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Holding too many MFs is a bad idea

Tools to check overlaps are available with a few investing apps and other online intermediaries

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RISK REDUCTION

If risk minimisation through diversification is what you seek, venture into different asset classes such as equity, fixed income and gold

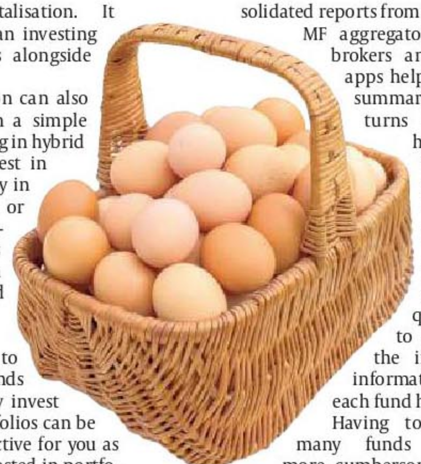
There's plenty of advice on how diversification is good for your overall portfolio and how it can help contain risks while optimising returns. But too much of a good thing can be bad as well. Mutual fund investors, who have over 1,500 open-ended schemes at their disposal, are especially spoiled for choice. Many end up following the fad and invest in the 'flavour of the season' funds. A few others fall prey to the marketing gimmicks of fund houses and invest in innumerable NFOs. Eventually, they end up with a portfolio of several mutual funds that neither diversify risk nor optimise returns. In fact, holding too many funds can hurt the returns of your overall portfolio as well.

Why diversification

Diversification is ideally viewed as holding on to assets that don't move in tandem with one another. Meaning, when things turn sour in one, the returns from other investments should help protect your portfolio from the downside. When investing in equity, exposure to companies from different industries, sizes, and markets will help protect your portfolio from the adversities of one.

Within mutual funds, diversification implies investing in funds that, in turn, invest in a combination of stocks based on different styles/metrics /market capitalisation. It could also mean investing in debt funds alongside equity funds.

Diversification can also be achieved in a simple way by investing in hybrid funds that invest in debt and equity in one portfolio, or through multi-asset funds that invest in debt, gold alongside equity.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Holding on to too many funds that ultimately invest in similar portfolios can be counter-productive for you as the money invested in portfolios with clashing objectives will cancel out the benefits that could have ideally come from investing in a focussed manner. Instead of adding too many funds, one should increase the investment amount in a limited number of funds.

Portfolio monitoring issues

Apart from just the sheer number of funds, their individual SIP dates and related tax matters, having too many funds is simply unmanageable. For one, by having to monitor and manage so many funds, investors with over-diversified portfolios have their work cut out for them. While the consolidated reports from registrars, MF aggregators, online brokers and fintech apps help you view summaries of returns and perhaps certain ratios, a detailed review of performance would require you to download the investment information from each fund house.

Having to monitor many funds becomes more cumbersome if you have invested offline.

If you do this offline, this would mean going through pages of documents for basic things such as investment amount, current portfolio value and returns, etc.

There are investors who, over the years, have accumulated 15-20 funds in their portfolio. Given the portfolio management nightmare, you might lose track of the funds that don't perform well. But they might end up sticking around for longer in your portfolio, earning sub-optimal returns. And when some funds in a large portfolio do very well, you might find it difficult to identify them and when you finally identify them, you will see that small allocations to best performers ultimately do not impact your overall portfolio return.

Many DIY investors are going for pure passive products such as index funds and ETFs, especially because they may be a low-cost option vs active funds. This approach also results in overlap. For instance, if you have a Nifty 100, adding Nifty 50 fund to your portfolio may not help much because Nifty 100 itself contains Nifty 50. If you own a Nifty 500 passive fund, you have pretty much covered the market.

Also, for the young who have ability to take higher risk and those with a long-term horizon, actively managed funds, especially outside the large-cap category, may still be a better fit.

The way out

Start with a clear-cut understanding of your goals and risk appetite. Your investment choices should strictly be in line with these, instead of being influenced by fads.

If equity is where your heart is, try diversifying across various styles of investing (value or growth or contrarian approach) or based on market capitalisation. Even when trying to invest across categories, try to eliminate cross-holdings as much as possible. Tools such as Portfolio Overlap (in Paytm Money app) Portfolio X-ray (available on FundsIndia.com) can help you spot identical holdings in your portfolio.