



Navigating the Equity Landscape: A Deep Dive into Multi-Cap Funds

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In the dynamic world of equity investing, diversification is often hailed as the cornerstone of a successful portfolio. Among the array of mutual fund offerings, the Multi-Cap Fund category stands out as a compelling, all-in-one solution designed to offer investors broad exposure across the entire market capitalisation spectrum.

What is a Multi-Cap Fund?

A Multi-Cap Fund is an equity mutual fund scheme that invests across companies of varying market capitalisations: Large-Cap, Mid-Cap, and Small-Cap. The core philosophy of this fund category is to harness the stability of large companies, the growth potential of mid-sized firms, and the high-return opportunities of smaller enterprises—all within a single product.

The SEBI Mandate and Categorisation

The Securities and Exchange Board of India (SEBI) is the regulator for the securities and commodity market in India. Its comprehensive classification of mutual fund schemes ensures transparency and standardisation.

Market Cap Category	SEBI Definition (Top n based on full market capitalisation)
Large-Cap	1 st to 100 th Company
Mid-Cap	101 st to 250 th Company
Small-Cap	251 st Company onwards

In September 2020, SEBI introduced specific and rigorous guidelines for Multi-Cap Funds to ensure they truly reflect their diversified mandate:

Minimum Equity Allocation: At least 75% of the total assets must be invested in equity and equity-related instruments.

Mandatory Allocation across Caps: The scheme must mandatorily allocate a minimum of 25% of its total assets to each of the three market capitalisation segments:

- Minimum 25% in Large-Cap stocks
- Minimum 25% in Mid-Cap stocks
- Minimum 25% in Small-Cap stocks

This clear mandate ensures that the fund remains well-diversified and provides guaranteed exposure to the high-growth potential of the Mid and Small-Cap segments.

History and Evolution of Multi-Cap Funds

Historically, before SEBI's 2017/2020 categorisation and subsequent re-categorisation, many funds labelled as "Multi-Cap" effectively operated with a dominant, often 60% or more, exposure to Large-Cap stocks. This effectively made them closer to large-cap-oriented funds, blurring the lines for investors seeking a truly balanced exposure.

The September 2020 guidelines were a pivotal moment. By mandating the 25-25-25 rule, SEBI redefined the category, compelling fund houses to increase their allocation to Mid and Small-Cap stocks. This move ensured that the Multi-Cap category delivered on its promise of diversification across market segments. This led to a significant rebalancing effort across the industry, establishing the Multi-Cap Fund as a distinct and truly balanced offering in the market.

What Should Investors Look For?

A Multi-Cap Fund is an excellent choice for investors seeking simplicity, diversification, and long-term wealth creation. When evaluating a fund, investors should focus on:

- **Consistency of Performance:** Look at rolling returns over multiple time frames (e.g., 3-year and 5-year rolling returns) rather than point-to-point returns. This shows how the fund performed across different market phases.
- **Risk-Adjusted Returns:** Metrics like the Sharpe Ratio or Sortino Ratio help assess the returns generated for the level of risk taken. Higher risk-adjusted returns are preferable.
- **Expense Ratio:** Choose a fund with a competitive expense ratio, as costs directly impact long-term compounding, especially in the Direct Plan option.
- **Fund Manager's Experience:** Examine the tenure and track record of the fund manager, particularly their ability to navigate different market cycles and adhere to the scheme's stated mandate.
- **Portfolio Quality:** While the 25-25-25 rule is mandatory, the manager's skill in stock selection within each segment is crucial. Look for a well-diversified portfolio across sectors.

Risks Involved

While offering diversification benefits, Multi-Cap Funds are still equity schemes and carry inherent risks:

- **Market Risk:** The value of investments will fluctuate based on overall stock market movements.
- **Higher Volatility:** Due to the mandatory minimum 50% exposure to Mid-Cap and Small-Cap stocks, these funds tend to be more volatile than pure Large-Cap funds. Mid and Small-Cap segments can witness sharper drawdowns during market corrections.

- Liquidity Risk: Small-Cap stocks can sometimes face liquidity challenges, making them difficult to sell quickly without impacting the price, especially during a sharp market downturn.
- Fund Manager Risk: Although the 25-25-25 rule limits tactical calls, the manager's ability to select quality stocks across all three segments is vital for alpha generation.

Positioning with Changing Market Cycles

The structured allocation of Multi-Cap Funds naturally positions them to weather market cycles effectively:

Market Cycle Phase	Typical Performance Driver
Bull Market	Mid-cap & Small-cap Segments tend to lead the rally.
Bear Market / Correction	Large-cap stocks, with their proven business models and stable earnings, offer relative stability.
Consolidation / Uncertainty	Large-Caps may offer better protection; select Mid-Caps may offer value.

History with Various Market Cycles

Multi-Cap Funds are designed to capture a complete market cycle. While they may underperform a pure Large-Cap fund during a severe bear market (due to Small-Cap exposure) or a pure Small-Cap fund during a small-cap frenzy (due to Large-Cap exposure), their strength lies in their consistent, compounded long-term returns. By mandating exposure across all three segments, the fund ensures it is never entirely out of favour and benefits from whichever segment leads the rally, delivering a balanced and smoother growth trajectory over 7+ years.

Conclusion

Multi-Cap Funds offer a highly effective solution for investors seeking an easy-to-manage, well-diversified, long-term equity investment. They combine the best elements of the equity market, managed by a professional, while adhering to a transparent and structured mandate. For an investor with a moderate-to-high risk appetite and a time horizon of five to seven years or more, a Multi-Cap Fund can serve as an excellent core equity holding.