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Analysis Of Mutual Fund During The Financial Crisis

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Abstract

The financial crisis of 2007 was the biggest crisis till now the main reason behind that was the price of the real state which gone much below then the expectation. The house rate increase permitted persons to engage in more consumption, this added fire by a decline in the savings rate and also for additional borrowing for houses as security.U.S. People those who have house, feeling rich due to less taxes, less interest rates and easy credit. Developed government services at low rate consumption items, and grow home rate, due to which personal savings rate gone below 2%, for first time from where noted Great Depression taking place in U.S. These reflect that the financial situation and financial markets condition during financial crisis of 2007. It further describes the conditions of mutual fund in India during the global financial crisis along with the glimpse of few international mutual fund and its return. The mutual fund market play a significant role in Indian financial economy. This is being shown in this paper and how the economy get effect by the role of mutual fund. Global financial crisis are expected to have its effect on the progress of the Indian mutual fund market as well. In this we describe situations of mutual fund during the crisis and also relate to growth in asset base of Indian mutual funds. Distribution of assets among various categories of mutual funds, and also the resources moving of various types of mutual funds. To understand this fact of flow of investment of mutual funds during the crisis, various study have been made to get the required knowledge and idea about the ups and down of the mutual fund.

Key words: mutual fund flows; financial crisis; price of real estate, investment banker, investors CDO broker.

Introduction

Definition of mutual fund: A mutual fund is an investment vehicle made up of a pool of money collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and other assets.

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Definition of financial crisis: A financial crisis is any of a broad variety of situations in which some financial assets suddenly lose a large part of their nominal value.

Types of mutual fund:

Open ended scheme of mutual fund

Close ended scheme of mutual fund

Interval scheme mutual fund

Growth scheme

Balance scheme

Money market scheme

Tax saving scheme

Sector specific scheme etc.

The history of mutual fund industry begins from 1963. The Act passed in Parliament to the set Unit Trust of India (UTI) as the first asset management company (AMC) in India to channel domestic savings, specially for the large number of people who do the small savings to boost them to the country's industrial development. In the year 1987 there came the entry of non-UTI that is public sector mutual funds set up by public sector banks and insurance corporations of India. Thereafter in the year 1993 private sector also entered as asset Management Company and playing the role of Indian mutual fund industry which provide the investors with a wider range of choice and increased much competition in the atmosphere. This was the year when first Mutual Fund Regulations started, where all mutual funds (except UTI) should be registered and governed. The industry which now functions under the SEBI (Mutual Fund) Regulations 1996.The biggest financial crisis took place in the year 2007 which brought the market much below. The main reason for the fall of the market was the fall of the price of the real state in the U.S.Household items, this period was giving hint that per capita consumption growing at fast rate, at the rate of $1,994 every year from 1980 to 1999, then suddenly a big change is noted that was $2,849 every year from 2001-2007.More consumption," stated that as consumption is more as compared wages and salary, accruals and proprietors' income, which went up by 230% from 2000 -2007.Some of higher consumption was financed by higher borrowing which came from the source of increase in price of home. Residential real estate increased which further increased mortgage borrowing faster. The home equity went down from 58% of home rate in

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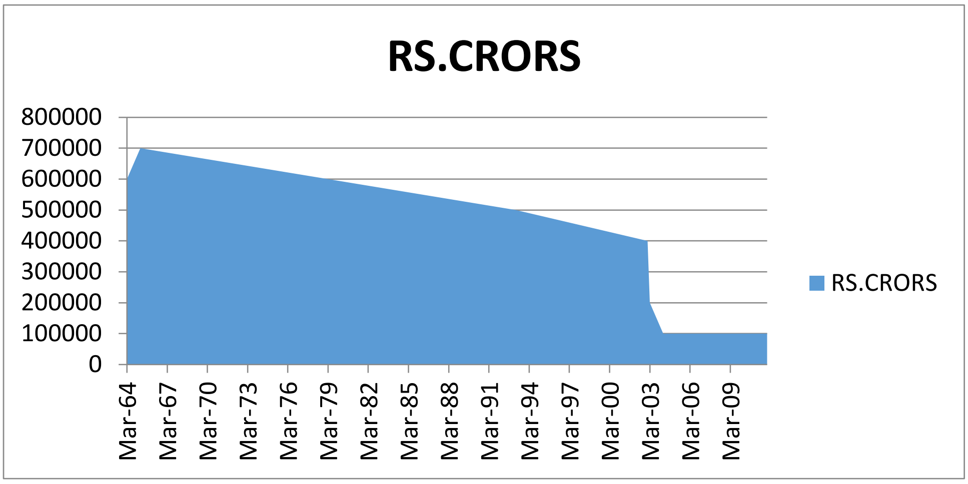
1995 to 52% of home rate in 2007.This increased the consumer leverage, which in return increased the house price, this played an important role in crisis which was about to come. Hence there wasfast increase in mortgage at the time of crisis which increased in subprime. There was large number of subprime of borrower during 1996. They show that, the period from 2002–2005, there was much subprime growth in mortgage credit, on the other hand there was significant decline in income growth this was not normal. In Past 18 years personal income and mortgage increase was negatively related. The investment bank gave the loan to the investors on subprime basis just seeing data of a person rather than checking the complete documents n detailed of the person. Good income person borrowers buying houses in areas where price of house price can go up. The investment bank concluded that high income and middle income investors' contribution was much in the price rise of the house which created fluctuation in the price. Which made the situation worst in 2007.But the fact was that investment bank gave the loan to the investor without seeing their situation that they will be able to pay the loan or not actually this made the situation worst, or it can be said that situation was not under the condition to handle. It was also accommodatedby an increase in the leverage of financial institutions, especially investment banks and others in the shadow banking system, which added fire to this situation to turnout financial crisis in the market 2009.

The following graph shows the fluctuations of liquidity



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LITERATURE REVIEW

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Ninh Hoang,(2015).To study the performance of the Swedish hedge and mutual funds during the financial crisis of 2008 is the main purpose. It also study that which mutual fund gave the best return during the financial crisis. A conditional four-factor model developed by Fink, Raatz and Weigert (2014) is used for the estimation of performance. The result showed that both hedge fund and mutual fund both performed badly but hedge fund was better than mutual fund.

SitikanthaParida and ZhihongWang, (Received: 19 November 2017).Accepted: 27 December 2017; Published: 5 January 2018).The purpose of this paper is to investigate between the mutual funds that hold high risk return than corporate social responsible stocks, or vs. mutual funds that hold low corporate social responsible stocks analysis shows that the corporate social ratings top funds improved through the crisis, whereas it worst for the bottom CSR funds. Our findings are for the “flight to quality”. It was observed that in the financial markets during market crises, investors preferred top CSR fund for investments as it was safe or of higher quality and hence, invest more in them during financial crises.

Suchismitabose,(may 2012). The paper overview the performance of mutual fund during the financial crisis period of 2007. The broad developments shows that while recovery in the industry post-crisis has been quite strong a nature towards risk handling akin to a global trend has become visiblewith the mutual fund asset base where resource movement and mobilisation and investment in capital markets has increased towards the most liquid asset classes. Due to low rate and risk don’t like to invest in debt fund Superior returns performance by equity mutual funds, however, are found to be encouraged by net withdrawals from these funds and net disinvestments by mutual funds in the equity market. An interesting finding of our study is the statistically significant change in the causal relationship between mutual funds’ and foreign institutional investors’ investments in the Indian equity market during the most recent bout of heightened economic and policy uncertainties.

Anjan V. Thakor, (14.5.2015).The literature review of 2007–2009 crisis reflect the worse condition of finance. The conditions was such which increased the housing price and the suddenly price decline that led to the situation of shrank of liquidity which put financial system of the market at risk. The market initially was influenced by both the belief that in the market there is much liquid and the second that the market subsequently fall to the risk of insolvent. The main reason of the financial crisis is that of increased price of real estate and then all of sudden falling price of the real estate also the rate of interest was reduced to 1% to stabilise the economy of the country.

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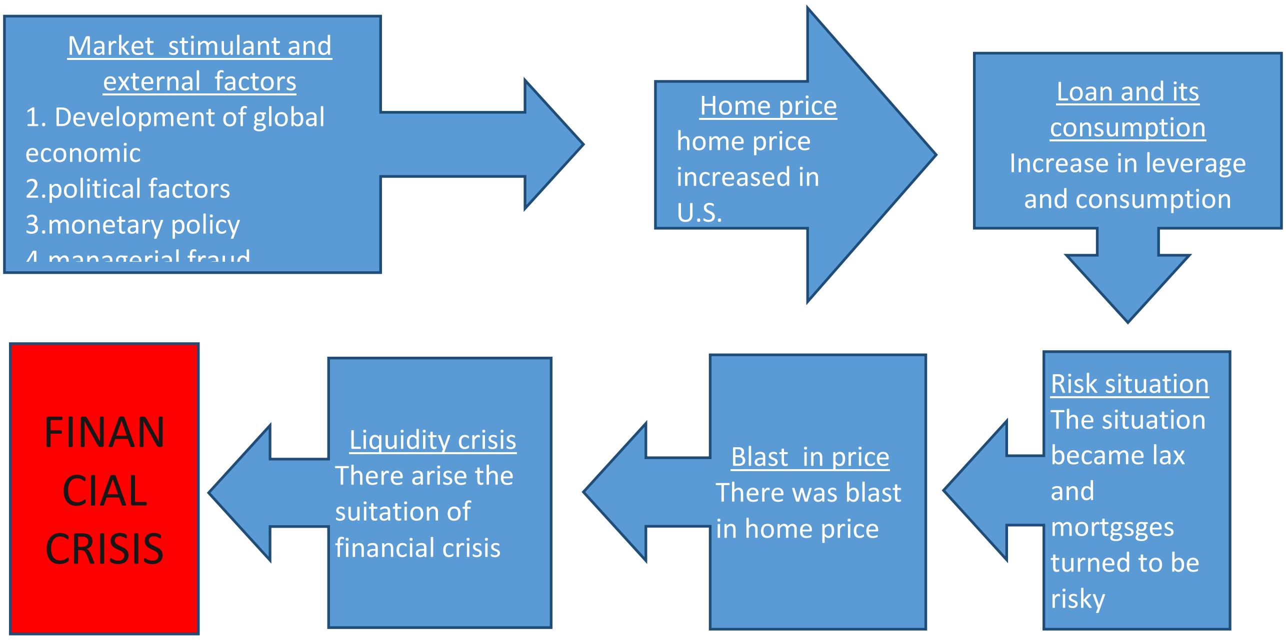
THE MAIN CAUSE OF THE BEGINING OF FINANCIAL CRISIS



The main financial crisis of 2007 was started when homeowners met investors. Homeowners are those who pay the amount of mortgage to Investors. Investor is the person who has much money and he always want to invest those money to somewhere to increase his money. They both met and they met with the help of Wall Street. Initially investors invested their money in Treasury bill of federal bank which is AAA rated which can be said as safest to invest. Thenthere suddenly .Com bust, at this the federal bank reduced its rate of interest to 1% to stabilise the economy of the country. Now the investors don't wanted to invest their money in bank so they started finding other source to invest their money and get more income. Now as the rate of interest is 1 % the banks can take the loan from federal bank. There was much credit in the market as us was flowing with the money of Middle East, China, Japan. Now this increases the leverage of the bank, the investment banker started taking loan from the bank and started to increase their business. Now the big investors got attracted to this and said the investment bank to teach them also this, at this the investment bank thought of idea and decided to give mortgages to investors. People were taking home on mortgages from the lander. After some time the investment banker took much loan from federal bank and purchased all the mortgages from the lander. Now the people who have taken the home on mortgages will pay the money directly to the investment banker, hence the investment banker was flowing with money. Now the investment banker did the three slice of the whole mortgages which they had purchased. The slice was such as 1st slice was safe second was ok and third was risky and gave

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the name CDO (collateralized debt obligation).The slice of CDO was divided into cascading form, which mean the money will come first in the safe slice than to ok slice n than to the last to the risky slice. Hence the rate of interest was also given in the same way the less interest to safe slice than bit high to ok slice n than the highest rate of interest was to the risky slice. Now the investment banker gone to AIG and took the insurance for the safe slice and called it CDS (credit Default Swaps). To make the safe slice safer, the investment banker went to rating agency and gave it to triple AAA rating. In the same way the slice ok got from rating agency triple BBB rating and there was no rating for risky slice. Now the investment banker sold slice of AAA to the investors who wanted the safest investment and sold BBB slice to investors who pay little less interest and finally risky to the risk taker. All were happy everything was going ok and all were enjoying money at their stage.

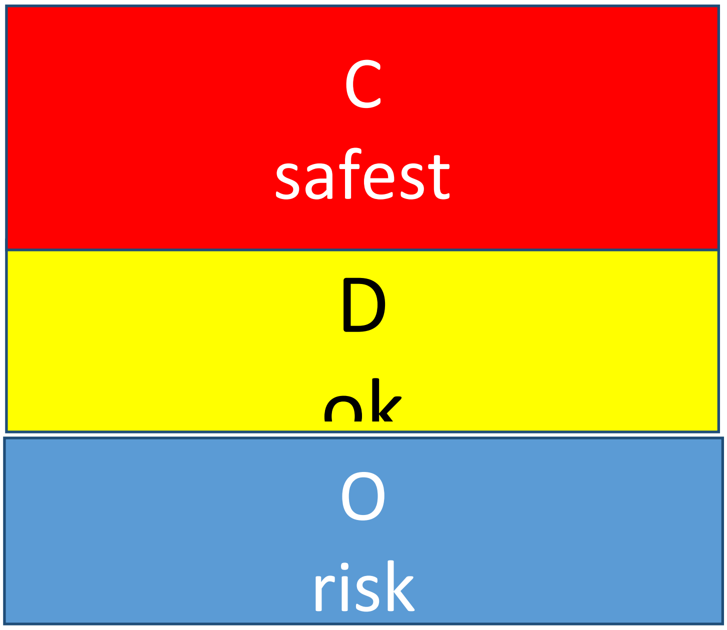

Figure showing the division of CDO according its level of risk

Now the time comes from where the market take the U turn. Investors were enjoying much money hence they decided to further make investment and called to investment banker and asked for more CDOs.The investment banker got idea he called to lander and lander called to the broker and asked for more persons and more mortgages. The broker made them understand that now we have already given to person who are capable. At this the lander explained to broker that if the investors who is not able to pay his mortgages we will take his home back hence both his paid money and home both will be ours. They will sell the home and get the

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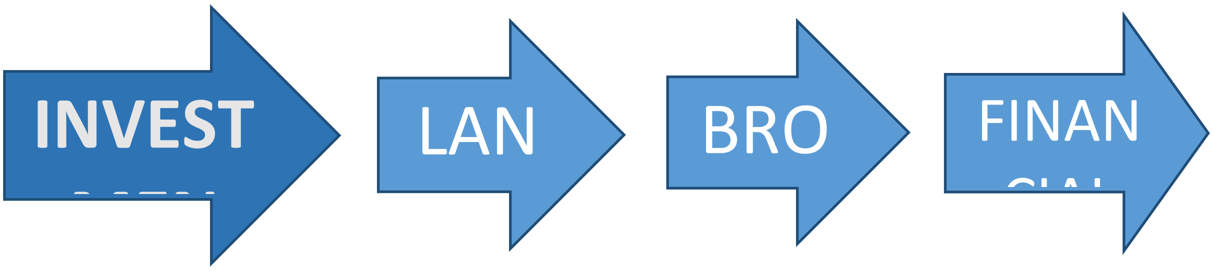
money back and further added that rate of property will remain high always, so there will be no loss.



<u>Following figure showing the chain for call of CDO which leading to financial crisis</u>

Broker said ok and again the same process started but this time mortgages was given at subprime basis which means not much inquiry of documents and strict regarding procedures. Initially the mortgages was giving at prime basis which means after seeing all documents and following various procedures. Again the investment bank took million and billions of loan from federal and purchased the mortgages from the lander and converted into CDO and started to sell it to the investors and enjoying. Now the situation came where one person not able to pay mortgages, the investment banker put his home on sell. The house got sold and investment banker got his money back there after next person and next so on were not able to pay their mortgages the investment banker kept their home also on sell now the situation was such that there are so many home for sell but no buyer to purchase it whole market was in such situation, the rate of home was so much less that even person who had purchased the home at high cost their home was also now at cheap rate and still they have to pay the high said mortgages, hence they also decided to stop to pay mortgages and get new other home at less rate as in whole market there was home of cheap rate. Hence there was frozen financial system situation in the market. Broker bringing more person for mortgages lander calling investment banker for selling mortgages and investment banker calling investors for sell of CDOs but the market is at frozen financial system nothing is working, no sell and purchase is taking place. Even those who had purchased CDOs also stopped to pay all transactions became stagnant and the value of real state was very low. Many of the investment banker became bank corrupt. Lehman brothers were first to declare themselves bank corrupt. All the investment got corrupted even insurance, mutual fund etc. They called their investors and informed them that everything had been corrupt.

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CONCLUSION

The financial crisis that took place in 2007 and got converted into a global financial crisis and economic crisis by 2008.Which affected both the volume of resources of the mutual fund industry andthe distribution of the resources worldwide among different fund bearing different degrees of risk. The mutual fund all over the world suffered a lot setback during the financial crisis, in both the areas of net assets and inflow of liquidity. There was much fall in the real estate and the rate of interest, due to which there was much financial crisis in the whole market. There created the situation of frozen financial system in the market. It shows that the crisis resulted from the effect of many factors such as politics, monetary policy, global economic developments, misaligned incentives, fraud, growth of securitization etc. The said results produced the insolvency and bank corrupt in the financial market which in return lead to the financial crisis. In the study of the various experts primarily there was liquidity crisis, policy, global economic developments, misaligned incentives, fraud, growth of securitization, a fragmented regulatory etc. With the study it was found that financial crisis could have been controlled if there had not been entered the greed in the atmosphere.

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