

BACK TO BASICS

Mutual fund cash levels

Cutting through money jargon, one topic at a time. This week Abhinav Kaul explains why funds sit on cash, what it costs you, and when it should worry you.

When you invest in a mutual fund, you expect your money to go into stocks or bonds. But fund managers don't always stay fully invested. A portion of the fund may, at any point, be sitting in cash or cash-equivalent instruments such as liquid funds, treasury bills or overnight money market instruments. This uninvested portion is referred to as the fund's cash level.

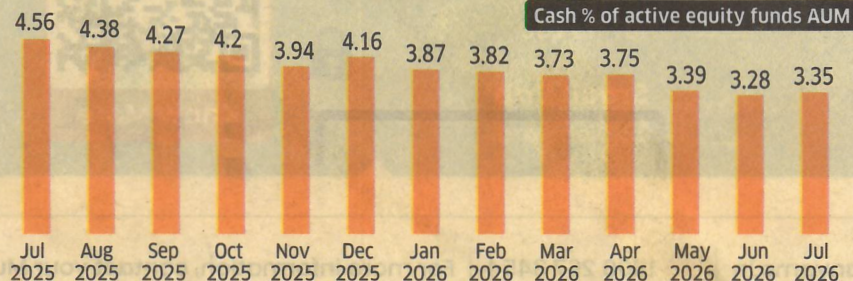
Paying you back

The most common reason a fund holds cash is to meet redemptions. If an investor wants to exit, the fund must pay them without being forced to sell stocks. Having a small cash buffer allows it to handle day-to-day outflows smoothly without disrupting the rest of the portfolio.

Waiting to deploy

When a fund receives large inflows, after a new fund offer or a surge in investments in existing funds, its manager does not invest it all at once. Doing so, especially in mid- and small-cap stocks where

Cash holdings of equity funds



Note: Cash holdings as a percentage of total assets under management (AUM) of active equity mutual funds.
Source: Prime Database MF.

trading volumes are thinner, can move prices unfavourably. The fund gradually builds positions over days or weeks.

Deliberate reserve

A fund manager may also hold cash tactically—ready to be deployed when a good buying opportunity emerges. If a stock that the manager wants to buy is currently overvalued, the manager waits. This kind of intentional cash holding can be a sign of patience and discipline, not a

lack of conviction.

Bearish stance

Sometimes, high cash levels reflect the manager's view on the market. If a manager believes equity valuations are stretched or a correction is around the corner, they may deliberately reduce stock exposure and hold more cash. It can work well if the market does fall; however, if it rises instead, the fund ends up missing out on gains.

The drag problem

Cash earns very little compared to equities. While the equity portion of a fund could potentially earn 12–15% over time, the cash portion may earn about 5–6%, the rate available on liquid or overnight instruments. When a fund holds 10–15% or more in cash, this difference quietly eats into overall returns, a phenomenon called cash drag. In a strong bull market, a fund sitting on excess cash will consistently lag its benchmark for reasons unrelated to stock selection.

Should you worry?

A cash level of 2–5% is common for many equity funds. A level of 10–15% or higher warrants a closer look. Check why: is it because the manager turned cautious, or because a large inflow is being deployed? If a fund has been sitting on high cash for several months without a market correction to justify it, and has underperformed its benchmark in the process, that is worth flagging. The factsheet cash levels, tracked over time, tell this story clearly.