

Equity Mutual Funds

Mutual funds are supposed to be a safer route of investing in equities. Equity mutual funds are also known as stock mutual funds. Equity mutual funds invest pooled amounts of money in the stocks of public companies. Stocks represent part ownership, or equity, in companies, and the aim of stock ownership is to see the value of the companies increase over time. Stocks are often categorized by their market capitalization, and can be classified in three basic sizes: small, medium, and large. Many mutual funds invest primarily in companies of one of these sizes and are thus classified as large-cap, mid-cap or small-cap funds.

Equity fund managers employ different styles of stock picking when they make investment decisions for their portfolios. Some fund managers use a value approach to stocks, searching for stocks that are undervalued when compared to other similar companies. Another approach to picking is to look primarily at growth, trying to find stocks that are growing faster than their competitors, or the market as a whole. Some managers buy both kinds of stocks, building a portfolio of both growth and value stocks. Since equity funds invest in stocks, they have the potential to generate more returns. On the other hand they carry greater risks too. Equity funds can be classified into diversified equity funds and sectoral equity funds.

How to Select an Equity Fund

Compare a fund with its peers:

One of the basic fundamental of benchmarking is to evaluate funds with in the same category. For example, if you are evaluating the performance of a thematic fund, say IT based fund, then you should compare its performance with another similar IT based fund. Comparing it with banking sector fund for example will not give the correct picture.

Compare performance over different time periods & Cycles

Comparing a fund over stock market cycle (boom and bust) will give investors a good idea about how the fund has fared.

Compare returns against those of the benchmark index:

Every fund mentions a benchmark index in the Offer Document. It can be BSE 100, BSE 200, Nifty or any other index. The benchmark index serves as a guidepost for both the fund manager and the investor.

Compare how the fund has fared against the benchmark index over a period of 3-5 years. The funds that have outperformed their benchmark indices during stock market volatility must be given a close look.

Compare against the fund's own performance:

Apart from comparing a fund with its peers and benchmark index, investors should evaluate its historical performance. By evaluating a fund against its own historical performance, you can get an idea about consistent performers.

Understand the risk profile carefully

Each category of fund has different amount of risks associated with it.

For example, mid cap funds have a higher risk associated as compared to a large cap fund. So the selection should be done on the basis of the investor's risk profile and the time horizon of investment.

The greater the horizon, the more is the risk taking ability. To create wealth in the long run some amount of investments into assets with higher risk is necessary.

Cost aspect: Important in the long run

In the current scenario, when the returns in equity mutual funds are extraordinary, expenses charged by the fund may seem to be insignificant. But this definitely becomes an important factor over the long run.

Expense structures are declared by the fund regularly . It is towards all costs of running the fund, including salaries paid to the fund manager and fees earned by the mutual fund house for running the business. The above factors may enable a person to take a more informed decision on selecting a mutual fund scheme.

But finally the success of making good returns is dependent on how focused and disciplined the person remains towards creating wealth and working towards achieving ones financial goals in life.

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