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Fund of Funds Vs Large-cap and Mid-cap Mutual Funds: Which One to Invest?

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Abstract- This paper tries to understand and check whether fund of fund is a better investment option as compared to other mutual fund schemes especially, large-cap and mid-cap mutual funds. The data of performance of mutual funds is taken from Morningstar India with emphasis on category performance, top performer and bottom performer in all three categories. It is found that in most cases, large-cap funds prove a better investment option than fund of funds

***Keywords* – Fund of Funds, Mutual Funds, Large-cap Funds, Mid-cap Funds, Investment Options, Performance.**

I. INTRODUCTION

The rapid advancements in the financial services industry has unearthed several new and hybrid financial products. Mutual Funds (What are Mutual Funds?, 2020) is one such product though whose existence has been in India since several decades; nevertheless, its prominence has increased in the last few years. Mutual Funds, as rightly coined, is an investment pool, wherein people come and investment money in small denominations and this accumulated money is further invested in a professional manner across various financial instruments by the fund managers. Mutual funds (Chandra, 2005), on a broad scale, are classified on the basis of financial instruments that they invest as per their investment policy. To list a few, these categories are equity funds, debt funds, and hybrid funds. On the basis of redemption, mutual funds are classified as open-ended and close-ended mutual funds wherein; in open-ended mutual fund schemes, the investors can withdraw their investment whenever required whereas in close-ended ones the withdrawal is possible only at maturity (What are Mutual Funds?, 2020).

However, there is one category of mutual funds which is less prominent among investors wherein; people have chances to invest and exploit its opportunities. This category is known as 'Fund of Funds (FOF)' (Fund of Funds (FOF), n.d.). This mutual fund scheme differs from others in terms of their underlying investment. For instance, most of the mutual fund schemes, allocate their pool of funds in various instruments such as equity, fixed income, commodities, and so on. On the contrary, a Fund of Funds scheme invests its corpus in the units of other mutual fund schemes that have invested their money in various underlying assets. Thereby, this scheme holds an indirect control over a plethora of financial instruments by way of its allocated mutual fund schemes. Also known by the name of multi-manager investment, this scheme, is generally suitable for individuals who aim to achieve broader degree of diversification across multiple schemes resultantly reducing the risk with small ticket size.

As these schemes usually invest in multiple Mutual fund schemes or hedge funds, they are categorized as Fettered investment and Unfettered Investments. The difference between both the schemes is that fettered investment schemes allocate the pool money in the in-house Asset Management Company's (AMC's) schemes while unfettered ones invest the collected pool in schemes of other asset management companies too. Using FOF mutual funds, investors can gain access to multiple financial instruments in an indirect manner which otherwise is not possible by investing in a single scheme. Some of the advantages (DarcMatter.com, 2016) of fund of funds scheme as compared to other mutual fund schemes are as follows.

- **Less Volatility**

Since, multi-manager investments invest in multiple mutual fund schemes, consequently, the level of volatility reduces by multiple notches. This is because through one scheme, individual can get access to all the financial instruments invested by most schemes.

- **Additional Level of Due Diligence**

Since, Fund of funds invest in mutual fund schemes that on a primary level conduct research of the underlying instruments resultantly, this additional level of screening can ensure that the right securities form part of the portfolio to earn maximum possible returns.

- **Spread is Large**

Since, The FOF schemes invest in mutual funds, they have access to high quantum of financial instrument as compared to one single investment. As a result, the spread or diversification increases to a greater extent thereby reducing

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the overall risk of the portfolio. This specially, is useful for people who look for greater degree of diversification through small investment amount.

- **Access to International Funds:**

Through these funds, individuals can have access to international mutual funds which otherwise is not possible.

As rightly said, there are two sides of a coin, fund of funds also come with certain set of disadvantages (DarcMatter.com, 2016). They are as follows.

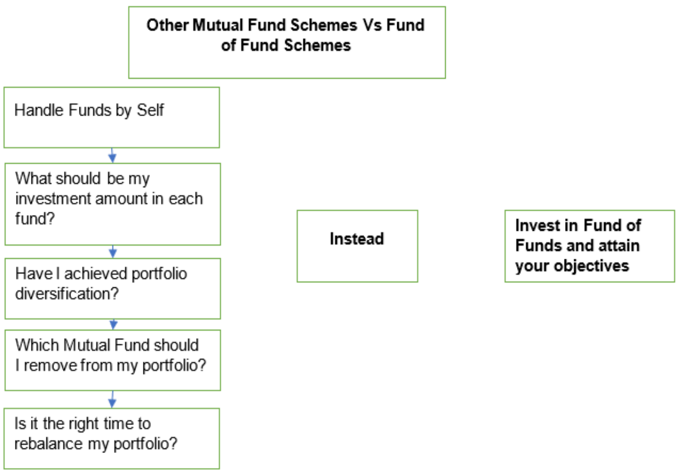
- **High Expenses**

As fund of funds, invest in multiple mutual fund schemes, their fees is comparatively high than other schemes. Additionally, these schemes also have to pay some fees to other mutual fund schemes in which they invest.

- **Less Returns**

Multi-manager investment schemes on a general note (DarcMatter.com, 2016), generate less returns as compared other mutual fund schemes. This is because, due to excess diversification, these funds reduce on the returns. Additionally, some of the schemes invest in international mutual funds, whose returns are generally lower as compared to other schemes.

In, simple words, fund of funds the comparison of fund of funds can be done versus other mutual funds can be shown using the following diagram.



II. OBJECTIVES OF STUDY

The objectives of this study is to compare the performance of fund of funds and large-cap and mid-cap mutual funds in India market. Here, the parameters to be compared include returns generated by both the categories, is the past performance based on 1-Year returns, 2-Year returns and 3-Year returns (Gala & Gala, 2018). The comparison is done across average category performance, top performer across categories and bottom performer across categories. The data for comparison of mutual funds is taken from Morningstar India a research company.

In this context, the types of equity funds considered for the study include large-cap funds and mid-cap funds. Large-cap Funds are the ones who invest the corpus money in equities and related instruments of large-cap companies whose market capitalization is considered to be more than Rs.10,000 Crores (Definition of Large Cap Funds, 2020). Mid-cap schemes are the ones whose pooled money is invested in stocks of mid-cap companies a notch below the large-cap companies. Furthermore, in these schemes also, direct growth plans are considered. A direct plan is one where investors can purchase the scheme directly from the company and not through any distributor. (What is a Direct Plan / Regular Plan?, 2020)

III. DATA AND ANALYSIS

The data of performance of mutual funds on for the last one year, last two years and last three years are as follows. The returns considered here are Compounded Annual Growth Rate (CAGR) returns which depicts the returns when the holding period is in excess of a year.

1-YEAR PERFORMANCE

Fund Category	Category Average (%)	Top Performer (%)	Bottom Performer (%)
Fund of Funds	8.48	21.66	-6.14
Large-cap Funds	12.89	22.06	4.61
Mid-cap Funds	13.79	23.93	2.90

Source: Morningstar India. Accessed on February 05, 2020

2-YEAR PERFORMANCE

Fund Category	Category Average (%)	Top Performer (%)	Bottom Performer (%)
Fund of Funds	5.46	18.04	0.68
Large-cap Funds	5.63	15.80	-0.05
Mid-cap Funds	2.08	14.40	-4.01

Source: Morningstar India. Accessed on February 05, 2020

3-YEAR PERFORMANCE

Fund Category	Category Average (%)	Top Performer (%)	Bottom Performer (%)
Fund of Funds	7.46	15.85	4.53
Large-cap Funds	10.82	19.74	6.10
Mid-cap Funds	8.57	18.13	3.85

Source: Morningstar India. Accessed on February 05, 2020

The data given above states that fund of funds have

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comparatively given less returns than other large-cap and mid-cap funds. This is evident in both category average performance as well as top performer. However, in bottom performer, fund of funds has comparatively generated better returns in year 2 as both large-cap and mid-cap funds have generated negative returns as compared to fund of funds which has a better return which are positive and not negative.

With respect to 1-Year Performance, the best category has been mid-cap as it has generated best average returns. While in the 2-Year performance, the best average has been large-cap category followed by fund of funds. Also, in 3-year performance, the average performance category is led by large-cap funds.

However, in bottom performer, fund of funds shows improvement, in all years as it shows a better progress thus, indicating, it can be a long-term investment.

IV. Conclusion

Thus, it can be said that the though fund of funds is a good investment category that can attain higher levels of diversification however, it does not generate much returns as excess diversification reduces the returns. Additionally, there exists scope of examination with respect to Assets under management, portfolio size which can help us to ensure that the asset quality is better.

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