Maximise gain from mkt fall with value-averaging plan

The plain-vanilla SIP, however, is simple and doesn't require a lump sum

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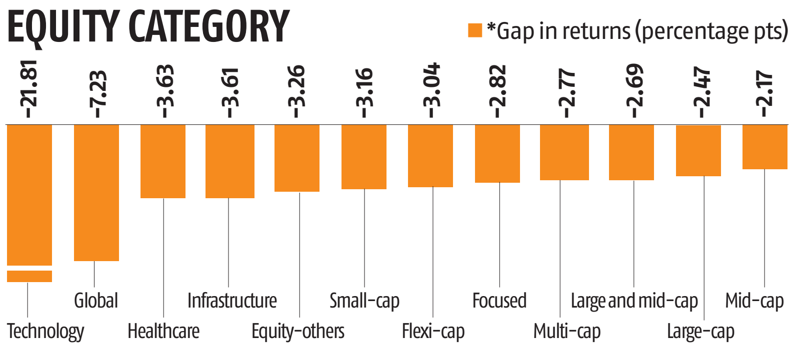
Mutual fund (MF) investors are often unable to derive the full benefit of the returns their funds generate owing to their behavioural biases. Many of them enter the markets amid a bull run, when valuations are expensive, because of the Fomo (fear of missing out) factor. When the markets inevitably correct and stay low for some time, they turn fearful and despondent, and ultimately exit. A recent Morningstar study says equity investors have earned between 2.17 and 21.8 percentage points less over five-year spans across different equity fund categories due to their tendency to enter and exit at the wrong time.



Data as on June 30, 2022
Source: Morningstar's 'Mind the gap-India' report
*Gap between fund return and investor return over 5 years

To combat this behavioural problem, Samco Mutual Fund has recently launched the TimerSTP (systematic transfer plan). Unlike a normal SIP (systematic investment plan) or STP, where the amount invested remains constant each month, here it varies, depending on market levels. In back testing done by the fund house, the TimerSTP has shown considerable outperformance over the normal STP (on investment in Nifty 500 index between January 2005 and July 2022). "The idea is to take emotions out of investing while also enabling investors to generate alpha," says Umeshkumar Mehta, chief investment officer, Samco Asset Management.

MF distributor. like Fundsindia.com, also offer what they call a value-averaging investment plan (VIP) where the concept is similar — to invest less if a fund has exceeded an expected rate of return, and more if it has fared worse.

How does TimerSTP work?

Samco MF has developed an index called the Equity Margin of Safety Index (EMOSI). It is derived using three parameters: interest rate (G-Sec yield), valuations, and technical factors. The index's value ranges from 1 to 200: one indicates the lowest margin of safety (expensive market) while 200 signifies the highest (inexpensive market). Currently the EMOSI is at 100, which indicates a fairly valued market.

The fund house also offers a table of multipliers, which shows the amount to be invested at a given EMOSI level. The multiplier ranges from a low of 0.01 to a high of six times the base instalment amount. The investor puts his money in an overnight fund and the appropriate amount gets invested each month in the target fund.

Benefit from bear market

Experts say VIPs, conceptually, are good products. "With a plain vanilla SIP, the amount of money invested remains the same. So even though you might get more units as a result of prices going down, it doesn't enable the investor to put in a larger amount to maximise the advantage," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Moreover, when there is a steep fall in the market, investors are unable to act due to fear. Many stop their SIPs, leave alone invest more. "Automating the process helps greatly in investing a higher amount in such an environment," adds Dhawan.

VIP requires deep pockets

The advantage of a plain-vanilla SIP is its simplicity. A fixed amount gets invested in a chosen equity fund each month. Many investors, who have just graduated from fixed income to equities, are able to identify with this form of investing as they have invested in a similar manner in products like the recurring deposit.

For VIP to work, the investor must have deep pockets. He must also have a lump sum available. "The investor must be able and willing to invest a much higher amount in a bear market for VIP to make a difference," says Vidya Bala, co-founder, Primeinvestor.in.

The multi-factor model launched by Samco is young. Whatever results it has shown is based on back testing. "One will have to wait for the model to perform in real market conditions over at least a seven-year cycle before one can say with confidence that it works," says Bala.

Bala adds that investors should do the bulk of their investing via plain-vanilla SIPs/STPs. "VIP can be a supplementary mode of investing which investors can use to fulfil their desire for outperformance," she says.