Volume : 1 | Issue : 10 | October 2012 ISSN - 2250-1991

Research Paper Management

Strategies for Mutual Fund Investment

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ABSTRACT

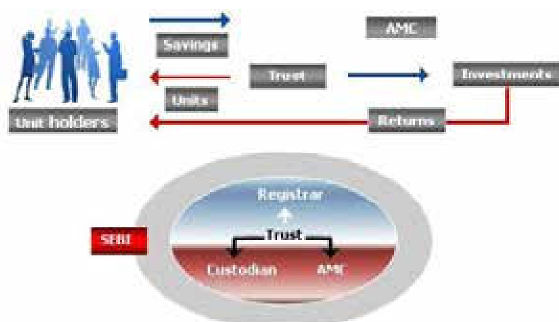
Over the past decade, investors of India increasingly have moved to mutual funds to save their hard earned money for their various goals. Mutual funds can provide the advantages of diversification and professional management. But, as with other investment choices, investing in mutual funds involves risk. Also fees and taxes may diminish a fund's returns. To make mutual funds work for you, you are required to understand their strategies and risks. On the other side there are thousands of mutual funds to choose from and a lot of options to consider. Knowing a strategy can enable mutual funds investors to properly evaluate performance, adopt reasonable expectations, and build a portfolio of funds that work together. It also can help investors to choose products that match their goals and tolerance for risk.

Keywords : Factors for mutual funds, Investor risk spectrum, Mutual fund schemes, Mutual fund investment strategies

Concept of Mutual Funds

A mutual fund is just the connecting bridge or a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual funds have fund manager who are responsible for investing the gathered money into specific securities depending upon the objective of the scheme. These could range from shares to debentures to money market instruments. When investors invest in a mutual fund, they are buying units or portions of the mutual fund and thus on investing becomes a unit holder of the fund. The income earned through these investments and the capital appreciations realized by the scheme are shared by its unit holders in proportion to the number of units held by them (pro rata). Mutual funds are regarded as one of the best available investment options as compare to others they are very cost efficient and also easy to invest in, thus by pooling money together in a mutual fund, investors can purchase stocks or bonds with much lower costs than if they tried to do it on their own. But the biggest advantage to mutual funds is diversification.

Working of Mutual Fund



Literature Review

Jensen (1968) brings forward two dimensions under which the ability and strategies of the fund manager can influence the fund returns. Polito (1992) says that fund/scheme selection by investors is based on past performance of the funds and money flows into winning funds more rapidly than they flow out of losing funds. Teo and Woo (2004) conclude that investors might profit from attempting to time style movement, but it remains unclear how this effect relates to managers' investment style consistency. There is no doubt that the investment styles of mutual funds influences the return the mutual funds produced (Harlow and Brown, 2004). Although most investors know that the actual investment style of mutual funds is the one of the most important factor which may affect their performance, few of them know that the style execution of mutual fund managers can also affect's fund return (Brown, Harlow and Zhang, 2009). According to Massa and Pager (2008) – The mutual funds with high level of risk have higher returns. The managers can induce the diversified portfolio to give the balanced of returns to the company.

NEED AND SIGNIFICANCE OF THE STUDY

The impressive growth of mutual funds in India has drawn the attention of Indian investors especially small investors during past ten years. The Indian mutual fund industry is currently in the phase of consolidation. The plethora of different types of mutual funds available in the market can leave a potential fund investor confused. The investor is lured to mutual funds as an investment option by the promise of less risk, as opposed to the risk entailed by inexperienced investors who are deal directly in the stock market. However, with the gamut of types of mutual funds on offer, an investor finds that selecting a suitable mutual fund is in itself a difficult task. This study emphasis on general guide to selecting a suitable fund and scheme from the different types of mutual funds available.

Statement of the Problem

When a person opens up a newspaper, he or she get to know reliance equity linked scheme is a good mutual fund. After a few hours, he switch on his television, he finds ICICI Prudential 100 is a good fund and there is a big list of other mutual funds which investors are unable to recognize and remind. But how many mutual funds should they have in their portfolio and what type of mutual funds should they have. This is a not a single word answer. Investors are wiling to investment in mutual funds to earn higher returns but they commit some mistakes due to which they suffer losses instead of profits. There are certain mutual funds investing strategies which must be considered by each and every investor.

OBJECTIVE OF THE STUDY

1. To gain an understanding and knowledge of Mutual Funds as an Investment Tool.

2. To study the diversification of mutual fund.
3. To frame suggested strategy for providing the quality investment products through the mutual funds.
4. To understand the factors to be considered while investing in mutual funds

Data Collection – Tool
A Research is purely and simply the framework of plan for a study that guides the collection and analysis of data. As the study is intended to explain strategies for mutual fund investment, secondary data has been an important source and was collected from the fact sheets, newspapers, journals, books, periodicals, websites, etc. The research is empirical in nature.

Various Schemes for Various Investors
Growth Schemes
These schemes aim is to provide capital appreciation over the medium to long term. These schemes normally invest a majority of their funds in equities and are willing to bear short term decline in value for possible future appreciation.

These schemes are ideal for
§ Investors who are in their prime earning years.
§ Investors who are seeking growth over the long term
§ These schemes are not for investors seeking regular income or needing their money back in the short term.

Income Schemes
These schemes aim is to provide regular and steady income to investors. These schemes generally invest in fixed income securities such as bonds and corporate debentures. Capital appreciation in such schemes may be limited.

These schemes are ideal for
§ Retired people and others who are in need for capital stability and regular income.
§ Investors who need some income to supplement their earnings.

Balanced Schemes
These schemes aim is to provide both income and growth by periodically distributing a part of the income and capital gains they earn. They are investing in both shares and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace or fall equally when the market rises or falls.

These schemes are ideal for
§ Investors who are looking for a combination of income and moderate growth.

Gilt Funds
Gilt funds are mutual funds that invest in government securities (G-Secs). Government securities include central government dated securities, state government securities and treasury bills. Unlike conventional debt funds that invest in all types of debt instruments, gilt funds target just a given category of debt instruments that is government securities. These securities are issued by the Reserve Bank of India (RBI) on behalf of the Government of India. Being sovereign paper, they do not expose investors to much credit risk. The first gilt fund in India was set up in December 1998.

These funds are ideal for
§ Those investors who want more safety for their investments or are risk-averse and, at the same time, are looking for reasonable returns on their money.

Money Market / Liquid Schemes
These schemes aim is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer, short term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate, depending upon the interest rates prevailing in the market.

These schemes are ideal for
§ Corporate and individual investors as a means to park their surplus funds for short periods or awaiting a more favourable investment alternative.

Other Schemes
Tax Saving Schemes (Equity Linked Saving Scheme - ELSS)
These schemes offer tax incentives to the investors under tax laws as prescribed from time to time and promote long term investments in equities through Mutual Funds.

These schemes are ideal for
§ Investors who are seeking tax incentives to reduce their tax on their income

Index Schemes
This category includes index schemes that attempt to replicate the performance of a particular index such as the BSE Sensex, the NSE 50 (NIFTY) or sector specific schemes which invest in specific sectors such as Technology, FMCG, Banking, Infrastructure, Pharma etc. Over and above, there are also schemes which invest exclusively in certain segments of the capital market, such as Large Caps, Mid Caps, Small Caps, Micro Caps, ‘A’ group shares, shares issued through Initial Public Offerings (IPOs), etc.

These schemes are ideal for
§ Investors who are satisfied with a return approximately equal to that of an index sector fund schemes
§ Those investors who have already decided to invest in a particular sector or segment

Fixed Maturity Plans
Fixed Maturity Plans (FMPs) are investment schemes floated by mutual funds and are close- ended with a fixed tenure, the maturity period ranging from one month to three to five years. These plans are predominantly debt-oriented, while some of them may have a small equity component. The objective of such a scheme is to generate steady returns over a fixed-maturity period and protect the investor against market fluctuations. FMPs are typically passively managed fixed- income schemes with the fund manager locking into investments with maturities corresponding with the maturity of the plan. FMPs are not guaranteed products.

These schemes are ideal for
§ Risk-averse investors who seek other avenues for investment and in the process keep money in the form of bank deposits
§ Investors who want to park money for a fixed period of time with a view to meeting certain financial goals in near future

Gold Funds or Gold Exchange Traded Funds (GETFs)
The objective of these funds is to track the performance of Gold. The units represent the value of gold or gold related instruments held in the scheme. Gold Funds which are generally in the form of an Exchange Traded Fund (ETF) are listed on the stock exchange. . The first Gold ETF in India, Benchmark GETF, opened for subscription on February 15, 2007 and listed on the NSE on April 17, 2007.

These funds are ideal for
§ Investors who want to participate in the bullion market without having to take physical delivery of gold and like earn return from the gold

Exchange Traded Funds (ETFs)
Exchange Traded Funds are essentially index funds that are listed and traded on exchanges like stocks. Globally, ETFs have opened a whole new panorama of investment opportunities to retail as well as institutional investors. The first ETF in India, Benchmark Nifty Bees, opened for subscription on December 12, 2001 and listed on the NSE on January 8, 2002.

These schemes are ideal for

§ Investors want to gain broad exposure to entire stock markets as well as in specific sectors with relative ease, on a real-time basis and at a lower cost than many other forms of investing..

Capital Protection Oriented Schemes
Capital Protection Oriented Schemes are schemes that attempt to protect the capital as the primary objective by investing in high quality fixed income securities and generate capital appreciation by investing in equity / equity related schemes as a secondary objective. The first Capital Protection Oriented Fund in India, Franklin Templeton Capital Protection Oriented Fund opened for subscription on October 31, 2006.

These Schemes are ideal for
§ Those investors who want to protect their capital invested in the mutual fund on maturity through focused investments in equity, debt and money market instruments, at the same time also seeking to invest for long-term growth in capital

Real Estate Mutual Funds
Real Estate Mutual Funds or realty funds as they are popularly known are the latest addition to the mutual fund offerings in India. SEBI recently paved way for the launch of such products, by making amendments to its existing Regulations. These schemes invest in real estate properties and earn income in the form of rentals, capital appreciation from developed properties. Also some part of the fund corpus is invested in equity shares or debentures of companies engaged in real estate assets or developing real estate development projects. REMFs are required to be close-ended in nature and listed on a stock exchange.

These schemes are ideal for
§ Those investors who propelling their investments into real estate rather than direct investment in real estate which require large chunk of money.

Funds Investing Abroad
With the opening up of the Indian economy, Mutual Funds have been permitted to invest in foreign securities/ American Depository Receipts (ADRs) / Global Depository Receipts (GDRs). Some of such schemes are dedicated funds for investment abroad while others invest partly in foreign securities and partly in domestic securities. While most such schemes invest in securities across the world there are also schemes which are country specific in their investment approach.

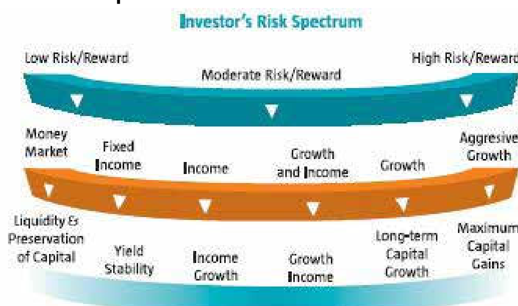
These schemes are ideal for
§ Those who like to invest in foreign markets by purchasing Exchange Traded Funds (ETFs) or mutual funds that hold a basket of international stocks and bonds.

Fund of Funds (FOFs)
Fund of Funds are schemes that invest in other mutual fund schemes. The portfolio of these schemes comprise only of units of other mutual fund schemes and cash / money market securities/ short term deposits pending deployment. The first FOF was launched by Franklin Templeton Mutual Fund on October 17, 2003. Fund of Funds can be Sector specific e.g. Real Estate FOFs, Theme specific e.g. Equity FOFs, Objective specific e.g. Life Stages FOFs or Style specific e.g. Aggressive/ Cautious FOFs etc.

These schemes are ideal for
§ These schemes allow investors who want to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories that are all wrapped up into one fund.

Risk for Mutual Fund Investment
Every type of investment including mutual funds involves risk. Risk refers to the probability that you will lose money (both principal and any earnings) or fail to make money on an investment. A fund's investment objective and its holdings are influential factors in determining how risky a fund is. Generally speaking, risk and potential return are related. This is the risk/return trade-off. Higher risks are usually taken with the expectation of higher returns at the cost of increased volatility. While a fund with higher risk has the potential for higher return, it also has the greater potential for losses or negative returns. The school of thought when investing in mutual funds suggests that the longer your investment time horizon is the less affected you should be by short-term volatility. Therefore, the shorter your investment time horizon, the more concerned you should be with short-term volatility and higher risk.

Investor risk spectrum



Most mutual fund products (except capital guaranteed funds) have underlying assets (Equities, Bonds etc.) that fluctuate on a daily basis. Hence capital loss due to lower prices of the underlying assets or default on bonds is possible.

There are commercials of mutual fund schemes that end with a disclaimer: "Mutual fund investments are subject to market risks ... "This is true. Like any non- guaranteed financial instrument there are various risks involved in investing in mutual funds such as Mutual funds invest in different securities which may be equities or bonds, depending upon the fund's objectives. Accordingly, different schemes have different risks depending on the portfolio composition.

Mutual funds face risks based on the investments they hold. For example money markets offer the greatest price stability but have yielded the lowest long-term returns. Fixed income mutual funds are an excellent diversification tool for investors' portfolios. Fixed income schemes have stable return while income schemes have moderate risk and income growth. Growth schemes have high risk and high return.

RISK IN MUTUAL FUND INVESTMENT
§ Price Risk (Risk of falling shares/bonds price in funds)
§ Principal Risk (Risk of losing principal amount)
§ Manager Risk (Fund manager fail to execute fund's investment strategy effectively)
§ Inflation Risk (Increase in cost of living make yields of mutual funds less)
§ Country Risk (Event in country can influence value of the funds)
§ Currency Risk (rising or falling value of the rupee against foreign currency results in a reduction in returns for investors)
§ Change in the government policy
§ Default risk (defaulting on repayment affecting income/ debt/hybrid funds and in turn impact on net asset value of the fund)
§ Credit Risk (Investment in dated securities may fail to pay interest and principal on time and result in fund value reduction)

Mutual Fund Investment Strategies
Appropriate asset allocation and effective diversification and suitable fund selections. These are some of the fundamental goals that every investor should be willing to have in a mutual fund portfolio. These goals are necessary for mutual fund portfolios to be successful. However, investors can face many roadblocks or pitfalls in the quest to attain these goals. The study examines three ways to make mutual funds investment

successful.

1. Identify Investment Objectives
First, identify the objective of the investment. Some objectives of investing in mutual funds may include:

§ Capital appreciation which aims at aggressive or optimal growth.
§ Regular income in the form of dividend payment, with preservation of capital.
§ Low level of risk
§ Easy liquidity
§ Tax planning

The investment objective may include one or more of the above, even combination. The investment goal of the fund must coincide with that of the investor. The fund should be chosen according to the investors risk tolerance. The objective of high returns is generally associated with high risk.

2. Asset Allocation Strategy
This is probably the most often made mistake every investor make while investing in mutual funds. The vast number of individuals who select specific mutual funds without giving any thought to an asset allocation strategy. Many investors may actually define and identify their investment objectives, but then ignore the next important step in establishing a successful mutual fund portfolio that is creating a detailed asset allocation strategy. Without a well defined, appropriate asset allocation strategy that accurately reflects individual investment objectives and preferences (time horizon, return objectives, risk tolerance, etc), the selection of mutual funds will be haphazard instead of a logical, clear-cut process. And the outcome of haphazard fund selection is inappropriate asset allocation, which in turn causes ineffective diversification -- with the final result being poor or mediocre portfolio performance.

Time Horizon- Time horizon is the expected number of months, years, or decades investor will be investing to achieve a particular financial goal or objective. An investor with a longer time horizon may feel more comfortable taking on a riskier, or more volatile, investment because he or she can wait out slow economic cycles and the inevitable ups and downs of markets. By contrast, an investor saving up for a teenager's college education would likely take on less risk because he or she has a shorter time horizon.

Return Objectives- What type of return or cash flows investor is expecting whether need a regular cash flow or need a lump sum amount to meet a specific goals or need after a certain period or they don't require a current cash flow but they want to build their assets for the future. By going through such an exercise, they will know what they want out of their investment and can set the foundation for a sound Mutual Fund investment strategy

Risk Tolerance - Risk tolerance is investor's ability and willingness to lose some or all of their original investment in exchange for greater potential returns. An aggressive investor, or one with a high-risk tolerance, is more likely to take risk losing money in order to get better results in term of high return. A conservative investor, or one with a low-risk tolerance, tends to favor investments that will preserve his or her original investment. In the words of the famous saying, conservative investors keep a "bird in the hand," while aggressive investors seek "two in the bush."

What investors all need to do is to effective diversification. Effective diversification is a direct result of an appropriate detailed asset allocation strategy that fits individual investment objectives and preferences. Effective diversification spreads investment assets among different fund categories to achieve both a variety of distinct risk/reward objectives and a reduction in overall risk.

A) ASSET ALLOCATION STRATEGY FOR AGGRESSIVE RISK INVESTOR
They are generally willing to take higher risk for greater long-term returns and typically will be having a longer investment horizon. The investment portfolio will consist of a larger proportion of shares and with little fixed interest or defensive assets exposure. It is typically suited to an investor seeking long-term capital appreciation and who is comfortable with short term fluctuations in his capital value.

Their portfolio of mutual funds should contain 5 % in money market schemes, 10 – 15 % in Income schemes, 10 – 20 % in balanced mutual fund schemes and 60 – 70% in Growth mutual fund schemes

B) Asset Allocation Model for Moderate Risk Investor
Investors are ready to accept some short-term fluctuations in their capital value in return for higher returns which are anticipated to be higher than a conservative investor. This asset allocation model is typically suited to moderate risk taker investors who either seek to diversify risk with reasonable returns or who have a medium-term investment horizon (minimum of 3 to 5 years).

A typical investment portfolio for a moderate investor will contain 10 % in money market schemes, 20% in Income schemes, 40 – 50 % in balanced mutual fund schemes and 30 – 40% in Growth mutual fund schemes

C) Investment Portfolio Strategy for Conservative Risk Investor
Investors with a conservative approach to investing are generally seeking to preserve capital and are usually prepared to accept lower investment returns. The main emphasis is on defensive assets because they cannot tolerate any erosion of capital.

A conservative portfolio is typically suited to an investors who prefers reliable consistent returns or who has a short-term investment horizon. People who are in the retirement phase would generally be looking to invest in income mutual funds which invest primarily in the debt market. There should be a limited exposure to equity mutual funds since equity mutual funds returns are subject to stock market risks and volatility.

A typical investment portfolio or asset allocation model for a conservative investor will contain 10 % in money market schemes, 50 – 60% in Income schemes, 20 – 30 % in balanced mutual fund schemes and 10% in Growth mutual fund schemes.

It is not necessary that only senior citizens prefer such an asset allocation. Youngsters who don't wish to take risk also prefer such an asset allocation.

3. Avoid Duplication of Fund
Investors should avoid duplication of funds in their portfolio. This happens when an investor has two or more funds with same objectives. For instance, owning two small-cap growth funds or two large-cap growth funds and one intermediate corporate bond fund in a five-fund portfolio is inefficient diversification due to the duplication of fund objectives in the small and large-cap growth categories; in this arrangement they lack the variety of distinct risk/reward characteristics of ideal diversification. **To avoid duplication of funds,** it is best to represent a fund category with just one fund.

4. Invest regularly
One of the best strategies that work best is to invest a fixed amount at specific intervals, say every month. By investing a fixed sum each month, investors get fewer units when the price is high and more units when the price is low, thus bringing down average cost per unit. This is called rupee cost averaging and is a disciplined investment strategy followed by investors all over the world. With many open-ended schemes offering systematic investment plans.

Factors to be considered for selecting Mutual Fund
Currently more than thirty five hundred mutual fund schemes are available in the market where investment can be made. In

such scenario, it is a tough job for the investors to select that particular scheme which is appropriate for them. Market advisors suggest few points which should be kept in mind before entering into any contract with the Mutual Fund Company.

- § Past performance
- § Age and Size of the Fund
- § Fund manager performance
- § Timing for Investment
- § Comparison of the fund with benchmark Index
- § Type of Service offered and fees charged by funds
- § The fund's portfolio turnover rate (Frequency of buys and sells securities in funds)
- § NAV of the funds
- § Reading Prospectus

How Funds Can Earn Money
Investors can earn money from their investment in three ways:

1. Dividend Payments — A fund may earn income in the form of dividends and interest on the securities in its portfolio. The fund then pays its unit holders nearly all of the income (minus disclosed expenses) it has earned in the form of dividends.
2. Capital Gains Distributions — The price of the securities a fund owns may increase. When a fund sells a security that has increased in price, the fund has a capital gain. At the end of the year, most funds distribute these capital gains (minus any capital losses) to investors.
3. Increased NAV — If the market value of a fund's portfolio increases after deduction of expenses and liabilities, then the value (NAV) of the fund and its shares increases. The higher NAV reflects the higher value of the investment.

With respect to dividend payments and capital gains distributions, funds usually will give investor a choice: the fund can send investors a check or other form of payment, or investors can have their dividends or distributions reinvested in the fund to buy more units often without paying an additional sales load

Conclusion
With the opening of more and more number of funds every year, offering a wide range of schemes to investors, it becomes more complex for the investors to choose a particular fund fitting best to their needs and finances. Generally, the success of mutual funds investments over time will depend largely on how much money investors have invested in each of the major asset classes – stocks, bonds, and cash – rather than on the particular securities they hold. When choosing a mutual fund, they should consider how their interest in that fund affects the overall diversification of their investment portfolio. Maintaining a diversified and balanced portfolio is key to maintaining an acceptable level of risk.

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