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Introduction, Type and Advantages Of Mutual Funds

Mutual Funds

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WHAT IS A MUTUAL FUND?

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. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is one of the most suitable investments for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. It is an ideal tool for people who want to invest but don't want to be bothered with deciphering the numbers and deciding whether the stock is a good buy or not.

WHO CAN INVEST IN A MUTUAL FUND?

Anybody with an investible surplus of as little as a few hundred rupees can invest in mutual funds. The investors buy units of a fund that best suit their investment objectives and future needs. A Mutual Fund invests the pool of money collected from the investors in a range of securities after charging for the AMC fees.

HOW DOES A MUTUAL FUND APPRECIATE YOUR INVESTMENT?

A mutual fund manager proceeds to buy a number of stocks from various markets and industries. Depending on the amount you invest, you own part of the overall fund. The beauty of mutual funds is that the investor can reap returns as high as those of equity markets or have a steady and comparatively secure investment as offered by debt instruments. A Mutual Fund is thus, not an alternative investment option to stocks and bond; rather it pools the money of several investors and invests this in stocks, bonds, money market instruments and other types of securities.

WHAT ARE THE ADVANTAGES OF INVESTING IN A MUTUAL FUND?

There are several benefits from investing in a Mutual Fund.

Small investments: Mutual funds help you to reap the benefit of returns by a portfolio spread across a wide spectrum of companies with small investments. Such a spread would not have been possible without their assistance. Professional Fund Management: Professionals having considerable expertise, experience and resources manage the pool of money collected by a mutual fund. They analyze markets and the economy to select good investment opportunities.

Spreading Risk: An investor with a limited amount of fund might be able to invest in only one or two stocks / bonds, thus increasing his or her risk. However, a mutual fund will spread its risk by investing in a number of sound stocks or bonds, across sectors, so the risk is diversified, along with taking advantage of the position it holds. Also in cases of liquidity crisis where stocks are sold at a distress, mutual funds have the advantage of the redemption option at the NAVs (Net Asset Values). Transparency and easy access to information: Mutual Funds regularly provide investors with information on the value of their investments. Mutual Funds also provide complete portfolio disclosure of the investments made by various schemes and also the proportion invested in each asset type and clearly layout their investment strategy to the investor.

Liquidity: Closed ended funds have their units listed at the stock exchange, thus they can be bought and sold at their market value. Over and above this the units can be directly redeemed to the Mutual Fund as and when they announce the repurchase.

Choice: The large amount of Mutual Funds offer the investor a wide variety to choose from. An investor can pick up a MF scheme depending upon his risk / return profile.

Regulations: All the mutual funds are registered with SEBI and they function within the provisions of strict regulation designed to protect the interests of the investor.

WHAT ARE THE VARIOUS TYPES OF MUTUAL FUND SCHEMES?

Broadly, there are two types of schemes available:

1. Open-Ended Schemes
2. Close-ended Schemes

Open Ended Schemes : Open-ended schemes usually do not have a fixed maturity period and are available for subscription and redemption on an ongoing basis. The units can be bought and sold any time during the life of the scheme at NAV-related prices. Open-ended schemes can issue and redeem units any time during the life of the scheme. (Note: BSE StAR MF will accept all applications of those Open ended schemes that are offered by the respective AMCs)

Close ended Schemes : Close-ended schemes cannot issue new units except in case of bonus or rights issue. Hence, the number of units of an open-ended scheme can fluctuate on a daily basis while that is not the case for close-ended schemes. Another way of explaining this difference is that new investors can join the scheme by directly applying to the mutual fund at applicable net asset value related prices in case of open-ended schemes while that is not the case in case of close-ended schemes, where new investors can buy the units from secondary market only. (Note: Certain close ended schemes of AMCS are presently available for trading on the BSE's BOLT (Equity segment))