an ideal investment horizon of two years and more, but can be withdrawn after one year, with no tax liabilities. This could be used towards building the marriage corpus. The monthly SIP of Rs 10,000 in liquid plus fund will add to the emergency fund and marriage fund corpus which could be used interchangeably depending on your requirement.

You also need to set up another long term corpus for your retirement, purchase of a house, assets etc. Invest the balance Rs 5 lakh FD in multicap diversified equity funds. The monthly investment in NPS, SIP in ELSS and normal equity SIP will add to this and build the corpus. Let us consider a monthly SIP of Rs 20,000 in the above fund and an annual increase of Rs 5,000. At an estimated 12% annual return over 10 years, your corpus would be Rs 1 crore which could grow to Rs 5.5 crore in 20 years. It's important to review this every year and any additional allocations would help you reach your goals earlier than expected.

***Arjun Rebelo** is Partner - Milestone Financial Consultants, Goa*

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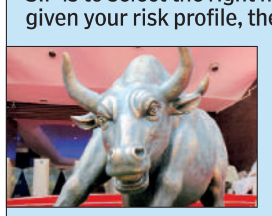
INVESTOR QUERY

I AM A GRADUATE AND RECENTLY GOT A JOB WITH RS 10K MONTHLY SALARY WHICH WILL SOON DOUBLE. I WANT TO UNDERSTAND HOW I CAN START INVESTING IN EQUITY AND/OR MUTUAL FUND SIPS ON A MONTHLY BASIS TO GET GOOD RETURNS ON A LONG TERM BASIS. MY DEMAT ACCOUNT WILL BE ACTIVATED IN THE NEXT WEEK.

Yash Deshpande

It's not very common that a person who has just started earning would consider investing. That way you stand out from the others since you have already taken the first step. The way to start a mutual fund SIP is to select the right mutual fund for you given your risk profile, the financial goal for which you want to build a corpus and also the time horizon for which you want to achieve your financial goal.



Since you have already opened a demat account so you already have your KYC done. This makes the process to start a mutual fund investment easier. After you have selected the right fund(s) to invest in, you can even go online and start investing. For those who do not understand the investing process and also investments, it's better to seek professional help from Sebi registered advisors/planners.

I AM 26 YEARS OLD. I SEEK ADVICE IN FINANCIAL PLANNING. I CAN SAVE MONTHLY RS 10,000. I WANT TO INVEST SOMEWHERE SO THAT I CAN GET A GOOD YEARLY RETURN.

Ankit Shah

Since you are not experienced in the process of investing and investments, it's a very good idea to seek help from experienced, registered advisors. Follow these steps while selecting a financial advisor:

- Be clear about the type of financial advisor you are looking for
- Meet the person, check out his level of competence, experience, processes he/she follows for investing, reviewing and rebalancing
- Try to find out if your way of thinking about finance and investing matches with that of the advisor
- Do a proper due diligence on the advisor before zeroing in on one

To read more articles on investments and investing processes, you can visit utiswatantra.com

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A CLOSED ENDED FUND COMES WITH SOME UNIQUE ADVANTAGES

- It allows the fund manager to take long term bets without bothering about cash flows
- There is no option for any premature sale of any asset from the portfolio
- As the discount between the fund's market price and its NAV narrows, investors stand to gain
- There is a possibility that a concentrated portfolio could appreciate faster than a diversified one
- These funds could generate higher returns compared to open ended peers

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NEXT EDITION

In our next edition we will compare close-ended tax saving schemes with other traditional tax-savings instruments to check which is the better option for investors.

DEMYSTIFIER

WHAT'S THE ANTI-PROFITEERING RULE UNDER GST?

Under the anti-profiteering rule, it's mandatory for sellers of goods and services to pass on the benefits of lower tax rates and input tax credits to consumers. If they don't do this with the intentions of higher profits, they could face penal actions. Anti-profiteering rules have been put in place to protect retail consumers from inflation due to GST. For example, after the recent reduction in GST for hotels and restaurants, eating out has become cheaper. To ensure restaurants pass on the benefits of lower rates, even government officials are being deployed on the field. These rules have been put in place after studying the launch of such tax regimes in other countries where, in some cases, it led to price rise.

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You can also tweet us **@utimutualfund** ot visit us at **www.utiswatantra.com**

Mutual Fund investments are subject to market risks, read all scheme-related documents carefully