CHAPTER 1- CONCEPT AND ROLE OF A MUTUAL FUND

CONCEPT AND ROLE OF A MUTUAL FUND

CONCEPT OF MUTUAL FUND

- Mutual fund is a vehicle (in the form of a "trust") to mobilize money from investors, to invest in different markets and securities, in line with the common investment objectives agreed upon, between the mutual fund and the investors

NET ASSET VALUE (NAV)

- NAV is the market value of the securities held by the scheme. Mutual Funds invest the money collected from investors in securities markets. Since market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date.
- When a scheme is first made available for investment, it is called a 'New Fund Offer' (NFO). During the NFO, investors get the chance of buying the units at their face value. Post-NFO, when they buy into a scheme, they need to pay a price that is linked to its NAV.

ASSETS UNDER MANAGEMENT (AUM)

- The relative size of mutual fund companies is assessed by their assets under management (AUM). When a scheme is first launched, assets under management is the amount mobilized from investors. Thereafter, if the scheme's NAV increase, its AUM goes up; a negative profitability metric will pull it down.

ADVANTAGES OF MUTUAL FUNDS FOR INVESTORS

PROFESSIONAL MANAGEMENT

- Investing is obviously not an easy task. Investing, be it in shares, real estate, gold, bonds, and so on depends on a multitude of factors that constantly need to be studied and understood.
- The advantage of mutual funds is that they are managed by professional experts. Thus, to ensure your money is invested in the right place, you have to choose the right mutual fund.

COST EFFECTIVE

- Large investment corpus leads to various other economies of scale. For instance, costs related to investment research and office space gets spread across investors. Further, the higher transaction volume makes it possible to negotiate better terms with brokers, bankers and other service providers.

DIVERSIFICATION

- One of the biggest advantages mutual funds give you is that of immediate diversification. You may not have enough money to spread your investments in varied stocks and sectors, but by pooling money from thousands of similar investors, a mutual fund spreads your investment and hence, risk. It is highly unlikely that all the stocks will go down by the same proportion on any particular day. This ensures that you have not kept all your eggs in one basket and are safe from incurring huge losses from a single bad investment.

LIQUIDITY

- You can easily move your money in and out of mutual fund investments. Investments in open-ended funds can be redeemed in part or as a whole any time to receive the current value of the units.

TAX BENEFITS

- There are various tax benefits available on your investments in mutual funds. For example, investments in Equity Linked Savings Schemes (ELSS) qualify for tax deductions(upto Rs. 150,000 in a financial year) under Section 80C of the Income Tax Act.

CONVENIENT OPTIONS

- The options offered under a scheme allow investors to structure their investments in line with their liquidity preference and tax position.
- There is also great transaction conveniences like the ability to withdraw only part of the money from the investment account, ability to invest additional amount to the account, setting up systematic transactions, etc.

INVESTMENT COMFORT

- Once an investment is made with a mutual fund, they make it convenient for the investor to make further purchases with very little documentation. This simplifies subsequent investment activity.

REGULATORY COMFORT

- The regulator, Securities and Exchange Board of India (SEBI), has mandated strict checks and balances in the structure of mutual funds and their activities. Mutual fund investors benefit from such protection.

SYSTEMATIC APPROACH TO INVESTMENTS

- Mutual funds also offer facilities that help investor invest amounts regularly through a Systematic Investment Plan (SIP); or withdraw amounts regularly through a Systematic Withdrawal Plan (SWP); or move money between different kinds of schemes through a Systematic Transfer Plan (STP). Such systematic approaches promote investment discipline, which is useful in long-term wealth creation and protection.

TYPES OF FUNDS

- Mutual funds can be classified in various ways, depending on their structure and the nature of investments they make.

OPEN-ENDED AND CLOSE-ENDED FUNDS

OPEN-ENDED FUNDS

- Open-ended funds are open for investors to enter or exit at any time, even after the NFO.
- The scheme does not have any kind of time frame in which it is to be closed.
- The on-going entry and exit of investors implies that the unit capital in an open-ended fund would keep changing on a regular basis.

CLOSE-ENDED FUNDS

- Close-ended funds have a fixed maturity.
- Investors can buy units of a close-ended scheme, from the fund, only during its NFO.
- The fund makes arrangements for the units to be traded, post-NFO in a stock exchange.
- Listing is compulsory for close-ended schemes.

INTERVAL FUNDS

- Interval funds combine features of both open-ended and close-ended schemes. They are largely close-ended, but become open-ended at pre-specified intervals.
- For instance, an interval scheme might become open-ended between January 1 to 15, and July 1 to 15, each year.
- The periods when an interval scheme becomes open-ended, are called 'transaction periods'; the period between the close of a transaction period, and the opening of the next transaction period is called 'interval period".
- Minimum duration of transaction period is 2 days, and minimum duration of interval period is 15 days.
- No redemption/repurchase of units is allowed except during the specified transaction period'.

EQUITY, DEBT, HYBRID, SOLUTION ORIENTED AND OTHER SCHEMES

EQUITY SCHEMES

Category	Scheme Characteristics

Multi Cap Fund	Minimum investment in equity & equity related instruments- 65% of total assets
Large Cap Fund	Minimum investment in equity & equity related instruments of large cap companies- 80% of total assets
Large & Mid Cap Fund	Minimum investment in equity & equity related instruments of large cap companies- 35% of total assets Minimum investment in equity & equity related instruments of mid cap stocks- 35% of total assets
Mid Cap Fund	Minimum investment in equity & equity related instruments of mid cap companies- 65% of total assets
Small cap Fund	Minimum investment in equity & equity related instruments of small cap companies- 65% of total assets
Dividend Yield Fund	Scheme should predominantly invest in dividend yielding stocks. Minimum investment in equity- 65% of total assets
Value Fund	Scheme should follow a value investment strategy. Minimum investment in equity & equity related instruments - 65% of total assets
Contra Fund	Scheme should follow a contrarian investment strategy. Minimum investment in equity & equity related instruments - 65% of total assets
Focused Fund	A scheme focused on the number of stocks (maximum 30). Minimum investment in equity & equity related instruments - 65% of total assets. Funds will mention where the scheme intends to focus, viz.,multi cap, large cap, mid cap, small cap
Sectoral/ Thematic	Minimum investment in equity & equity related instruments of a particular sector/ particular theme- 80% of total assets
ELSS	Minimum investment in equity & equity related instruments - 80% of total assets. An open ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit

*Mutual funds will be permitted to offer either Value fund or Contra fund

DEBT SCHEMES

Category	Scheme Characteristics
Overnight Fund	Investment in overnight securities having maturity of 1 day
Liquid Fund	Investment in Debt and money market securities with maturity of upto 91 days only
Ultra Short Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 3 months - 6 months
Low Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 6 months- 12 months
Money Market Fund	Investment in Money Market instruments having maturity upto 1 year
Short Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 1 year - 3 years
Medium Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 3 years - 4 years

Medium to Long Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 4 - 7 years
Long Duration Fund	Investment in Debt & Money Market Instruments such that the Macaulay duration of the portfolio is greater than 7 years
Dynamic Bond	Investment across duration
Corporate Bond Fund	Minimum investment in corporate bonds- 80% of total assets (only in highest rated instruments)
Credit Risk Fund	Minimum investment in corporate bonds- 65% of total assets (investment in below highest rated instruments)
Banking and PSU Fund	Minimum investment in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions- 80% of total assets
Gilt Fund	Minimum investment in Gsecs- 80% of total assets (across maturity)
Gilt Fund with 10 yearconstant duration	Minimum investment in Gsecs- 80% of total assets such that the Macaulay duration of the portfolio is equal to 10 years
Floater Fund	Minimum investment in floating rate instruments- 65% of total assets

HYBRID SCHEMES

Category	Scheme Characteristics
Conservative Hybrid Fund	Investment in equity & equity related instruments- between 10% and 25% of total assets; Investment in Debt instruments- between 75% and 90% of total assets

Balanced Hybrid Fund*	Equity & Equity related instruments- between 40% and 60% of total assets; Debt instruments- between 40% and 60% of total assets. No arbitrage would be permitted in this scheme
Aggressive Hybrid Fund*	Equity & Equity related instruments- between 65% and 80% of total assets; Debt instruments- between 20% 35% of total assets
Dynamic Asset Allocation or Balanced Advantage	Investment in equity/ debt that is managed dynamically
Multi Asset Allocation #	Invests in at least three asset classes with a minimum allocation of at least 10% each in all three asset classes
Arbitrage Fund	Scheme following arbitrage strategy. Minimum investment in equity & equity related instruments- 65% of total assets
Equity Savings	Minimum investment in equity & equity related instruments- 65% of total assets and minimum investment in debt- 10% of total assets. Minimum hedged & unhedged to be stated in the SID.
Mutual Funds will be permitted to offer either an Aggressive Hybrid fund or Balanced fund. #Foreign securities will not be treated as a separate asset class	

SOLUTION-ORIENTED SCHEMES

Category	Scheme Characteristics
Retirement Fund	Scheme having a lock-in for at least 5 years or till retirement age whichever is earlier
Children's Fund	Scheme having a lock-in for at least 5 years or till the child attains age of majority whichever is earlier

OTHER SCHEMES

Category	Scheme Characteristics
Index Funds/ ETFs	Minimum investment in securities of a particular index (which is being replicated/ tracked)- 95% of total assets
FoFs (Overseas/ Domestic)	Minimum investment in the underlying fund- 95% of total assets