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A STUDY OF THE MUTUAL FUND AS A TOOL FOR PORTFOLIO INVESTMENT

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Abstract:

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 realized is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. Mutual funds, also referred to as investment companies, offer an alternative investment choice for individuals with a long-term horizon. The way they operate is that individual investor money are pooled and invested in many different companies. Assets are professionally managed to meet various investment objectives. They issue and sell shares to shareholders and also redeem them (buy them back) upon request. Prices of shares are set daily at the close of business, based on the value of all investments in the mutual fund's portfolio. Their major advantages are diversification and professional management, which are not readily available to small investors outside the mutual fund arena.

Key Words: Mutual fund, Investors, Capital Market, Shares.

Introduction:

Mutual funds now offer products for the entire range of needs of investors. The encouraging response to index funds and sector funds shows the growing maturity among investors. Open-end funds, which provide liquidity to investors at daily NAV related prices, are growing in popularity. The funds have been adopting technology to provide good service to investors and with the proposed introduction of electronic funds transfer and the growing trend towards E-Banking; the efficiency of service will increase even further. In the coming year's mutual funds as saving intermediaries will play a greater role in bringing the gap between investors and issuers, especially in the area of equity funds? At present these funds represents 13% of BSE market capitalization. This is expected to go up with increasing flows into financial savings, especially the mutual fund with the growth and stability in the capital market flows into equity funds are expected to go up.

Money market mutual funds are short-term funds. They invest in short-term cash and cash equivalent instruments, such as Treasury bills, certificates of deposit, and short-term notes. Mutual funds may own stocks and bonds of many different companies. A mutual fund is the ideal investment vehicle for today's complex and modern financial scenario. Markets for equity shares, bonds and other fixed income instruments, real estate, derivatives and other assets have become mature and information driven. Price changes in these assets are driven by global events occurring in faraway places. A typical individual is unlikely to have the knowledge, skills, inclination and time to keep track of events, understand their implications and act speedily. An individual also finds it difficult to keep track of ownership of his assets, investments, brokerage dues and bank transactions etc.

History of Mutual Funds

In 1924 three Boston securities executives pooled their money together to create the first mutual fund. The idea of pooling money together for investing purposes started in Europe in the mid-1800s. The first pooled fund in the U.S was created in 1893 for the faculty and staff of Harvard University on March 21st, 1924 the first official mutual fund was born. It was called the Massachusetts Investors Trust. However in India UTI was the first to introduce mutual funds in the Indian markets and it commenced its operations from July 1964, Government allowed public sector banks and institutions to set up mutual funds. In the year 1992, Securities and exchange Board of India (SEBI) Act was passed. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market. As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI

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notified regulations for the mutual funds in1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors. All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The risks associated with the schemes launched by the mutual funds sponsored by these entities are of similar type. It may be mentioned here that Unit Trust of India (UTI) is not registered with SEBI as a mutual fund (as on January 15, 2002. The end of millennium marks 36 years of existence of mutual funds in our country. The ride through these 36 years is not been smooth. Investor opinion is still divided. While some are for mutual funds others are against it.

Benefits of Mutual Fund Investment

Professional Management: Mutual Funds provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and Prospects of companies and selects suitable investments to achieve the objectives of the scheme.

Diversification: Mutual Funds invest in a number of companies across a broad cross-section of Industries and sectors. This diversification reduces the risk because seldom do all Stocks decline at the same time and in the same proportion. You achieve this Diversification through a Mutual Fund with far less money than you can do on your own.

Convenient Administration: Investing in a Mutual Fund reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save your time and make investing easy and convenient.

Return Potential: Over a medium to long-term, Mutual Funds have the potential to provide a higher Return as they invest in a diversified basket of selected securities.

Low Costs: Mutual Funds are a relatively less expensive way to invest compared to directly Investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.

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Liquidity: In open-end schemes, the investor gets the money back promptly at net asset value related prices from the Mutual Fund. In closed-end schemes, the units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.

Transparency: You get regular information on the value of your investment in addition to disclosure on the specific investments made by your scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

Flexibility: Through features such as regular investment plans, regular withdrawal plans and Dividend reinvestment plans, you can systematically invest or withdraw funds according to your needs and convenience.

Affordability: Investors individually may lack sufficient funds to invest in high-grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy.

Well Regulated: All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

Advantages of mutual funds include:

- Diversification of risk,
- Professional management
- Different investment options and ability to purchase a large selection of Investments at a modest cost.
- their large size permits them to buy larger volumes of stocks at a discount
- the investor can be a part owner of many different companies even with a modest investment

Disadvantages of mutual funds include:

- Inability to make one's own decisions
- No guarantee that the professional managers will provide anticipated results
- Investment company managers can switch styles of investing, even while adhering to the objectives and policy agreed upon by the mutual fund. This makes it difficult for the investor to keep track of the investments owned by the fund and the activity of fund managers.
- Past performance, a highly reported indicator is just that, one of many indicators; it is no guarantee for future performance. Careful scrutiny is warranted when reading a fund's advertisement about past stellar performance.

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Risks and Return

Investors' interest in investments is largely pecuniary – to earn a return on their money. However, selecting stocks exclusively on the basis of maximization of returns is not enough. The fact that most investors do not place available funds into the one, two or even three stocks promising the greatest returns suggests that other factors must be considered besides returns in the selection process. Investors not only like returns but they also dislike risk. Their holding of an assortment of securities attests to that fact. To say that investors like returns and dislike risk is however, simplistic. Before we can analyze securities and portfolios within a risk – return context, we must begin with a clear understanding of the meaning of both, risk and return, what creates them and how they should be measured? The ultimate decisions to be made in investments are:

What mutual funds should be held?

How much to allocate to each.

Security analysis and portfolio management is built around the idea that investors are concerned with two principal properties inherent in securities: the return that can be expected from holding a security, and the risk that the return that is achieved will be less than the return that was expected.

Conclusion:

Investors want to maximize expected returns subject to their tolerance for risk. The level of risk you are willing to take typically determines the funds you decide to invest in. Mutual funds offer 3 levels of risk - low, medium and high. In general, the higher the risk, the greater the potential gain or loss. As a result, unit prices for high-risk mutual funds fluctuate far more widely than for lower risk funds. People who are more cautious would tend to purchase lower risk funds, while more aggressive investors tend to purchase higher risk units. One method of investment that many people like to use is diversification - that is, buying a variety of funds across the various risk levels. As a result, they will never totally miss out on major market gains, and their losses will be less than if they invested only in high risk funds. Depending on how quickly you want to build your capital, you can choose from a number of investment styles, ranging from conservative to Aggressive.

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