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Equity funds for long-term wealth

If you are looking to build a portfolio for the long term, one that beats inflation, then equity funds are the way to go. Equity funds invest at least 65 per cent of their assets (maximum up to 100 per cent) into stocks. If are in your twenties or thirties, an early start can help you benefit from the power of compounding.

An investment of ₹1 lakh in a top performing equity fund, say, 20 years back, would be worth ₹16 lakh today at an annual compounded growth rate of 15 per cent!

For the moderate risk-taker

Equity diversified funds are further classified as large-cap, mid-cap, small-cap and multi-cap. Most large-cap funds have a mandate of investing 80 per cent into large-caps (above ₹10,000 crore). Top performing funds in this category have delivered 16 and 13 per cent return over five and 10-year periods, respectively.

Mid- and small-cap funds, on the other hand, invest predominantly in smaller stocks (with market cap of less than ₹10,000 crore). These funds carry higher risk than large-cap funds, but also reward investors in market rallies.

Top performing funds such as Reliance Small Cap, Mirae Asset Emerging Bluechip and DSPBR Micro-Cap Fund have delivered tidy returns of 31, 30 and 31 per cent over a five-year period. Multi-cap funds invest across the market capitalisation spectrum, though most have a large-cap bias.

For those who prefer stability of returns and have a moderate risk appetite, large-cap funds are a good bet. While these funds deliver inflation-beating returns over the long run, they tend to cap losses well, in volatile markets.

For instance, ICICI Pru Focused Bluechip Equity Fund, one of the top performing large-cap funds, fell by 16 per cent in the 2011 bear phase, while the Sensex lost a higher 23 per cent.

For those who are game for more risk, mid- and small-cap funds are good options. The top performing funds delivered stellar returns of 92 per cent in the market rallies of 2014 (while large-cap funds delivered 52 per cent).

But they also tend to fall more than large-cap funds. In the 2011 bear market, for instance, these funds lost 26 per cent.

For the aggressive investor

Within equity funds, there are some funds that carry far higher risk than diversified funds, by pegging up their exposure to a particular theme or sector.

Thematic funds such as Franklin Build India Fund (infrastructure), Birla SL MNC fund (MNC), Taurus Ethical Fund (Shariah) and Tata Dividend Yield Fund (dividend yield) and contra funds (Invesco India Contra Fund) and sector funds such as those under categories like FMCG, technology, banking, pharma.etc., fall under this category.

These funds carry concentrated bets and their performance is prone to cyclical swings. For instance, concerns over regulatory action against Indian drug makers by the US Food and Drug Administration have led to the under-performance of pharma funds over the past year. These funds managed to deliver just 1 per cent return. With the software sector facing headwinds, IT funds have incurred losses of 6 per cent over the past year.

But these funds can deliver spectacular returns when the tide turns. ICICI Pru Banking and Financial Services Fund, for instance, delivered chart-topping returns of 60 per cent over the past year, as banking stocks gained handsomely on hopes of a revival in the economy.

Investors wishing an exposure to other geographies can invest in global funds. These funds are riskier than other diversified funds.