Fund of Funds

A "Fund of Funds" (FOF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in different asset classes. This type of investing is often referred to as multi-manager investment. They can either invest in other schemes of the same fund house or third party schemes.

FoF offers diversification at two levels i.e. (a) diversification at the mutual fund level by offering a basket of different schemes and (b) diversification at the FoF level by offering different kinds of FoF to choose from. Traditionally FoF's are seen as a multi manager, asset allocation tool in India.

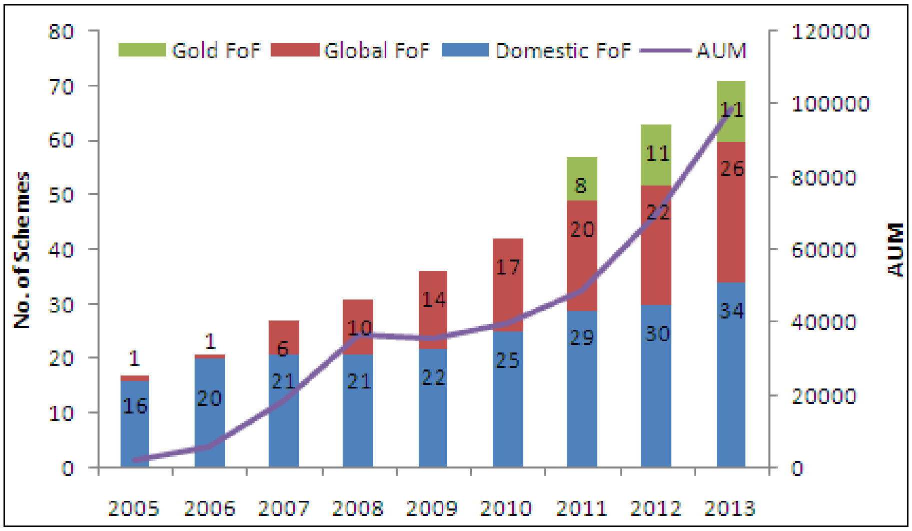
Classification of FoF

- **Domestic FoF-** A FoF that invests in Domestic mutual fund schemes
  - **Equity Based FoF-** FoF that basically have equity theme and invests majority of its corpus in equity mutual funds.
  - **Debt Based FoF-** A debt based FoF that have debt schemes as their major component.
  - **Asset Based FoF-** A hybrid FoF looks to offer best of equity and debt & have an mix of both in their portfolio.

- **Global FoF-** FoF that invests in mutual fund schemes outside India
  - **Geographic Based FoF-** A Global FoF can invest in different countries and different types of markets. Some schemes such as HSBC Emerging Markets Fund invest money in a global fund of HSBC Group that invests in countries that qualify as emerging or developing nations of the world.
  - **Asset Based FoF-** An Global FoF can be asset based also, that is it can invest in equities, debt, commodities or other MF with the same theme.
  - **Sector/ Thematic Based FoF-** An Global FoF which invests based on themes like, agriculture and real estate, emerging markets, mining companies etc. For example ING Global Real estate Fund that invests in units of ING (L) Invest Global Real Estate, which invests in Global real estate equities.

- **ETF Based FoF-** FoF is majorly invested in ETFs offered by their sister company. ETF FoFs offer the benefit of investing in ETFs without opening any demat account & a cheaper way to invest in ETF's (SIP route). Currently there are only Gold ETF based FoF available in India. These Funds invest 90-100% of their corpus in Gold ETF's by their sister company and rest in money market instruments. Ex Reliance gold saving FoF, SBI Gold Fund etc.

Growth of FoF in India



Advantage

- Diversification is one of the biggest advantage of FoF. For example investors can add a global fund to their portfolio without any hassle.
- Mutual fund itself offers quality management, but FoF takes it forward by offering a well managed & diversified portfolio of mutual fund schemes.
- It works out best for retail and first time investors. For example, one could either invest Rs 2,000 SIP per month in 5-6 scheme or Rs 2,000 in just one scheme which comprises of 4-5 schemes.
- Saving of capital gain tax- No capital gain tax is levied on fund managers changing funds within 12 months, whereas if an investor does so, they will be charged short term capital gain tax.

Disadvantages

- High management Fee- Management fees for Funds of Funds are typically higher than those on traditional investment funds because they include the management fees charged by the underlying funds.
- High Expense ratio
- Debt Taxation- the biggest drawback of FoF's is that they are treated on par with debt funds as far as taxation is concerned. So, even if FoF's invest their entire corpus in equity fund, they will still be taxed the way debt funds are.

Returns

FOF Category	1 yr	3 yr	5 yr
Domestic FoF	13.73	8.74	9.24
Global FoF	7.07	2.61	7.88
Gold FoF	-2.71	4.72	--
SENSEX	22.62	9.19	10.3
NIFTY	20.84	8.95	9.81
Gold- India	-1.31	6.26	12.41

Returns are average returns of all the funds in the category
Source: ACE MF

A fund of funds will not deliver performance equal to or better than the single best performing fund that it has invested in because it holds many funds in it. The return of a fund of funds will always be closer to the weighted average returns of the funds it has invested in, and by the very same logic, a FoF will not go down as much as the worst performing fund it holds inside it. For this very reason, fund of funds are known to give superior risk adjusted returns.

Appendix

Taxation

Debt oriented MF schemes			
Tax	**Individual / HUF**	**Domestic Corporates**	**NRI**
Dividend Received by the Investor	NIL	NIL	NIL
Dividend Distribution Tax (Payable by the Scheme)			
Fund	**Individual / HUF**	**Domestic Corporates**	**NRI**
Money Market & liquid Fund	25% + 10% Surcharge + 3% Cess = **28.325%**	30% + 10% Surcharge + 3% Cess = **33.99%**	25% + 10% Surcharge + 3% Cess = **28.325%**
Debt Scheme	25% + 10% Surcharge + 3% Cess = **28.325%**	30% + 10% Surcharge + 3% Cess = **33.99%**	25% + 10% Surcharge + 3% Cess = **28.325%**

Capital Gain Taxation				
Holding Period	**Type of Gains**	**Individual / HUF**	**Domestic Corporates**	**NRI**
Less than one year	STCG	30% ^ + 10% Surcharge $ + 3% Cess = **33.99%**	30% + Surcharge as applicable $$ + 3% Cess = 32.445% or **33.99%**	30% ^ + 10% Surcharge $ + 3% Cess * = **33.99%**
More than one year	LTCG	**Without indexation**: 10% + 10% Surcharge$ + 3% Cess = **11.33%**	**Without indexation:** 10% + Surcharge$$ + 3% Cess =**10.815%** or **11.33%**	**Without indexation:** 10% + 10% Surcharge $ + 3% Cess * = **11.33%**
		With indexation: 20% + 10% Surcharge $ + 3% Cess = **22.66%**	**With indexation:** 20% + Surcharge$$ + 3% Cess =**21.63%** or **22.66%**	**With indexation**: 20% + 10% Surcharge $ + 3% Cess * = **22.66%**
Tax deduced at Source (TDS)				
Holding Period	**Type of Gains**	**Individual / HUF**	**Domestic Corporates**	**NRI**
Less than one year	STCG	Nil	Nil	**33.99%**
More than one year	LTCG	Nil	Nil	**22.66%**

$ Surcharge at the rate of 10% shall be levied in case of individual / HUF unit holders where their income exceeds Rs 1 cr
$$ Surcharge at the rate of 5% shall be levied for domestic corporate unit holders where the income exceeds Rs 1 cr but less than Rs10 cr and at the rate of 10%, where income exceeds Rs 10 cr
^ Assuming the investor falls into the highest tax bracket @ after providing for indexation
**These are the tax rates applicable to capital gains, in case the rate of tax is lower than 20% and if the NRI does not have a Permanent Account Number, then for the purpose of TDS, the withholding tax rate would be 20%.*

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