7 Mutual Funds

7.1 Regulatory body for mutual funds

⇒ SEBI (Securities and Exchange Board of India) regulates all mutual funds.

⇒ All mutual funds must register with SEBI

7.1.1 What are mutual funds?

⇒ Investors pool money to invest with a common financial goal.

⇒ Managed by Asset Management Companies (AMC)

⇒ Fund manager invests in stocks, bonds, money market instruments etc

⇒ Diversification across sectors reduces risk

⇒ Investors receive units based on their

⇒ Gains /losses are shared proportionately

Concept Summary

• Pool money → Buy units → Fund manager invests → Gains / losses shared → Diversified portfolio

7.1.2 Benefits of mutual funds

⇒ Small investments possible
⇒ Professional management by experts
⇒ Risk diversification across many sectors
⇒ Transparency via regular disclosures and NAV updates
⇒ Wide choice of schemes for different risk / return profile
⇒ Regulated by SEBI, ensuring investor protection

7.2 NAV (Net Asset Value)

⇒ $\dfrac{\text{(Total assets - liabilities)}}{\text{Number of outstanding units}}$ → Net value of assets
⇒ Basis for buying and selling units
⇒ Open-ended fund → NAV declared daily
⇒ Closed-ended fund → NAV declared weekly

7.3 Risks in mutual funds

⇒ Market risk - Overall market fall affects portfolio value

⇒ Non market risk - Company / sector specific problems

⇒ Interest rate risk - Bond prices fall when interest rates rise

⇒ Credit risk - Company may default on its debt obligations

7.4 Types of Mutual Funds

Based on Objective:

⇒ Equity Funds:

→ Invest in shares; high return potential; long-term

→ Types: Large cap fund, Mid cap fund, small cap fund, Specific sector fund, Equity Linked Saving scheme.

⇒ Debt / Income funds

→ Invest in bonds, debentures, govt securities

→ Suitable for low-risk, stable income

⇒ Hybrid Funds

→ Mix of equity funds + debt/income funds

→ Balanced risk + steady return

⇒ Solution Oriented Funds

→ For goals like retirement, child education

⇒ Others

→ Index funds, international fund, fund of funds

Index funds

⇒ Replicate market index (eg Nifty 50)

⇒ Objective: match market returns, not beat them

Based on Flexibility

1. Open ended funds

⇒ Buy / sell anytime

⇒ Their prices are linked to daily net asset value

⇒ Highly liquid

2. Close ended funds

⇒ Entry only during Initial Public Offer (IPO)

⇒ Fixed date of redemption

⇒ Generally traded at a discount to NAV; discounts narrows as maturity nears

⇒ Traded on stock exchanges

⇒ Redeemable only on maturity

7.5 Investment Plans in Mutual Funds

1. Growth Plan

Returns reinvested → capital appreciation

2. ICDW (Income Distribution Cum Capital Withdrawal)

a. Payout of ICDW option - Dividend is paid out

b. Reinvestment of ICDW option - Dividend is reinvested to buy more units

7.6 Rights of a mutual fund investor

⇒ Receive unit statements within 6 weeks

⇒ Get information on investment policies, investment objectives, financial position and general affairs on the scheme

⇒ Receive dividends within 30 days of declaration

⇒ Redemption / repurchase within 10 days

⇒ Must be informed of adverse events affecting investments

⇒ ~~70~~ 75% of unitholders can:

→ replace AMC

→ Wind up the scheme

⇒ Can complain to SEBI to resolution

7.7 Fund Offer Document

Contains complete information about a scheme

⇒ Investment objectives

⇒ Risk factors and special considerations

⇒ Summary of expenses

⇒ Constitution of the funds

⇒ How to invest

⇒ Organisation and capital structure

⇒ Tax provisions

⇒ Finacial details

⇒ Includes:

→ Scheme Information Document (SID)

→ Scheme of Additional Information (SAI)

→ Key Information Memorandum (KIM)

7.8 Active vs Passive Fund Management

Active Fund Management

⇒ Fund manager actively selects investment

⇒ Two styles:

i] Growth Investing → Invest in high-growth potential companies

ii] Value Investing → Invest in unvalued stocks

Passive Fund Management :

⇒ Replicates a market index (Index funds)

⇒ No stock selection by manager

⇒ Lower cost, lower risk of wrong decision

⇒ Broad diversification, low expense ratio

7.9 Exchange Traded Fund (ETF)

⇒ Similar to index fund but trades like a stock

⇒ Like Index funds, an ETF represents a basket of stocks, reflects an index such as the NIFTY.

⇒ Isn't mutual fund; trades just like any other company on a stock exchange

⇒ Prices changes throughout the day

⇒ Lower expense ratio

⇒ Offer : diversification + flexibility

7.10 SIP, SWP, STP

⇒ Systematic Investment Plans: Invest fixed amount periodically (eg: monthly)

⇒ Systematic Withdrawal Plans: Withdraw fixed amount perodically

⇒ Systematic Transfer Plans: Transfer money periodically from one fund to another (Same AMC)