'HEALTH TEST' FOR YOUR 'WEALTH PORTFOLIO'

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There has been a tectonic shift in the way we invest in the last two decades. Traditional investments in Gold, Real Estate, Fixed Deposits, Direct Equity have paved way to Mutual Funds (MFs), Portfolio Management Schemes (PMS), Structured products, Alternate Investment Funds (AIFs), Private Equity (PE)/ funds among others.

As these products are still evolving and finding favour with first time investors, it is prudent to test your portfolio for its robustness on the following parameters:

Goal oriented – product suitability
Assess the portfolio to check if it is in line with your stated goals of (a) capital preservation for meeting short-term goals like buying a car, a house or for a foreign holiday (b) long-term growth for meeting long-term goals like Retirement, Children's higher education.

Risk capacity and Risk tolerance
Risk capacity is a mathematical measure of how much risk (volatility and potential losses) one can take before it affects their financial goals. In contrast, risk tolerance is measured by psychometric tests which determine our intrinsic attitude towards risk. To elaborate, a 70 year old investor may have a high risk tolerance but may not have the capacity if it is his 'nest portfolio' meant to provide a regular income for the next 25 years.

Asset allocation
A combination of goals and risk analysis will determine an ideal asset allocation for you. Do remember that 80% of your portfolio returns will be determined by asset-allocation rather than product selection.

Concentration risk
Benefit of diversification cannot be overstated. Concentration should be avoided across securities, security type (skewness in exposure to large/mid/small caps in case of equity and AAA/AA vs Low credit securities in case of fixed income), sectors, product manufacturer and fund manager. Investors being advised by in-house advisors of product manufacturers need to be more vigilant.

Liquidity
How liquid is your portfolio? This is a litmus test. In case of an emergency or a sudden fund requirement, what percentage of your portfolio can be liquidated at a short notice with or without exit load/penalty?

Prevent Leakage of returns for a higher IRR
Einstein famously said that 'compounding' is the Eighth Wonder of the world. Use compounding to your advantage. In Mutual Funds, till you redeem there is no tax liability hence you compound at the gross rate of return unlike an FD where you have to pay tax on deemed interest. Similarly, investing in the growth option in Mutual Funds is a better option than dividend option which is subject to dividend distribution tax, again leading to leakage of return.

Tax efficiency
Is your portfolio invested in the most tax efficient way? Mutual Funds are more tax efficient than fixed deposits or AIFs; returns in the form of capital gains attract lower tax compared to interest income which gets taxed at your marginal rate of tax. If you are in a lower tax bracket, high yielding bonds/corporate fixed deposits will be more attractive compared to tax free bonds. Similarly investing in equity through Mutual Funds will be more tax efficient compared to investing directly or through the PMS route as Mutual Funds are not taxed when the fund manager churns the portfolio but only on redemption.

Performance
While evaluating the performance of a product or a portfolio, always focus on the post- expenses, post-profit sharing (where applicable), post-tax returns. Also, performance should be seen on an IRR basis over the entire tenor of a product, as short term performance on a long term product often swings like a pendulum creating both euphoria and panic intermittently with market fluctuations.

How is your portfolio stacked up on the product pyramid?
Most goals of investors can be met by a variety of Mutual Funds. Mutual Funds – debt/equity/hybrid should form the base of your portfolio pyramid. AIFs, SPs and PE funds are exotic products and should collectively form only the tip of the pyramid. Mutual Fund schemes are undoubtedly the superfoods of Investments. It may be a good idea to assess the % of superfoods in your portfolio.

You can assess your portfolio on the above parameters yourself or with the help of your Financial Advisor.

Mutual Fund Investments are subject to market risk, read all scheme related documents carefully.