MUTUAL FUNDS-AN INVESTMENT VEHICLE

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ABSTRACT

When the concept of companies initially formed, people who knew each other and were willing to take the risk of the venture used to put in the share capital of the company. Slowly, entrepreneurs realized that many are interested in investing financially in the company but do not want to take the day-to-day hassle of managing the company. Thus began the concept of passive investing in companies: with shareholders and executives separated. Similarly, in the case of mutual funds, people are not interested in the day-to-day management of the funds but are interested in the final outcome of the investment. Hence, they pool their money together, hire an investment manager who manages funds for them and expect to earn a return onthem.there aremany companies which are performimg investment of funds at large,medium and small level.

Introduction:-

Mutual funds are those that pool in money from thousands of small investors for investing in to securities, such as bonds, stocks, short-term debts and real estate. Anyone investing in the fund gets his/her shares of the total investment. The essential aspect of a **mutual fund** is that it provides access to markets that were previously only accessible to seasoned investors.

Mutual funds:-

A mutual fund is a company or trust that raises funds by selling fund shares or units to many investors. Mutual funds are managed by specialists who are equipped with tools for optimizing returns that are not available to the average investor. In exchange for this expertise, investors pay management fees.

Over 5,000 mutual funds are available in Canada. They're classified into more than 30 categories: bond funds, equity funds, sector funds, specialty funds, regional funds, diversified funds, balanced funds, index funds, etc. In short, the funds meet specific objectives and needs.

Mutual funds are also known as **mutual investment funds**. The official term, which is rarely used, is investment company In consideration of the money you place into the mutual fund, you receive units or shares that represent your share of the mutual fund’s assets. Ownership is in the form of shares if the mutual fund is set up as a business corporation, in which case it is referred to as an open-ended investment company. Ownership is in the form of units if the mutual fund is set up as a trust.2 For the sake of convenience, only the term “units” will be used in this brochure. In general, mutual funds offer units continually, which means that new investors can purchase them. Generally, existing investors can ask for their units to be redeemed at any time, and obtain the proceeds quickly. When you ask for your units to be redeemed, the amount you receive is based on their value, less any redemption fee.

History of mutual funds

Phase 1-1964-87:

in1963, UTI was set up by parliament under UTI act and given a monopoly.the first equity fund was launched in 1986

Phase 2-1987-9393 (entryof public sector funds)

non UTI, public sector mutual funds.

Like- SBI MUTUAL FUND,

LIC MUTUAL FUND

INDIAN BANK MUTUAL FUND

GCI MUTUAL FUND AND PNB MUTUAL FUND

Phase 3-1993-96(entry of private sector funds)

introducing private sector funds.as well as open-end funds

Phase-4-1996:

investor friendly regulatory measures action taken by SEBI to protect the investor,and to enhance investor's returns through tax benefits.

Structure of mutual funds in india

- Mutual funds in india follow a 3-tier structure
- The first tieris the sponsor who thinks of starting the fund.
- The second tier is the trustee.the trustees role is not to manage the money.their job is only to see,whether the money is being managed as per stated objectives.trustees may be seen as the internal regulators of a mutual fund.
- Trustee appoint the assets management company(AMC)who form the third tier,to manage investor's money.the AMCin return charges a fee for the services provide and this fee is born by the investors as it is deducted from the money collected from them

SPONSOR:-

- Any corporate body which initiates the launching of a mutual fund is referred to as "the sponsor"
- The sponsor is expected to have a sound track record and experience in financial services for a minimum period of 5 years and should ensure various formalities required in establishing a mutual fund.

- According to SEBI ,the sponsor should have professional competence,financial soundness and reputation for fairness and integrity.the sponsor contributes 40% of the net worth of the AMC.the sponsor appoints the trustee,the AMC and custodians in compliance with the regulations.

Need of mutual fund

- Mutual Funds are managed by investment professionals who posses sound financial expertise
- Mutual Funds lets you participate in a diversified portfolio of bluechip stocks with as little as Rs. 500 per month
- SEBI regulations have made the Mutual Funds Industry transparent. You can track your investments and mutual fund portfolio at ease from various research sources
- Due to variety of Mutual Funds available in the market, it provides diversification of your portfolio ————————————and helps reduce the underlying risk

Before choosing a mutual fund

Every investment decision requires a thorough understanding of your financial situation. Draw up your balance sheet, and make sure you have paid off your debts and set aside an emergency fund before you contemplate making an investment.

Then, determine your tolerance for risk and pinpoint your investment goals (buying a house, children's education, retirement, etc.). These steps will help you decide which funds match your needs.

You can also turn to a financial planner for help with your choices

Management fees

Mutual fund managers receive annual fees for their research, analysis, security selection and portfolio monitoring services. The fees represent a percentage of fund assets and generally vary between 1% and 3%.Among other things, the percentage depends on the complexity of the portfolio as well as the market in which the asset is invested. For example, management fees for an **equity fund** are higher than those of a **money market fund**.Also, among equity funds, specialized funds and international funds generally charge higher management fees than traditional Canadian or North American equity funds.With **index funds**, where the portfolio fully replicates the make-up of the benchmark index, management fees are lower. In fact, they are managed passively, that is, the manager does not do any research and does few transactions.

Mutual Fund Objectives

There are many different types of mutual funds, each with its own set of goals. The investment objective is the goal that the fund manager sets for the mutual fund when deciding which stocks and bonds should be in the fund's portfolio.

For example, an objective of a growth stock fund might be: This fund invests primarily in the equity markets with the objective of providing long-term capital appreciation towards meeting your long-term financial needs such as retirement or a child' s education.

Depending on investment objectives, funds can be broadly classified in the following 5 types:

- Aggressive growth means that you will be buying into stocks which have a chance for dramatic growth and may gain value rapidly. This type of investing carries a high element of risk with it since stocks with dramatic price appreciation potential often lose value quickly during downturns in the economy. It is a great option for investors who do not need their money within the next five years, but have a more long-term perspective. Do not choose this option when you are looking to conserve capital but rather when you can afford to potentially lose the value of your investment.

- As with aggressive growth, growth seeks to achieve high returns; however, the portfolios will consist of a mixture of large-, medium- and small-sized companies. The fund portfolio chooses to invest in stable, well established, blue-chip companies together with a small portion in small and new businesses. The fund manager will pick, growth stocks which will use their profits grow, rather than to pay out dividends. It is a medium - long-term commitment, however, looking at past figures, sticking to growth funds for the long-term will almost always benefit you. They will be relatively volatile over the years so you need to be able to assume some risk and be patient.

- A combination of growth and income funds, also known as balanced fun**ds**, are those that have a mix of goals. They seek to provide investors with current income while still offering the potential for growth. Some funds buy stocks and bonds so that the portfolio will generate income whilst still keeping ahead of inflation. They are able to achieve multiple objectives which may be exactly what you are looking for. Equities provide the growth potential, while the exposure to fixed income securities provide stability to the portfolio during volatile times in the equity markets. Growth and income funds have a low-to-moderate stability along with a moderate potential for current income and growth. You need to be able to assume some risk to be comfortable with this type of fund objective.

- That brings us to **income funds**. These funds will generally invest in a number of fixed-income securities. This will provide you with regular income. Retired investors could benefit from this type of fund because they would receive regular dividends. The fund manager will choose to buy debentures, company fixed deposits etc. in order to provide you with a steady income. Even though this is a stable option, it does not go without some risk. As interest-rates go up or down, the prices of income fund shares, particularly bonds, will move in the opposite direction. This makes income funds interest rate sensitive. Some conservative bond funds may not even be able to maintain your investments' buying power due to inflation.

- The most cautious investor should opt for the **money market mutual** fund which aims at maintaining capital preservation. The word preservation already indicates that gains will not be an option even though the interest rates given on money market mutual funds could be higher than that of bank deposits. These funds will pose very little risk but will also not protect your initial investments' buying power. Inflation will eat up the buying power over the years when your money is not keeping up with inflation rates. They are, however, highly liquid so you would always be able to alter your investment strategy

Types of mutual funds

(1)Based on the maturity period

- **Open-ended Fund**
  An open-ended fund is a fund that is available for subscription and can be redeemed on a continuous basis. It is available for subscription throughout the year and investors can buy and sell units at NAV related prices. These funds do not have a fixed maturity date. The key feature of an open-ended fund is liquidity.
- **Close-ended Fund**
  A close-ended fund is a fund that has a defined maturity period, e.g. 3-6 years. These funds are open for subscription for a specified period at the time of initial launch. These funds are listed on a recognized stock exchange.
- **Interval Funds**
  Interval funds combine the features of open-ended and close-ended funds. These funds may trade on stock exchanges and are open for sale or redemption at predetermined intervals on the prevailing NAV.

(2) Based on investment objectives

- **Equity/Growth Funds**
  Equity/Growth funds invest a major part of its corpus in stocks and the investment objective of these funds is long-term capital growth. When you buy shares of an equity

mutual fund, you effectively become a part owner of each of the securities in your fund's portfolio. Equity funds invest minimum 65% of its corpus in equity and equity related securities. These funds may invest in a wide range of industries or focus on one or more industry sectors. These types of funds are suitable for investors with a long-term outlook and higher risk appetite.

- **Debt/Income Funds**

  Debt/ Income funds generally invest in securities such as bonds, corporate debentures, government securities (gilts) and money market instruments. These funds invest minimum 65% of its corpus in fixed income securities. By investing in debt instruments, these funds provide low risk and stable income to investors with preservation of capital. These funds tend to be less volatile than equity funds and produce regular income. These funds are suitable for investors whose main objective is safety of capital with moderate growth.

- **Balanced Funds**

  Balanced funds invest in both equities and fixed income instruments in line with the pre-determined investment objective of the scheme. These funds provide both stability of returns and capital appreciation to investors. These funds with equal allocation to equities and fixed income securities are ideal for investors looking for a combination of income and moderate growth. They generally have an investment pattern of investing around 60% in Equity and 40% in Debt instruments.

- **Money Market/ Liquid Funds**

  Money market/ Liquid funds invest in safer short-term instruments such as Treasury Bills, Certificates of Deposit and Commercial Paper for a period of less than 91 days. The aim of Money Market /Liquid Funds is to provide easy liquidity, preservation of capital and moderate income. These funds are ideal for corporate and individual investors looking for moderate returns on their surplus funds.

- **Gilt Funds**

  Gilt funds invest exclusively in government securities. Although these funds carry no credit risk, they are associated with interest rate risk. These funds are safer as they invest in government securities.

- **Some of the common types of mutual funds and what they typically invest in:**

Type of fund	typical investment
1) Equity or growth fund	equities like stocks
2) Fixed income fund	fixed income securitieslike govt and corporate bonds
3) Money market fund	short-term fixed income securities like treasury bills
4) Balanced fund	a mix of equities and fixed income securities
5) Sector-specific fund	sectors like IT , pharma ,auto etc
Index fund	equities or fixed income secutities chosen to replicate a specific index for example S&p CNX nifty

(3) Other Schemes

- **Tax-Saving (Equity linked Savings Schemes) Funds**

  Tax-saving schemes offer tax rebates to investors under specific provisions of the Income Tax Act, 1961. These are growth-oriented schemes and invest primarily in equities. Like an equity scheme, they largely suit investors having a higher risk appetite and aim to generate capital appreciation over medium to long term.

- **Index Funds**

  Index schemes replicate the performance of a particular index such as the BSE Sensex or the S&P CNX Nifty. The portfolio of these schemes consist of only those stocks that represent the index and the weightage assigned to each stock is aligned to the stock's weightage in the index. Hence, the returns from these funds are more or less similar to those generated by the Index.

- **Sector-specific Funds**

  Sector-specific funds invest in the securities of only those sectors or industries as specified in the Scheme Information Document. The returns in these funds are dependent on the performance of the respective sector/industries for example FMCG, Pharma, IT, etc. The funds enable investors to diversify holdings among many companies within an industry. Sector funds are riskier as their performance is dependent on particular sectors although this also results in higher returns generated by these funds.

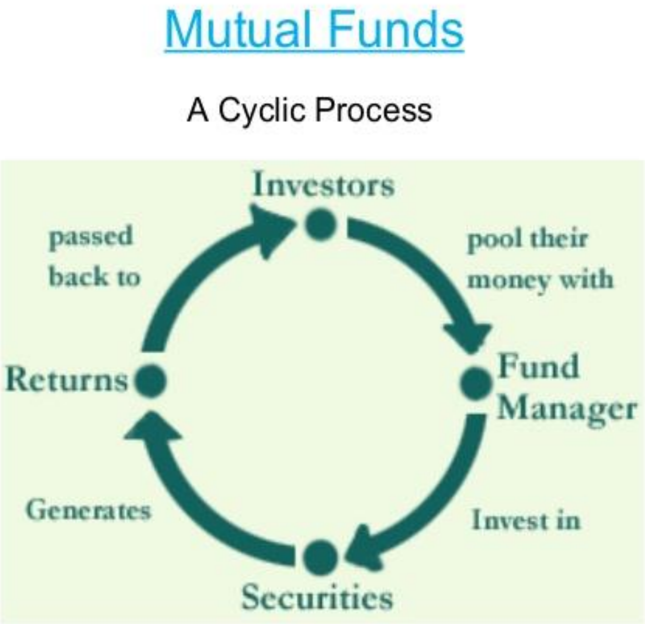
Top ranked mutual fund companies in india:-

Large cap

1)Birla sun life top 100(g)
2) BNP Paribas equaty fund (g)
3)SBI blue chip fund(g)
4)UTI equity fund (g)

Small & mid cap

1)can robeco emerg-equities (g)
2)UTI mid cap (g)
3)Reliance small cap fund(g)


Mutual Funds
A Cyclic Process
Investors
pool their money with
Fund Manager
Invest in
Securities
Generates
Returns
passed back to

ADVANTAGES:

-As an investor, you would like to get maximum returns on your investments, but you may not have the time to continuously study the stock market to keep track of them. You need a lot of time and knowledge to decide what to buy or when to sell. A lot of people take a chance and speculate, some get lucky, most don t. This is where mutual funds come in. Mutual funds offer you the following advantages :

- **Professional management.** Qualified professionals manage your money, but they are not alone. They have a research team that continuously analyses the performance and prospects of companies. They also select suitable investments to achieve the objectives of the scheme. It is a continuous process that takes time and expertise which will add value to your investment. Fund managers are in a better position to manage your investments and get higher returns.

- **Diversification.** The cliché, "don't put all your eggs in one basket" really applies to the concept of intelligent investing. Diversification lowers your risk of loss by spreading your money across various industries and geographic regions. It is a rare occasion when all stocks decline at the same time and in the same proportion. Sector funds spread your investment across only one industry so they are less diversified and therefore generally more volatile.

- **More choice.** Mutual funds offer a variety of schemes that will suit your needs over a lifetime. When you enter a new stage in your life, all you need to do is sit down with your financial advisor who will help you to rearrange your portfolio to suit your altered lifestyle.

- **Affordability.** As a small investor, you may find that it is not possible to buy shares of larger corporations. Mutual funds generally buy and sell securities in large volumes which allow investors to benefit from lower trading costs. The smallest investor can get started on mutual funds because of the minimal investment requirements. You can invest with a minimum of Rs.500 in a Systematic Investment Plan on a regular basis.

- **Tax benefits.** Investments held by investors for a period of 12 months or more qualify for capital gains and will be taxed accordingly. These investments also get the benefit of indexation.

- **Liquidity.** With open-end funds, you can redeem all or part of your investment any time you wish and receive the current value of the shares. Funds are more liquid than most investments in shares, deposits and bonds. Moreover, the process is standardised, making it quick and efficient so that you can get your cash in hand as soon as possible.

- **Rupee-cost averaging.** With rupee-cost averaging, you invest a specific rupee amount at regular intervals regardless of the investment's unit price. As a result, your money buys more units when the price is low and fewer units when the price is high, which can mean a lower average cost per unit over time. Rupee-cost averaging allows you to discipline yourself by investing every month or quarter rather than making sporadic investments.

- **Transparency.** The performance of a mutual fund is reviewed by various publications and rating agencies, making it easy for investors to compare fund to another. As a unitholder, you are provided with regular updates, for example daily NAVs, as well as information on the fund's holdings and the fund manager's strategy.
- **Regulations.** All mutual funds are required to register with SEBI (Securities Exchange Board of India). They are obliged to follow strict regulations designed to protect investors. All operations are also regularly monitored by the SEBI.

DISADVANTAGES :-

- **No Insurance**: Mutual funds, although regulated by the government, are not insured against losses. The Federal Deposit Insurance Corporation (FDIC) only insures against certain losses at banks, credit unions, and savings and loans, not mutual funds. That means that despite the risk-reducing diversification benefits provided by mutual funds, losses can occur, and it is possible (although extremely unlikely) that you could even lose your entire investment.

- **Dilution**: Although diversification reduces the amount of risk involved in investing in mutual funds, it can also be a disadvantage due to dilution. For example, if a single security held by a mutual fund doubles in value, the mutual fund itself would not double in value because that security is only one small part of the fund’s holdings. By holding a large number of different investments, mutual funds tend to do neither exceptionally well nor exceptionally poorly.

- **Fees and Expenses**: Most mutual funds charge management and operating fees. that pay for the fund’s management expenses (usually around 1.0% to 1.5% per year for actively managed funds). In addition, some mutual funds charge high sales commissions, 12b-1 fees, and redemption fees. And some funds buy and trade shares so often that the transaction costs add up significantly. Some of these expenses are charged on an ongoing basis, unlike stock investments, for which a commission is paid only when you buy and sell .

- **Poor Performance**: Returns on a mutual fund are by no means guaranteed. In fact, on average, around 75% of all mutual funds fail to beat the major market indexes, like the S&P 500, and a growing number of critics now question whether or not professional money managers have better stock-picking capabilities than the average investor.

- **Loss of Control**: The managers of mutual funds make all of the decisions about which securities to buy and sell and when to do so. This can make it difficult for you when trying to manage your portfolio. For example, the tax consequences of a decision by the manager to buy or sell an asset at a certain time might not be optimal for you. You also should remember that you are trusting someone else with your money when you invest in a mutual fund.

- **Trading Limitations**: Although mutual funds are highly liquid in general, most mutual funds (called open-ended funds) cannot be bought or sold in the middle of the trading day. You can only buy and sell them at the end of the day, after they've calculated the current value of their holdings.

- **Size**: Some mutual funds are too big to find enough good investments. This is especially true of funds that focus on small companies, given that there are strict rules about how much of a single company a fund may own. If a mutual fund has $5 billion to invest and is only able to invest an average of $50 million in each, then it needs to find at least 100 such companies to invest in; as a result, the fund might be forced to lower its standards when selecting companies to invest in.

- **Inefficiency of Cash Reserves**: Mutual funds usually maintain large cash reserves as protection against a large number of simultaneous withdrawals. Although this provides investors with liquidity, it means that some of the fund's money is invested in cash instead of assets, which tends to lower the investor's potential return.

- **Too Many Choices**: The advantages and disadvantages listed above apply to mutual funds in general. However, there are over 10000 mutual funds in operation. and these funds vary greatly according to investment objective, size, strategy, and style. Mutual funds are available for virtually every investment strategy (e.g. value, growth), every sector (e.g. biotech, internet), and every country or region of the world. So even the process of selecting a fund can be tedious.

Evaluation of mutualfunds:

- ✓ It is essential that the performance of mutual fund is evaluated and appraised.such appraisal helps the fund to compare itself with other funds besides being a potential source of information to the present and prospective investors
- ✓ Evaluation includes simple evaluation tools to sophisticated models which take into consideration the risk and uncertainty associated with the returns.some of the models used are treynor’s model and sharpe’s model
- ✓ **Sharpe’s performance index:-** it offers a single value for performance ranking of different fund or portfolio in terms of its total risk.
- ✓ Sharpe’s index= (average portfolio return – risk free rate of return) /standard deviation of portfolio

- ✓ **Treynor’s performance index:**

Here the fund’sperformance is measuredagainst the market performance.it is usedto calculate return per unit of marketrisk.
Treynor’s index= (average portfolio return – risk free rate of return) market risk of portfolio

Conlusion:-

The mutual fund industry poised to enter a phase of consolidation because of

1) redemption pressures
2) lack of new issuances
3) sinking stock markets

Mutual funds are really a boom for small and medium investor by their services. And differentiations in their verity on the basis of investor need make mutual funds a basket with full of facilities plus income plus security.

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