TOPIC 3 - MUTUAL FUND

INTRODUCTION -: Mutual fund is a step forward which tries to minimize the risk , one faces in the stock market.

The mutual fund industry in India began in 1963 with formation of unit trust of India (UTI). Much later in 1987, SBI mutual fund was the first non-mutual fund in India.

Today there are 43 assets under management (AUMs) of mutual funds in India and the total number of mutual fund schemes is around 2800.

TYPES OF MUTUAL FUNDS

Broadly , mutual funds can be classified into 3 categories:

1. **Equity schemes** : These schemes invest a large portion of the funds in equity shares or equity linked instrument.

2. **Debt schemes** : These schemes invest in debt instrument namely , bonds , and cash .

3. **Hybrid schemes** : These schemes invest in both , equity and debt instrument.

DEFINITION AND NAV (Net Asset Value)

Definition -: Mutual fund is a trust that collects money from number of investors with a common investment objectives. The trust then invests the money in equities , bonds, money market instruments and other securities. Each investment owns units which is a proportion of holding of the fund. The income /gain generated by this collective investment is distributed

proportionately amongst the investor after deducting the expenses.

The combined holdings of mutual fund are know as its portfolio.

Net Asset Value (N.A.V.) -:

The N.A.V. represents market value of unit of the fund . this is the price at which investors buy units from a fund or sell it back to the fund . it is calculated by dividing the total value of all asset in a portfolio ,minus all its liabilities

ADVANTAGES OF INVESTMENT IN MUTUAL FUNDS

1. **Professional management** -: The fund managers do the research and select securities. They monitor the performance of the securities regularly.

2. **Diversification** -: since mutual funds invest in various companies/ industries , it helps to lower risk of the investor.

3. **Affordability** -: Most mutual funds set a relatively low amount for initial investment and subsequent purchases . this help a person with marginal savings to invest in a mutual funds.

4. **Liquidity** -: Mutual funds investors can easily redeem their units at any time.

BENEFITS OF MUTUAL FUNDS

1. **DIVIDEND PAYMENT** -:

2. **CAPITAL GAINS DISTRIBUTION**-:

3. **INCREASE N.A.V. -:**

ENTRY LOAD AND EXIT LOAD

Entry Load -: This is the charge a fund levies on the investor at the time of purchase this is generally in percentage if the face value of a unit is Rs.100 and entry load 2% then an investor has to pay Rs 102 to purchase a unit . now a day very few mutual funds charge entry load

EXIT LOAD -: This is the charge, an investors has to pay to the fund while selling units of a scheme. It is also in percentage.

It is levied on the market value of the unit (N.A.V.) -: for example , if the market value of a unit is Rs 140 and exit load is 2% , then then the mutual fund company charges Rs. 2.80 on purchase (redeem) of a unit. Thus the investor will receive Rs 137.20 per unit.

Mutual fund

1] Amit invests Rs. 10,000 in a mutual fund. Entry load is 2% and exit load is 1% before 2 years and nil after 3 years. He receives dividend of Rs. 1000 Rs. 1100 and Rs. 1200 for 3 years in a Cumulative dividend scheme. What is his
a) Total rate of return
b) annualised rate of return, if he redeems all units after 3 years

Solution :- Due to entry load of 2% his outgo is Rs. 10,000 + 200 = 10,200/-

He has received a total amount of
Rs. 10,000 + 1000 + 1100 + 1200 = 13300
(1y) (2y) (3y)

Since he sells the unit after 3 years he does not have to pay any exit load.

a) Total return = 13300 − 10,200
Total rate of return = 3100

Rate of return = $\frac{3100 \times 100}{10,200}$ = 30.39

b) Annualised return = $\frac{30.39}{3}$
= 10.13

2] Anita invests Rs. 200,000 in a debt fund of 4 years. She received a dividend of Rs. 16,000 for first year, 12000 for second year 14000 for third year and 15,000 for fourth year. What is the rate of return if NAV remains unchanged?

→ Solution :-

By way of dividend, Anita received Rs. 57,000 (16000 + 12000 + 14000 + 15000)
F.Y. S.Y T.Y. fourth Y.

Rate of return = $\frac{57000 \times 100}{2,00,000}$ = 28.57.

Annualised rate of return = $\frac{28.5}{4 \text{ years}}$

= 7.125%.

3] Salman invested Rs 50,000 in a mutual fund scheme with nil entry load & 2% exit load. He received a dividend of Rs 3000, 4000 and 4500 for first, second & third year. He redeemed all his units after 3 years. What is the rate of return?

Solution :- Since the rate of exit load is 2%. total exit load on units of Rs. 50,000 is Rs. 1000/-

At the end of 3 years, Salman receives

$50,000 + 3000 + 4000 + 4500 - 1000 = 60500$

$(50,000 \times \frac{2\%}{100} = 1000)$

His net gain = 10,500 (60500 - 50,000)

Total rate of return = $\frac{10,500 \times 100}{50,000}$

= 21% (divide into 3)

Annualised rate of return = 7%.

4] Prakash invests Rs. 1,00,000 in a mutual fund scheme in which there is no entry load and no exit load. He received dividend of Rs. 10,000 for first year, nil for the second year and 15,000 for third year. At the end of third year, he redeems all units but N.A.V. has dropped to 95000. What is his annualised return?

Solution :-

In all, he has received a dividend of Rs. 25000. But due to a drop in NAV he will received Rs. 95000 for his unit.

At the end of 3 years he has received Rs. 1,20,000

His gain in 3 years is 20,000 i.e. 20%.

Annualised rate of return $= \frac{20}{3}$

Annualised rate of return = **6.66%.**

5] Suresh invested Rs. 2,50,000 in a mutual fund scheme with entry load of 1% and exit load 2% (for 3 years). He had to redeem all the units after 2 years when NAV had dropped to 2,30,000, in the mean while, he had received a dividend of Rs. 15000. What is his gain or loss % (percent)

Solution :- By 1% entry load = Rs. 2500
At 2% Exit load = 4600 (on NAV at a time of exist)

His outgo = 250000 + 2500 + 4600
= 2,57,100

At the time of sale, he will receive 230,000
Adding dividend he has received 2,45,000
loss = 2,57,100 − 2,45,000 = 12,100/−

Rate of loss $= \frac{12,100 \times 100}{2,50,000}$
$= 4.84$ (for 2 years)

Annualised rate to loss 2.42%.
$\left(\frac{4.84}{2} = 2.42\right)$

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