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Emerging Opportunities in Mutual Funds

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ABSTRACT

A mutual fund is an entity that pools the money of many investors its unit holders to invest in different securities. Investments may be in shares, debt securities, money market securities or a combination of these. Every mutual fund launches different scheme, each with a specific objective. A growth mutual fund simply wants his assets to appreciate over time. Growth mutual funds are generally invested primarily in the stock market and include stock market sectors from small to large cap. In this paper mostly discuss the recent opportunities in mutual funds in India.

1. INTRODUCTION

Mutual funds are in the form of trust usually called Asset Management Company that manages the pool of money collected from various investors for investment in various classes of assets to achieve certain financial goals. We can say that mutual funds is trusts which pool the savings of large number of investors and then reinvests those funds for earning profits and then distribute the dividend among the investors. Every mutual fund/launches different scheme, each with a specific objective. Investors who share the same objectives invest in that particular scheme. Each mutual fund scheme is managed by a fund manager with the help of his team of professionals.

INVEST THROUGH MUTUAL FUNDS

A mutual fund is an entity that pools the money of many investors its unit holders to invest in different securities. Investments may be in shares, debt securities, money market securities or a combination of these. Securities are professionally managed on behalf of the unit-holders, and each investor holds a pro-rata share of the portfolio i.e. entitled to any profits when the securities are sold, but subject to any losses in value as well.

PROFESSIONAL INVESTMENT MANAGEMENT

Funds can afford to do so as they manage large pools of money. The managers have real-time access to crucial market information and are able to execute trades on the largest and most cost-effective scale.

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DIVERSIFICATION

Mutual funds invest in a broad range of securities. Investment risk by reducing the effect of a possible decline in the value of any one security. Mutual fund unit-holders can benefit from diversification techniques usually available only to investors wealthy enough to buy significant positions in a wide variety of securities.

PERSONAL SERVICE

One call puts you in touch with a specialist who can provide you with information you can use to make own investment choices. They will provide personal assistance in buying and selling your fund units, provide fund information and answer questions about your account status.

LIQUIDITY

In open-ended schemes, you can get your money back promptly at net asset value related prices from the mutual fund itself.

TRANSPARENCY

In regular information on the value of your investment in addition to disclosure on the specific investments made by the mutual fund scheme. When considering investment opportunities, the first challenge that almost every investor faces is a plethora of options. From stocks, bonds, shares money market securities, to the right combination of two or more of these, however, every option presents its own set of challenges and benefits. Mutual funds allow investors to pool in their money for a diversified selection of securities, managed by a professional fund manager. It offers an array of innovative products like fund of funds, exchange-traded funds, Fixed Maturity Plans and many more.

OVERCOME

Mutual Funds help investors generate better inflation-adjusted returns, without spending a lot of time and energy on it. While most people consider letting their savings 'grow' in a bank, they don't consider that inflation may be nibbling away its value.

EXPERT MANAGERS

Backed by a dedicated research team, investors are provided with the services of an experienced fund manager who handles the financial decisions based on the performance and prospects available in the market to achieve the objectives of the mutual fund scheme.

CONVENIENCE

Mutual funds are an ideal investment option when you are looking at convenience and timesaving opportunity. With low investment amount alternatives, the ability to buy or sell them on any business day and a multitude of choices based on an individual's goal and

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investment need, investors are free to pursue their course of life while their investments earn for them.

DIVERSIFICATION

Going by the adage, 'Do not put all your eggs in one basket', mutual funds help mitigate risks to a large extent by distributing your investment across a diverse range of assets. Mutual funds offer a great investment opportunity to investors who have a limited investment capital.

HIGHER RETURN POTENTIAL

Based on medium or long-term investment, mutual funds have the potential to generate a higher return, as you can invest on a diverse range of sectors and industries.

TYPES OF FUNDS

No matter what type of investor you are, there is bound to be a mutual fund that fits your style. According to the last count there are more than 10,000 mutual funds in North America! That means there are more mutual funds than stocks. It's important to understand that each mutual fund has different risks and rewards. In general, the higher the potential return, the higher the risk of loss. Although some funds are less risky than others, all funds have some level of risk - it's never possible to diversify away all risk. This is a fact for all investments.

Each fund has a predetermined investment objective that tailors the fund's assets, regions of investments and investment strategies. At the fundamental level, there are three varieties of mutual funds.

1) Equity funds(stocks)
2) Fixed-income funds(bonds)
3) Money market funds

All mutual funds are variations of these three asset classes. For example, while equity funds that invest in fast-growing companies are known as growth funds, equity funds that invest only in companies of the same sector or region are known as specialty funds.

MONEY MARKET FUNDS

The money market consists of short-term debt instruments, mostly Treasury bills. This is a safe place to park your money. You won't get great returns, but you won't have to worry about losing your principal. A typical return is twice the amount you would earn in a regular checking/savings account and a little less than the average certificate of deposit (CD).

BOND/INCOME FUNDS

Income funds are named appropriately: their purpose is to provide current income on a steady basis. When referring to mutual funds, the terms "fixed-income," "bond," and "income" are synonymous. These terms denote funds that invest primarily in government and corporate debt.

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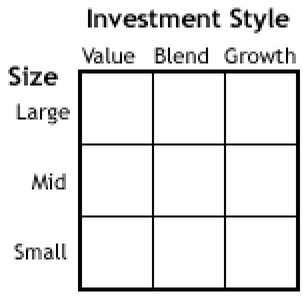
While fund holdings may appreciate in value, the primary objective of these funds is to provide a steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees.

BALANCE FUNDS

The objective of these funds is to provide a balanced mixture of safety, income and capital appreciation. The strategy of balanced funds is to invest in a combination of fixed income and equities. A typical balanced fund might have a weighting of 60% equity and 40% fixed income. The weighting might also be restricted to a specified maximum or minimum for each asset class.

EQUITY FUNDS

Funds that invest in stocks represent the largest category of mutual funds. Generally, the investment objective of this class of funds is long-term capital growth with some income. There are, however, many different types of equity funds because there are many different types of equities. A great way to understand the universe of equity funds is to use a style box, an example of which is below.



The idea is to classify funds based on both the size of the companies invested in and the investment style of the manager. The term value refers to a style of investing that looks for high quality companies that are out of favor with the market. These companies are characterized by low P/E and price-to-book ratios and high dividend yields. The opposite of value is growth, which refers to companies that have has strong growth in earnings, sales and cash flow. A compromise between value and growth is blend, which simply refers to companies that are neither value nor growth stocks and are classified as being somewhere in the middle.

GLOBAL/INTERNATIONAL FUNDS

It's tough to classify these funds as either riskier or safer than domestic investments. They do tend to be more volatile and have unique country and/or political risks. But, on the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification..

2. OBJECTIVES OF MUTUAL FUND

GROWTH MUTUAL FUNDS

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Probably the most common mutual fund objective is investing for growth. What investor doesn't want growth right? Even income investors want growth. A growth mutual fund simply wants his assets to appreciate over time. Growth mutual funds are generally invested primarily in the stock market and include stock market sectors from small to large cap.

INCOME MUTUAL FUNDS

The second more common mutual fund objective is investing for income. Many investors – typically those who are older and looking for cash flow to supplement their income – want an income distribution from their investment. Income mutual funds typically will distribute cash payments based on how many shares you own every month and the income generally varies over time. Most income mutual funds will invest in all types of bonds as well as some high quality dividend paying stocks and hybrids like preferred stocks.

SOCIALLY RESPONSIBLE MUTUAL FUNDS

Some investors prefer to invest with social responsibility as their focus. There are various types of socially responsible mutual funds. A socially responsible mutual fund will either invest FOR an objective or AGAINST an objective (avoiding alcohol, tobacco and firearms).

SECTOR MUTUAL FUNDS

Some mutual funds will invest only in a specific sector, such as biotechnology or healthcare. This provides them exposure to advances in smaller sections of the economy, such as when money floods into technology sectors due to the advent of a faster computer chip or more stable programming platform.

LIMITATIONS OF A MUTUAL FUND

Mutual fund also has some disadvantages. Some of the disadvantages of mutual funds are the following:

MUTUAL FUNDS ARE NOT CUSTOMIZED PORTFOLIOS

Mutual funds are like pre-plated meals; there is no customized assembling of the meal by the customer. Mutual funds are standard products, managed centrally, offering significant advantages to investors who are not equipped to make complex investment choices. Investors do not exercise any direct control on how the portfolio is managed, but participate equity in it.

NO DIRECT CONTROL OVER COSTS

Investors are a mutual fund participates in the pool of the funds, according to the proportion they have contributed. The costs for managing the fund are centrally incurred and apportioned to every unit. Investors cannot directly determine what costs can be incurred and how it would be apportioned. SEBI has however, imposed limits on the amount and type of a cost a mutual fund can incur.

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MUTUAL FUND OFFER TOO MANY PRODUCT VARIANTS

To the investor, making a choice among many funds becomes tough when so many variants of the same product are available in the market. Mutual funds try to vary their products, even if slightly, to provide a choice to customers. If these are similar in objective and performance, investors may find it tough to differentiate the products and make the right choice for their needs.

3. ADVANTAGES OF MUTUAL FUND

ADVANCED PORTFOLIO MANAGEMENT

A management fee as part of your expense ratio, which is used to hire a professional portfolio manager who buys and sells stocks, bonds, etc. This is a relatively small price to pay for help in the management of an investment portfolio.

DIVIDEND REINVESTMENT

As dividends and other interest income is declared for the fund, it can be used to purchase additional shares in the mutual fund, thus helping your investment grow.

RISK REDUCTION

A reduced portfolio risk is achieved through the use of diversification, as most mutual funds will invest in anywhere from 50 to 200 different securities - depending on their focus. Several index stock mutual funds own 1,000 or more individual stock positions.

CONVENIENCE AND FAIR PRICING

Mutual funds are common and easy to buy. They typically have low minimum investments (some around $2,500) and they are traded only once per day at the closing net asset value (NAV). This eliminates price fluctuation throughout the day and various arbitrage opportunities that day traders practice.

4. DISADVANTAGES OF MUTUAL FUNDS

HIGH EXPENSE RATIOS AND SALES CHARGES

If you're not paying attention to mutual fund expense ratios and sales charges, they can get out of hand. Be very cautious when investing in funds with expense ratios higher than 1.20%, as they will be considered on the higher cost end. Be weary of 12b-1 advertising fees and sales charges in general. There are several good fund companies out there that have no sales charges. Fees reduce overall investment returns.

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MANAGEMENT ABUSES

Churning, turnover and window dressing may happen if your manager is abusing his or her authority. This includes unnecessary trading, excessive replacement and selling the losers prior to quarter-end to fix the books.

TAX INEFFICIENCY

Like it or not, investors do not have a choice when it comes to capital gain payouts in mutual funds. Due to the turnover, redemptions, gains and losses in security holdings throughout the year, investors typically receive distributions from the fund that are an uncontrollable tax event.

POOR TRADE EXECUTION

If you place your mutual fund trade anytime before the cut-off time for same-day NAV, you'll receive the same closing price NAV for your buy or sell on the mutual fund. For investors looking for faster execution times, maybe because of short investment horizons, day trading, or timing the market, mutual funds provide a weak execution strategy.

5. CONCLUSION

Mutual funds are a method for investors to diversify risk and to benefit from professional money management. The prospectus identifies key information about the fund including its operating boundaries and its costs. The fund manager operates within those boundaries and is a critical to achieving strong results within those boundaries.

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