

NFO Insight: Is Groww Small Cap Fund a smart bet amid market volatility?

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Groww Mutual Fund's latest NFO, the Groww Small Cap Fund, is now open for subscription. The open-ended equity scheme targets small-cap companies and seeks long-term capital appreciation through a bottom-up stock selection process guided by Groww's QGaRP framework — Quality and Growth at a Reasonable Price. Investors can bid in the offer till January 22.

Investment approach

Groww Small Cap Fund follows a true-to-label mandate, investing predominantly in small-cap stocks. The scheme adopts a purely bottom-up approach, avoiding macro or thematic calls, and focuses on identifying fundamentally strong, scalable businesses with sustainable growth drivers and reasonable valuations.

What experts say

Experts typically advise investors to avoid NFOs unless the scheme offers something genuinely unique — either an investment option not currently available in the market or a meaningful enhancement to an existing category. Otherwise, they argue, investors are better served by established funds with long performance track records, as these provide historical data to guide investment decisions, something new offerings inherently lack.

Pallav Agarwal, Certified Financial Planner, Bhava Services LLP, told ETMutualFunds that the stock selection in this fund will follow a disciplined QGaRP framework as per the AMC, which means Quality and Growth At a Reasonable Price, and if the above framework is followed strictly, one may invest in this NFO for a very long time horizon.

Vishal Dhawan, Founder & CEO, Plan Ahead Wealth Advisors, shared with ETMutualFunds that small-cap valuations are still above long-term historical averages, which reduces margin of safety and increases downside risk if earnings disappoint or liquidity tightens and with limited valuation comfort, the risk-adjusted return profile is unattractive, favouring a wait-and-watch or staggered (SIP-only) approach rather than fresh lump-sum exposure in this NFO.

According to the fund house, one should consider Groww Small Cap Fund as it is true-to-label investing, QGaRP-led decisions, bottom-up approach for stock selection, and expertise in small caps.

Dhawan highlighted that the key differentiator in this fund is high fund-manager discretion, with wide flexibility on stock selection, sector allocation, cash levels, and sizing, making outcomes heavily dependent on active judgment and unlike passive funds, the manager is not bound to index weights and can avoid overvalued or illiquid small-cap stocks.

According to an analysis by ETMutualFunds, smallcap mutual funds got the tag of worst performers of 2025. The category, on average lost 4.62% in the current calendar year so far. There were 29 funds in the category in the said time period, of which 27 gave negative returns, and two gave positive returns.

Groww Mutual Fund in its release document said that after a year of relative underperformance, the small cap segment has seen moderation in valuations across pockets, even as fundamentals for many

companies have continued to improve. This combination of improving fundamentals and more reasonable valuations has broadened the opportunity set for bottom-up stock selection.

The release document further highlights the valuation of Nifty Smallcap 250. The current PE (As of December 31, 2025) is 29.25 whereas one year ago it was 33.41 and the five year median is 28.93.

So with valuations still above long term historical average and a year of underperformance, does it still make sense to invest in small cap funds through NFOs or in existing funds?

To this Dhawan said that these funds were underperformers largely due to elevated valuations at the start of the year, earnings moderation, and a clear shift in investor preference towards larger, more stable companies and this phase of underperformance reflects the inherently cyclical and volatile nature of the small-cap segment rather than a permanent impairment of the asset class.

From an investment standpoint, Dhawan said that poor one-year performance alone should not drive decisions as these funds have historically delivered higher long-term growth, but only for investors who can tolerate volatility and stay invested through cycles. “For investors with a long-term horizon, the current phase can offer selective accumulation opportunities, provided valuations and fundamentals are reasonable.”

On the other hand, Agarwal said that at times like these, when smallcap space has witnessed a decent correction, investing in an NFO may make more sense as existing funds might have some legacy issues with the portfolio, which, in the case of a new fund is not an issue and the fund managers may pick up stocks judiciously to build a fresh portfolio.

The smallcap segment can be extremely volatile in the short term, but it has the potential to offer very high returns over a long period. Smallcap schemes are recommended only to aggressive investors with a high-risk appetite and a long investment horizon, say, around seven to 10 years. ETMutualFunds does not recommend smallcap schemes to new and inexperienced investors.

Should first-time investors avoid small-cap funds, or can they allocate a small portion—and how long should one stay invested to manage volatility? Agarwal said first-time investors should ideally avoid these funds, as navigating such a high-volatility category requires considerable awareness and experience.

“If at all one decides to invest in a smallcap fund, the time horizon should be more than 7-8 years, and a staggered approach is better through SIPs or STPs,” he added.

Sharing a similar viewpoint, Dhawan also said that these funds should not be the starting point of the equity portfolio, given their higher volatility and sharper drawdowns. That said, they do not need to be avoided entirely. A small, controlled allocation can be considered, especially for investors who have a long-term horizon and are comfortable seeing short-term fluctuations without reacting emotionally.

He further said that first-time investors should limit small-cap exposure to a small satellite portion of the portfolio, while keeping the core allocation in large-cap or diversified equity funds as this approach allows participation in the long-term growth potential of small caps without taking disproportionate risk early in the investment journey and the to manage volatility effectively, investors should be prepared to stay invested for at least five to seven years and choose investing through SIPs rather than lump sums can further help manage timing risk.

What is the outlook of small cap mutual funds?

According to Groww Mutual Fund, India’s economy is undergoing a broad-based transformation, with strengthening physical, financial, and technological capacity reshaping the opportunity set for businesses across the size spectrum. Rising infrastructure spending, deeper capital markets, improved access to formal credit, and population-scale digital platforms are reducing historical disadvantages

faced by smaller companies. As a result, many small businesses today are better positioned to scale operations, access new markets, and compete more effectively.

Dhawan recommended that from an asset-allocation standpoint, smallcap funds should remain a limited part of the overall portfolio, even at current levels; for most investors, a 10–15% allocation to small-cap funds is considered reasonable, while more aggressive investors may go up to 20%, but typically not beyond that and the broader principle in 2025 has been to ensure that mid- and small-cap exposure combined does not dominate the portfolio.

“As for the outlook, the stance on small caps remains cautious but balanced. While parts of the segment have corrected and valuations have become more reasonable than earlier peaks, near-term volatility is still expected due to uneven earnings visibility and liquidity sensitivity. That said, the long-term growth case for small caps remains,” he further said.

On the other hand, Agarwal said that allocation in these funds should be very low, maybe around 10-15% of the overall portfolio, which can be increased by investing in further corrections or through SIPs or STPs.