



## Rebal tool: Fund of funds

ONE of the best tools to implement the rebalancing strategy is to buy a mutual fund type called a Fund of Funds (FoF). An FoF is a mutual fund scheme that buys units of other mutual funds and not equity or debt directly from the market. The main aim of an FoF is to diversify the fund manager risk and to keep the asset allocation of an investor intact. Through an FoF you choose an asset allocation based on your goals and risk profile and stick with it, whatever the condition of the market. A balanced fund can also do this, but it is not tax efficient and most funds leave enough scope for the asset allocation to change according to the fund manager's will. During the tech boom of 2000, many balanced funds became equity heavy, seriously jeopardising the desired optimal asset allocation of the investors. Balanced funds are tax inefficient as compared to FoF's since the latter do not have to pay the capital gains tax when they sell the winning asset class. But look out for higher annual fees charged by the FoF, for not only are you paying for the fund you buy, you are also paying for the funds that the FoF buys, nudging up the annual costs to between 2.5 to 2.75 per cent, from 2 per cent that most equity funds charge.

*Web 2.0*

**"We have been advising clients to reduce their equity allocation in this market"**

REBALANCING is more of a risk reduction technique rather than a return enhancing one. It improves the return per unit of risk. We did some back testing and found that the standard deviation, which is a measure of risk, goes down in a rebalanced portfolio. In the long run it also helps to improve the return. Thus, return per unit of risk is much better for a rebalanced portfolio than a static portfolio.

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We recommend rebalancing when the market moves between 20 to 23 per cent in either direction. The impact of this varies across different asset allocations. For a client with a 50:50 allocation, we will rebalance when the portfolio shifts by 5 per cent away from this allocation. For a 60:40 client, we shift him at a 4 per cent change in this allocation and a 70:30 client shifts for a 3 per cent change in the portfolio allocation. In a market like this, we are advising not just a rebalancing but a reallocation of the portfolio away from equity. For example, for clients with a 50:50 allocation, who saw this change in favour of equity, we are not just pulling them back to a 50:50, but to 45:55.

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