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Portfolio Management service vs investing in mutual funds

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Thinking of putting money in a PMS product? Here is what you should keep in mind.

It is important to understand the differences between availing of a Portfolio Management Service versus investing in mutual funds.

The first thing which distinguishes a Portfolio Management Service from a mutual fund is that you directly own shares in various companies rather than units in a fund where there are many co-investors with you. The advantage here is that you know exactly what you own and depending on the agreement with your portfolio manager, you may have a say in selecting your investments. Your portfolio does not get affected with the subscriptions and redemptions of other co-investors as in the case of a mutual fund.

The second thing to consider is that there is a wide variety of portfolio managers. The total number of SEBI registered portfolio managers in India is at 268 compared to 51 registered mutual funds. With the variety also comes complexity. There are many agencies tracking the performance of various mutual fund schemes and information is widely available. In the case of portfolio managers however the information availability is an issue. All portfolio managers are required to give prospective investors a document called disclosure document. This document gives details of the past performance, organisation structure, key personnel etc. There is no central place where one can get the details of the performance of all portfolio managers and one would have to go through the disclosure document of each portfolio manager separately in order to make comparisons.

A reassuring factor while selecting a portfolio manager would be availability of references of existing and past clients who can vouch for their experience with the service provider. Some of the questions to ask apart from past returns would be volatility of returns, portfolio churn and investment philosophy. It is very important that the investment philosophy of the client and that of the portfolio manager matches so that there is no heart burn later on.

Investors should guard against unnecessary churn in the portfolio. Portfolio Management transactions are usually done with a single or limited number of brokers and many a times the brokerage is a big source of revenue for the portfolio manager. A high level of churn will incur avoidable expenses of brokerage, STT and short term capital gains tax. Tax authorities also tend to classify portfolios with a high level of churn as trading / business activity rather than investing activity. This classification will result in all income being taxed at the normal income tax rates rather than the concessional rates applicable to capital gains.

Operational aspects to be considered by prospective clients would include the kind of reports that are available to clients and their periodicity, whether reports are accessible on the internet, the auditors auditing the portfolio management transactions and whether the funds and securities are held by professional custodians rather than the staff of the portfolios manager.

For small investors, the entry level to avail of portfolio management services is steep at a minimum of Rs. 5 lacs per investor. This is the SEBI prescribed minimum amount. Portfolio Managers have an option of keeping their entry amounts higher than the SEBI prescribed minimum and many of them do so. In some rare cases the entry amount can be as high as Rs. 5 crores. Entry into mutual funds on the other hand is quite accessible at Rs. 5,000.