What is a Mutual Fund?

A Mutual Fund is a body corporate registered with the Securities and Exchange Board of India (SEBI) that pools up the money from individual / corporate investors and invests the same on behalf of the investors / unit holders, in equity shares, Government securities, Bonds, Call money markets etc., and distributes the profits. In other words, a mutual fund allows an investor to indirectly take a position in a basket of assets

Why should I choose to invest in a mutual fund?

For a retail investor who does not have the time and expertise to analyze and invest in stocks and bonds, mutual funds offer a viable investment alternative. This is because:

- Mutual Funds provide the benefit of cheap access to expensive stocks
- Mutual funds diversify the risk of the investor by investing in a basket of assets
- A team of professional fund managers manages them with in-depth research inputs from investment analysts.
- Being institutions with good bargaining power in markets, mutual funds have access to crucial corporate information which individual investors cannot access.

How do mutual funds diversify their risks?

Financial theory states that an investor can reduce his total risk by holding a portfolio of assets instead of only one asset. This is because by holding all your money in just one asset, the entire fortunes of your portfolio depend on this one asset. By creating a portfolio of a variety of assets, this risk is substantially reduced.

If that is the case then why has Morgan Stanley Fund given such poor returns?

A very important factor that determines the returns on a fund is the timing of the fund's launch. Morgan Stanley Fund was launched when the equity markets were at their peak and then saw a sustained downtrend for close to 5 years. That is the reason the fund has taken such a long time to appreciate.

Can mutual funds be viewed as risk-free investments?

No. Mutual fund investments are not totally risk free. In fact, investing in mutual funds contains the same risk as investing in the markets, the only difference being that due to professional management of funds the controllable risks are substantially reduced.

What are the risks involved in investing in mutual funds?

A very important risk involved in mutual fund investments is the market risk. When the market is in doldrums, most of the equity funds will also experience a downturn. However, the company specific risks are largely eliminated due to professional fund management.

What are open-ended and closed-ended mutual funds?

In an open-ended mutual fund there are no limits on the total size of the corpus. Investors are permitted to enter and exit the open-ended mutual fund at any point of time at a price that is linked to the net asset value (NAV). In case of closed-ended funds, the total size of the corpus is limited by the size of the initial offer.

Do both open-ended and closed-ended funds come out with an initial offering?

Yes. But the only difference is that in case of open-ended funds, a month after the initial offer closes the continuous offer period starts when the investor can enter and exit the fund at a price linked to the NAV

Is the purchase and redemption in case of open-ended funds done at the NAV?

Generally every fund levies either an entry load or an exit load or both to provide for administrative and other routine costs. The purchase price will be higher than the NAV to the extent of the entry load and the redemption price will be lower than the NAV to the extent of the exit load.

What is the investor's exit route in case of a closed-ended fund?

According to Sebi regulations, all closed-ended funds have to be necessarily listed on a recognized stock exchange. Thus the secondary market provides an exit route in case of closed-ended funds.

How do I invest money in Mutual Funds?

One can invest by approaching a registered broker of Mutual funds (Mehta Tradelink Pvt Ltd) or the respective offices of the Mutual funds in that particular town/city. An application form has to be filled up giving all the particulars along with the cheque or Demand Draft for the amount to be invested.

What are the parameters on which a Mutual Fund scheme should be evaluated?

Performance indicators like total returns given by the fund on different schemes, the returns on competing funds, the objective of the fund and the promoters image are some of the key factors to be considered while taking an investment decision regarding mutual funds.

What are the different funds we currently have in India?

Currently there exist balanced funds, Income fund, Growth funds, Sector funds etc. To get more details about the different funds and their features please visit our mutual fund glossary

What are the different types of plans that any mutual fund scheme offers?

That depends on the strategy of the concerned scheme. But generally there are 3 broad categories. A dividend plan entails a regular payment of dividend to the investors. A reinvestment plan is a plan where these dividends are reinvested in the scheme itself. A growth plan is one where no dividends are declared and the investor only gains through capital appreciation in the NAV of the fund.

Which plan should I choose?

It depends on your investment object, which again depends on your income, age, financial responsibilities, risk taking capacity and tax status. For example a retired government employee is most likely to opt for monthly income plan while a high-income youngster is most likely to opt for growth plan.

What is a Systematic Investment Plan and how does it operate?

A systematic investment plan is one where an investor contributes a fixed amount every month and at the prevailing NAV the units are credited to his account. Today many funds are offering this facility.

What are the benefits of s Systematic Investment Plan?

A systematic investment plan (SIP) offers 2 major benefits to an investor:

- It avoids lump sum investment at one point of time
- In a scenario of falling prices, it reduces your overall cost of acquisition by a process of rupee-cost averaging. This means that at lower prices you end up

getting more units for the same investment

What is SIP?

SIP works on the principle of regular investments. It is like your recurring deposit where you put in a small amount every month. It allows you to invest in a MF by making smaller periodic investments (monthly or quarterly) in place of a heavy one-time investment i.e. SIP allows you to pay 10 periodic investments of Rs 500 each in place of a one-time investment of Rs 5,000 in an MF. Thus, you can invest in an MF without altering your other financial liabilities. It is imperative to understand the concept of rupee cost averaging and the power of compounding to better appreciate the working of SIPs

Can non-resident Indians (NRIs) invest in mutual funds?

Yes, non-resident Indians can also invest in mutual funds. Necessary details in this respect are given in the offer documents of the schemes.

What is NAV and how it is calculated?

NAV is the net asset value of the fund. Simply put it reflects what the unit held by an investor is worth at current market prices. For details on calculation methodology and formulae, please click on our mutual fund glossary

Like IPOs, can there be any situation wherein I am not allotted the units applied for in the initial offer?

In case of closed-ended funds there is a target amount and the funds are permitted a green-shoe option to retain over-subscriptions up to a certain limit. In case of open-ended funds there are no such limits and all applications are honored.

Can a Mutual Fund assure fixed returns?

As per Sebi Regulations, mutual funds are not allowed to assure returns. However, funds floated by AMCs of public sector banks and financial institutions were permitted to assure returns to the unitholders provided the parent sponsor was willing to give an explicit guarantee to honor such a commitment. But in general, mutual funds cannot assure fixed returns to their investors.

How much return can I expect by investing in mutual funds?

Investors need to be clear that mutual funds are essentially medium to long term investments. Hence, short-term abnormal profits will not be sustainable in the long run. But in the medium to long run the mutual funds tend to outperform most other avenues of investments at the same time avoiding the risk of direct investment accompanied with professional fund management.

What is the difference between mutual funds and portfolio management schemes?

While the concept remains the same of collecting money from investors, pooling them and investing the funds, the target investors are different. In the case of portfolio management the target investors are high networth investors while in case of mutual funds the target investors are the retail investors.

How does the concept of entry load work in case of unit purchases?

An entry load is an additional cost that an investor pays at the point of entry. Assume that your proposed investment is Rs.10,000/-. Also assume that the current NAV of the fund is Rs.12.00 and that the entry load is Rs.0.50. Then you will receive 10000/12.50 = 800 units. For detailed explanation of entry load, refer our mutual fund glossary. Currently, there is no Entry load for investing in mutual funds.

How does the concept of exit load work in case of unit redemptions?

An exit load is levy that an investor pays at the point of exit. This is levied to dissuade investors from exiting the fund. Assume that the current NAV of the fund is Rs.12.00 and that the exit load is Rs.0.50. Now if you sell 800 units then you stand to receive 800X11.5 = Rs. 9200. For detailed explanation of exit load, refer our mutual fund glossary.

Can an investor redeem part of the units?

Yes. One can redeem part units also.

Say I redeem and buy and do likewise several times then, how do I keep track of my portfolio?

The moment you buy or get allotted the units, it will appear online at www.mehtatradelink.com. In mutual fund terminology it is called Account Statement.

You will also be able to view your percentage returns alongwith tax impact on every transaction.

What are the broad guidelines issued for a MF?

SEBI is the regulatory authority of MFs. SEBI has the following broad guidelines pertaining to mutual funds :

- MFs should be formed as a Trust under Indian Trust Act and should be operated by Asset Management Companies (AMCs).
- MFs need to set up a Board of Trustees and Trustee Companies. They should also have their Board of Directors.
- The net worth of the AMCs should be at least Rs.5 crore.
- AMCs and Trustees of a MF should be two separate and distinct legal entities.
- The AMC or any of its companies cannot act as managers for any other fund.
- AMCs have to get the approval of SEBI for its Articles and Memorandum of Association.
- All MF schemes should be registered with SEBI.
- MFs should distribute minimum of 90% of their profits among the investors.

There are other guidelines also that govern investment strategy, disclosure norms and advertising code for mutual funds.

Am I eligible for rebate on income tax by investing in a MF?

Yes in case of certain specific Equity Linked Saving Schemes, tax benefits are available under Section 88 of the Income Tax Act. In such cases the fund prospectuses explicitly states that it is a tax saving fund. In such cases 20 percent of your contribution will qualify for rebate under Section 88 of the Income Tax Act.

Do mutual fund investments attract wealth tax?

No. Under the Wealth Tax Act, all financial assets, including mutual fund units are exempt totally from Wealth Tax.

If I gift mutual fund units, does it attract gift tax?

No. With effect from 1st October 1998, units of a mutual fund gifted by unitholders are no longer chargeable to Gift Tax.

Is my income from mutual funds exempt from income tax?

Yes. Your income from mutual funds in the form of dividends is entirely exempt from income tax provided the fund in question is a equity/growth fund where more than 50 percent of the portfolio is invested in equities.

Moreover, Long Term Capital Gains (investment more than 12 months) in equity funds is exempt from Income Tax.

Please note that in the current Union Budget 2000, the tax on debt funds has been increased from 10 percent to 20 percent.

What are my major rights as a unit holder in a mutual fund?

Some important rights are mentioned below:

- Unit holders have a proportionate right in the beneficial ownership of the assets of the scheme and to the dividend declared.
- They are entitled to receive dividend warrants within 42 days of the date of declaration of the dividend.
- They are entitled to receive redemption cheques within 10 working days from the date of redemption.
- 75% of the unit holders with the prior approval of SEBI can terminate AMC of the fund.
- 75% of the unit holders can pass a resolution to wind-up the scheme.

How can the investors redress their complaints?

Investors would find the name of contact person in the offer document of the mutual fund scheme whom they may approach in case of any query, complaints or grievances. Trustees of a mutual fund monitor the activities of the mutual fund. The names of the directors of asset management company and trustees are also given in the offer documents. Investors should approach the concerned Mutual Fund / Investor Service Centre of the Mutual Fund with their complaints,

If the complaints remain unresolved, the investors may approach SEBI for facilitating redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with it regularly. Investors may send their complaints to:

Securities and Exchange Board of India,
Office of Investor Assistance and Education (OIAE)
Plot No.C4-A , "G" Block, 1st Floor,

Bandra-Kurla Complex, Bandra (E), Mumbai - 400 051.
Phone: 26449199-88-77

How to diversify?

Don't just zero in on one mutual fund (to avoid the risk of being overly dependent on any one fund). Pick two, preferably three mutual funds that would match your investment objective in each asset allocation category and spread your investment. We recommend a 60:40 split if you have shortlisted 2 funds and a 50:30:20 split if you have shortlisted 3 funds for investment.

Is it good to buy a fund just before it goes ex-dividend?

When a fund goes ex-dividend, the unit holders (as of the ex-dividend date) are paid out a dividend and the NAV of the fund declines by the amount of dividend per unit paid out. For an investor (who has bought the fund prior to the ex-dividend date), this results in an income that is tax-free in the hands of the investor and a capital loss (as the ex-dividend NAV will be lower than the cum-dividend NAV at which the investor made his investment) . For e.g., if a funds NAV is Rs11 and it pays out Rs1 as dividend, its ex-dividend NAV will be Rs10. In this case, the investor has a dividend (tax-free) income of Re1 and a capital loss of Re1 (Rs11-Rs10) . If the investor has made a corresponding capital gain, then it is tax-beneficial to purchase the units of mutual fund just before it goes ex-dividend, take the dividend and then sell the units (at the ex-dividend rate) and book the capital loss. If there were no tax benefits, from a pure returns perspective, there would not be any difference in buying a fund cum- or ex-dividend.

What are the different types of Mutual Funds?

Mutual Funds are classified by structure in to:

Open - Ended Schemes
Close-Ended Schemes
Interval Schemes
Equity (Growth) Schemes
Income Schemes
Money Market Schemes
Tax Saving Schemes
Balanced Schemes
Offshore funds
Special Schemes like index schemes etc

Why should you invest through Mutual Funds?

Firstly, we are not all investment professionals. We go to a doctor when we need medical advice or a lawyer for legal guidance, similarly mutual funds are investment vehicles managed by professional fund managers. And unless you rate highly on the Investment IQ Quiz, we recommend you use this option for investing. Mutual funds are like professional money managers, however a key factor in their favour is that they are more regulated and hence offer investors the ability to analyse and evaluate their track record.

Secondly, investing is becoming more complex. There was a time when things were quite simple - the market went up with the arrival of the first monsoon showers and every year around Diwali. Since India started integrating with the world (with the start of the liberalisation process), complex factors such as an increase in short-term US interest rates, the collapse of the Brazilian currency or default on its debt by the Russian government, have started having an impact on the Indian stock market. Although it is possible for an individual investor to understand Indian companies (and investing) in such an environment, the process can become fairly time consuming. Mutual funds (whose fund managers are paid to understand these issues and whose asset management company invests in research) provide an option of investing without getting lost in the complexities.

Lastly, and most importantly, mutual funds provide risk diversification: Diversification of a portfolio is amongst the primary tenets of portfolio structuring (see The Need to Diversify). And a necessary one to reduce the level of risk assumed by the portfolio holder. Most of us are not necessarily well qualified to apply the theories of portfolio structuring to our holdings and hence would be better off leaving that to a professional. Mutual funds represent one such option.