# UNIT-V

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# INTRODUCTION

Mutual fund is a professionally managed, collective investment choice which pools money from many investors to purchase securities.

# Definition

- A trust that pools the savings of investors who share a common financial goal is known as mutual fund. The money collected is then invested in financial instruments such as shares, debentures and other securities the income and capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them.
- Investment in securities are spread over a wide cross section of industries and sectors reducing the risk of the portfolio.
- Mutual funds are mobilizers of saving of the small investors in instruments like stock and money market instruments.
- Mutual funds are corporation that accept money from investors and use this money to buy stocks, long term bonds, short term debt instruments issued by businesses or Govt.

# Features

- Mobilizing small savings: mutual funds mobilize funds by selling their own shares known as units. This gives the benefit of convenience and satisfaction of owning shares in many industries. Mutual fund invest in various securities and pass on the returns to the investors.
- Investment Avenue: the basic characteristic of a mutual fund is that it provides an ideal avenue for investment for investors and enables them to earn a reasonable return with better liquidity. It offers investors a proportionate claim on the portfolio of assets that fluctuate in value.
- Professional management: mutual fund provides investors with the benefit of professional and expert management of their funds. Mutual fund employees professionals/experts who manage the investment portfolios efficiently and profitably. Investors are relieved from the responsibility of following the markets on a regular basis.

- Diversified investment: mutual fund have the advantage of diversified investment of funds in various industries and sectors. This is beneficial to small investors who cannot afford to buy shares of established companies at high prices. Mutual fund allow millions of investors who have investments in variety of securities of different companies.
- Better liquidity: mutual fund have the distinct advantage of better liquidity of investment. There is always a market available for mutual funds. In case of mutual funds it is obligatory that units are listed and traded thus offering our secondary markets for the funds. A high level of liquidity is possible for the fund holders because of more liquid securities in the mutual fund portfolio.
- Reduced risks: the risk on mutual fund is minimum. This is because of expert management diversification , liquidity and economies of scale in transaction cost.

- Investment protection: mutual funds are regulated by guidelines and legislative provisions put in place by regulatory agencies such as SEBI in order protect the investor interest the mutual funds are obligated to follow the provisions laid down by the regulators.
- Switching facility: mutual funds provide investors with the flexibility to switch from one scheme to another, this flexibility enables investors to switch from income scheme to growth scheme and from close ended scheme to open ended scheme.
- Tax benefits: mutual funds offer tax shelter to the investors by investing in various tax saving schemes under the provisions provided by the income tax act.
- Low transaction cost: the cost of purchase and sale of MF's is relatively lower.

- Economic development: MF's contribute to economic development by mobilizing savings and channelizing them to more productive sectors of the economy.
- Convenience: MF units can be traded easily with little or no transaction cost.

# Mutual Fund Set Up

A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company (AMC) and custodian. The trust is established by a **sponsor.**

**Asset Management Company (AMC)** approved by SEBI manages the funds by making investments in various types of securities.

**Custodian,** who is registered with SEBI, holds the securities of various schemes of the fund in its custody.

The **trustees** monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors.

Also, 50% of the directors of AMC must be independent.

All mutual funds are required to be registered with SEBI before they launch any scheme.

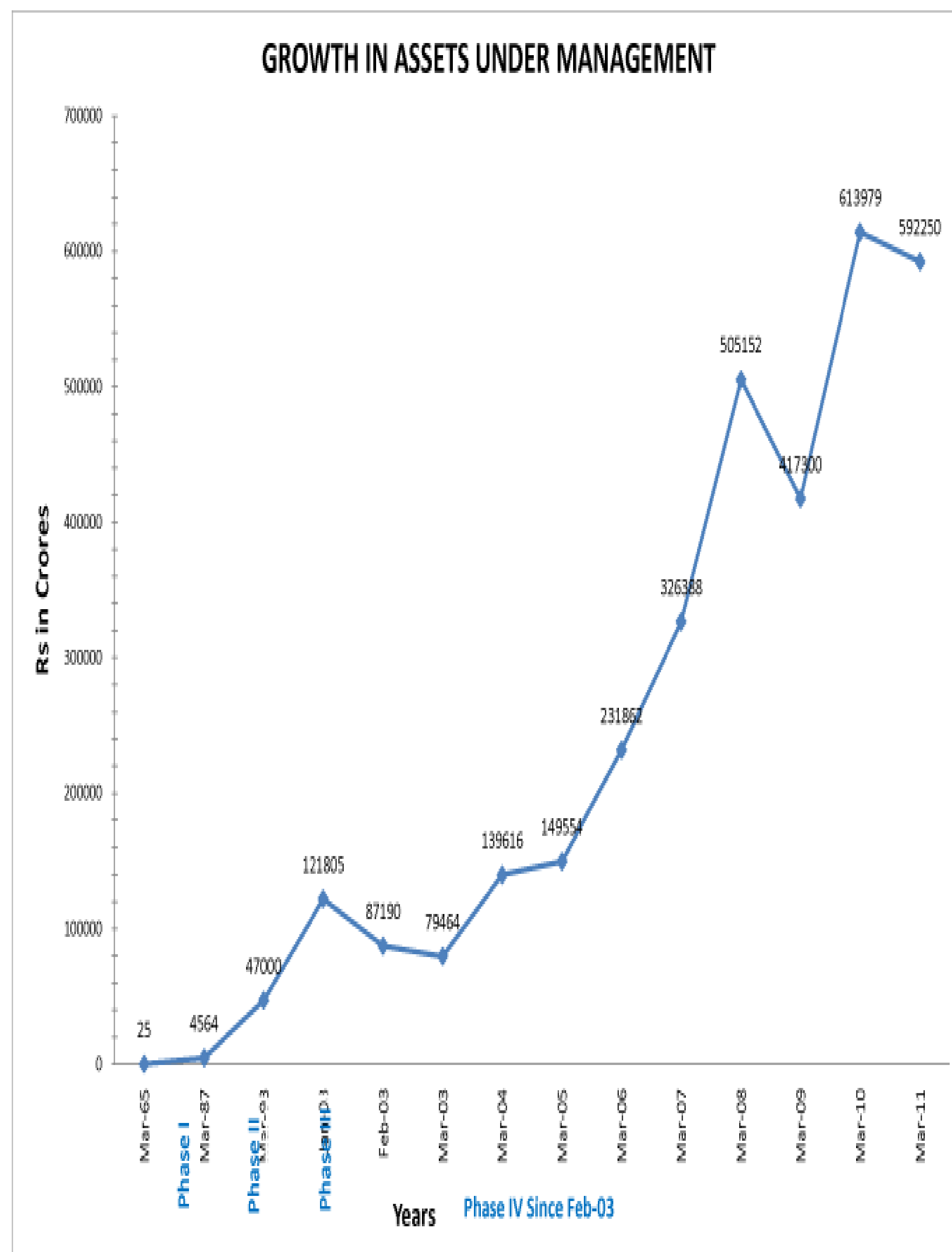
# HISTORY

**First Phase – 1964-87** Unit Trust of India (UTI) was established on 1963 by an Act of Parliament.

**Second Phase – 1987-1993 (Entry of Public Sector)**

**Third Phase – 1993-2003 (Entry of Private Sector Funds)**

**Fourth Phase – since February 2003**



# NAV-Net Asset Value

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV).

**NAV= Mrkt Value of the Fund's investment + other Current Assets + Deposits – All CurrentLiabilities except Unit Capital, Reserves & P &L Account**

**No. of Units Outstanding**

# Types of Schemes

**Schemes according to Maturity Period:**

**Open-ended Fund/ Scheme**

- An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis.
- Do not have a fixed maturity period.
- The key feature of open-end schemes is liquidity.

**Close-ended Fund/ Scheme**

- A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years.
- The fund is open for subscription only during a specified period at the time of launch of the scheme.

# Schemes according to Investment Objective:

- **Growth / Equity Oriented Scheme**

  Provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Have comparatively high risks.

- **Income / Debt Oriented Scheme**

  Provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments.

- **Balanced Fund**

  Provide both growth and regular income as such. Invest both in equities and fixed income securities in the proportion indicated in their offer documents.

- **Money Market or Liquid Fund**

  These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income.

- **Gilt Fund**

  These funds invest exclusively in government securities.

- **Index Funds**

  Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc

# Advantages

Advantages of Mutual Funds

- Liquidity
- Diversification
- Expert Management
- Less cost for bulk transactions
- Cost-efficiency
- Automated payments
- Suit your financial goals
- Quick & painless process
- Tax-efficiency
- Invest in smaller denominations
- Safety
- Systematic or one-time investment

**a. Liquidity**

- Unless you opt for close-ended mutual funds, it is relatively easier to buy and exit a scheme. You can sell your units at any point (when the market is high). Do keep an eye on surprises like exit load or pre-exit penalty. Remember, mutual fund transactions happen only once a day after the fund house releases that day’s NAV.

**b. Diversification**

- Mutual funds have their own share of risks as their performance is based on the market movement. Hence, the fund manager always invests in more than one asset class (equities, debts, money market instruments etc.) to spread the risks. It is called diversification. This way, when one asset class doesn’t perform, the other can compensate with higher returns to avoid the loss for investors.

**c. Expert Management**

- Mutual fund is favored because it doesn't require the investors to do the research and asset allocation. A fund manager takes care of it all and makes decisions on what to do with your investment. He/she decides whether to invest in equities or debt. He/she also decide on whether to hold them or not and for how long.

**d. Less cost for bulk transactions**

- One must have noticed how price drops with increased volume, when you buy any product. The same logic applies to mutual fund units as well. If one buys multiple units at a time, the processing fees and other commission charges will be less compared to when you buy one unit.

**e. Invest in smaller denominations**

- By investing in smaller denominations (SIP), one gets exposure to the entire stock (or any other asset class). This reduces the average transactional expenses – one benefits from the market lows and highs. Regular (monthly or quarterly) investments as opposed to lumpsum investments gives one the benefit of rupee-cost averaging.

**f. Suit your financial goals**

- There are several types of mutual funds available in India catering to investors from all walks of life. It is easy to find a mutual fund that matches one's income, expenditures, investment goals and risk appetite.

**g. Cost-efficiency**

- One has the option to pick zero-load mutual funds with less expense ratios. One can check the expense ratio of different mutual funds and choose one that fits in your budget and financial goals. Expense ratio is the fee for managing your fund. It is a useful tool to assess a mutual fund's performance.

**h. Quick & painless process**

- One can start with one mutual fund and slowly diversify. These days it is easier to identify and handpick fund(s) most suitable for one. Maintaining and regulating the funds too will take no extra effort from one's side. The fund manager with the help of his team of will decide when, where and how to invest. In short, their job is to consistently beat the benchmark and deliver one maximum returns.

**i. Tax-efficiency**

- One can invest up to Rs. 1.5 lakhs in tax-saving mutual funds mentioned under 80C tax deductions. ELSS is an example for that. Though a 10% Long Term Capital Gains (LTCG) is applicable for returns in excess of Rs 1 Lakh after one year, they have consistently delivered higher returns than other tax-saving instruments like FD in the recent years.

**j. Automated payments**

- It is common to forget or delay SIPs or prompt lumpsum investments due to any given reason. Onecan opt for paperless automation with the fund house or agent. Timely email and SMS notifications help to counter this kind of negligence.

**k. Safety**

- There is a general notion that mutual funds are not as safe as bank products. This is a myth as fund houses are strictly under the purview of statutory government bodies like SEBI and AMFI. One can easily verify the credentials of the fund house and the asset manager from SEBI. They also have an impartial grievance redressal platform that work in the interest of investors.

**l. Systematic or one-time investment**

- One can plan the mutual fund investment as per the budget and convenience. For instance, starting an SIP (Systematic Investment Plan) on a monthly or quarterly basis suits investors with less money. On the other hand, if one has surplus amount, then one can go for a one-time lump sum investment.