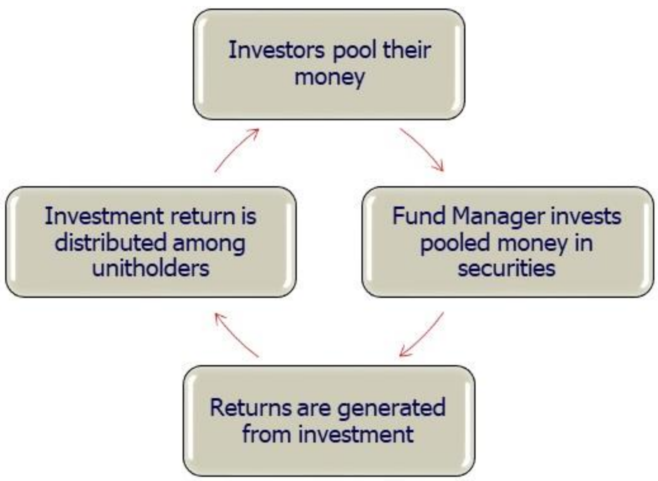
Introduction to Mutual Funds

Module 2

2.1 What are Mutual funds?

A mutual fund is an investment vehicle that collects money from various investors which then pool the money and is accessible to the managers of the fund. The money is then invested by their pre-defined objectives in different asset classes. The return that is generated from the investments are then distributed among investors based on the proportion of the amount invested by them.



Have you ever looked at the details of your mutual fund investment? Did you ever wonder what is the expense ratio? The expense ratio will be deducted from return before the fund distributes it among investors. If the return for an investment was 12% and the mutual fund has an expense ratio of 0.4% then the return investors would be 11.6%.

A mutual fund is the easiest and most commonly used method by investors to manage their funds professionally by paying a fee in the form of management expenses. This is similar to availing the services of a specialized doctor by paying consultation fees for helping manage one’s health.

2.2 Mutual Fund Hatke Hai

If you have watched ads on the television you must have heard the advertisements promoting Mutual Funds. Do you remember it?

Mutual Funds Sahi Hai!

Now that we know what are mutual funds what they do, why don't we look at why they might be the right investment tool for anyone.

Mutual funds have numerous advantages, some of which are listed below:

1. Professionally managed: All mutual fund schemes are managed professionally by qualified fund managers who have specialised knowledge and skill sets to manage your money. This enhances the probability of better management of your money. Why risk your money take the trouble to do it yourself when someone more qualified than you is willing to do it?

2. Investments can start with as little as Rs. 100: Many-a-times, investing a big sum may be a concern for investors. But in case of mutual funds, you can start an investment from as low as Rs.100 per month through some schemes. In case of lumpsum investments, some funds offer a minimum investment of Rs. 500. Usually, most funds offer a Systematic Investment Plan (SIP) with a minimum of Rs. 500 and lumpsum investment of Rs. 5,000.

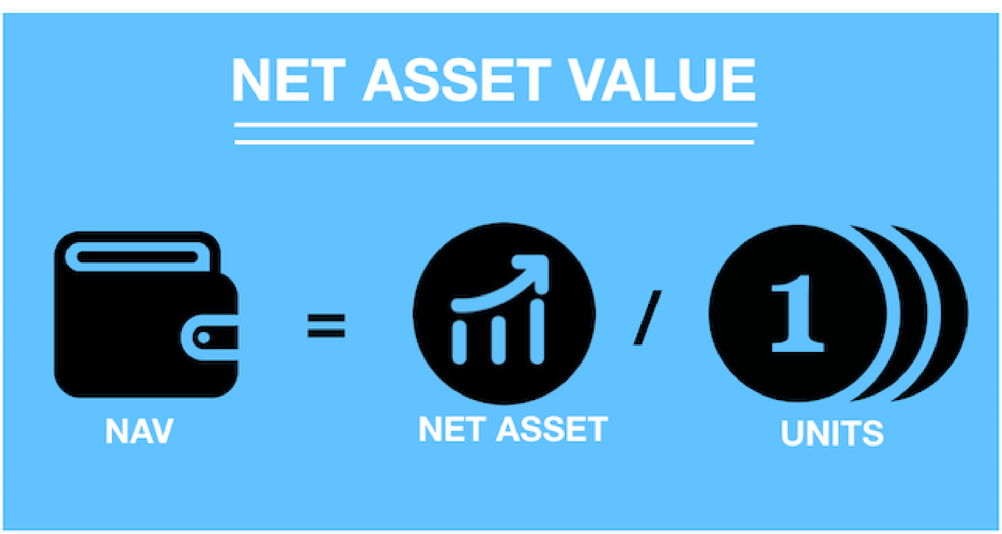
3. Helps in portfolio diversification: Diversification of the portfolio is a key component to reduce risk. Often, investors are unable to create a diversified portfolio despite knowing its importance. In mutual funds, whatever you invest - even a small amount of Rs. 500 - will have a diversified portfolio as the mutual fund managers would invest in a many different assets considering diversification in mind.

4. Highly liquid: Most short-term debt mutual funds don't have any lock-in period and provide returns on par with band Fixed Deposits (FD) which makes it easy for you to withdraw funds anytime as per your need. Equity Mutual funds tend to have a lock-in period from 6 months to a year. You could still withdraw your money from the fund anytime you want for a small fee.

5. Low fund management expenses: Due to the unique structure of mutual funds, the cost of managing the fund is distributed among all unitholders which makes mutual funds affordable to investors in terms of cost. SEBI has also placed a cap on the expenses of a fund which mandates that the expense be in proportion with Asset Under Management (AUM) slab. Higher the AUM, lesser would be the expenses. The fund can charge up to 2.5% of AUM p.a. as expenses. This is the power of large numbers, everyone would share the costs and losses, but would share the profits too!

6. Ease of purchase and redemption: All mutual fund schemes can be purchased and sold through various channels. Majority of the banks, broking houses, wealth management companies, and fintech companies offer both online and offline transaction facilities. There are a number of apps available in the market as well which facilitate mutual fund transactions.

7. Transparency and easy access to track fund value: All mutual funds offer full transparency related to their portfolio, expenses, Net Asset Value (NAV), etc. SEBI has made stringent guidelines in relation to these disclosures and all mutual fund companies comply with it. The NAV of the funds is declared daily which makes it easy for investors to track their fund value and performance. You can also find mutual fund holdings in the factsheet of the mutual fund scheme, which is updated every month. So, you can track how your fund doing compared to other funds. With the ease of liquidity provided you could withdraw and change funds when you think its necessary.



8. Variety of schemes to invest as per needs and goals: There are more than 1,800 mutual fund schemes with different investment objectives that suit the needs of every individual. You can conveniently choose a suitable scheme as per your risk appetite, financial goal, and time horizon.

9. Low risk compared to direct investments in securities: All mutual funds offer diversification benefits that make them less risky in comparison to investment in direct shares. As these funds are managed by experts, they are in a position to take timely action as per market conditions and safeguard the interest of investors.

10. Regulated by SEBI: Mutual funds are regulated by the strong regulatory body, SEBI. On a time to time basis, SEBI creates norms to protect the interests of investors in these funds. Due to the a very stringent regulatory environment, investors feel confident about mutual fund investments.

11. Tax saving benefits: We can invest and save on tax paid? Yes we can, some mutual funds schemes offer tax benefits under Section 80 C of the Income Tax Act. Equity Linked Saving Schemes (ELSS), popularly known as tax saver funds offer good investment options under Section 80C along with good returns and shorter lock-in periods of around 3 years.

12. Flexibility to switch from one fund to another: One has the flexibility to switch from one scheme to another scheme of the same mutual fund house. Assume that you have invested in equity schemes. At any point, if you think that the market is overheated and you want to keep your money safe, you can easily switch to a debt fund offered by the same AMC. You can also use the Systematic Transfer Plan (STP) to systematically switch from one scheme to another instead of shifting all your units at once.

13. Multiple investment options - Lumpsum or installments (SIP): It is not necessary to invest a lumpsum amount in a mutual fund. You can choose the investment frequency as per your cash flow cycle and even a preferred date each month for making an investment. In case of an installment option, most mutual fund distributors offer the flexibility to stop or pause your investment if you have a shortage of funds during the investment period.