

## Wealth Creation Through Mutual Funds

Mutual Funds are investment products that operate on the principle of 'strength in numbers'. They collect money from a large group of investors, pool it together, and invest the same in capital market instruments such as shares, debentures and other securities. Mutual Fund is the most suitable investment option for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. Compared to other asset classes, Mutual Funds offer several features that make them a powerful and convenient wealth creation vehicle worthy of investment.

There are two approaches an investor can choose for wealth creation through Mutual Funds.

- 1) Invest a lump sum amount and stay invested for long-term
- 2) Invest systematically through SIP for long-term

In both the cases, it can be seen that, emphasis is given on long-term investment. Investment of long-term nature is inevitable for wealth creation. There are no shortcuts for wealth creation and if some see they are short lived. Normally, a period of more than 5 yrs is considered as long-term nature. Secondly, the volatility will decrease as the horizon gets longer. If you see the returns generated by Sensex, S & P Nifty and CNX Midcap in the last 5 years then the difference is nominal. BSE Sensex and S & P Nifty both have given around 18% CAGR return while the CNX Midcap has given around 19% CAGR return.

Let us understand the two approaches of wealth creation through mutual funds :

### Option 1 : Investor invests a lump sum amount and stay invested for long-term

|                              | Period : Feb 2000- Nov 2004 |  | Period : Jan 2008 onwards   |  |
|------------------------------|-----------------------------|--|-----------------------------|--|
|                              | Sensex Low                  | Sensex New High                            | Sensex Low                  | Current Sensex Level                       |
|                              | 2600                        | 6009                                       | 8160.4                      | 19966.93                                   |
|                              | % Fall from High (Absolute) | % Rise in Wealth from Prev High (Absolute) | % Fall from High (Absolute) | % Rise in Wealth from Prev High (Absolute) |
| <b>Sensex Previous High</b>  | 5924                        |  | 20873                       |  |
| <b>Sensex Prev High Date</b> | 14-Feb-00                   |  | 8-Jan-08                    |  |
| <b>Time Horizon</b>          | 4.78 yrs                    |  | 2.90 yrs                    |  |
| Franklin Blue Chip Fund      | -42.95                      | 121.75                                     | -54.97                      | 15.74                                      |
| Franklin India Prima         | -63.15                      | 156.67                                     | -69.23                      | -4.17                                      |
| HDFC Equity fund             | -48.67                      | 112.97                                     | -59.49                      | 34.02                                      |
| HDFC Prudence Fund           | -28.35                      | 135.37                                     | -50.70                      | 34.99                                      |
| HDFC Top 200                 | -54.00                      | 88.77                                      | -54.52                      | 31.08                                      |
| ICICI Pru Power              | -58.33                      | 41.49                                      | -61.41                      | -0.67                                      |
| Reliance Growth              | -63.80                      | 121.56                                     | -61.79                      | 4.72                                       |
| Reliance Vision Fund         | -58.76                      | 155.61                                     | -60.19                      | -1.39                                      |
| Tata Pure Equity             | -48.86                      | 78.80                                      | -56.55                      | 6.05                                       |
| <b>Sensex</b>                | <b>-56.11</b>               | <b>1.44</b>                                | <b>-60.90</b>               | <b>-4.34</b>                               |

(% Change in NAVs are calculated using dividend re-invest NAVs of the respective schemes)

Just have a look at the above table. We have taken two time horizons and three scenarios for each horizons. The first horizon is the Dot Com Bubble which happened in Y2K. The second period taken is the Global

Financial Crisis which started in Aug '07. The 3 scenarios are the Pre-crisis level, Post-crisis Impact and the recovery phase happened after hitting the bottom. For the same periods, we have taken MF schemes having good track record.

In the first horizon, Sensex fell by 56.11%, while Franklin Bluechip fell the least by 42.95%. In the recovery phase, when the Sensex hit a new high of 6009, 1.44% change from the previous high, Franklin Bluechip increased by 122%. This 122% increase in Wealth wouldn't have been possible without staying invested for 4.78 yrs (nearly 5 yrs).

Now consider the second horizon. Sensex topped out at 20873 on 8th Jan 2008. Then it hit the bottom of 8160 on 9th March 2009. It fell 61% from the high and currently it is hovering around 19967 levels. To reach the high of 20873 points, it has to increase by another 4.34%. However, see the Franklin Bluechip returns. It fell by 54% (less than the mkts.) and currently it has not only recovered but has given 15.74% absolute returns in a period of 2.90yrs. Our past experience (Feb 2000- Nov 2004) says that it is prudent for an investor who has invested in Jan 2008 to wait for another 2.10 yrs to receive the benefits of Staying Long Term. If he continues to hold the investment for another 2.10 or more years then he may surpass the returns earned during the previous years. This is the strength of long term investment.

### **Option 2 : Invest systematically through SIP for long-term**

The second option an investor can opt is investing through SIP. SIP offers great benefits to the small investors as they don't have money for lumpsum investment. SIP helps them to save periodically a specified amount over a period of time, which helps them to build a capital for their future requirements. SIP is an arrangement where-in one can invest a particular amount on monthly, daily or quarterly basis. There are fixed SIP dates on which investment can be done.

SIP over a longer period of time, helps the investor to automatically time the market. Through an SIP, one can avail the benefit of rupee cost averaging. The advantage of rupee cost averaging is that the purchase cost is averaged out, as one will be entering the fund at different NAVs, which may be higher or lower depending on the market condition.

The beauty of SIP is that it works in all market conditions. When markets are falling, you buy more units. When markets are rising, your accumulated units have more value. And when the markets are rangebound like the one we are experiencing (from Feb 2008 till now), then also SIPs are yielding >30% CAGR returns.

### **Beating Range Bound Markets Systematically**

In a span of last 2 and a half years, Sensex has moved from 20301 Jan 2008 level to 19967 December 2010. This means, had you invested a lump sum amount 2 and half years back in index stocks your investment would just have break-even or in some cases or stocks invested amount has also not got recovered. However, this doesn't hold true for investment through an SIP. Our calculations show that, though the index is at the same level of Jan 2008 level, an SIP in an Equity Diversified or Large cap Mutual Fund would have yielded >30% CAGR returns. This clearly shows the Effectiveness of SIP and it is an inevitable tool for Wealth Creation.

The first table shows the SIP returns for select Largecap/Diversified/Opportunity Funds and the second table for the Midcap funds.

We have considered following things for calculation –

SIP Start Date – 1<sup>st</sup> Jan 2008 (Sensex Level – 20301)  
 SIP End Date – 1<sup>st</sup> Dec 2010 (Sensex Level – 19850)  
 Amount – Rs. 1000 per Month

Valuation as on – 03rd December 2010  
 Sensex Level on 03rd Dec – 19966.93  
 Frequency of SIP – Monthly

If one had started an SIP of Rs. 1000 p.m. in ICICI Pru Discovery Fund in Jan 2008, the Present Value of Rs. 34,000 invested would be Rs. 64406, a yield of 43.91% CAGR. The last column shows the Profit earned for Lumpsum investment. For all the Schemes, you can see that the Profit earned through SIP is higher than the Profit earned through Lumpsum investment. This proves how efficiently an SIP can deliver in a range bound market.

| Largecap/Diversified/Opportunity Funds | Total Amt Invested | Present Value | Yield | Profit-SIP | Profit-One Time Investment |
|--|--------------------|---------------|-------|------------|----------------------------|
| ICICI Prudential Discovery Fund        | 36000              | 64406.48      | 43.91 | 28406.48   | 11042.09                   |
| HDFC Equity Fund                       | 36000              | 62478.90      | 41.40 | 26478.90   | 12380.69                   |
| Reliance Equity Opportunities Fund     | 36000              | 61721.27      | 40.39 | 25721.27   | 6303.69                    |
| UTI Master Value Fund                  | 36000              | 61424.65      | 40.00 | 25424.65   | 4759.49                    |
| Birla Sun Life Dividend Yield Plus     | 36000              | 61066.13      | 39.52 | 25066.13   | 12800.36                   |
| HDFC Core & Satellite Fund             | 36000              | 59607.74      | 37.55 | 23607.74   | 6092.32                    |
| HDFC Top 200                           | 36000              | 57916.24      | 35.23 | 21916.24   | 11827.87                   |
| UTI Dividend Yield Fund                | 36000              | 56514.79      | 33.28 | 20514.79   | 9338.30                    |
| Fidelity Equity Fund                   | 36000              | 56141.65      | 32.75 | 20141.65   | 6072.90                    |
| Reliance RSF - Equity                  | 36000              | 55814.56      | 32.29 | 19814.56   | 3575.57                    |
| UTI Opportunities Fund                 | 36000              | 55510.24      | 31.86 | 19510.24   | 6567.16                    |
| Principal Large Cap Fund               | 36000              | 55452.68      | 31.77 | 19452.68   | 684.91                     |
| Franklin India Flexi Cap Fund          | 36000              | 55419.94      | 31.73 | 19419.94   | 3813.12                    |
| Templeton India Growth Fund            | 36000              | 55406.80      | 31.71 | 19406.80   | 7161.65                    |
| DSP BlackRock Opportunities Fund       | 36000              | 54499.16      | 30.41 | 18499.16   | 961.03                     |
| Franklin India Bluechip                | 36000              | 54082.01      | 29.80 | 18082.01   | 5853.66                    |
| DSP BlackRock Equity Fund - Div        | 36000              | 54047.01      | 29.75 | 18047.01   | 4197.14                    |
| Birla Sun Life Frontline Equity Fund   | 36000              | 53945.26      | 29.61 | 17945.26   | 5119.69                    |
| ICICI Prudential Dynamic Plan          | 36000              | 53729.65      | 29.29 | 17729.65   | 6348.48                    |
| Tata Select Equity Fund - Appr         | 36000              | 53557.86      | 29.04 | 17557.86   | -5352.51                   |
| BSE Sensex                             | 36000              | 49334.29      | 22.72 | 13334.29   | -591.90                    |
| S&P Nifty                              | 36000              | 49245.23      | 22.58 | 13245.23   | -887.94                    |

| Midcap Funds                         | Total Amt Invested | Present Value | Yield | Profit-SIP | Profit-One Time Investment |
|--------------------------------------|--------------------|---------------|-------|------------|----------------------------|
| DSP BlackRock Micro Cap Fund         | 36000              | 66219.02      | 46.41 | 30219.02   | 1188.65                    |
| DSP BlackRock Small & Midcap Fund    | 36000              | 61863.66      | 40.58 | 25863.66   | 5266.47                    |
| HDFC Mid-Cap Opportunities Fund      | 36000              | 61625.61      | 40.27 | 25625.61   | 9183.00                    |
| IDFC Premier Equity Fund - Plan A    | 36000              | 60869.87      | 39.26 | 24869.87   | 8626.79                    |
| Sundaram Select Midcap               | 36000              | 58777.45      | 36.42 | 22777.45   | 2064.40                    |
| Canara Robeco Emerging Equities      | 36000              | 58568.12      | 36.13 | 22568.12   | -3284.06                   |
| Birla Sun Life Mid Cap Fund - Plan A | 36000              | 57761.84      | 35.02 | 21761.84   | 1681.09                    |
| Franklin India Prima Fund            | 36000              | 57255.50      | 34.32 | 21255.50   | -1943.99                   |
| UTI Mid Cap Fund                     | 36000              | 56954.68      | 33.90 | 20954.68   | -979.94                    |
| Reliance Growth                      | 36000              | 53975.38      | 29.65 | 17975.38   | 1944.94                    |
| CNX Midcap                           | 36000              | 55958.06      | 32.49 | 19958.06   | -1465.68                   |

HAPPY (SIP) INVESTING!