

Question Paper

Portfolio Management and Mutual Funds - II (252) : January 2007

Section D : Case Study (50 Marks)

- This section consists of questions with serial number 1 - 5.
- Answer all questions.
- Marks are indicated against each question.
- Do not spend more than 80 - 90 minutes on Section D.

Case Study

Read the case carefully and answer the following questions:

1. Systematic withdrawal plan of Kotak involves redeeming fixed or variable sums at monthly or quarterly intervals. What are the advantages of systematic withdrawal plan of Kotak? [< Answer >](#)
(8 marks)
2. Show the number of units accumulated and the value of the investment as on 1st August 2005, if Mr. Suraj opts for SIP in Kotak 30 Growth Fund and his investment commences from 1st September 2004 by investing Rs.5,000 p.m. for a period of 12 months. [< Answer >](#)
(8 marks)
3. Compute the number of units and amount of investment in both Kotak 30 Growth Fund and Kotak Bond Regular as on 1st August 2006, if Mr. Suraj opts for STP (Fixed Option) from Kotak 30 Growth Fund to Kotak Bond Regular which commences on 1st September 2005 by transferring Rs.5,000 p.m. for a period of 12 months. [< Answer >](#)
(12 marks)
4. Compute the number of units and amount of investment in both Kotak 30 Growth Fund and Kotak Bond Regular as on 1st August 2006, if Mr. Suraj opts for STP (Appreciation Option) from Kotak 30 Growth Fund to Kotak Bond Regular which commences on 1st September 2005 by transferring the appreciation amount for a period of 12 months. [< Answer >](#)
(14 marks)
5. Systematic investment plan, which is similar to dollar cost averaging, can be considered as a formula plan. Formula plans relieve the investor from the pressures relating to forecasting of fluctuations in security prices. However, formula plans should not be looked at as a sure short way of maximizing returns. These plans have their own weaknesses. Explain. [< Answer >](#)
(8 marks)

Mr. Suraj, aged 52 years, is a middle level employee of a private company earning Rs.15,000 p.m. He has one son and one daughter. His son is a software engineer, working in U.S.A. His daughter is a leading doctor in one of the reputed private hospitals. Both are well settled with their respective independent families. The only person who is dependent on Mr. Suraj is his wife. Mr. Suraj does not have any inherited or accumulated property and is planning to be financially independent of his children even after retirement. He will receive pension after his retirement. And he wants to maintain his life more comfortable and hence planning for different investment avenues. For this purpose, he approached Mr. Narendra, an investment advisor. Mr. Narendra suggested him to opt for systematic investment plan, systematic withdrawal plan and systematic transfer plans being offered by Kotak Mutual Fund. He also suggested him to opt for Kotak 30 growth option and Kotak bond fund (Regular) for such investment.

Systematic Investment Plan (STP) offered by Kotak

The best way to enter a mutual fund is via an SIP. In a SIP, a fixed sum is invested at periodic intervals in any asset. With small

sums, it may also not be appropriate to take direct exposure to stocks. Therefore, going the mutual fund way is a superior option. Investor can make a small beginning today by using SIP. Investors need not wait to accumulate a large sum before investor takes exposures to equity. An SIP is a vehicle offered by mutual funds to help investor save regularly. It is just like a recurring deposit with the post office or bank where investor puts in a small amount every month. The difference here is that the amount is invested in a mutual fund. The minimum amount to be invested can be as small as Rs.500 and the frequency of investment is usually monthly or quarterly.

It makes investor disciplined in his savings. Every month, investors are forced to keep aside a fixed amount. It helps investor make money over the long term. Since investor gets more units when the NAV drops and fewer when it rises, the cost averages out over time. So investor tides over all the ups and downs of the market without any drastic losses.

Thus, an SIP helps investor reach his financial goals by investing a fixed sum monthly/quarterly, in a chosen fund, for a pre-determined number of periods. So that investor averages out on market fluctuations (no need to time the market).

Systematic Withdrawal Plan (SWP) offered by Kotak

Through SWP, investor can redeem sums at a monthly or quarterly frequency by giving a one-time instruction to Kotak. Investor may choose to regularly withdraw either a fixed sum or just the appreciation part of the investment.

Systematic Transfer Plan (STP) offered by Kotak

Through STP, investor can transfer amounts at a weekly (on chosen dates 1,7,14,21), monthly or quarterly frequency from one scheme of Kotak to another scheme. Investor may choose to regularly switch either a fixed sum or just the appreciation part of his investment. In brief, it is the combination of SWP and SIP.

Fixed Option: It is suitable, if investor wishes to transfer a fixed amount regularly.

Appreciation Option: It is suitable, if investor does not want this transfer to disturb the capital contribution and would like only to switch the appreciation generated in the investment.

Kotak 30 Growth Fund

Objective of the scheme is to generate capital appreciation from a portfolio of predominantly equity and equity related securities with investment in, generally, not more than 30 stocks. It is a diversified equity growth scheme, with a portfolio of generally not more than 30 choicest stocks, handpicked by the fund management team. The portfolio comprises of stocks with an emphasis on financial strength of the company, quality of management, brands and franchises, its track record and the market liquidity of the stock regardless of the sector to which they belong. The scheme is suitable for investors with a time horizon of 2 to 3 years.

Kotak Bond Regular Fund

Objective of the scheme is to create a portfolio of debt and money market instruments of different maturities so as to spread the risk across a wide maturity horizon and different kinds of issuers in the debt markets. It is an open-ended debt scheme with growth, bonus, dividend payout and dividend reinvestment options.

	Kotak 30 Growth Fund	Kotak Bond Regular Fund
Structure:	An Open Ended Equity Growth Scheme	An Open Ended Debt Scheme
Date of Allotment:	December 29, 1998	November 25, 1999
Corpus as on August 31, 2006:	Rs.329.73 crore	Rs.31.14 crore
Entry Load:	1) NIL: (a) Where switch-in is made from another Equity/ Balanced/FOF Scheme of the Fund (b) Where purchase/switch-in amount is greater than or equal to Rs.5 crore (Switch-ins being from schemes other than those indicated in (a) above) (c) Where Units are allotted upon reinvestment of Dividends (d) Where the investor is a Fund-of-Funds as defined under SEBI Regulations (e) Where investments are made by FIIs or sub a/c of FIIs. 2) 1.25% , where investments are made through SIP / STP of less than Rs.25 lakh per installment and for, investments other than those indicated in (d) and (e) above. 3) 2.25% , in cases not covered above.	Nil

Exit Load:	1) 1.00% , for investment through SIP / STP for less than Rs.25 lakhs per installment, for exit within 24 months (calculated as date to date) 2) 1.00% , for investment through SIP/STP for greater than or equal to Rs.25 lakhs but less than Rs.5 crores (per installment), for exit within 6 months (calculated as date to date) & for investment through non-SIP/non-STP, less than Rs.5 crores, for exit within 6 months 3) Nil , in cases not covered above	Nil
Fund Manager:	Mr. Anand Shah	Ritesh Jain Lakshmi Iyer

Appendix - I

Date	NAV of Kotak 30 (Growth) Fund (Rs.)	NAV of Kotak Bond Fund (Regular) (Rs.)
1-Sep-04	25.020	17.062
1-Oct -04	26.290	17.093
1-Nov-04	26.220	17.062
1-Dec-04	28.440	17.211
3-Jan-05	32.550	17.469
1-Feb-05	31.890	17.407
1-Mar-05	33.240	17.488
1-Apr-05	32.620	17.553
2-May-05	30.710	17.585
1-Jun-05	32.890	17.729
1-Jul-05	33.990	17.788
1-Aug-05	37.680	17.891
1-Sep-05	40.820	17.954
3-Oct-05	42.450	18.019
2-Nov-05	43.150	18.102
1-Dec-05	45.590	18.183
2-Jan-06	47.630	18.261
1-Feb-06	51.410	18.228
1-Mar-06	54.830	18.280
1-Apr-06	59.460	18.330
2-May-06	64.800	18.454
1-Jun-06	54.880	18.517
3-Jul-06	54.070	18.612
1-Aug-06	53.320	18.704

**END OF SECTION
D**

Section E : Caselets (50 Marks)

- This section consists of questions with serial number 6 - 11.
- Answer **all** questions.

- Marks are indicated against each question.
- Do not spend more than 80 - 90 minutes on Section E.

Caselet 1

Read the caselet carefully and answer the following questions:

6. Explain the possible advantages and disadvantages of Real Estate Funds.

[< Answer >](#)

(8 marks)

7. Explain the various factors to be considered while selecting Real Estate Mutual Funds.

[< Answer >](#)

(9 marks)

If you have been reading the business dailies even with a cursory glance, there is one bit of news that would have caught your eye at regular frequency - real estate/property funds. Some of the biggest names in Indian business have either already launched such funds or have rolled out ambitious plans to do so. In all the buzz surrounding real estate funds - the obvious question on top of the discerning investor's mind is - what's in it for me?

If you have a fair idea about how mutual funds work, then you won't have a problem understanding real estate funds, because they both work towards a common cause - maximising returns for the investor. Like mutual funds, real estate funds (or Real Estate Investment Trusts - REITs as they are commonly referred to in the US) are founded by a group of real estate professionals/experts to manage property/real estate for the investor.

Mr. Ashwin Ramesh (CIO at Primary Real Estate Advisory, a real estate management firm) elaborates, 'The real estate mutual fund industry in the US has evolved in to a concept called the REIT, the Real Estate Investment Trust. It is a publicly listed entity, which basically passes on at least 90% of its profits to investors. REITs typically own large commercial office spaces, hotels and rely mainly on rental incomes. However, there are some that are more focussed on capital appreciation as well.' There are three basic types of REITs. Equity REITs, Mortgage REITs and Hybrid REITs. Equity REITs buy properties and collect rent. Their assets are obviously the properties they own, while revenues are the rents gathered. Mortgage REITs loan money against mortgages on real estate. Their revenue source is the interest earned on the mortgages. Hybrid REITs combine the investment strategies of equity and mortgage REITs.

REITs buy, develop and sell property and share profits with investors/unit holders from any capital appreciation on the sale of property. Apart from sale of property, real estate funds also make money from rentals on property owned by them.

Some real estate funds may not actually own property as that may involve above-average risk from volatility in property prices. Instead such funds invest in bonds/instruments that are secured by property. The coupon rate that they receive on these bonds/instruments is then distributed to investors/unit holders as dividends.

Needless to say, this expertise comes at a cost to the investor. Real estate funds like regular mutual funds charge fund management fees, brokerage fees (for buying and selling property), administration fees, marketing fees and the like. So investors clock a return on real estate fund units only after accounting for fees and charges.

While real estate funds have just announced their arrival in the country, real estate as an asset class has been around for some time. Mr. Ramesh opines, 'Whenever a `new' sector comes on the screen, there is an interest, in general. Real Estate, though an old asset class, is for the first time being opened up to retail Indian and foreign participation. The fact that the last few years has seen rise in prices and volumes has helped the cause.'

So what value do real estate funds add to your portfolio? According to Personalfn's Asset Allocator, real estate has the most important role to play in your portfolio and not without reason. You can survive without stocks, bonds and gold, but you can't live without property. To be sure, the role of property in the individual's portfolio is pivotal to say the least and every individual must work at ensuring he has adequate property in his portfolio.

To be sure, the regulator (SEBI) has set the ball rolling for real estate funds. However, it will be some time before retail investors can begin investing in real estate funds. As of now, the real estate window is open only to high networth individuals (HNIs), institutional investors and global investors. ICICI Venture, with mobilizations in the region of Rs.10 bn (Rs.1,000 crore) and HDFC Property Fund of Rs.7.5 bn (Rs.750 crore) are among the first off the block with their real estate products. Pantaloon Group (Kshitij Venture Capital Fund) and Kotak Group are some of the other names that plan to roll out real estate funds soon. Not surprisingly, overseas investors have also taken note of the opportunities in the Indian real estate segment. Tishman Speyer Properties, a US real estate company, has already outlined plans for the Indian property market in association

with ICICI Ventures. Others are also expected to make a move towards Indian shores.

Surely such a high level of investment requires enough property to absorb it without any repercussions on the overall real estate market. We can take real estate in a broader sense to include residential, commercial, IT development, hospitality to some extent. However, it will depend, to some extent on government policies, which need to be liberalized so they do not choke the free supply and market pricing of land.

Also purely for investment purposes and diversification across asset classes, it makes sense for an investor to have the option of investing in real estate, along with equities and debt. However, the issue of matching inflows and outflows of the fund would need to be addressed at the AMC level.

Caselet 2

Read the caselet carefully and answer the following questions:

8. Explain the ideal process for retirement planning.

[< Answer >](#)

(9 marks)

9. According to the caselet, retirement planning is an essential element of any financial plan. Explain.

[< Answer >](#)

(7 marks)

Retirement planning is an essential element of any financial plan. Retirement planning is a comprehensive process for determining how much money you will need when you retire. Retirement planning also helps you identify the best ways to save for retirement given your financial situation.

If you are like most people, you probably think retirement planning is only important when you retire. However, proper planning requires a much longer period of time, from the day you start working until well beyond your actual retirement date. In fact, it's never too early to start planning for your retirement.

At age 65, the average man will live almost 19 more years, while the average woman will live another 22 years. We will probably spend 25 per cent to 30 per cent of your life in retirement, requiring vast sums of money to support yourself.

In India, many of us put off retirement planning because we are too busy trying to meet our immediate financial needs to think about what will happen 20 or 30 years hence. Planning for retirement is more important especially in India.

It's easy to understand why meeting your monthly bills seem more important, especially if your retirement is still far off. But here's something to think about: As you move through your life, you will experience many life events that will affect your future financial security such as getting married, starting a family, purchasing a home, and sending your children to college. Each of these events will affect your ability to plan for your future financial security. If you develop a flexible long-term plan, you can overcome these obstacles and ensure financial independence in your retirement years.

When defining your retirement goals, your description should be specific and measurable. For example, a goal to "retire at age 60 with resources to sustain current living expenses of Rs.1,00,000 per year" is a goal, which is both specific and measurable.

If you have several goals, you should prioritize them so that your resources will be allocated to the most important goal first. By assigning a priority to each goal, you also ensure that secondary goals won't take precedence over primary goals. In this process, it is important to understand your needs. To determine the appropriate percentage for your retirement, you need to determine if any of your current expenses will change when you retire. Will your travel and leisure expenditures increase? Will your job-related expenses for commuting and clothing change? Will you have to pay more for medical costs? It's generally accepted that many of your routine annual expenses will change during your retirement years. The trick is determining whether those expenses will increase or decrease, and by how much.

Both living expenses and inflation are important in understanding your retirement needs because you are planning for a period of time, not a point in time.

Once you develop your plan, the process is dynamic. As you revise and prioritize your projected goals, you may see changes in your estimated income needs, projected resources, and other assumptions. It's a good idea to review your action plan regularly and if necessary, make changes to make sure that it still meets your needs. Finally, a successful retirement plan requires your active involvement and long-term commitment.

Caselet 3

Read the caselet carefully and answer the following questions:

10. According to the caselet, the areas of greatest difference between the mutual funds and hedge funds are fee structure, leveraging practices, pricing and liquidity, degree of regulatory oversight and investor characteristics. Explain these differences in detail. [< Answer >](#)
11. Explain the various hedge fund strategies discussed in the caselet in detail. [< Answer >](#)

(8 marks)

(9 marks)

Like mutual funds, hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss.

Unlike mutual funds, however, hedge funds are not required to register with the regulatory authority. Mutual funds and hedge funds differ in many ways. The areas of greatest difference between the two are: fees; leveraging practices; pricing and liquidity; degree of regulatory oversight; and investor characteristics.

Hedge fund investors do not receive all of the federal and state law protections that commonly apply to most registered investments. For example, you won't get the same level of disclosures from a hedge fund that you'll get from registered investments. Without the disclosures that the securities laws require for most registered investments, it can be quite difficult to verify representations you may receive from a hedge fund.

Hedge funds are aggressively managed portfolio of investments which use non-traditional and advanced investment strategies such as leverage, long, short and other derivative positions to offset risk. The aim here is to generate higher returns. Hedge funds make investments in domestic as well as international markets. They are more an investment strategy rather than a separate asset class.

Hedge funds are privately offered and managed investment options, which are open to a limited number of investors. They require a very large initial investment amount. Generally, they operate as limited partnerships or limited liability companies and they rarely have more than 500 investors each.

The industry for hedge funds is growing up and undergoing transformation. The mix of investors has changed dramatically in the past five years. Because of change in investor profile, big shifts have occurred in fund size, competition, risk profile, transparency and the regulations.

It is estimated to be a \$1.1 trillion industry and growing every year, with approximately 9000 active hedge funds. It includes a variety of investment strategies, some of which use leverage and derivatives while others are more conservative and employ little or no leverage. Many hedge fund strategies seek to reduce market risk specifically by shorting equities or derivatives. Most hedge funds are highly specialized, relying on the specific expertise of the manager or management team. Usually hedge fund strategies include distressed Securities, Special Situations, Convertible Arbitrage, Fixed Income Arbitrage, Aggressive Growth, Market Neutral Securities Hedging, Opportunistic, Value, Macro/Futures, Market Timing, Emerging Markets, Income, Multi-Strategy, Short Selling, Distressed Securities and Special Situations. Performance of many hedge fund strategies, particularly relative value strategies, is not dependent on the direction of the bond or equity markets -- unlike conventional equity or mutual funds (unit trusts), which are generally 100% exposed to market risk. Many hedge fund strategies, particularly arbitrage strategies, are limited as to how much capital they can successfully employ before returns diminish. As a result, many successful hedge fund managers limit the amount of capital they will accept. Hedge fund managers are generally highly professional, disciplined and diligent.

Many, but not all, hedge fund strategies tend to hedge against downturns in the markets being traded. Hedge funds are flexible in their investment options (can use short selling, leverage, derivatives such as puts, calls, options, futures, etc). Hedge funds benefit by heavily weighting hedge fund managers' remuneration towards performance incentives, thus attracting the best brains in the investment business.

The popular misconception is that all hedge funds are volatile -- that they all use global macro strategies and place large directional bets on stocks, currencies, bonds, commodities, and gold, while using lots of leverage. In reality, less than 5% of hedge funds are global macro funds. Most hedge funds use derivatives only for hedging or don't use derivatives at all, and many use no leverage.

So they offer the potential to achieve investment returns with relatively low volatility and largely unrelated to whether a

particular investment market (such as shares or bonds) is going up or down. The main reasons for this are; Hedge fund managers generally try to remove some market exposure and aim to produce a positive return irrespective of market direction. Often this will involve making an offsetting bet to hedge against losing money on the original investment position. The unrestricted nature of hedge funds means that the investment managers are able to fully utilise their skill to produce positive performance. Operating in fairly small areas of the market means that investing in a number of funds can reduce volatility through the benefits of diversification.

One feature often attributed to hedge funds is the widespread use of derivatives; sophisticated bets on the future direction of an underlying asset such as a share, currency, or even a whole financial market. The truth though is that the use of derivatives is commonplace in conventional banks, investment banks and other more sober financial outfits such as insurance companies and the treasury departments of big companies. Hedge funds have become an increasingly popular form of investment for professional investors who have diversified away from mainstream share and bond investment. Their place should be considered alongside other alternatives such as private equity, property and commodities.

**END OF SECTION
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**END OF QUESTION
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Suggested Answers

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Section D : Case Study

1.
 - As the capital gain tax would be levied only on the number of units withdrawn, SWP becomes a tax efficient way of getting regular income from the investments. [< TOP >](#)
 - It is more suitable for the Investors wanting regular funds inflow from their investments and for those who are interested in booking their gains at a regular interval.
Withdrawal facility for different times (monthly, quarterly or half-yearly) according to the needs and investment goals of different investors is available.
 - In case of resident Indians, there is no Tax Deduction at Source on withdrawal/redemption.
 - There is a choice of two unique options according to the requirements of investors: Variable Plan and Fixed Plan.
 - At the time of withdrawal, direct credit facility with select banks is available.

2. [< TOP >](#)

Date	Kotak 30 (Growth) NAV (Rs.)	Purchase Price = NAV/ (1-0.0125) (Rs.)	Amount invested under SIP (Rs.)	Number of units to be allotted
(1)	(2)	(3)	(4)	5 = (4/3)
1-Sep-04	25.02	25.34	5000	197.316
1-Oct -04	26.29	26.62	5000	187.829
1-Nov-04	26.22	26.55	5000	188.324
1-Dec-04	28.44	28.80	5000	173.611
3-Jan-05	32.55	32.96	5000	151.699
1-Feb-05	31.89	32.29	5000	154.847
1-Mar-05	33.24	33.66	5000	148.544
1-Apr-05	32.62	33.03	5000	151.378
2-May-05	30.71	31.10	5000	160.772
1-Jun-05	32.89	33.31	5000	150.105
1-Jul-05	33.99	34.42	5000	145.264
1-Aug-05	37.68	38.16	5000	131.027
Total number of units				1940.716

Value of investment as on 1st August 2005 = $1,940.716 \times 37.68 = \text{Rs.} 73,126.18$.

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Date	Kotak 30 (Growth) NAV(Rs.)	NAV/(1+Exit load) (Rs.)	Units before transfer	Value of investment before transfer	Amount Transferred	Units Transferred	Units after transfer	Value of investment after transfer
1	2	3= 2/(1+0.01)	4	5=4×2	6	7=6/3	8=4-7	9=8×2
1-Sep-05	40.82	40.42	1940.716	79220.03	5000	123.701	1817.015	74170.55
3-Oct-05	42.45	42.03	1817.015	77132.29	5000	118.963	1698.052	72082.31
2-Nov-05	43.15	42.72	1698.052	73270.94	5000	117.041	1581.011	68220.62
1-Dec-05	45.59	45.14	1581.011	72078.29	5000	110.767	1470.244	67028.42
2-Jan-	47.63	47.16	1470.244	70027.72	5000	106.022	1364.222	64977.89

06								
1-Feb-06	51.41	50.90	1364.222	70134.65	5000	98.232	1265.99	65084.55
1-Mar-06	54.83	54.29	1265.990	69414.23	5000	92.098	1173.892	64364.50
1-Apr-06	59.46	58.87	1173.892	69799.62	5000	84.933	1088.959	64749.50
2-May-06	64.8	64.16	1088.959	70564.54	5000	77.930	1011.029	65514.68
1-Jun-06	54.88	54.34	1011.029	55485.27	5000	92.013	919.016	50435.60
3-Jul-06	54.07	53.53	919.016	49689.04	5000	93.406	825.61	44640.73
1-Aug-06	53.32	52.79	825.61	44019.86	5000	94.715	730.895	38971.32

Date	Bond Fund NAV (Rs.)	Amount Invested (Rs.)	Units bought
1	2	3	4=3/2
1-Sep-05	17.954	5000	278.489
3-Oct-05	18.019	5000	277.485
2-Nov-05	18.102	5000	276.213
1-Dec-05	18.183	5000	274.982
2-Jan-06	18.261	5000	273.808
1-Feb-06	18.228	5000	274.303
1-Mar-06	18.280	5000	273.523
1-Apr-06	18.330	5000	272.777
2-May-06	18.454	5000	270.944
1-Jun-06	18.517	5000	270.022
3-Jul-06	18.612	5000	268.644
1-Aug-06	18.704	5000	267.322
Total number of units			3278.512

Value of investment bond fund= 3278.512 × Rs.18.704 = Rs.61,321.29

Total value of investments in both the funds = 38971.32+ 61321.29 = Rs.1,00,292.61

4.

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Date	NAV (Rs.)	NAV/ (1+ exit load) (Rs.)	Units Before transfer	Value of investment before transfer (Rs.)	Units to be maintained after transfer	Units transferred	Amount transferred	Value of investment after transfer (Rs.)
1	2	3 = 2/ (1+0.01)	4	5 = 4×2	6 = 9/2	7 = 4-6	8=3×7	9 = 2×6
1-Aug-05	37.68	—	1940.716	73126.18	—	—	—	—
1-Sep-05	40.82	40.42	1940.716	79220.03	1791.430	149.286	6034.14	73126.18
3-Oct-05	42.45	42.03	1791.430	76046.20	1722.643	68.788	2891.14	73126.18
2-Nov-05	43.15	42.72	1722.643	74332.03	1694.697	27.946	1193.83	73126.18

1-Dec-05	45.59	45.14	1694.697	77261.24	1603.996	90.701	4094.25	73126.18
2-Jan-06	47.63	47.16	1603.996	76398.33	1535.297	68.699	3239.86	73126.18
1-Feb-06	51.41	50.90	1535.297	78929.60	1422.412	112.885	5745.85	73126.18
1-Mar-06	54.83	54.29	1422.412	77990.83	1333.689	88.722	4816.74	73126.18
1-Apr-06	59.46	58.87	1333.689	79301.16	1229.838	103.851	6113.71	73126.18
2-May-06	64.8	64.16	1229.838	79693.51	1128.490	101.348	6502.47	73126.18
1-Jun-06	54.88	54.34	1128.490	61931.55	-	-	-	61931.55
3-Jul-06	54.07	53.53	1128.490	61017.45	-	-	-	61017.45
1-Aug-06	53.32	52.79	1128.490	60171.09	-	-	-	60171.09

Date	Bond fund NAV (Rs.)	Amount transferred (Rs.)	Units bought
1	2	3	4 = 3/2
1-Sep-05	17.954	6034.13	336.089
3-Oct-05	18.019	2891.14	160.450
2-Nov-05	18.102	1193.83	65.950
1-Dec-05	18.183	4094.25	225.169
2-Jan-06	18.261	3239.86	177.420
1-Feb-06	18.228	5745.85	315.221
1-Mar-06	18.280	4816.74	263.498
1-Apr-06	18.330	6113.71	333.536
2-May-06	18.454	6502.47	352.361
1-Jun-06	18.517	-	-
3-Jul-06	18.612	-	-
1-Aug-06	18.704	-	-
Total number of units			2229.694

(incase of depreciation no transfer takes place)

Value of investment in bond fund = $2229.694 \times 18.704 = \text{Rs.}41,704.2$

Vaule of investments in both the funds = $60171.09 + 41,704.2 = \text{Rs.}1,01,875.29$.

5. Weaknesses of the formula plans:

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- They offer no suggestions to select securities.
- They are rigid and offer no flexibility. Due to this, it is necessary to know when to change the formula to suit the changing circumstances which is not an easy task.
- The plans are not suitable for too short a period or too long a period. Plans need adequate time to work optimally. Longer the time-frame, greater is the possibility that the invetment environment and the circumstances of the investor may change, making it necessary to change the formula itself, for which the investor is left clueless.
- Formular plans appear mechanical, but do not really eliminate the need for projections regarding the

movement of asset prices.

Section E: Caselets

Caselet 1

6. Merits

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- The only asset class is property that can preserve the value of the portfolio from the eroding effect of inflation.
- Another important touch a real estate fund adds to portfolio is that of stability. Although property prices can also be volatile, the volatility is a far cry from what investors are used to seeing in stocks for instance. When turbulence in global oil prices or economic upheavals rock portfolio, investor can expect real estate/real estate funds to be the rock in his portfolio.

Limitations

- Real estate funds have the same risks that are associated with equity/debt mutual funds. For instance i.e. investor could make the wrong choice while selecting a real estate fund in which case investor could be saddled with a non-performer. Although this is not a limitation with real estate funds per se, it serves to highlight that there can be poorly managed real estate funds just like there can be poorly managed equity/debt funds.
- If with equities three years is the minimum investment time frame, then with real estate investments investor need to be even more patient. Buying property, developing it and then renting it out or selling it, is a high gestation activity. It could take some time before his real estate mutual fund actually starts making money.

7. **Objective:** What is the objective of the fund (besides asset class diversification)? Is it to get regular income or is it for capital gains? The former warrants for a dividend option fund, while the latter warrants for growth option.

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Select top-down: Start with funds that are owned and managed by the best mutual fund companies. These are the ones that are most likely to have the best and the experienced managers behind them.

Past Returns: Once REMFs are around for say five to seven years, the previous selection criterion will change. After all, this is why funds grow – they deliver results. While there always is a caveat that ‘past returns are not indicative of future returns’; this holds true to an extent for a comparative analysis of similar funds. In the five years, the fund manager would have experienced a range of market conditions and there is no reason to believe that given similar conditions (that will be faced by all other fund managers), the fund manager will not perform as she/he had done before. A change in guard at the helm of the management of the fund, however, raises a red flag over the expected future performance.

Risk tolerance: To what extent can you tolerate risk within your real estate portfolio? Here are the risk profiles, if the different types of REMFs that are in the offing:

REMFs that depend on rents for their revenues (like American Equity REITs) will experience little volatility in their NAVs as the monthly rents will remain fairly certain. The value of the properties in question will change as per regular appraisals.

The REMFs that invest in mortgages will have higher volatility. This is due to the mortgages being exposed to interest rate risk, thereby rising and falling with the interest rates prevailing in the market.

REMFs that invest in unlisted securities of companies that deal in properties may have a seemingly high risk, but since the equity of these companies is not traded, the value of equity most probably will be ascertained by the book value of the shares. Book values of shares change on every balance sheet, which is quarterly.

NAV of REMFs undertaking development of property are expected to climb slowly and steadily because of the long-term investment horizon.

REMFs that invest in other securities will be the ones that invest in publicly traded real estate and real-estate related companies.

Caselet 2

8. Start saving early

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Even a small sum of money saved regularly and invested regularly makes a big amount, which will come in very handy after retirement. One should not believe that after retirement, one can place all savings into income generating investment and spend rest of life in happiness. If you don't plan early, you could end up eroding your principal savings in order to have to supplement your monthly income.

The key to a financially independent future is "sooner the better". Cautious investors believe in this principal and plan their retirement accordingly. They not only save, they save early and regularly. . The catch is to make the power of compounding work one's benefit.

Retirement should be your top priority

Retirement should be kept as a top priority because if one does not keep it at the top one might end up depending on one's children, which probably no one would relish.

Create a Retirement Plan

Develop a plan for saving based on your requirements at the time of retirement. The goals you keep for saving depend on your lifestyle but you will need at least about 66% of your pre-retirement income to maintain your standard of living when you stop working.

Understand your pension plan

If your employer offers on pension plan, understand carefully your benefit level, financial stability of plan and the vesting period. Use retirement plans even if you already have enough money.

With retirement plans your money grows in a tax efficient manner and compounding interest over time makes it one of the best investment options.

Balance your risk tolerance and your investment strategy

Evaluate your risk profile and then balance your investment strategy to invest in various avenues to get the most out of your retirement money keeping your risk profile unhampered.

Diversify your investments & allocate your assets carefully. Depending on your work profile divide your savings into equity , bonds, Mutual Funds, and other investment avenues. Don't invest too heavily in one sector or one company, since the risk associated with putting all your eggs in one basket is indeed very high.

Save and invest Regularly

Saving and investing regularly makes a big difference at the time of retirement. Investing at regular intervals builds your retirement fund over time and helps you to minimize risk and gives a tension free retirement-a time to pursue your hobbies, fulfill your dreams and passions.

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9. Retirement planning is an essential element of a financial plan, because

- We retire only from work, not from life. A retirement plan is an assurance that you will continue to earn a satisfying income and enjoy a comfortable lifestyle, even when you are no longer working.
- An increasing number of young Indian professionals are moving away from the traditional joint family structure. Since support no longer comes easily, parents have realized the need to provide for themselves during their retirement years.
- Skyrocketing costs throw even a well-salaried person off balance. With rates rising everyday, you can imagine how high they will be when you are ready to retire. A retirement plan provides you with a steady income every month, to arm you in the face of rising costs.
- Only 4% of India working population- mostly government employees – are covered by pensions. The remaining 96% comprises of self-employed and salaried professionals who do not have a formal, mandated provision for pensions.

Caselet 3

10. Fees

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Mutual fund sales charges and other distribution fees are subject to specific regulatory limits. Mutual fund fees

and expenses are disclosed in detail, as required by law, in a fee table at the front of every prospectus. They are presented in a standardized format, so that an investor can easily understand them and can compare expense ratios among different funds.

There are no limits on the fees a hedge fund adviser can charge its investors. Typically, the hedge fund manager charges an asset-based fee and a performance fee. Some have front-end sales charges, as well.

Leveraging Practices

There are restrictions on mutual fund's ability to leverage or borrow against the value of securities in its portfolio. There are requirements that funds engaging in certain investment techniques, including the use of options, futures, forward contracts and short selling, "cover" their positions. The effect of these constraints has been to strictly limit leveraging by mutual fund portfolio managers.

Leveraging and other higher-risk investment strategies are a hallmark of hedge fund management. Hedge funds were originally designed to invest in equity securities and use leverage and short selling to "hedge" the portfolio's exposure to movements of the equity markets. Today, however, advisers to hedge funds utilize a wide variety of investment strategies and techniques. Many are very active traders of securities.

Pricing and Liquidity

Mutual funds are required to value their portfolios and price their securities daily based on market quotations that are readily available at market value and others at fair value, as determined in good faith by the board of directors. In addition to providing investors with timely information regarding the value of their investments, daily pricing is designed to ensure that both new investments and redemptions are made at accurate prices. Moreover, mutual funds are required by law to allow shareholders to redeem their shares at any time.

There are no specific rules governing hedge fund pricing. Hedge fund investors may be unable to determine the value of their investment at any given time.

Investor Characteristics

The only qualification for investing in a mutual fund is having the minimum investment to open an account with a fund company, which is typically around Rs.5,000, but can be lower. After the account has been opened, there is generally no minimum additional investment required, and many fund investors contribute relatively small amounts to their mutual funds on a regular basis as part of a long-term investment strategy.

A minimum investment in multiples of million or more is often required of hedge fund investors. This measure is intended to help limit participation in hedge funds and other types of unregulated pools to highly sophisticated individuals.

11. **Distressed Securities:** Invests long/short in the debt and/or equity of companies likely to declare bankruptcy in the near future, currently in the bankruptcy reorganization process or companies emerging from bankruptcy. Such securities can be bought at deeply discounted prices. [< TOP >](#)

Special Situations: Invests in event-driven situations such as mergers, hostile takeovers, reorganizations, or leveraged buy outs. May involve simultaneous purchase of stock in companies being acquired, and the sale of stock in its acquirer, hoping to profit from the spread between the current market price and the ultimate purchase price of the company. May also utilize derivatives to leverage returns and to hedge out interest rate and/or market risk.

Convertible Arbitrage

This involves going long in convertible securities (usually share or bonds) that are exchangeable for a certain number of another form (usually common shares) at a preset price, and simultaneously shorting the underlying equities. This strategy did very well for the past several years, but has been less effective recently.

Fixed Income Arbitrage

The manager takes offsetting positions in fixed income securities and their derivatives in order to exploit mispricings between interest rate securities like interest rate swaps, government and corporate debt, mortgage-backed and asset-backed securities, etc.

Aggressive Growth: Invests in equities expected to experience acceleration in growth of earnings per share. These include stocks with high P/E ratios, low or no dividends; often smaller and micro cap stocks which are expected to experience rapid growth.

Market Neutral Securities Hedging

Typically, equal amounts of capital are invested long and short in the market, attempting to neutralize risk by

purchasing undervalued securities and taking short positions in overvalued securities.

Opportunistic: Investment theme changes from strategy to strategy as opportunities arise to profit from events such as IPOs, sudden price changes often caused by an interim earnings disappointment, hostile bids, and other event-driven opportunities. May utilize several of these investing styles at a given time and is not restricted to any particular investment approach or asset class.

Value: Invests in securities perceived to be selling at deep discounts to their intrinsic or potential worth. Such securities may be out of favour or underfollowed by analysts. Long-term holding, patience, and strong discipline are often required until the ultimate value is recognized by the market.

Market Timing: Allocates assets among different asset classes depending on the manager's view of the economic or market outlook. Portfolio emphasis may swing widely between asset classes. Unpredictability of market movements and the difficulty of timing entry and exit from markets adds to the volatility of this strategy.

Emerging Markets

Investing in securities issued by business and/or governments of countries with developing economies that have the potential for significant future growth. e.g. Brazil, Russia, India and China.

Income: Invests with primary focus on yield or current income rather than solely on capital gains. May utilize leverage to buy bonds and sometimes fixed income derivatives in order to profit from principal appreciation and interest income.

Multi Strategy: Investment approach is diversified by employing various strategies simultaneously to realize short- and long-term gains. Other strategies may include systems trading such as trend following and various diversified technical strategies. This style of investing allows the manager to overweight or underweight different strategies to best capitalize on current investment opportunities.

Short Selling: Sells securities short in anticipation of being able to rebuy them at a future date at a lower price due to the manager's assessment of the overvaluation of the securities, or the market, or in anticipation of earnings disappointments often due to accounting irregularities, new competition, change of management, etc. Often used as a hedge to offset long-only portfolios and by those who feel the market is approaching a bearish cycle.

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