Personal Finance - Mutual Funds

Introduction to Mutual Funds

Mutual Funds: Breaking Down the Basics

Mutual funds are types of investments where money is pooled by multiple investors. Fund managers then take the funds and invest in various asset classes, such as bonds, stocks and others. Fund managers are experienced in analysing the prevalent conditions in the market, based on which they can make informed decisions. So, they are responsible for choosing the financial assets and investing the pooled money from the mutual fund. Because these funds are managed professionally, they are popular among investors.

Understanding the Mutual Fund Ecosystem

A mutual fund is a kind of investment option where money is gathered from various investors. Asset Management Companies (AMCs) create mutual funds and charge investors a fee for managing their funds. Even though the fee amount varies, SEBI has set guideline regarding the maximum amount it can be based on the fund's net asset value (NAV)

Know Before You Buy: Key Factors to Assess Mutual Funds

- **Performance:** Compare the fund’s returns against the benchmark index. This gives insights into how the fund has performed in the past. For instance, compare small-cap fund schemes against a small-cap benchmark.
- **Net Asset Value (NAV):** NAV refers to the price per unit of mutual funds. NAV is calculated at the end of every business day and it reflects the current market value of the mutual fund's portfolio. Investors take NAV into account to buy or sell units of the mutual fund.
- **Expense Ratio:** All mutual funds have some costs associated with managing the fund. These administrative and operating costs are known as expense ratio. The expense ratio is an important consideration for investors as it affects their investment returns.
- **Risk Level:** Each mutual fund category has its own level of risk. However, comparing the risk of different categories on a common scale isn't straightforward. Therefore, it’s important to check the riskometer of mutual funds. The riskometer is a risk measurement

scale introduced by SEBI for mutual fund schemes. It displays five levels of risk.

- **Investment Objective:** Different investors have different needs when it comes to investing in mutual funds. Some investors opt for liquid funds as they offer safety in investments with low interest. Others go for solution-oriented mutual funds that cater to specific goals such as retirement planning or children's education.

How to Calculate Mutual Fund Returns

Investors need to analyse the return from mutual fund investments. The easiest way to calculate mutual fund returns is by subtracting the amount of investment from the current value of the investment. The method helps to figure out exact profit or loss from an investment. To calculate the loss or gain as a percentage, divide the amount of gain or loss by the total amount invested and multiply by 100. The formula for calculating mutual fund return rate is:

((Current Value - Initial Investment) / Initial Investment) * 100.

Also, consider reinvested dividends or distributions and any fees or expenses incurred. Annualised returns can be calculated using the compound annual growth rate (CAGR) formula, accounting for the investment's time horizon.

Income Fund

Navigating Income Funds: Your Guide to Debt Market Investments
Income funds are essentially debt funds, where investors place their capital in longer-term instruments such as debentures, government securities and corporate bonds. The duration of investment for income funds is considerable. According to SEBI, the weighted average term to maturity of cash flows for income funds is 4 years and more. So, two kinds of income funds can be categorised as part of mutual funds. These are -

- **Medium to Long Duration Fund:** Ranges between four and seven years.
- **Long Duration Fund:** Exceeds seven years.

How do Income Mutual Funds Work?
The fund manager tries to provide sizable returns to income fund investors, irrespective of the interest rates. So, regardless of whether the rates are increasing or declining, income funds have a high likelihood of offering good returns. Fund managers often follow one of two strategies here:

- **Generating Income From Interests:** This is a strategy that relies on raising the returns from the interests of the debt instruments. However, the instruments have to be held until their maturity to achieve this.
- **Earning Gains:** In this strategy, the fund managers sell the debt instruments in the market as soon as their price goes up.

Income Funds: Who Should Invest in Them?
Income funds are ideal for investors with a moderate risk tolerance. Those who seek stability, a balanced approach and stable income over higher returns find income funds viable investment options.

Income Funds: Exploring Their Advantages for Investors
The primary benefits of investing in an income fund are as follows:

- **Better Returns Than Fixed Deposits:** Like fixed deposits, income funds generate regular returns. The income generated from income funds tends to be better than fixed deposits.
- **High liquidity:** In fixed deposits, premature withdrawals lead to penalties. However, income funds do not have any lock-in periods. However, it's important to note that withdrawing income funds within one to three years may incur a fee.
- **Tax Benefits:** When compared to fixed deposits, income funds offer many tax advantages, especially for those who are in the high income tax category. In fixed deposits, interest is taxed based on the investor's income tax bracket. On the other hand, when held for more than three years, income funds invite lower taxes.

Interval Fund

Interval Funds: Finding a Balance Between Flexibility and Stability
Interval funds offer investors the flexibility to invest in equity and debt instruments. This flexibility helps create a diversified investment portfolio. The funds get their name because of their distinct feature that allows investors to sell or buy units only during specific time intervals as announced by the asset management companies (AMCs).

This is in stark contrast to open-ended funds, where transactions can take place daily without restrictions. Similarly, interval funds are different from closed-ended funds, where only a fixed number of shares are available but there is flexibility when it comes to redemption. With interval funds, investors can easily access a wide range of assets. They also offer stability due to their predetermined transaction periods.

Decoding How Interval Mutual Funds Work
Interval funds offer the perfect balance between open-ended and closed-ended funds. During the predetermined transaction windows, investors can freely buy or sell units at their net asset value (NAV). Since the AMCs are in charge of determining the transaction windows, fund managers can create strategies without having to worry about sudden liquidity or redemption requests.

Who Should Invest in Interval Mutual Funds?
As explained above, interval funds are special types of funds that investors cannot buy or sell quickly. Investors have to wait for a particular time to sell these units. This makes interval funds ideal for long-term investors who are willing to wait to sell their shares during scheduled repurchase offers. Interval funds are also suited to investors who have a moderate risk appetite and short-term financial goals.
Pros and Cons of Interval Funds
Pros:

- **Higher Yield:** The primary benefit of interval funds is that they have the potential of offering higher yields compared to many other mutual fund options.
- **Less Volatile:** Funds are typically less reactive to market fluctuations. The reason being investments are not only tied to equities.

- **Investor Behaviour:** The long-term structure of interval funds helps discourage typical investor behaviour of ‘buying high and selling low.’

Cons:

- **Limited Liquidity:** Interval funds allow investors to sell or redeem units only at certain predetermined windows of time. When faced with emergencies, investors would not be able to redeem the units. Similarly, the units of interval funds cannot be sold in any secondary market.
- **Redemption Possibility:** As repurchase occurs on a pro-rata basis, there's no guarantee that investors will be able to redeem all shares during a redemption window.

Index Funds

Investing Simplified: All You Need to Know About Index Funds
Index mutual funds are designed to mimic the performance of a specific stock market index, such as BSE Sensex, NSE Nifty or others. This means that these funds don’t try to outperform the market but rather aim to replicate its performance. They are passively managed funds. This implies, fund managers invest in the same securities and the same amount as in the original index. They do not alter the portfolio composition in any way. Index funds look to deliver returns comparable to the tracked index.

Understanding the Basics of Index Funds
Index funds offer a straightforward way for investors to gain exposure to various segments of the financial market while keeping costs low. Whether investors are interested in specific sectors or not, the funds are invested in the same assets with the same weights as the target index. This way, index funds aim to replicate its performance.
So, unlike actively managed mutual funds where the goal is to outperform the benchmark, passively managed index funds only try to match the returns offered by its tracked index.

Who Should Invest in Index Funds?
Index funds track a market index and offer returns comparable to the underlying index. So, they are more suited to investors who have minimal risk appetite. These investors may want to invest in the equity market without facing the risk that comes with it. In actively managed funds, the fund manager can change the portfolio composition based on the performance of the underlying securities. This tends to increase the risk in the portfolio. In case of index funds, these risks are low. However, the returns of index funds will not outperform the index that it is tracking.

Risks and Returns of Index Funds
Risks

- **No Tailored Approach:** Index funds are known for being cost efficient. However, they follow a pre-set investment strategy based

on the index they track. This limits the ability to offer a tailored investment strategy.

- **Underperformance:** Index funds run the risk of underperformance in comparison to actively managed funds, particularly under certain market conditions or investment strategies.

Returns

- **Low Volatility**: One of the key advantages of index funds is that they are less volatile than actively managed equity investments. This offers investors a more stable investment option.
- **Stable Returns:** Index funds often deliver stable returns, closely tracking the performance of the market index they are based on. This means investors in an index fund will achieve identical returns to all other investors who hold the same fund.
- **Lower Expense Ratio:** Index funds generally have lower expense ratios when compared to actively managed funds. This means more of the investment capital is directed towards the portfolio.
- **Diversification:** Investing in index funds offers broad market exposure, spreading the risk across multiple securities within the index.
- **Passive Management:** Index funds need not be managed actively. This reduces the need for constant monitoring.

Exchange-traded Funds

ETFs Demystified: Understanding the Basics and Beyond
An exchange-traded fund (ETF) is a collection of securities. These can be either bonds or equities. The primary feature of ETFs is that investors get to invest in a wide range of securities simultaneously. The fees for such investments are typically lower than most other types of funds. The ETFs can be traded on an exchange just like individual stocks. However, ETFs’ share prices fluctuate during the trading day and they are bought and sold, unlike mutual funds, which can be typically traded once daily after the market closes.

How do ETFs Provide Access to Diverse Asset Classes?
Here is a look at how exactly ETFs work:

- First, an ETF provider has to create a portfolio using a variety of assets, such as bonds, commodities and stocks. This bundle of assets will have its stock ticker.
- Investors can buy a part of this basket, in the same way they can buy shares of a company.
- Just like stocks, ETFs undergo buying and selling on an exchange throughout the day.

Different Types of ETFs That You Need to Know:
There are various kinds of ETFs. The following are the types:

- **Equity ETFs:** Equity ETFs are extremely popular ETFs that are traded in the stock markets. The prices of such an ETF are determined through market movement. Equity ETFs track the Nifty 50 and other similar indexes. There are 89 ETF schemes available in total.
- **Commodity ETFs:** These ETFs are designed to track the price of certain items or commodities. In India, only gold and silver commodities are presently available for investment. Gold and silver ETFs allow investors to invest in the digital format of the precious metal instead of physical ones.
- **Bond ETFs:** In these types of ETFs, you can invest in fixed-income options, such as debentures and government bonds. They are traded in the open cash market throughout the day. Investors do not earn any interest on their investments.

Unlocking Investment Opportunities: Advantages of ETFs

- **Simple to Trade**: You can buy or sell ETFs at any time of the day, unlike other mutual fund instruments that only trade at the end of the day.
- **Transparency:** The ETFs are required to report their holdings daily, which leads to increased transparency.
- **Trading Transactions:** Investors are free to place order types, such as limit orders, when trading ETFs. This is possible since such funds are traded similar to stocks.

Navigating the Pitfalls: Understanding the Risks of ETFs

- **Trading Costs**: If you invest small amounts frequently, it makes more sense to find a fund company and deal with them directly by investing in a no-load fund. This would be less expensive than ETFs.
- **Illiquidity:** In case of lightly traded ETFs, you may face substantial ask spreads and bids. So, you may be forced to buy when the spread's price is high and sell when it is at a low point.
- **Settlement aDtes:** After selling your ETFs, you will need to wait two days for its settlement. So, you will not be able to reinvest the funds immediately after trading in your ETFs.

Before You Dive in: Key Consideration for ETFs

Liquidity: While purchasing an ETF, you should consider other factors, including liquidity, tracking errors and the total expense ratio (TER).

Mutual Fund Investment Strategies

Mutual Funds Success: Strategic Approaches to Say Ahead
Mutual fund investments involve much more than simply buying the top-performing funds to ensure the highest returns. In today's internet era, it's easy to know the best-performing mutual funds, there is no guarantee that the top-performing funds will continue delivering impressive returns in the future. That is why a solid strategy is essential before investing in mutual funds to maximise returns from investments.

The balancing Act: Importance of Asset Allocation
Asset allocation is distributing your money in different instruments or asset classes, such as fixed income, equity, debt and more. Asset allocation and diversification are important to reduce the risk associated with investments. Since it is tricky to predict market performance, you should always look to invest in multiple asset classes. This can help balance the risk that tends to arise due to market volatility. So, even if one of the asset classes underperforms, another class may perform much better and help balance your returns.

Building a Mutual Fund Portfolio: What You Need to Know
A mutual fund portfolio contains diverse investments in various assets such as stocks, bonds, cash equivalents and other securities. The various types of assets are chosen to achieve the fund's stated objectives, this could be capital appreciation, income generation, or both.
When building a mutual fund portfolio, you must keep the following things in mind:

- **Asset Allocation:** Asset allocation involves spreading investment funds across diverse asset classes, including bonds, debt instruments, equities, and others. Assets are allocated based on the goals of the investor and the risk appetite one has.
- **Diversification:** This is the practice of investing in a variety of financial instruments to spread the overall risk.
- **Risk Management:** Risk management is balancing the risk in one's investment portfolio by investing in funds that align with their risk tolerance.

Diversification Strategies Across all Mutual Fund Categories

- **Understand the Risk Tolerance:** The very first step is to establish your risk tolerance level. Risk tolerance refers to an investor's readiness to withstand potential financial losses. Given the volatile nature of the market, it's important to be financially prepared to weather short-term fluctuations and have sufficient liquidity elsewhere to navigate such scenarios.
- **Set Goals:** The next step requires you to establish what you wish to achieve from your portfolio. Remember, the goals of a risk-tolerant investor will be different from those of a risk-averse one.
- **Build a Portfolio:** Once you've identified your risk tolerance level, select asset classes that match your risk tolerance level and investment goals. Diversify your investments so that gains from some investments can offset losses in others.
- **Choose from Various Industries:** While you may be interested in certain industries or sectors, it's important to choose financial instruments from different industries. The reason is that this will minimise the industry-specific risks.
- **Do Your Homework About the Fund Manager:** Much of the success or failure of a diversified mutual fund portfolio depends on the abilities of the fund manager. The manager is responsible for choosing just when and where to invest the available funds.

Types of Mutual Fund Investments

From Equity to Debt Funds: Navigating Different Types of Mutual Funds

Equity Funds
Equity funds are those mutual fund instruments where your money is invested in company shares. So, they carry some risks as your returns would depend on how the company's stock performs in the stock market. These are typically 'high risk high reward' options that are suited to investors with a moderate to high risk appetite. Equity funds can be divided into several other categories, such as :

- Small-Cap funds
- Mid-Cap funds
- Large-Cap funds
- Equity Linked Savings Scheme

There are other categories too. Investors may consider investing in equity mutual funds for long-term goals, provided their portfolios can tolerate the increased risk associated with such investments.

Debt Funds
Debt funds are mutual funds where your money is invested into various fixed-income securities, such as government securities, treasury bills and corporate bonds. Debt funds are highly stable options that have low risk associated with them. Investment in debt funds is ideal for those looking for a regular and stable income. However, the returns do not tend to be as substantial as in equity fund investments. Debt funds can be divided into further categories:

- Liquid funds
- Low-duration funds
- Overnight funds
- Credit risk funds
- Gilt funds

Hybrid Funds
In hybrid funds, as the name suggests, capital is invested into both equity funds and debt instruments. Splitting the capital into the two kinds of funds can ensure that there is a balance between the risk and

the returns. Such investment in hybrid funds can be varied or fixed depending on the policies of the asset management company (AMC) or fund house managing the portfolio. Hybrid funds can also be divided broadly into two distinct types. They are:

- Aggressive funds
- Balanced funds

Depending on market conditions and overall investment objectives, investors can select the appropriate type of hybrid fund. Risk appetite plays a crucial role in determining the allocation of equity instruments within the portfolio.

Different Modes of MF investment (SIP)

Different Modes of Investment: Understanding SIPs, Lump Sums and STPs

Investing in mutual funds is a smart way to grow your money. But do you know there are different ways to do it? Whether you are planning to opt for SIPs, lump sum or STPs, each comes with its own pros and cons. Before investing your hard-earned cash, it's crucial to grasp the ins and outs of these methods:

- **Lump Sum:** As the name suggests, a lump sum investment is a one-time investment that many investors opt for because it doesn't come with regular commitments. It's a good choice for those who are confident in timing the market accurately. Investors who are not confident of their timing must stay steer clear of lump sum investments. This is ideal for high risk takers.
- **Systematic Investment Plan (SIP):** A Systematic Investment Plan (SIP) is a great choice for everyday investors as it distributes the cost of investing over time. With SIP, you can split a large sum into smaller chunks. This helps investors to avoid trying to time the market. Since they are buying at various intervals, it reduces the pressure of getting the timing right. Remember, that any investment restrictions apply to each SIP installment. If you prefer hassle-free and automatic investing, SIP is the ideal way.
- **Systematic Transfer Plan (STP):** A Systematic Transfer Plan (STP) is typically used when investors have a lump sum to invest. Similar to a SIP, an STP helps distribute investments over time to even out the purchase cost. This strategy reduces the risk of investing a large sum all at once when the market might be at its peak. With an STP, investors can invest the consolidated amount in one scheme and then regularly transfer a fixed amount to another scheme. This can involve moving money from an equity fund to a debt fund or vice versa. By doing this, you lower the chance of your investments taking a hit close to the target date, like maturity.