NPTEL

Course Name: Security Analysis and Portfolio Management

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Session # 6: Mutual Fund Investment: Concepts & Practices

Q.1: Define mutual fund. State how does the mutual fund industry play a role in financial market?

Ans.: A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. By subscribing to mutual fund schemes, the investors are supposed to get the benefit of diversification thus reduction in risk involved. Mutual fund industry play the following role in financial market and economic growth.

- Channelization of Household Savings
- Augmenting Resource Mobilization in the Primary Market
- Substantiating Small Investors' Investment Avenues
- Providing Liquidity Facility (entry and exit options) to Investors
- Contributing to Growth in GDP

Q.2: What are the advantages of investing in mutual funds?

Ans.: the different advantages of investing in mutual funds are:

- Professional Management by qualified/ experienced personnel
- Diversification because of large number of stocks/ instruments
- Convenient Administration because of large pool of funds
- Return Potential
- Low Costs
- Liquidity (repurchase options provided by the AMC/ traded in the market)
- Transparency ensured by the regulator (SEBI in case of India)
- Flexibility in terms of amount involved, different types of schemes available
- Tax benefits (in case of select tax savings schemes floated)
- Well regulated

Q.3: What are different classifications of mutual funds?

Ans.: Mutual funds can be classified based on the following:

- By Structure: Open ended/ Close ended

- By Investment Objective: Growth/ Income/ Balanced
- Specialized funds: Sectoral funds/ money market funds/ tax savings funds etc.
- Base on load: no load or with load (entry or exit load) funds.

Q.4: What is a contra fund?

Ans.: A contra fund is a diversified equity fund. It parts company with other diversified equity funds in the types of stocks it chooses to invest in. As the name suggests, it follows a contrarian view to investing. This means the fund manager will deliberately bypass the popular stocks that everyone else is chasing. Instead, he will invest in companies that are not in fashion. Usually the fund managers invest in undervalued stocks fulfilling criteria fundamental strength, underperformance and change in the business environment

Q.5: What are the warning signals to be observed while investing in mutual funds?

Ans.: the following warning signals should be observed while investing in mutual funds:

- Fund's management changes
- Performance slips compared to similar funds.
- Fund's expense ratios climb
- Beta, a technical measure of risk, also climbs.
- Independent rating services reduce their ratings of the fund.
- It merges into another fund.
- Change in management style or a change in the objective of the fund.