HDFC MF

Weekend Bytes

A weekly series from HDFC Mutual Fund

Mutual Funds over Direct Stocks

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Tenet 3: **Mutual Funds over Direct Stocks**

In our previous editions of Weekend Bytes, we have been discussing various tenets that you can adopt to reduce risks while investing in equities, namely, tenet 1 – Diversification and tenet 2 – Thinking Long Term. In this edition, we discuss tenet 3: Opting for Mutual Funds over Direct Stocks.

Scott D. Cook once quoted –

"Mutual funds were created to make investing easy, so consumers wouldn't have to be burdened with picking individual stocks!"

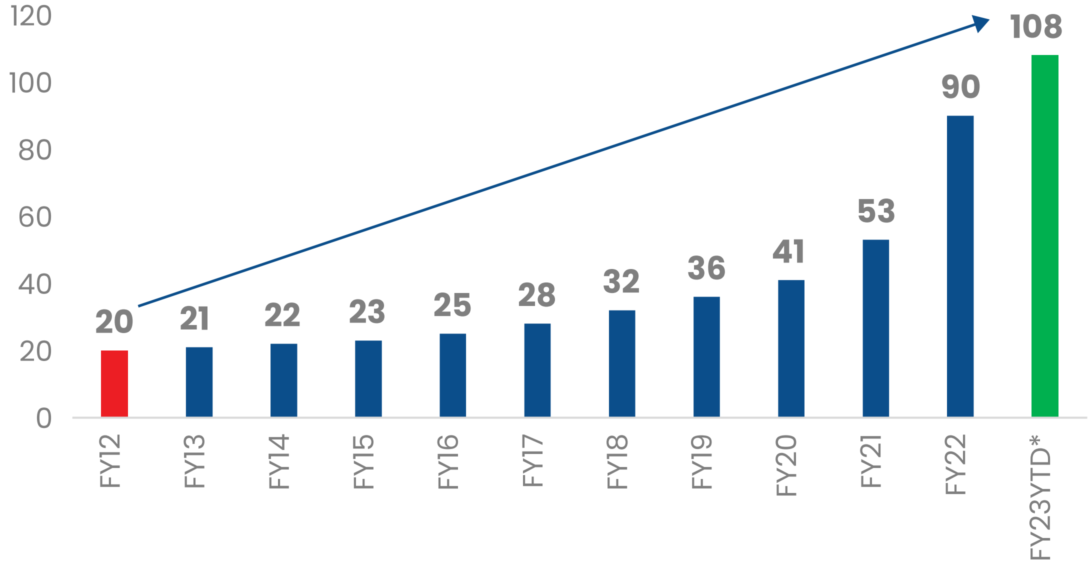
While equities have the potential for long-term wealth creation, investors do tend to get drawn by short term fluctuations in the market and may commit mistakes including:

- ✗ **Market timing** – buying and selling based on short term price movements
- ✗ **Emotional investing** – Making decisions driven by emotions including greed and fear / panic
- ✗ **Inadequate diversification** – Concentrating large investments into too few stocks or similar set of stocks
- ✗ **Neglecting to do research**

Trend of Investors investing directly in the Stock Markets

In recent times, we have seen an emerging trend of millennials investing directly in stock markets. This is evident from the multifold rise in the number of demat accounts opened.

Demat Accounts have increased multifold in the past 11 years!



Source: NSDL, CDSL, *FY23YTD: March 31, 2022 to December 31, 2022

In the recent past, a higher number of retail investors have invested during an up-trending market.

A similar example of this trend was seen during the bull run of 2003-08. However, after the sharp fall during the Global Financial Crisis, such investors found it difficult to re-enter the equity markets because of the fear of loss. While apps have made trading easier, direct investing is more complicated than expected.

Wide dispersion of returns in equities makes a case for investing through MFs!

While it may be tempting to invest directly in stocks, the divergence of returns across companies makes direct investing an endeavor fraught with risk. If one considers 5 year returns of NIFTY 500 companies (As of 31-Dec-22), while 95 out 402^ companies yielded returns above 20% CAGR, almost an equal number of companies yielded negative returns (110 companies). A quick look at the below table shows the extent of return dispersion in equities. Such wide dispersion in equity returns makes stock selection extremely critical.

Return Range %	Number of companies	% of constituents in the return range
Negative returns	110	27%
0 to 10%	115	29%
10% to 20%	82	20%
Above 20%	95	24%

Source: Capitaline, Only NIFTY 500 constituents as of Dec'22, which were listed on or before Dec'17 have been considered

In view of the above, it is prudent to invest in equities via MFs, which have a well-diversified portfolio and professional fund management expertise.

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Conclusion

While diversification and thinking long term are key tenets to reduce risks while investing in equities, investing in mutual funds over direct stocks is also key tenet to reduce risk, while ensuring investing discipline. Why so?

Direct Investing	Mutual Funds
Requirement of time and skill to research companies, study the microeconomic and macroeconomic factors worldwide, including non-financial events like a pandemic, geopolitical developments and others	Ability to benefit from the expertise of Fund Managers. An asset management company employs a team of sector analysts and fund managers, who follow a predefined investment process.
Tendency of higher emotional ups and downs as a result of higher volatility of individual stocks	Manage emotions better with SIP in MFs
Portfolio churning is more costly and less tax efficient	Portfolio churning is more cost and tax efficient (due to economies of scale and since transactions in securities by mutual funds are exempt from tax)
Risk of concentration	Easy diversification
Selecting a portfolio of stocks difficult with a low-ticket size of investment	Lower investment amount (Rs.100 for most HDFC MF schemes)

But are there more techniques to reduce risks while investing in equities?

Sr. No.	Tenets
1	Diversification
2	Thinking Long Term
3	Mutual Funds or Direct Stocks?
4	????

Tune in for the next edition of this series to know more!