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A Comparison Study of Mutual Fund Investment and Equity Market Returns with Special Reference to Indian Equity Market

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ABSTRACT

The article was discussed about the mutual fund investments have emerged as important players in the Indian equity market in the recent past. This research makes an attempt to understand whether a relationship exists between Mutual Fund investment and Equity Market returns in India. The past ten years of data was analyzed with appropriate statistical tools to prove the impact of Mutual Fund Investments in Indian Equity Market. Markets become more efficient with the growing presence of institutional investors who predominantly go by

fundamentals. The popular belief that fund inflows and returns are positively related. is also proved.

Keywords: investments, players, relationship, analyzed, predominantly

I- Financial Basics Overview

You're not alone if you feel like you missed the class in school that taught financial basics. Even long-term investors occasionally want to brush up on the fundamentals. The bedrock concepts covered in this section can provide a sturdy foundation for meeting financial goals.

Without a basic understanding of financial concepts, you will find it difficult to make good investing decisions. The more time you have to reach your goal, the more choices you have. It's much easier to tolerate risk when you have plenty of time to ride out short-term volatility—the ups and downs in the value of your investment.

A long time frame means you can choose to go after the higher long-term returns that equities have historically delivered. Another advantage of a long time frame is that the more years your money compounds, the less you need to save to reach your goal.

Next understand your investment options

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While there are hundreds of mutual funds to choose from, they mostly fall into 3 categories.

- ✓ Equities (also called stocks)
- ✓ Fixed-income (also called bonds)
- ✓ Cash equivalents (a type of liquid investment such as a money market fund)

The risk of losing money with cash-equivalent investments is low, but so is the long-term return as compared with equities. With equities, the risk of losing money in the short run is much higher, but the potential for higher long-term returns is also there.

The best asset mix is a very personal decision. One size definitely doesn't fit all investors. If you're a long-term investor, investing solely in cash equivalents could leave you open to the risk of inflation. Short-term investors on the other hand, need to be more concerned with the risk posed by volatility.

Strategies for reducing risk

Successful investors use several strategies to reduce their investment risk including:

- ✓ Diversification
- ✓ Asset allocation
- ✓ Rupee-cost averaging

Diversification is a big word that means it's not a good idea to put all your eggs in one basket. It' s not the same as asset allocation which is how you divide your money between stocks, bonds and liquid investments.

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The best asset allocation will give you the return you need while not having more risk than you can tolerate .Even though your investment strategy is in place, you may be hesitant to start investing. May be the financial markets are ready to tumble.

No one wants to invest at the wrong time, but investment professionals will tell you that there no way to know the perfect time. That's where rupee-cost averaging comes in. It' s an automatic investing technique-you put in the same amount at a regular frequency

II- Mutual Fund

These days you are hearing more and more about mutual funds as a means of investment. If you are like most people, you probably have most of your money in a bank savings account and your biggest investment may be your home.

Apart from that, investing is probably something you simply do not have the time or knowledge to get involved in. You are not the only one. This is why investing through mutual funds has become such a popular way of investing.

A mutual fund is a pool of money from numerous investors who wish to save or make money just like you. Investing in a mutual fund can be a lot easier than buying and selling individual stocks and bonds on your own. Investors can sell their shares when they want.

1. Professional Management.

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Each fund's investments are chosen and monitored by qualified professionals who use this money to create a portfolio. That portfolio could consist of stocks, bonds, money market instruments or a combination of those.

2. Fund Ownership.

As an investor, you own shares of the mutual fund, not the individual securities. Mutual funds permit you to invest small amounts of money, however much you would like, but even so, you can benefit from being involved in a large pool of cash invested by other people. All shareholders share in the fund' s gains and losses on an equal basis, proportionately to the amount they've invested.

3. Mutual Funds are Diversified

By investing in mutual funds, you could diversify your portfolio across a large number of securities so as to minimize risk. By spreading your money over numerous securities, which is what a mutual fund does, you need not worry about the fluctuation of the individual securities in the fund's portfolio.

4. Mutual Fund Objectives

There are many different types of mutual funds, each with its own set of goals. The investment objective is the goal that the fund manager sets for the mutual fund when deciding which stocks and bonds should be in the fund's portfolio.

Depending on investment objectives, funds can be broadly classified in the following types:

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- ✓ Aggressive growth means that you will be buying into stocks which have a chance for dramatic growth and may gain value rapidly. This type of investing carries a high element of risk with it since stocks with dramatic price appreciation potential often lose value quickly during downturns in the economy. It is a great option for investors who do not need their money within the next five years, but have a more long-term perspective. Do not choose this option when you are looking to conserve capital but rather when you can afford to potentially lose the value of your investment.

- ✓ As with aggressive growth, growth seeks to achieve high returns; however, the portfolios will consist of a mixture of large-, medium- and small-sized companies. The fund portfolio chooses to invest in stable, well established, blue-chip companies together with a small portion in small and new businesses. The fund manager will pick, growth stocks which will use their profits grow, rather than to pay out dividends. It is a medium - long-term commitment, however, looking at past figures, sticking to growth funds for the long-term will almost always benefit you. They will be relatively volatile over the years so you need to be able to assume some risk and be patient.
- ✓ A combination of growth and income funds, also known as balanced funds, are those that have a mix of goals. They seek to provide investors with current income while still offering the potential for growth. Some funds buy stocks and bonds so that the portfolio will generate income whilst still keeping ahead of

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inflation. They are able to achieve multiple objectives which may be exactly what you are looking for. Equities provide the growth potential, while the exposure to fixed income securities provide stability to the portfolio during volatile times in the equity markets. Growth and income funds have a low-to-moderate stability along with a moderate potential for current income and growth. You need to be able to assume some risk to be comfortable with this type of fund objective.

- ✓ That brings us to income funds**.** These funds will generally invest in a number of fixed-income securities. This will provide you with regular income. Retired investors could benefit from this type of fund because they would receive regular dividends. The fund manager will choose to buy debentures, company fixed deposits etc. in order to provide you with a steady income. Even though this is a stable option, it does not go without some risk. As interest-rates go up or down, the prices of income fund shares, particularly bonds, will move in the opposite direction. This makes income funds interest rate sensitive. Some conservative bond funds may not even be able to maintain your investments' buying power due to inflation.
- ✓ The most cautious investor should opt for the money market mutual fund which aims at maintaining capital preservation. The word preservation already indicates that gains will not be an option even though the interest rates given on money market mutual funds could be higher than that of bank deposits. These funds will pose very little risk but will also not protect your initial investments' buying

power. Inflation will eat up the buying power over the years when your money is not keeping up with inflation rates. They are, however, highly liquid so you would always be able to alter your investment strategy.

III- Benefits of investing in a mutual fund

1. Professional management.

Qualified professionals manage your money, but they are not alone. They have a research team that continuously analyses the performance and prospects of companies. They also select suitable investments to achieve the objectives of the scheme. It is a continuous process that takes time and expertise which will add value to your investment. Fund managers are in a better position to manage your investments and get higher returns.

2. Diversification.

The cliché, "don't put all your eggs in one basket" really applies to the concept of intelligent investing. Diversification lowers your risk of loss by spreading your money across various industries and geographic regions. It is a rare occasion when all stocks decline at the same time and in the same proportion. Sector funds spread your investment across only one industry so they are less diversified and therefore generally more volatile.

3. More choice.

Mutual funds offer a variety of schemes that will suit your needs over a lifetime. When you enter a new stage in your life, all you need to do is sit down with your financial advisor who will help you to rearrange your portfolio to suit your altered lifestyle.

4. Affordability.

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As a small investor, you may find that it is not possible to buy shares of larger corporations. Mutual funds generally buy and sell securities in large volumes which allow investors to benefit from lower trading costs. The smallest investor can get started on mutual funds because of the minimal investment requirements. You can invest with a minimum of Rs.500 in a Systematic Investment Plan on a regular basis.

5. Tax benefits.

Investments held by investors for a period of 12 months or more qualify for capital gains and will be taxed accordingly. These investments also get the benefit of indexation.

6. Liquidity.

With open-end funds, you can redeem all or part of your investment any time you wish and receive the current value of the shares. Funds are more liquid than most investments in shares, deposits and bonds. Moreover, the process is standardized, making it quick and efficient so that you can get your cash in hand as soon as possible.

7. Rupee-cost averaging.

With rupee-cost averaging, you invest a specific rupee amount at regular intervals regardless of the investment's unit price. As a result, your money buys more units when the price is low and fewer units when the price is high, which can mean a lower average cost per unit over time. Rupee-cost averaging allows you to discipline yourself by investing every month or quarter rather than making sporadic investments.

8. Transparency.

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The performance of a mutual fund is reviewed by various publications and rating agencies, making it easy for investors to compare fund to another. As a unit holder, you are provided with regular updates, for example daily NAVs, as well as information on the fund's holdings and the fund manager's strategy.

9. Regulations.

All mutual funds are required to register with SEBI (Securities Exchange Board of India). They are obliged to follow strict regulations designed to protect investors. All operations are also regularly monitored by the SEBI.

Investing In Equities

IV- Investing in debt

Our approach to fixed-income investing emphasizes a single-minded focus on delivering steady returns while carefully controlling risk factors.

- ✓ We believe that safety is of paramount importance and do not hesitate to give up short term speculative gains.
- ✓ We manage default risk through a careful selection process including analysis of the rating, the integrity and efficiency of management, the general finances of the company, and an in-depth study of the specific borrowing program. (Why is the money needed? Is the expansion necessary? Will it generate sufficient revenues to interest and principal?

- ✓ We manage interest-rate risk by maintaining the portfolio maturity of the fund at intermediate levels and do not believe in timing the market interest rates.
- ✓ We maintain a prudent balance between government securities and corporate bonds, and ensure adequate diversification through strict limits on single company exposures.
- ✓ We take advantage of our strong and proprietary equity research, to help identify the strongest issuers of debt and discover undervalued sectors.
- ✓ We have stringent liquidity norms to ensure that the portfolio can be liquidated at any time to meet redemptions.

V- Stocks and stock funds

When a company needs to grow or expand, it may sell part of its ownership to the public in the form of shares (stock). In exchange for the money received from the sale, the company gives shareholders a portion of its future profits, as well as a measure of its decision-making power.

When a mutual fund buys stocks, the fund's shareholders become part owners of the companies that issued those stocks. Stock prices can change greatly from day to day, depending on the supply and demand for the stock. If many investors want to buy the stock, the price may go up. If fewer investors are interested in buying the stock, the price may go down.

1. Not all stock funds are alike.

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A stock fund's risk and return depend on the types of companies it buys. Pure growth funds buy companies that are expected to grow rapidly. These companies tend to use their profits to finance future growth rather than paying them out as dividends. Other stock funds invest more conservatively, favoring large, established companies that pay reliable dividends which provide income that can reduce the fund's volatility.

2. Benefits of investing for growth.

People invest in stock funds because they hope their investment will have grown substantially when they finally sell it. Over the long term, stock funds have outperformed bond funds and money market funds and have been the best hedge against inflation. In order to enjoy the benefits of investing in stock funds, you should maintain a long-term view. While stocks have produced the greatest returns over time, stock prices fluctuate, sometimes widely.

3. Do stock funds make sense for you

That depends on your answers to the 3 questions we posed before. If your time frame is flexible, you might be able to wait out any temporary downward price movements in the value of your stock fund. On the other hand, if your time frame is fixed, and especially if it's short, volatile investments such as stock funds can be risky. While volatility is not of great concern to the average long term, buy-and-hold investor, it can be worrisome to people who check fund prices daily and can't get a good night's sleep when a stock fund is losing value. Using rupee-cost averaging rather than a lump-sum approach to buying and selling investments helps ameliorate the average person's discomfort.

4. Bonds and fixed-income funds

A bond is a negotiable IOU, or debt security, issued by a corporation, government or government agency. When investors buy a bond, they're lending a certain sum of money (principal) to the bond issuer for a specified time period (term).

VI- In return, the issuer promises to:

- ✓ Make regular interest payments during the term at a rate set when the bond is issued.
- ✓ Repay the face value of the bond on the maturity date.

About maturity**.** A bond's maturity indicates when its issuer is required to repay the principal. Bonds are classified in 3 general maturity ranges:

- ✓ Short-term—usually less than 3 years
- ✓ Intermediate-term—between 3 and 10 years
- ✓ Long-term—greater than 10 years

In general, the longer the maturity, the higher the bond's interest rate. This is to compensate you for the risk of tying up your money at a fixed-interest rate for a longer period of time.

5. How interest rates affect prices.

Between the time you buy a bond or bond fund and the time you sell it the value of your principal will fluctuate. Generally, when interest rates go up, bond prices move lower-and when

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they move down, bond prices move higher. As you might expect, the best time to invest in bonds generally is when interest rates are declining. Typically, the longer a bond's maturity, the higher the interest-rate risk, or the more sensitive its price will be to interest rate changes.

6. Can you lose money investing in bonds

People mistakenly assume that the word "fixed-income" means they can't lose money owning a bond. But, the interest rate that the issuer pays is the only part of the investment that is "fixed." The value of your principal, on the other hand, has the ability to increase or decrease depending on whether interests rates move up or down.

7. It's different with bond funds

The fund typically doesn't hold all the bonds until they mature. When you buy a bond fund, you get diversification because the fund owns many bonds, not just one. This diversification helps protect you from *credit risk*—the risk that the issuer fails to make timely interest payments or to repay principal. However, this means that the income you receive from the fund fluctuates along with your principal, as the fund buys and sells bonds paying different rates of interest.

Types of bonds.

There are many types of fixed-income securities to choose from. Funds will often emphasize one type or another to help investors meet their investment objectives.

- ✓ Government securities issued by the Indian government are considered the most credit worthy of all debt instruments-since they are backed by the full faith and

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credit of the government. Treasury bonds, bills and notes have a wide range of maturities.

- ✓ Corporate bonds are issued by companies in order to finance projects ranging from building a new plant to modernizing at a current location. Risk and return vary, depending on the financial strength of a corporation. Bonds issued by corporations with lower credit quality generally pay a higher rate of interest to compensate investors for the higher repayment risk.
- ✓ State government bonds are issued by local governments in order to finance a variety of projects, ranging from water systems and public schools, to hospitals and police protection. State government bonds are generally considered to be relatively low risk investments, second only to securities issued by the federal government and its agencies. However, within state government bonds themselves, there is a wide range of credit quality.

These bonds are exempt from federal taxes and, in the state of issue, often free of state and local income tax as well. Before choosing a tax-free fund, you should consider the equivalent taxable yield-what a taxable investment would have to yield before taxes to equal the tax-free yield of a particular tax-free bond investment.

8. Do bond funds make sense for you.

Nearly all investors can benefit from having a portion of their portfolio allocated to bonds. Even for investors whose primary objective is long-term growth, bonds can play an important role in building a well-diversified portfolio. Let's go back to the questions we posed

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earlier. First is your time frame. Bond funds offer greater potential return than cash-equivalent investments such as money market funds, But they can be riskier than money market funds for people with very short time frames and for those who need to withdraw all their money on a fixed date. Bond funds provide diversification and can be a key element in your asset allocation strategy to combat the volatility of stocks, While bond prices and returns can fluctuate, over the long haul bond funds have been less volatile than stock funds, For people who are very risk averse, while bond funds lag behind stock funds as an inflation fighter, they are better than cash-equivalent investments are at preserving your purchasing power.

9. Cash-equivalent investments and money market funds

In many respects, most money market instruments are just short-term versions of bonds. They are short-term, high-quality, fixed-income securities, such as Treasury bills, short-term bank certificates of deposit (CDs), and commercial paper issued by corporations. The average maturity of a money fund's portfolio must be 90 days or less to help protect against interest rate risk. The income money funds provide is generally determined by short-term interest rates.

10. Do money market funds make sense for you.

Money funds provide you with current income and seek to preserve your principal. Because of their stability, money funds are often used for emergency cash reserves or for a very short-term financial goal. Cash-equivalent investments and money market funds are the least volatile of the investment types we discussed and are therefore ideal for people with extremely low risk tolerance. However, the income from this type of investment is only slightly higher than

interest rates offered by banks on savings accounts making them poor choices to combat the damage inflation inflicts on your purchasing power.

11. Risk and reward go hand-in-hand

When choosing investments, remember the tradeoff between risk and return. The higher the return you seek, the more risk you'll need to accept. There's no such thing as a low risk-high return investment. As always, you will want to consult your financial advisor about how fixed income funds could playa role your investment strategy.

VII- Importance of an Advisor

With the variety of investment options available today, we suggest that you seek guidance from a financial advisor. Nearly every investment entails special risks that should be discussed with an experienced professional. Your investment goals are unique, and an advisor can help you find the right fund to match your needs. When taking a full-service approach to investing, you put a professional's training, knowledge, expertise and resources to work for you. Consider these benefits:

- ✓ Potential access to important investment news when it is most valuable
- ✓ Professional advice that may help improve your investment results
- ✓ Expert help in determining the best way to allocate your assets
- ✓ A trained and objective professional who can help you avoid panic selling

You may be thinking that the Internet and financial planning software can cater to all these needs, but although they are convenient tools, they cannot equal the personal attention and experience of a professional. He or she can make that difference in helping you manage your financial future.

VIII - Expect From a Financial Advisor

The key for mutual fund investors is to define and recognize the value of professional financial services, and then insist on getting that value. When you pay a sales charge or a fee, what can you expect a professional to do for you? Your advisor should at least:

- ✓ **Understand your needs and help you formulate long-term investment goals and objectives.**

  Before making specific recommendations, your advisor should try to gain a whole picture of your past experience, lifestyle and goals, as well as your other investments and current financial situation. When are you planning to retire, for example? Do you have life insurance? Do you own real estate? How secure is your job?
- ✓ **Help you develop realistic expectations by discussing the risks and rewards of each investment.**

  Every investment choice has its strengths and weaknesses, and you should never feel less than fully informed. When you ask questions, or have doubts, you

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should expect your financial advisor to answer honestly, and help you develop a strategy that is both realistic and comfortable for you.

- ✓ **Match your goals and objectives with appropriate mutual funds.** You should expect your advisor to make clear and specific recommendations, and explain the reasons behind them in terms you can understand. Of course, the advisor should be confident and well informed about the management and portfolio strategies of any mutual funds recommended.
- ✓ **Continually monitor your portfolio and help you interpret performance.** Your advisor cannot influence or predict a fund's results. However, he or she should discuss results with you and help you judge your progress. You should feel that you can always ask your advisor,

IX- Conclusion

One of the most valuable services your advisor can provide is to help you "stay on course" with your investment program. But "staying on course" long term does not necessarily mean staying put. Expect your financial advisor to work with you to adjust your portfolio in response to any significant change in your lifestyle, priorities, assets or responsibilities. These are the basic services that investors should expect from their financial advisors. Beyond the basics, many investors could use even more specialized assistance, like advice on retirement plan distribution options, setting up and servicing retirement plans for small businesses and self-employed individuals, developing tax-advantaged strategies for children's college education, insurance, estate, and trust planning; and year-end mutual fund tax advice.