Mutual Funds

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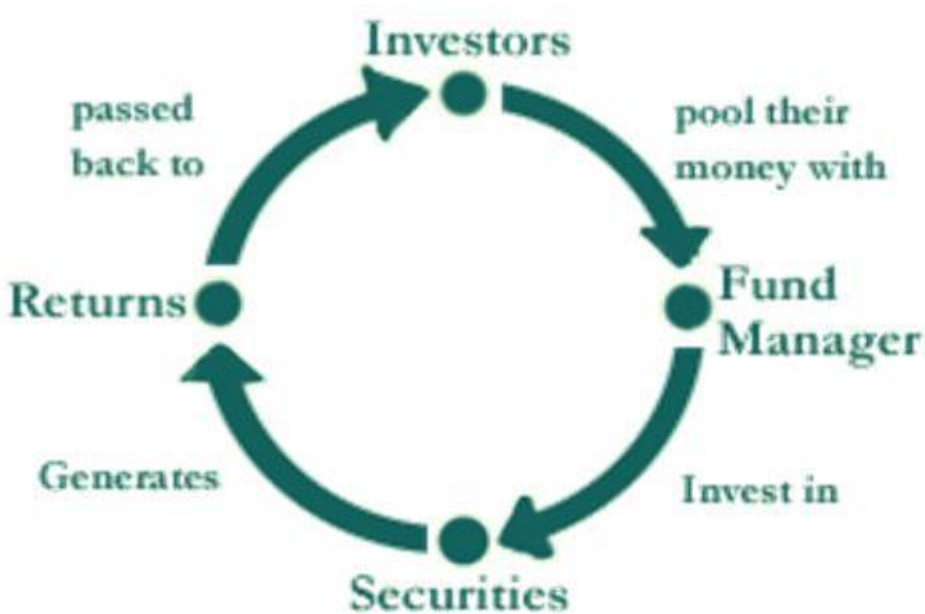
Meaning and Concept

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them.



FREQUENTLY USED TERMS

- **Net Asset Value (NAV)**: Net Asset Value is the market value of the assets of the scheme minus its liabilities. The per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the Valuation Date.
- **Sale Price:** Is the price you pay when you invest in a scheme. Also called Offer Price. It may include a sales load.
- **Repurchase Price:** Is the price at which units under open-ended schemes are repurchased by the Mutual Fund. Such prices are NAV related.
- **Redemption Price:** Is the price at which close-ended schemes redeem their units on maturity. Such prices are NAV related.
- **Sales Load :** Is a charge collected by a scheme when it sells the units. Also called, ‘Front-end’ load. Schemes that do not charge a load are called ‘No Load’ schemes.
- **Repurchase or ‘Back-end’ Load:** Is a charge collected by a scheme when it buys back the units from the unit-holders.

NAV, Entry Load and Exit Load

- NAV or Net Asset Value of the fund is the cumulative market value of the assets of the fund net of its liabilities. NAV per unit is simply the net value of assets divided by the number of units outstanding. Buying and selling into funds is done on the basis of NAV-related prices.
- The NAV of a mutual fund are required to be published in newspapers. The NAV of an open end scheme should be disclosed on a daily basis and the NAV of a close end scheme should be disclosed at least on a weekly basis.
- Unit-holders' Funds in the Scheme ÷ No. of Units, or
- (Total Assets minus Liabilities other than to Unit holders) ÷ No. of Units

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- Mutual fund companies collect an amount from investors when they join or leave a scheme. This fee is generally referred to as a 'load'.
- Entry load can be said to be the amount or fee charged from an investor while entering a scheme or joining the company as an investor.
- Exit load is a fee or an amount charged from an investor for exiting or leaving a scheme or the company as an investor.

Types of Mutual Fund Schemes

a) **On the basis of Objective**

- Equity Funds/ Growth Funds
- Diversified funds
- Sector funds
- Index funds
- Tax Saving Funds
- Debt/Income Funds
- Liquid Funds/Money Market Funds
- Gilt Funds
- Balanced Funds

b) **On the basis of Flexibility**

- Open-ended Funds
- Close-ended Funds

Exchange Traded Funds

- ***Exchange Traded funds (ETF)* are open-ended index funds that are traded in a stock exchange.** A feature of open-ended funds, which allows investors to buy and sell units from the mutual fund, is made available only to very large investors in an ETF.
- Other investors will have to buy and sell units of the ETF in the stock exchange. In order to facilitate such transactions in the stock market, the mutual fund appoints some intermediaries as ***market makers***, whose job is to offer a price quote for buying and selling units at all times.
- **In a regular open-ended mutual fund, all the purchases of units by investors on a day happen at a single price.** Similarly, all the sales of units by investors on a day happen at a single price. The market however keeps fluctuating during the day. **A key benefit of an ETF is that investors can buy and sell their units in the stock exchange, at various prices during the day that closely track the market at that time.**
- Further, the unique structure of ETFs, make them **more cost-effective than normal index funds**, although the investor would bear a brokerage cost when he transacts with the market maker.

Advantages of Mutual Funds

- Professional Management
- Diversification
- Convenient Administration
- Return Potential
- Low Costs
- Liquidity
- Transparency
- Flexibility
- Choice of schemes
- Tax benefits
- Well regulated
- Systematic approach to Investment (SIP, SWP, STP)

Limitations of a Mutual Fund

- Market risk
- Non-market risk
- Interest rate risk
- Credit risk
- Lack of portfolio customization
- Choice overload