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MARKET STATS ▼

SENSEX

26,324 ▼ -235.79

NIFTY 50

8,116 ▼ -76.90

GOLD (MCX) (Rs/10g.)

28,200 ▲ 280.00

USD/INR

68.36 ▲ 0.02

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How to diversify your mutual fund portfolio

 By [Shivani Bazaz](#), ECONOMICTIMES.COM | Nov 30, 2016, 05.52 PM IST

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A series of sharp falls in stock markets often serve as a wake-up call for many investors. Especially to investors who have invested only in [mid and small cap funds](#). Many of them suddenly remember the merits of [diversification](#) of the investment portfolio.

"Diversification is to reduce the risk as well as to have the taste of other asset classes in different market conditions," says Kanav Chhabra, Investment Advisor, Karvy Private Wealth . The basic idea of diversification is very simple. When you put your entire nest eggs in one basket, you are exposing the eggs to higher risk. However, if you spread them around different baskets, you can reduce the risk.

When the rule is applied to investments, it means that you just won't invest your entire money in a single asset class, say, equity [mutual funds](#). You would spread your investments across different asset classes based on your risk profile and investment horizon so that you are not at the mercy of a single asset class.

Vishal Dhawan , Founder and CEO, Plan Ahead Wealth Advisors, explains the process of diversification with an example: "Any diet needs to be a mix of carbohydrates, proteins, minerals, vitamins etc. Similarly, in a cricket team you have batsmen, bowlers, fielders because all of them play a different role. That's called diversification. Financial portfolios need to have things that are playing different parts."

For example, debt mutual funds can give you predictable outcome with less [volatility](#) and equity mutual funds can provide higher capital appreciation.



"Diversification is important because the components of your portfolio tend to behave differently at different points of time," says Vishal Dhawan .

Investors can diversify their mutual funds portfolio in different ways:

Diversification within the asset class: You have decided to invest in an equity mutual fund scheme to meet a long term financial goal. Since it is a long term financial goal and you are okay with risks involved in [stocks](#), you decide to invest the entire money in a smallcap scheme.

This strategy will actually expose your money to higher risk. You can invest in a multicap scheme (also known as diversified fund) to invest in stocks across different market caps such as large cap, mid cap and small cap. Or you can also spread your investment across large cap scheme or mid and small cap scheme.

Diversification across asset classes: This diversification would happen if you identify your various financial goals and invest according to your risk profile and investment horizon. For example, ideally you should invest in safer avenues like bank deposit and debt mutual funds to achieve your short-term financial goals that have to be met within a few years.

Similarly, you should park your money in equity mutual funds to meet your long-term financial goals that are at least five years away.

This diversification would ensure that a sudden volatility in the [stock market](#) would not adversely impact your financial plans. Predictable returns from bank deposits and debt mutual funds would help you to meet your short-term financial goals.

Geographical diversification: At this point of time, the emerging markets have been hit badly and the US markets are doing well. People who have put a certain percentage of their total corpus in the US-focussed international funds will reap the benefit of a buoyant US market. Investing across different geographical locations enhances your chances of downsizing risk and getting returns when the Indian markets are not doing well.

Management diversification: If you put all of your money in a particular mutual fund, you will increase your risk. That is why it is necessary to diversify your investments across different mutual fund houses, so that when one fund is not doing well, the others might perform well.

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