Volume-4, Issue-8, August-2015 • ISSN No 2277 - 8160

Research Paper | Management

Mutual Funds : Risk vs Return, Awareness among Investors

Ms. Arpita Gupta — Assistant Professor, CMR Institute of Technology, VTU, Bangalore. Research Scholar, Bharathiar University Coimbatore,

Dr. R K Gopal — Professor & Program Chair, MBA Department, PES University, Bangalore, India

ABSTRACT

With the development of capital market, investment in stocks became a good option for generating higher returns. However, greater risk and lack of knowledge about the movement of stock prices were also associated with them. Therefore, mutual funds emerged as an ultra-modern method of investment to lessen the risk at low cost with experts' knowledge.

Because of the large number of mutual fund companies and schemes, retail investors are facing problems in selecting right funds. Also, it is of paramount importance for policy makers, governing bodies and mutual fund companies to analyse as which schemes are efficient performers. Therefore, to study the performance of mutual funds in terms of efficiency and the methods of improving it is of crucial importance.

KEYWORDS : Mutual Fund, Industry Growth, Risk, Return, Investments.

Introduction

The mutual fund industry, today presents a picture of opportunity and challenges. As the industry sensitises itself to the changing regulatory landscape, business strategies are endeavouring to respond to these developments. Amidst this changing business and regulatory environment, asset management companies and all service providers, including distributors, have to re-examine their business models and embrace the changing business landscape.

The last few years have seen a series of events, both within and outside the Indian economy, which have impacted the industry. Additionally, investors appear to have adopted a more cautious approach. The present scenario demands vigorous innovation and reinvention. Among others, the purpose may be served by adopting a cluster of key initiatives in the areas of cost efficiency, product design and positioning, alternative distribution models, revenue diversification and capacity creation.

Investors Inclination

Many investors equate risk with losses. Many individuals believe that all mutual fund schemes invest money in shares. In reality, not all schemes invest in shares. And not other investments are free of risks.

Risk: Misconception about Mutual Funds

"Mutual fund investments are subject to market risks. Please read the offer document carefully before investing." – These lines are part of any marketing communication by any mutual fund company. This is a regulatory requirement. This line has the potential to strengthen a major myth

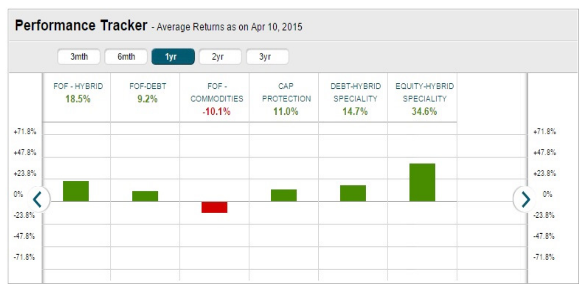
Since mutual fund investments are subject to market risk and there is only one risky market -misconception about mutual funds. The reality is: Not all mutual funds invest in equity.

Whereas it is a good idea to talk about risks while investing, picking up only one product and sparing the others has the potential to lead the investors to believe that only those products are risky where one talks about risk. Any other product where the word "risk" is not mentioned is assumed to be risk-free.

it is not the mutual fund that carries the risk, but the underlying investments where the mutual fund has invested. Mutual funds simply pass on some of the risks and reduce some others.

Price Fluctuations: Mutual Fund

When we talk about price fluctuations, it is important to separate the market price fluctuation from that in the price of individual securities. There are certain factors that impact the broader market and prices of most securities fluctuate at the same time – this is called market price fluctuation; whereas some factors only impact individual securities, resulting into fluctuation in the price of an individual security. Diversification can help reduce the latter, but cannot reduce the former.



Growth: Under Mutual Funds

The rate of growth of investment in mutual funds has increased dramatically over the past decade. Many studies have developed models for performance evaluation and have examined whether fund managers provide value added for investors. Most of these studies, however, have focused on the developed markets and only a few examine whether the findings carry over to emerging markets as well.

Flexible fund managers are, in comparison, more active and adjust their portfolios dynamically according to economic information. There is persistence in performance in general mutual funds.

Size, age and fund family also have explanatory power in fund performance but it is specific to investment policy and the evidence is not economically significant. Net cash flows, in general, have no impact on fund performance. However, the significant amount of cash inflows can severely lower performance in mutual fund since the fund managers are unable to allocate their portfolio immediately and leave large amounts in their cash position. Liquidity also plays a major role in mutual fund performance. We find that funds which contain more illiquid assets in their portfolios perform better and this suggests that there is a liquidity premium in mutual funds. As a result, a liquidity-augmented model which includes one liquidity factor is proposed.

Notwithstanding the recent growth and challenges, mutual funds continue to be an efficient vehicle offering varied investment products at a reasonable cost to investors.

Role of Fund Manager

The tax-benefit fund managers are more passive than managers of general funds but they do not employ any different strategy from that used by managers of general funds. Tax-benefit funds are more sensitive to cash flows and contain slightly more illiquid stocks in their underlying assets. Thus, the superior performance in tax-benefit funds is not only attributable to the liquidity premium, but also to the fund managers' superior ability, as well as to the long-term restrictions which help tax-benefit fund managers to reduce nondiscretionary trading cost in these funds.

Importance of Prospectus in Mutual funds

A mutual fund prospectus is to a mutual fund what an owner's manual is to a car.

Key Information in the Prospectus

Investment Objectives

The goal of the fund is defined in the prospectus. Each mutual fund has a different goal. One fund may have a goal of income with preservation of capital while another fund's goal might be long-term capital appreciation.

Investment Strategy -- The prospectus details the strategy of the mutual fund. Does the fund invest in stocks and/or bonds? The strategy section will describe if the fund is focused on US investments or international investments or a combination of the two, known as global investments.

Shareholder Information -- The prospectus provides information relating to the purchase and redemption of fund shares. Minimum account balances and tax consequences of buying, selling, holding, or exchanging shares of the fund are listed in this section of the prospectus.

Risks -- The prospectus describes the risks associated with investing in the fund. If the fund invest in equities, for example, prospectus will discuss risks of investing in the stock market. The prospectus will also list risks of investing in the particular strategy of the fund. For example, the prospectus for the US large cap fund Vanguard 500 Index reads: "Large-cap stocks tend to go through cycles of doing better -- or worse -- than the stock market in general.

These periods have, in the past, lasted for as long as several years." You should read about, and understand, the risks of the fund prior to investing.

Performance Information -- You will find performance information sliced in many ways in the prospectus. The total return for various time periods since inception including: calendar year returns, trailing period returns (1 year, 3 year and 5 year, for instance), and both before tax and after tax returns. The performance data is based on formulas set forth by the SEC which allows you to compare performance from one fund to the next with confidence that you are comparing apples to apples. There is probably no reason for me to mention that past performance doesn't guarantee future performance (but we can hardly discuss performance without the caveat).

Fees and Expenses -- The prospectus lists the shareholder fees and the annual operating expenses of the fund. The shareholder fees consist of sales charges and redemption fees. The operating expenses -- also known as the expense ratio -- include management fees and 12b-1 fees. The prospectus also includes a hypothetical investment and the impact these fees and expenses would have on the hypothetical investment over time. The hypothetical example will allow you to compare the costs of investing in one fund covered by the prospectus versus costs of investing in other mutual funds.

Financial Highlights -- The financial highlights section of the prospectus includes audited data that is derived from the fund's financial statements. The data is listed in a table and *-------includes a reconciliation of the beginning period net asset value and ending period net asset value (for five calendar years). In other words, what was the fund worth at the beginning of the year, how much did it earn, what were the charges, and how much was the fund worth at the end of the year.

Conclusion

Indian mutual fund industry is still lacking far behind in terms of total assets with respect to other developed nations. One of the main reasons for poor growth is the lack of awareness and investors' trust on companies and policy makers

Therefore, for promoting the growth of Indian mutual fund industry, it is very crucial to understand the investors' behaviour towards different investment options and for mutual funds. For motivating investors towards the investment in mutual funds, companies must know the factors in which these are lacking in comparison to other investment options. From the above discussion, it can be concluded that Indian mutual fund industry is in its growth phase and possesses a tremendous scope for development. Some crucial issues which need to be investigated are the analysis of mutual funds' performance in terms of their efficiency, impact of various attributes on performance and behaviour of investors towards mutual funds and other investment options.

REFERENCES

Websites | http://www.presidencybusinessschool.org/download/Factors_influencing_consumer_adoptionof_internet_banking%20_in_India.pdf | http://www.arraydev.com/commerce/jibc/2010-04/Singh.pdf | http://www.iajet.org/iajet/iajet_files/vol.2/no.1/Internet%20Banking%20Adoption%20in%20an%20Emerging%20Economy%20Indian%20Consumers%20Perspect\\.pdf... | http://is2.lse.ac.uk/asp/aspecis/20110250.pdf | http://www.thefreelibrary.com/An+insight+into+factors+influencing+bank+selection+decisions+of...-a0179978535 | http://shodhganga.inflibnet.ac.in/bitstream/10603/3563/12/12_chapter%204.pdf | http://jms.nonolympictimes.org/Articles/marticle.pdf | http://www.isrj.net/UploadedData/884.pdf | http://indianresearchjournals.com/pdf/APJMMR/2012/December/2.pdf | http://indianresearchjournals.com/pdf/IJMFSMR/2012/June/11.pdf | http://indianresearchjournals.com/pdf/APJMMR/2012/December/2.pdf | http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1543420 | http://www.imf.org/external/pubs/ft/fandd/2002/09/nsouli.htm | http://businesstoday.intoday.in/story/best-banks-2012-indian-banking-challenges/1/189858.html | http://media2.intoday.in/businesstoday/images/KPMG-column-indian-banking-system%20_2_.pdf | http://www.rbi.org.in/scripts/PublicationReportDetails.aspx?ID=243 | http://scholar.google.co.in/scholar?start=80&q=research+papers+on+investors+behaviour+in+india&hl=en&as_sdt=0,5 | http://papers.ssrn.com/sol3/papers.cfm?abstract_id=876874 | file:///D:/Download/SSRN-id876874.pdf | http://vslir.iimahd.ernet.in:8080/xmlui/handle/123456789/1642 | http://vslir.iimahd.ernet.in:8080/xmlui/handle/123456789/31 | http://joaag.com/uploads/4_PrasannaFinal3_2_.pdf | http://vis.sagepub.com/content/9/4/27.short | http://www.tandfonline.com/doi/abs/10.1080/13600819808424151#.VBU-SvmSwyI | http://www.tandfonline.com/doi/pdf/10.1080/13600819808424151#.VBU_WfmSwyI | http://www.jstor.org/discover/10.2307/4413246?uid=3738256&uid=2&uid=4&sid=21104160742011 | file:///C:/Users/SESA70717/Desktop/Articles/SSRN-id876874.pdf | http://www.investopedia.com/terms/b/behavioralfinance.asp | |