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Get a prudent mix of debt and equity: Don’t buy or sell, just rebalance your portfolio

By *Babar Zaidi*, ET Bureau | 10 Dec, 2013, 05.24AM IST

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NEW DELHI: With the Sensex touching an all-time high level on Monday, mutual fund investors should get going. This is not the time to buy equity funds, but only to rebalance portfolios.

If the upsurge in stock prices has increased your allocation to equities by more than 10 percentage points, your portfolio carries more risk than planned. The current rally is a good opportunity to bring down the risk by rebalancing the portfolio. Shift some of the money out of equity funds to the stability of debt.

For investors who have been sitting on the sidelines, this may not be the best time to enter the stock market. The current rally is not based on fundamentals but merely on sentiment and expectations of a BJP government at the Centre in 2014.

However, do keep in mind that the market valuations are not as stretched as they were at the peak of January 2008. The Nifty is trading at a P/E of 18.87, just marginally higher than the 10-year average P/E of 18.75 and far below the 27-28 levels in January 2008 before the crash.

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Feeling confused whether you should invest in equity funds at this stage? A few funds resolve this dilemma by continuously booking profits on your behalf. Their allocation to equities is not based on the fund manager's outlook for the market, but on the market's valuations.

The Franklin Templeton Dynamic P/E Ratio Fund invests in two schemes — the Franklin India Bluechip Equity Fund and Templeton India Income Fund —and reduces its allocation to equities when the Nifty P/E goes up.

This has ensured stable 16.42% annualised returns for the fund in the past 10 years, beating the 15.1% offered by the average large-cap equity fund and the 14% delivered by the Nifty during the same period.

The surge in indices often leads small investors to enter at the peak and the error is compound the error by staying away from equity when the market turns bearish. This is where asset allocation funds take the right decisions on behalf of investors.

When the market tanked and the Nifty PE hit a low multiple of 12-13 times in December 2008, the FT Dynamic PE Ratio Fund had 90% in equity. Currently, Nifty P/E is 18.87 times and the fund has about 65% in stocks.

Just as the FT Dynamic P/E Ratio Fund looks at the index P/E, the ICICI Prudential Dynamic Plan considers the price-to-book value (PBV) ratio of the market while deciding its exposure to equity. When the Nifty PBV crosses 3.5, the fund reduces its equity exposure to the minimum 65% it is supposed to maintain.

This prudent allocation has enabled the fund deliver 20.56% annualised returns in the past 10 years, compared to 17.51% delivered by the average large- and mid-cap equity fund during the same period.

Now, when the Nifty is trading at a PBV of about 3.01, the fund has about 80% of its corpus invested in stocks.

Experts say that SIPs remain the best strategy for small investors. "It is very evident that markets will see-saw to political developments over the next 5-6 months. The best way to avoid making mistakes is to stagger your investments through monthly SIPs," says Vidya Bala, head research, Mutual Funds, FundsIndia.com. Bala advises investors to avoid sectoral and thematic funds and stick to the boring but stable diversified equity funds.

"If the prospects of any sector are looking bright, a good diversified fund will on its own increase exposure to it," she points out. This is also a good time to get into debt funds. The 10-year benchmark bond yield is at 8.93%, and income funds and dynamic bond funds can offer good capital appreciation over the next 2-3 years.

If your investment tenure is shorter, go for short-term debt funds. Though the income they generate is taxable, debt funds have greater liquidity than the tax-free bonds currently on offer.