Systematic investing gives benefit of rupee-cost averaging

MFs are a recommended route as they offer benefits of professional management and diversification

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I am 22 years old and want to invest `2 lakh as a lump sum amount in the equity market and in mutual funds. My time horizon is three to five years. How should I go about my investments?

—Mohit M. Kukreja

There are many ways to invest in the equity market. And there are various products as well within equities. Here are a few pointers on how to proceed.

How to invest: You can invest either a lump sum or stagger your investments through a systematic approach.

In case you have a lump sum amount, you could consider a systematic transfer plan (STP), wherein the total amount is invested in an ultra short-term scheme and a fixed amount is switched out from it (also called as transferor scheme) and into the desired scheme called as transferee scheme. This exercise is repeated over a fixed period.

In case there is a regular income that has to be invested, the same principle works and instead of two schemes working in conjunction, the fixed amount is debited from your bank and credited to the desired scheme. This is called a systematic investment plan (SIP).

Both these options offer you the benefit of rupee-cost averaging, i.e., by purchasing units over a period of time, you automatically buy more units when prices are low and fewer units when prices are high, resulting in lower per unit acquiring cost.

Rupee-cost averaging does not guarantee a profit, but with a sensible and long-term investment approach, it can smoothen the market's ups and downs and reduce the risks of investing in volatile markets.

Besides disciplined investing, it will also stop you from giving in to the temptation of spending your money before you can invest it in a product.

Where to invest: As you are young and have a reasonable time horizon of three to five years, you can, and have rightly so, considered equity as an asset class for investment.

At the same time, with equity being an inherently volatile asset class, you should be prepared to increase your investment horizon by a few more years in the eventuality of under- or non-performance.

Within equity, you have the option of choosing from direct stocks or mutual funds.

Mutual funds are a recommended route as they offer the benefits of professional management and diversification since you own many stocks in one fund, there is economy of scale as well as liquidity. The risk is spread out.

Investing directly in stocks is also a good option provided you have the necessary expertise, knowledge as well as time to manage the portfolio.

Within the equity asset class you should create a portfolio that has a mix of large-cap, mid-cap, and in case of mutual funds, multi-cap schemes. This will help you in creating an asset allocation structure within your stocks/mutual funds portfolio.

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