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Risk and Performance of Mutual Fund

KEYWORDS: Debt fund, equity fund, fund allocation, Scheduled Commercial Bank

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ABSTRACT *Investors have two options to invest either in equity or in debt fund in mutual fund. The Indian financial institutions chose debt fund. More than two-third of total collected funds by Scheduled Commercial Banks has been allocated to debt fund. The State Bank of India has allocated most of its fund in debt having low risk and has performed well.*

Introduction

Investors have two options-Demat account or mutual funds-to choose. In the former case investors directly enter the financial market by opening Demat account in which securities are bought or sold with the help of brokers. In the later case capitals of the investors are pooled through selling retail investment products and funds are professionally managed by fund manager. This capital in mutual fund is either invested in equity fund or debt fund. It infers that an investor has three options – opening Demat account, Choosing equity fund or opting debt fund.

Literature Review

Mutual fund is the combination of equity, debt and hybrid fund. Equity mutual fund is risk adjusted return in which individual fund does not earn higher returns from following the momentum strategy in stock (Carhart, 1997) because of investment constraints (Almazan, 2004). Restriction on competing products is the reason of the development of money market and short term bond funds (Klapper, 2000). Therefore, an investor should invest in small equity fund whose trading activity is high (Dahlquist, 2000) or whose expense ratio is low (Malkiel, 1995) . Funds that heavily underperform have very high expense ratio, while funds that are successful do not increase revenues by raising their fees but benefit from increased size of their funds (Elton 1996, Carhat 1997). Actively managed equity funds charge higher fees than index tracking funds or bond and money market funds, reflecting the higher costs of employing investment management staff to achieve diversification and strategy (James et al. 1999). Funds charge lower fees when they have smaller boards and a large proportion of independent directors (Tufano and Sevick, 1997). Larger and more mature funds as well as no load funds have lower expense ratio (Malhotra and Mcleod, 1997). Aggressive growth funds charge higher entry and exit fees to discourage redemption because they hold more of the smaller, less liquid stocks (Chordia, 1996). However, despite the basic academic advice offered to investors to prefer low expense index funds, actively managed funds continue to be popular (Gruber, 1996). To decrease the risk it is advised to use derivative. Bond mutual fund uses derivatives more than equity mutual funds. Use of derivative is negatively correlated with fund age and positively correlated with fund size (Johnson and Yu 2004) and it is positively correlated with asset turnover (Koski and Pontiff, 1999). Derivatives are used for trading rather than hedging (Minton et al. 2009).

Objective

To know the risk and performance associated with mututal fund.

Methodology

Risk (β), expense ratio and NAV (Net Asset Value) has been used in the present study to the risk and performance of the fund. A case study of State Bank of India (SBI) has been undertaken for the study to know the pragmatic knowledge about risk.

Analysis

Table-1 gives better ideas about allocation of funds. It shows that risk taker rich investors should invest in equity fund and risk averter poor investors should invest in debt fund (G-Sec, Certificate of Deposit and so on). Table-2 and able-3 infer that equity fund is highly risk than debt fund. Equity fund gives higher return than debt fund.

Table-1: A comparative study of gain between Equity Fund and Debt Fund

Issues	Mutual Fund	
	Equity Fund	Debt Fund
Volatility	Highly volatile	Less volatile
Gain depends on	Market growth	Government declaration
Possibility of no gain	yes	No
Possibility of Loss	Yes	No
Possibility of very high gain	yes	Lower than equity fund
Suitable for	Rich investors	Middle
Who should invest	flexible income investor	Fixed income investor

Table-2: Risk and Performance associated with SBI Equity Mutual Fund

Funds	Risk (β)	Expense ratio	Minimum Investment (Rs.)	NAV		Sectoral Fund Allocation	
				Growth	Dividend	Production	Services
Equity	0.91	2.25	1000	41	27.56	26.69	73.31
Global	0.94	2.08	2000	53.64	27.23	45.96	54.54
Emerging	1.07	2.25	2000	42.29	16.01	32.26	67.74
Multiplier	0.80	2.02	1000	72.95	46.08	32.33	67.67
FMCG	0.64	2.49	2000	-	33.26	0.33	99.67
Pharma	1.02	2.49	2000	45.92	37.96	98.21	1.79
I.T.	0.99	2.49	2000	-	21.79	0.00	100
Contra	0.94	1,86	2000	48.86	16.05	39.60	60.40
PSU	-	2.28	5000	8.35	8.35	20.79	79.21
Arbitrage	0.49	1.84	25000	14.42	12.42	7.80	92.20

Source: SBI Mutual Fund Brochure, February 2012

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Table-3: Risk and Performance associated with SBI Debt Mutual Fund

Funds	Risk (β)	Expense ratio	Min Inves tment (Rs.)	NAV CD		Asset Allocation (%)				
						CP	NCD	G-sec	Other	
Ultra	-	0.33	10000	1000		65.05	27.30	-	-	7.65
S.T.	-	0.63	10000	10.35		35.86	0.77	54.47	-	8.90
MIP	-	1.99	10000	10.33		13.79	5.73	40.14	15.58	20.76
Liquid Premier	-	0.07	50 L	1003		64.42	28.74	-	-	6.84
Children Benefit	-	1.54	1500	23.82		12.24	-	43.64	-	44.12
Income Plus	-	1.25	25000	11.9	10.78	-	-	49.06	-	50.94
Income Magnum	-	1.30	2000	11.31		21.31	-	28.06	29.61	21.02
Gilt Short	-	0.84	25000	20.9	11.27	-	-	-	6.76	93.24
Gilt Long	-	1.19	25000	10.5		-	-	-	57.69	42.31
Floater	-	1.65	10000	10.47		67.64	-	15.08	-	17.28

Source: SBI Mutual Fund Brochure, February 2012

Note:
(1) Other source of asst allocation includes -Reserve repo, equity Shares, T-bills, Zero Coupon bond, Short term deposit
(2) Production Sector includes automobile, construction, metals, pharmacy, cement, industrial manufacturing, textiles, fertilizers & pesticides and chemicals

Conclusion

Mutual fund gives two options two be invested- equity and debt funds. Equity fund is volatile and highly risky but it gives comparatively more return to investors. Debt fund is less risky, less volatile but gives comparatively low return.

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