YOUR MONEY

PASSIVE HYBRID FUNDS

Invest for lower volatility, hassle-free asset allocation

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The mutual fund industry has begun to launch hybrid index funds that combine equity and debt. Edelweiss Mutual Fund earlier launched the Edelweiss Nifty LargeMid Cap 250 Plus 8-13 Year G-sec 70:30 Index Fund. The new fund offers of the Mirae Asset Nifty200 Momentum 30 Plus 8-13 Year G-sec 75:25 Index Fund and the Mirae Asset Nifty200 Momentum 30 Plus 8-13 Year G-sec 50:50 exchange-traded fund (ETF) are open.

Growth with stability

A passive hybrid fund combines the long-term growth potential of equities with the relative stability of government securities (G-sec). "In the Edelweiss Nifty LargeMidcap250 Plus 8-13 Yr G-sec 70:30 Index Fund, equities act as the primary return driver while G-secs help cushion market volatility," says Bhavesh Jain, president and co-head, factor investing, Edelweiss Mutual Fund. He adds that this structure aims to deliver a smoother investment experience and better risk-adjusted outcomes. G-secs can also reduce risks arising from the credit quality of instruments in the debt portfolio.

Disciplined asset allocation

Passive hybrid funds follow a rule-based strategy. "Investors can be reasonably confident that the fund will follow its stated strategy," says Deepesh Raghaw, Securities and Exchange Board of India (Sebi)-registered investment advisor (RIA). These funds follow a defined rebalancing approach. "Automatic rebalancing creates discipline in asset allocation," says Vishal Dhawan, founder and chief executive officer (CEO), Plan Ahead Wealth Advisors.

"Passive hybrid funds offer a low-cost and transparent approach to hybrid investing," says Siddharth Srivastava, head – ETF product and fund manager, Mirae Asset Mutual Fund.

Rebalancing takes place within the fund, so investors need not sell one asset class and buy another to restore the prescribed allocation. "Internal rebalancing does not create a tax liability for the investor. This makes a combined product more tax-efficient," says Raghaw. Investors can choose index combinations that suit their risk profile. "They can select the equity and debt indices that provide exposure to market-cap segments and investment strategies that suit their objectives," says Srivastava.

Equity upside gets capped

Since these funds do not have a 100 per cent equity portfolio, their investors do not participate fully in an equity-market rally.

"A hybrid fund with equity exposure below 65 per cent would be subject to non-equity taxation, which would reduce its post-tax return," says Dhawan.

Treat back-tests with caution

Passive hybrid index funds and ETFs are new. Any long track record they display is based on back-tested data, not live performance.

"Performance can change significantly once real money begins tracking the index," says Raghaw. Investors should treat back-tests as one input, not as a predictor of future returns.

Who should invest

First-time equity investors and conservative investors may consider these funds for a less volatile experience than a pure-equity fund. "Investors seeking a hassle-free, tax-efficient asset-allocation solution may consider these funds," says Jain.

These funds may also suit investors who accept the prescribed allocation and do not want frequent tactical changes. Existing equity investors seeking lower portfolio volatility may also consider them.

Who should stay away

Investors seeking high equity exposure may find these funds unsuitable. "Aggressive investors may find the equity allocation restrictive," says Dhawan.

Those who actively manage their asset allocation or make tactical shifts between asset classes may find the structure limiting. Investors working with an adviser may prefer a customised allocation. "They may prefer separate funds," says Dhawan. Separate funds make portfolio-level asset allocation easier to control.

Investors must understand the underlying equity and debt indices. "Those who find these structure too complex should avoid these funds," says Raghaw.

Indices' risk-return profile

Large and midcap index

- Largecap stocks can provide stable returns
- Midcaps can improve long-term returns
- Largecaps may offer lower upside than midcaps
- Midcaps come with higher volatility

Momentum index

- Can capture upside strongly in favourable equity markets
- Can see sharp drawdowns

8-13-year G-sec index

- G-secs may offset equity drawdowns
- Do not carry credit risk
- But have long duration, can fall considerably when interest rates rise

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