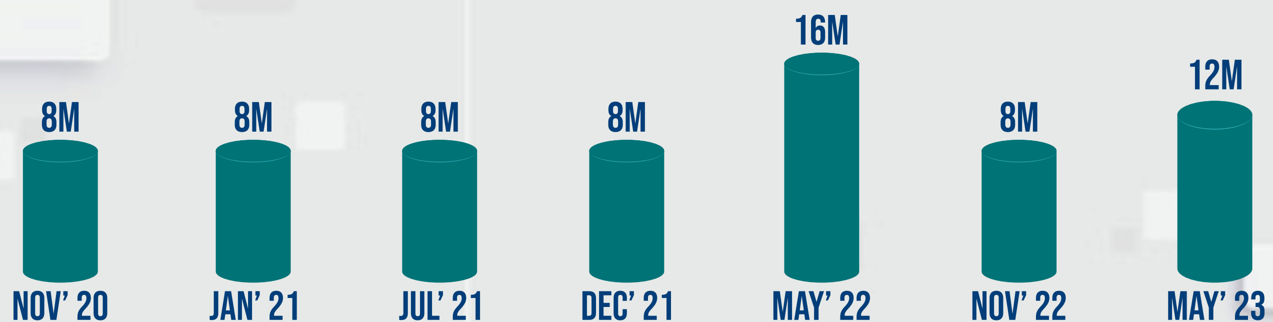
CHAPTER 7

MUTUAL FUNDS

"Don't let the noise of others' opinions drown out your own inner voice." STEVE JOBS

MARKS ALLOCATION (ICAI PAST EXAMS)



STUDY MENTOR

Path to Exemption

Your Friend, Philosopher & Guide...

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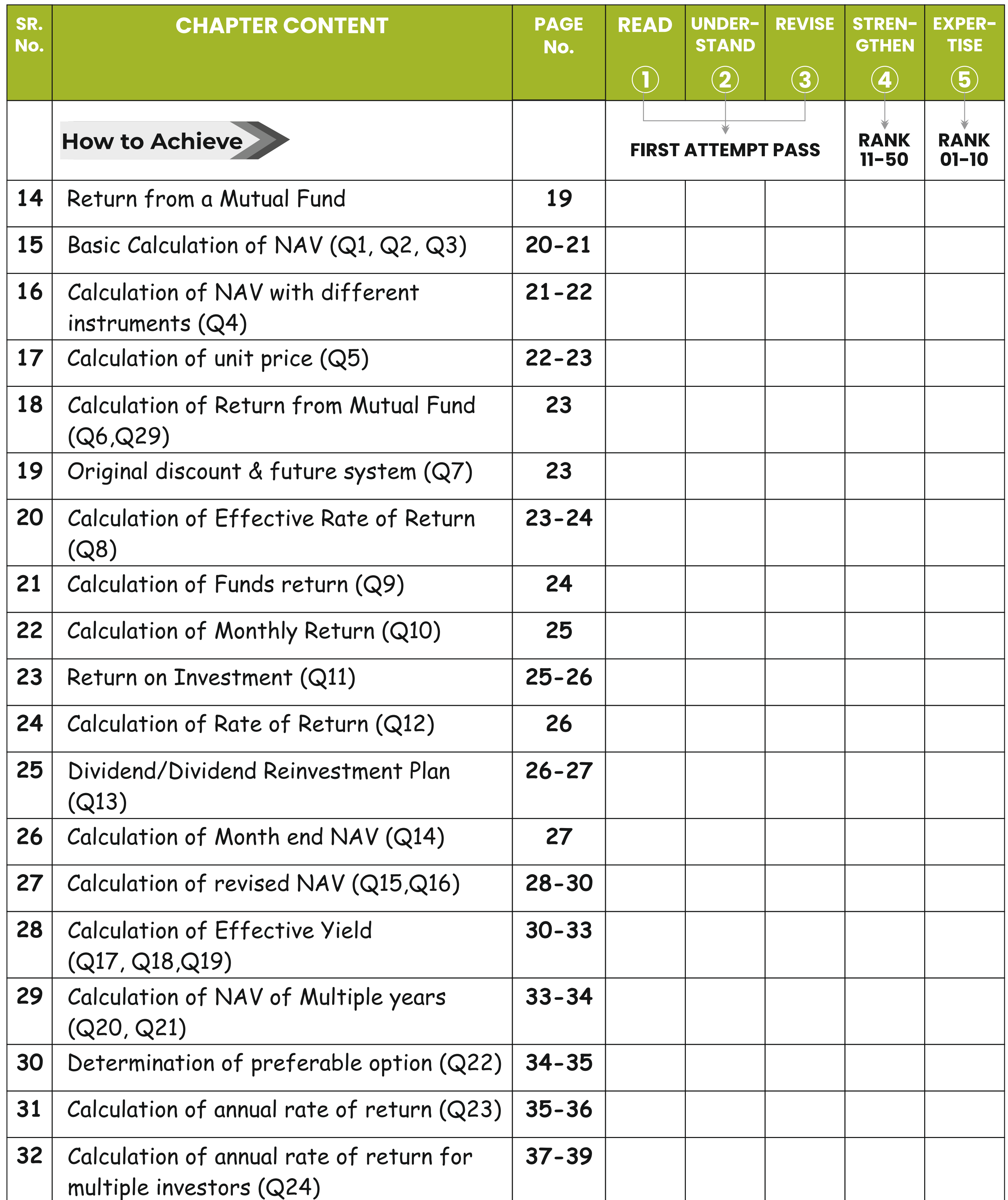

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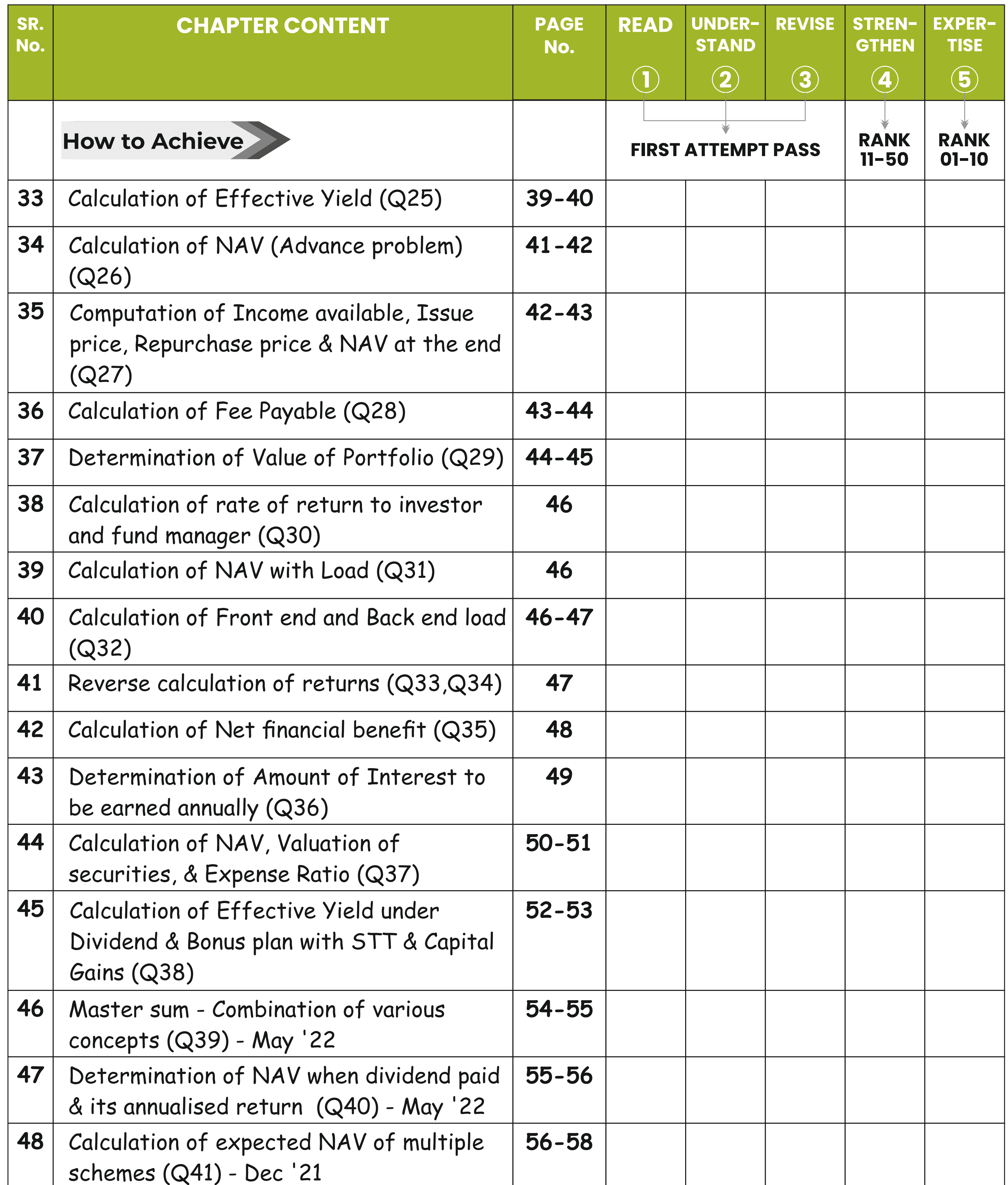

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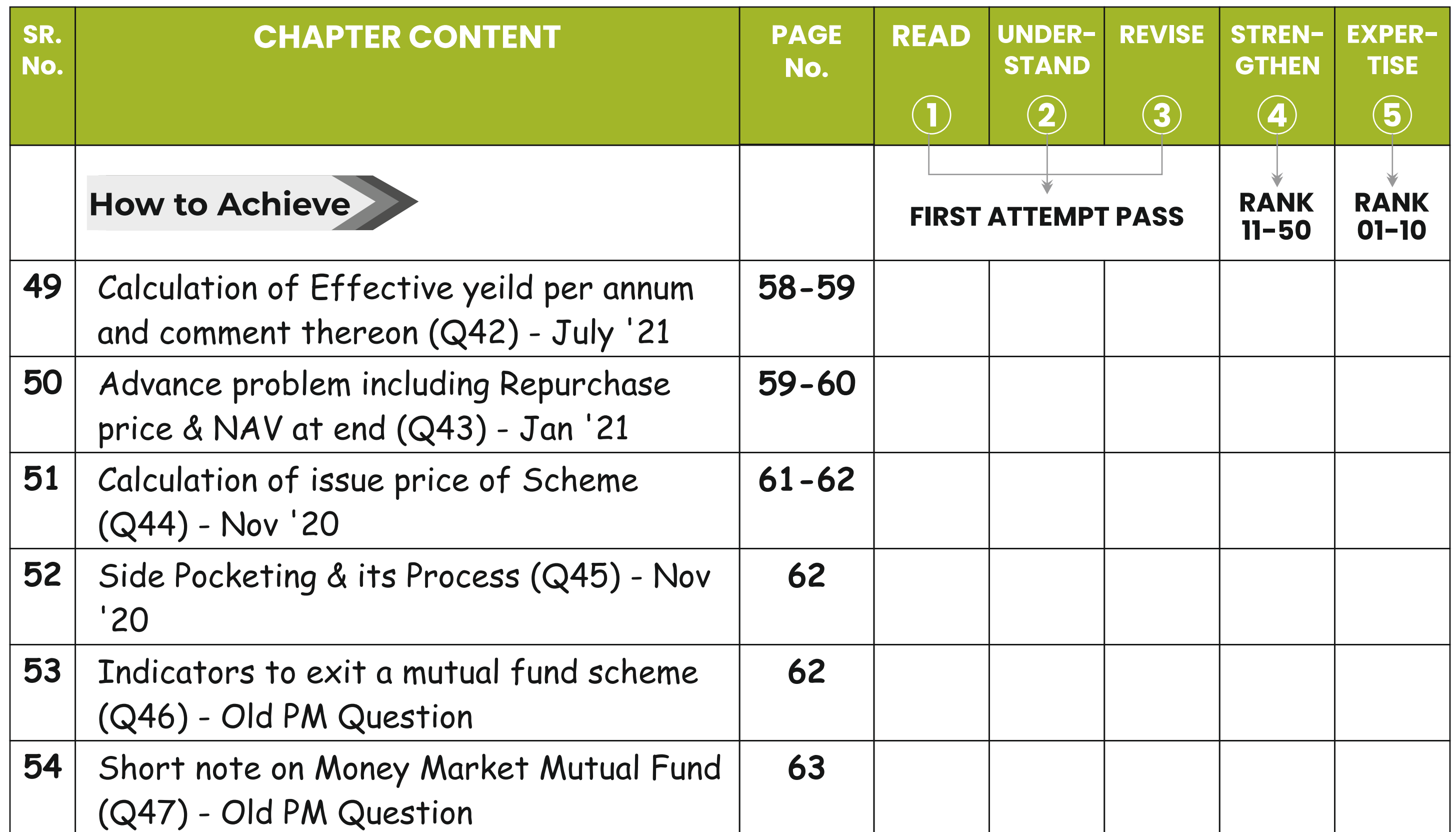

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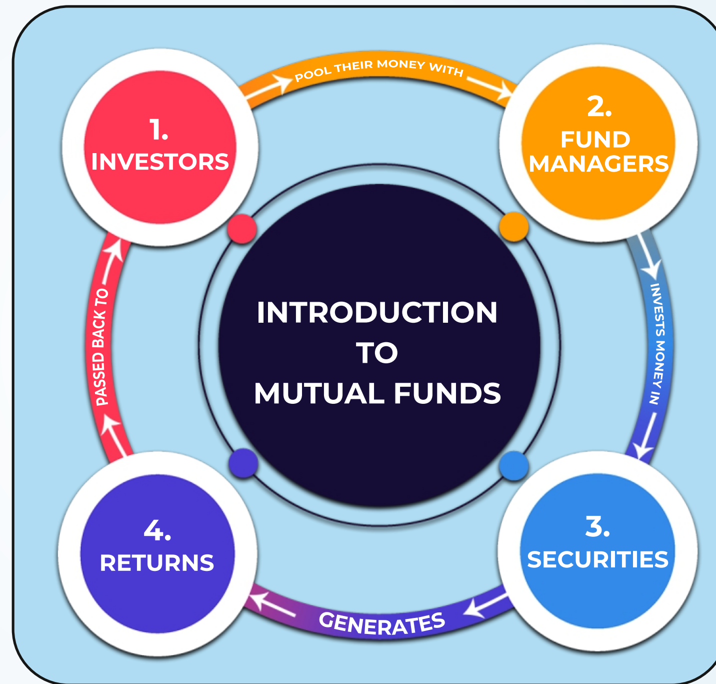
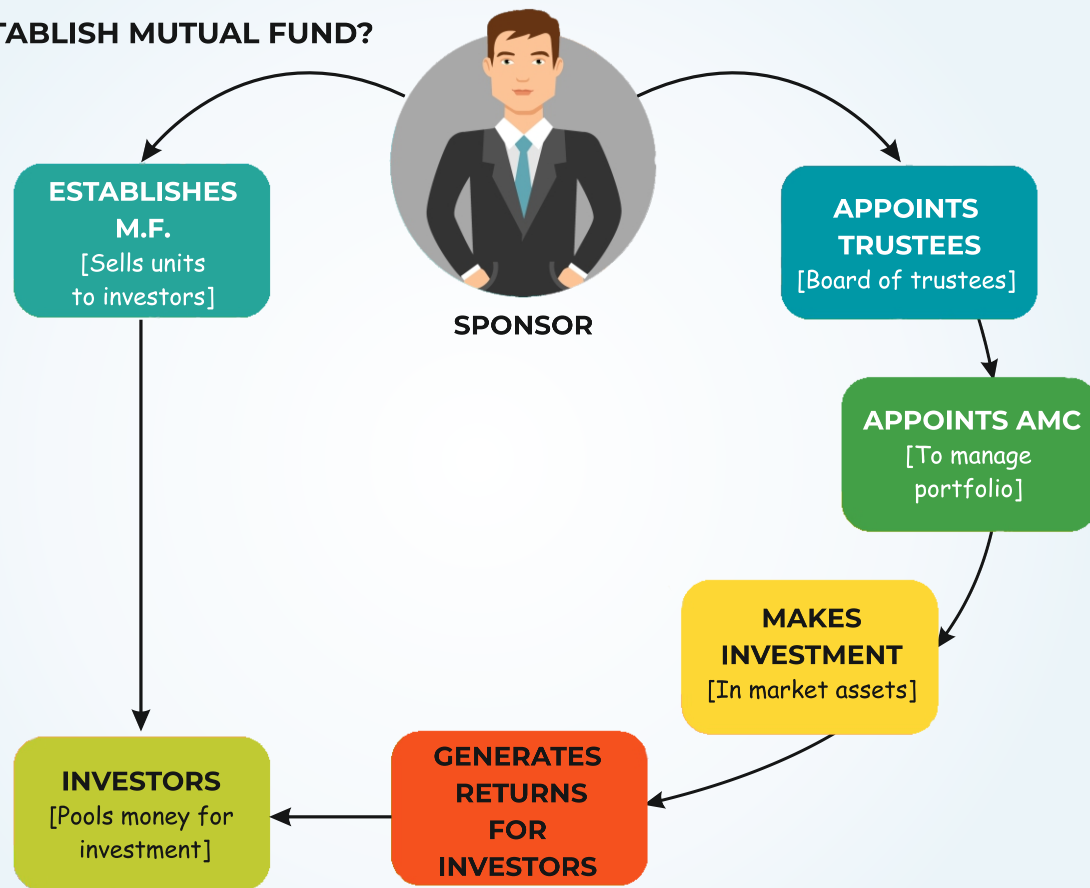
PREVIEW

1] INTRODUCTION TO MUTUAL FUNDS?



2] HOW TO ESTABLISH MUTUAL FUND?



3] TYPES OF SCHEMES

TYPES OF MF SCHEMES

01 **BALANCED FUNDS** [DEBT + EQUITY]

02 **EQUITY DIVERSIFIED FUNDS** [Investment in wide array of stocks]

03 **ELSS** [To save tax under section 80C]

04 **SECTOR FUNDS** [Focused in particular industry]

05 **THEMATIC FUNDS** [Focused on stocks tied to same theme]

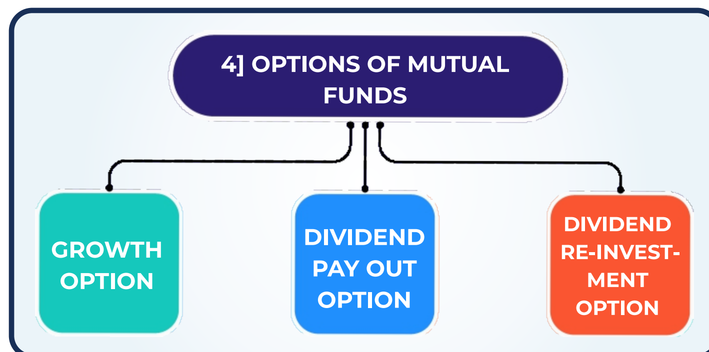
06 **ARBITRAGE FUNDS** [For safety of deposits by exploiting price difference in different market]

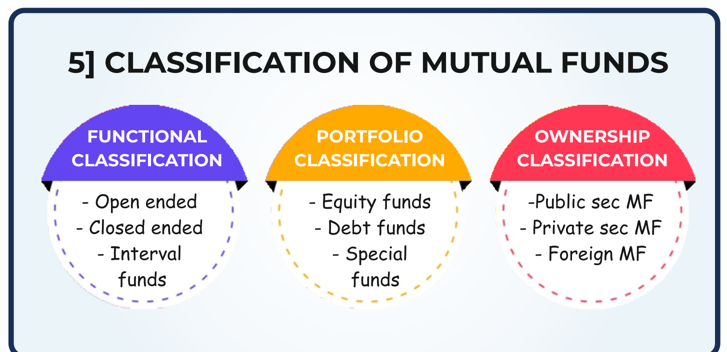
07 **HEDGE FUNDS** [Lightly regulated investment fund]

08 **CASH FUND** [Open ended liquid scheme to generate returns with lower volatility]

09 **EXCHANGE TRADED FUNDS {ETFS}** [Hybrid product that combines features of listed stocks & index fund]

10 **FIXED MATURITY PLANS** [Closely ended funds where one can invest during NFO]



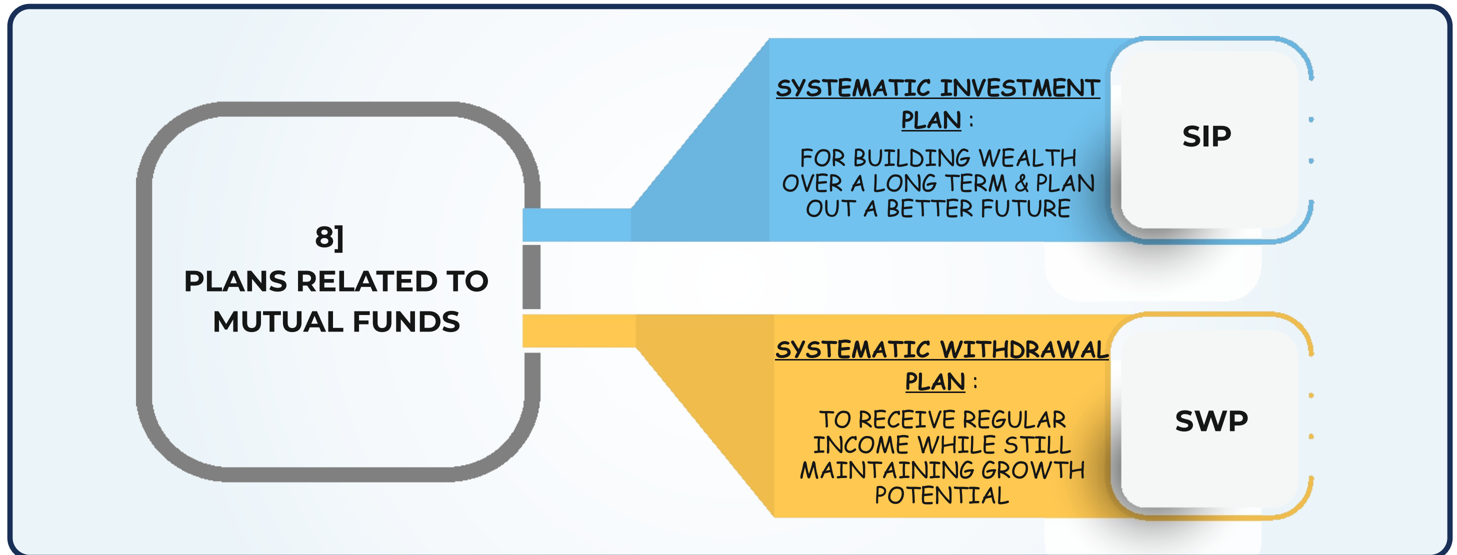


6] BENEFITS -

PROFESSIONAL MANAGEMENT | DIVERSIFICATION | LIQUIDITY | FLEXIBILITY | WELL REGULATED | TRANSPARENCY | LOW COST | HIGHER RETURNS | ECONOMIES OF SCALE

7] DRAWBACKS-

NO GUARANTEE OF RETURN | SELECTION OF PROPER FUND | COST FACTOR | UNETHICAL PRACTICE | TRANSFER DIFFICULTIES | LOCK IN PERIOD | TAXES



9] NAV = EVERY MF SHOULD CALCULATE NAV ON DAILY BASIS

$$NAV = \frac{\text{NET ASSETS OF THE SCHEME}}{\text{NO OF UNITS OUTSTANDING}}$$

Where,
Net Asset Value of the Scheme = Market value of investments + Receivables + Other accrued income + Other assets – Accrued Expenses – Other payables – Other Liabilities

10] RETURN

$$\frac{[NAV_{end} - NAV_{beginning}] + \text{Dividend} + \text{Capital Gain}}{NAV_{beginning}} \times 100$$

11] EXPENSE RATIO

$$\frac{\text{EXPENSE INCURRED PER UNIT}}{\text{AVERAGE NAV}}$$

12] REQUIRED RETURN

$$R_2 = \frac{1}{1 - \text{Initial expenses (\%)}} R_1 + \text{Recurring Expenses (\%)}$$

13] TRACKING ERROR

$$TE = \sqrt{\frac{\Sigma(d-\bar{d})^2}{n-1}}$$

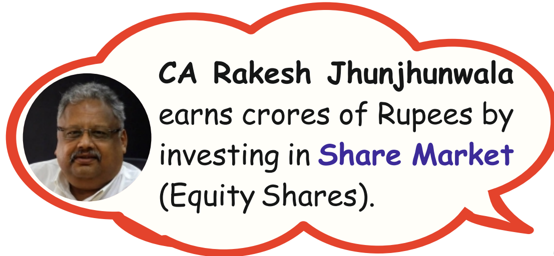
d = Differential return
$\bar{d}$ = Average differential return
n = No. of observation

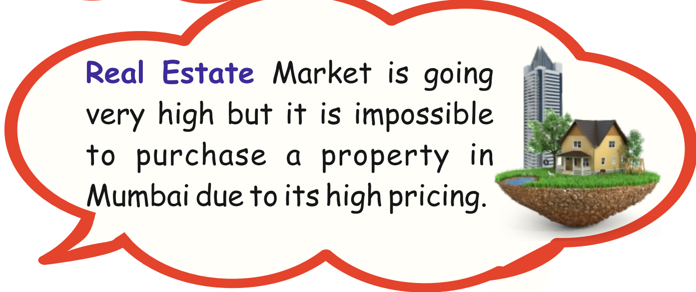
14] ENTRY LOAD [AT TIME OF PURCHASE]

S.P = NAV(1+LOAD%)

15] EXIT LOAD [AT TIME OF SALE]

R.V = NAV(1- EXIT LOAD%)





I have so less money, but I want to invest in above Assets (Shares, Gold, Real Estate). How Can I do this??

The Solution to above problem is Mutual Funds.

Gold Rate (24 Karat per 10 grams)

YEAR	PRICE	YEAR	PRICE	YEAR	PRICE	YEAR	PRICE
1995	Rs.4,680	2002	Rs.4,990	2009	Rs.14,500	2016	Rs.28,623
1996	Rs.5,160	2003	Rs.5,600	2010	Rs.18,500	2017	Rs.29,667
1997	Rs.4,725	2004	Rs.5,850	2011	Rs.26,400	2018	Rs.31,438
1998	Rs.4,045	2005	Rs.7,000	2012	Rs.31,050	2019	Rs.35,220
1999	Rs.4,234	2006	Rs.10,800	2013	Rs.29,600	2020	Rs.48,651
2000	Rs.4,400	2007	Rs.12,500	2014	Rs.28,006	2021	Rs.48,720
2001	Rs.4,300	2008	Rs.14,500	2015	Rs.26,343	2022	Rs.52,670

NIFTY RATES (YEAR WISE)

YEAR	PRICE	YEAR	PRICE	YEAR	PRICE	YEAR	PRICE
1995	Rs.909	2002	Rs.1,094	2009	Rs.5,201	2016	Rs.8,186
1996	Rs.899	2003	Rs.1,880	2010	Rs.6,351	2017	Rs.10,531
1997	Rs.1,079	2004	Rs.2,081	2011	Rs. 4,624	2018	Rs.10,863
1998	Rs.884	2005	Rs.2,837	2012	Rs.5,905	2019	Rs.12,168
1999	Rs.1,480	2006	Rs.3,966	2013	Rs.6,304	2020	Rs.13,981
2000	Rs.1,264	2007	Rs.6,319	2014	Rs.8,283	2021	Rs.17,203
2001	Rs.1,059	2008	Rs.2,959	2015	Rs.7,964	2022	Rs.18,159

1. What are Mutual Funds?

The money pooled in by large number of investors is what makes up a Mutual Fund.

A mutual fund is a pool managed by a professional Fund Manager.

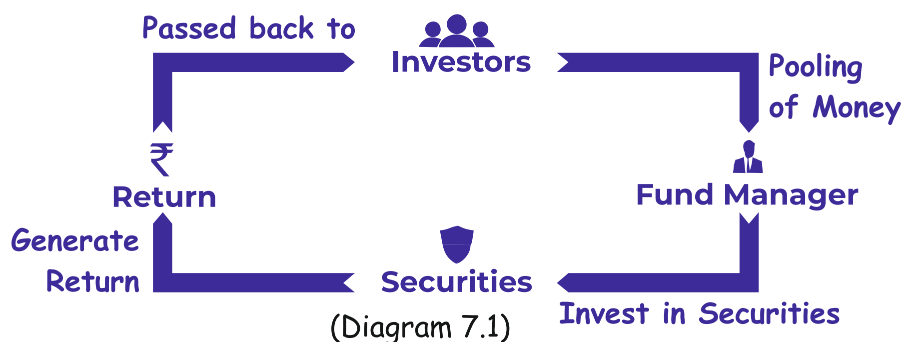
It is a trust that collects money from a number of investors who share a common investment objective. Then, it invests the money in equities, bonds, money market instruments and/or other securities. Each investor owns units, which represent a portion of the holdings of the fund. The income/gains generated from this collective investment is distributed proportionately amongst the investors after deducting certain expenses, by calculating a scheme's "Net Asset Value" or "NAV". In other words, a Mutual Fund is one of the most viable investment option for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Here's a simple way to understand the concept of Mutual Fund Unit.

Let's say there is a box of 12 chocolates costing Rs. 40. Four friends decide to buy the same, but they have only Rs.10 each and the shopkeeper only sells one of the box. So the friends decide to pool in Rs.10 each and buy the box of 12 chocolates. Now based on their contribution, they each receive 3 chocolates or 3 units, if equated with Mutual Funds. And how do you calculate the cost of one unit? Simply divide the total number of chocolates: Rs.40/12 Chocolates = Rs.3.33 Per Chocolate.

So if you were to multiply the number of units (3) with the cost per unit (3.33), you get the initial investment of Rs.10.

This results in each friend being a unit holder in the box of chocolates that is collectively owned by all of them, with each person being a part owner of the box.



(Diagram 7.1)

1.1 Who can invest in Mutual Funds ?

Anybody with an investible surplus of as little as a few thousand rupees can invest in mutual funds by buying units of a particular mutual fund scheme that has a defined investment objective and strategy.

1.2 How Mutual Funds work for you ?

The money collected from the investors is invested by a fund manager in different types of securities. These could range from shares and debentures to money market instruments depending upon the scheme's stated objectives.

The income earned through these investments and capital appreciation realized by the scheme is shared by its unit holders in proportion to the units owned by them. (please refer the diagram 7.1 above)

2. Net Asset Value (NAV)

The performance of a particular scheme of a Mutual Fund is denoted by Net Asset Value (NAV). In simple words, NAV is the market value of the securities held by the scheme.

EXAMPLE: In stock market, share price is market value of Shares and;
In Mutual Funds, NAV is market value of units of Mutual Fund.

How NAV is calculated?

It is value of net assets of the funds. The investor's subscription is treated as the unit capital in the balance sheet of the fund and the investments on their behalf are treated as assets. The fund's net assets are defined as the assets less liabilities.

$$NAV = \frac{\text{Net asset value of the scheme}}{\text{Number of units outstanding}}$$

Where,
Net Asset Value of the Scheme = Market value of investments + Receivables + Other accrued income + Other assets – Accrued Expenses – Other payables – Other Liabilities

3. Should we invest in Stocks or Mutual Funds?

As soon as, you have set your goals and decided to invest in equity the question arises should you invest in stocks or mutual funds? Well, you need to decide what kind of an investor you are.

First, consider if you have the kind of disposable income to invest in 15 – 20 stocks. That is how many stocks you will have to invest in if you want to create a well-diversified portfolio. Remember the familiar saying: Do not put all your eggs in one basket? If Rs. 5,000 were all you have to spare, it would be impractical to invest it across many stocks.

Many beginners tend to focus on stocks that have a market price less than Rs. 100 or Rs.50 ; that should never be a criterion for choosing a stock. Also, brokerage could eat into your returns if you purchase small quantities of a stock.

On the other hand, you would be able to gain access to wide basket of stocks for Rs.5,000 if you buy into a fund. Investing in funds would also be an easy way to build your equity portfolio over time.

Let's say you can afford to put away Rs. 1,000 a month in the market. You can simply invest in fund every month through a Systematic Investment Plan (SIP) as a matter of financial discipline. You can save yourself the trouble of scouting for a stock every month.

That brings us to the next point. Do you have the time to pick stocks? You need to invest a considerable amount of time reading newspaper, magazines, annual reports, quarterly updates, industry reports and talking to people who are familiar with industry practices. Else, you certainly won't catch a trend or pick a stock ahead of the market. How many great investors have you heard of who have not made investing their full-time job?

Plus, you may have the time, but not the inclination. You have to be an active investor, which means continuously monitor the stocks you pick and make changes – buy more, cut exposures- depending upon the turn of events. These actions have costs as well. As you churn your portfolio, you bear expenses such as capital gains tax. Funds do not pay capital gains tax when they sell a stock.

All this assumes you know what you are doing and have the skill to pick the right stocks. You are likely to be better at investing in a industry you understand. Only, too bad if that industry appears to be out of favour in the market.

If you love the thrill of the ups and downs in the stock market; if you find yourself turning to business channels and business newspapers hoping that you can pick the next Infosys; if you have an instinct for spotting stocks and, importantly, the discipline to act on it; if you have the emotional maturity to cut your losses when you are ahead, then you can trust yourself to invest in stocks.
Otherwise, hand over your money to the professional. Mutual funds could be the best avenue for the risk-averse Investors.

4. How to Establish a Mutual Fund?

In India, a mutual fund is required to be registered with SEBI which regulates securities market before it can collect funds from public.

MF is Regulated by SEBI and it comprises of 4 main pillars as below

Sponsor	MF Trust	AMC (Assets Management Company)	Custodian
Establishes the MF & gets it registered with SEBI.	Job of the MF Trustees • To ensure that schemes floated and managed by the AMC are in accordance with SEBI & trust deed. • Ensures that funds are deployed in interest of unit holders.	Responsible for managing the assets of a mutual fund, by deciding the investment opportunities.	Responsible for securing & managing the securities held within a mutual fund.
• Sponsor should be in Profitable financial services business for more than 5 years. • Should contribute at least 40% Net worth of the AMC. **Eg:** For Birla Sun Life Mutual Fund, Aditya Birla Financial Services are sponsors.	Sponsors is the capital provider while trustee is the Internal regulator of the fund. **Eg:** HDFC Trustee Co. Ltd.	AMC services all the administrative, managerial and operating functions of mutual fund. **Eg:** HDFC AMC	Funds portfolio manager makes trading decisions. Securities owned by the fund are held by the custodian and not directly with the fund itself. This is done to reduce the risk of fraud. **Eg:** HDFC Bank Limited

4.1. AUM (Assets Under Management)

AUM of Indian Mutual fund industry as on October 31, 2022 is Rs. 39.5 Trillion.
Which is a 5 times increase from Rs. 7.68 Trillion on October 31, 2012, within a span of 10 years.

5. Benefits & Drawbacks of Investing through Mutual funds

I. Benefits

Professional Management	Diversification	Liquidity	Flexibility	Well Regulated	Transparency
Skilled & Experienced managers with a Research Team.	Investment in cross section of industries and sector by balancing the risk.	• Open Ended (Purchase & Redemption directly from MF) • Close Ended (Buying & Selling on Stock Exchange)	• Systematically invest (SIP) or withdraw (SWP) funds from wide range of schemes. • Investors can also invest in different types of instruments with even small savings	Registered with SEBI & provide excellent investor protection.	Regular investment disclosure on monthly/ quarterly/ half yearly basis. (NAV published daily)

Low Cost	Max around 2.5% of amount received by AMC

Higher Returns	Very good return over medium to long term duration.

Economies of Scale	Allows access to high entry level markets; like real estate.

II. Drawbacks of a Mutual Fund:

No Guarantee of Return:	Selection of Proper Fund	Cost Factor	Unethical Practice	Taxes	Transfer Difficulties:	Lock-in Period:
Risk of losing investment on account of Poor performance of fund manager. May provide less returns than Benchmark. Focus on short term and neglect the long term.	Past Performance may not guarantee future returns.	Management fees reduce the return to investors. + Payment of entry & exit load.	Sale of holdings to its sister concerns for substantive notional gains.	Fund managers do not consider personal tax situations. Eg: Capital gain tax and other taxes.	Liquidating a MF portfolio may increase risk, fees and commissions.	Can deny investors with short term benefits.

6. Classification of Mutual Funds

1 Functional Classification

- Open Ended
- Closed Ended
- Interval Funds

2 Portfolio Classification

- Equity Funds
  (Growth Aggressive, Income)
- Debt Fund
  (Bond, Gilt etc.)
- Special Funds

3 Ownership Classification

- Public Sector MF
- Private Sector MF
- Foreign MF

4 Direct Plan

- - -

6.1. Functional Classification (Also called as Structural Classification)

a Open Ended Funds	b Close Ended Scheme	c Interval – funds
Available for subscription (Sale & Repurchase) throughout the year	Investor can buy during IPO or from stock market after listing.	Open for purchase of redemption during pre-specified intervals (monthly, quarterly, annually)
Convenience to Buy & Sell Units @ NAV, directly from the mutual fund company.	Exit by selling in the stock market.	Not required to be listed on stock exchange.
Key feature = Liquidity (Direct from MF Company)	Fixed Maturity period (3 – 15 years).	Fresh issue possible during specified interval period @ prevailing NAV. Maturity period not defined.

6.2. Portfolio Classification (Also Called as Investment Objective Classification)

(i) Equity Oriented Mutual Fund

(Majority of money collected is invested in Equity Shares.)

Main Aim:

- Capital appreciation by increase in share value.
- Regular inflow of dividend.
- Ideal for investors having a long term outlook seeking growth over a period.

a Growth – Long Term	b Aggressive – Short Term	c Income - Mid-Term
Long term capital appreciation	Expecting Super normal returns by investing in (Start-ups, IPO'S, Speculative Stocks best for risky investment)	Maximise regular income of investors by investing in companies providing regular dividend and in high yield money market instruments.

(ii) Debt Funds

a Bond Funds	b Gilt Funds
Invest in fixed Income Securities - Eg: Govt. Bonds, Corporate Debenture, Money Market etc.	Invest majority money in Government Securities and Treasury Bills
(Less) Volatile than Shares & provide regular income (Interest)	

Risks with Bond Funds

- Interest rate risk
  (Change in interest rate leading to fall in market value of Bonds.)
- Credit Risk
  (Risk of default in repayment of loans.)
- Prepayment Risk
  (Related to early refund of money by issue of bonds before date of maturity.)

(iii) Special Funds

a Index Funds	b International Funds (similar to offshore funds)	c Sector Funds	d Money Market Funds
Measures upward & downward sentiment of stock market. Invest in stock, Index (like NIFTY, BANK-NIFTY)	Invest Globally and the return will be accordingly.	Entire fund is invested in a particular industry. Eg: Utility fund for utility industry like power, gas, public works, etc.	Debt oriented schemes with main objective: • Preservation of capital • Easy liquidity • Moderate Income • Used to park surplus funds for short period.
So the mutual fund will receive whatever the market delivers.		The return will be as per that particular industry.	Investment: Commercial paper, Certificate of Deposits, Treasury Bills, G-Secs, Etc.

e Fund of Funds	Schemes which invest in other mutual fund schemes, based on its overall objective.

f Capital Protection Oriented Funds

These are closed ended funds that are hybrid in nature. They allocate money to debt and equity securities. The allocation to debt securities is done in such a way that at the end of the term of the product, the value of debt investment is equal to the original investment in the fund. The equity portion aims to add to the returns of the product maturity. These funds are oriented towards protection of capital and do not offer guaranteed returns.

Example: AAA bonds are quoting at interest rate of 10% p.a. for a 5 – year term.

a. This means that at the end of 5 years, the investment of Rs.100 in such bonds would be worth Rs.161.05, assuming reinvestment of the interest.

b. On the other hand, if one invests Rs.62.09 in such bonds, the value of bonds at the end of 5 years would be Rs.100.

In such a case, the allocation between equity and debt would be 37.91 : 62.09 respectively. So, if the equity value reduces to zero, the investor gets back the original amount invested.

The asset allocation is a function of prevailing interest rates on high quality (AAA rated) bonds. It is mandatory for the fund to be rated by at least one rating agency in order to be called a capital protection oriented fund. Debt securities held in the portfolio must be of highest rating.

g Gold – Funds

This fund offers investors an opportunity to participate in the bullion market without having to take physical delivery of Gold.

The units represent value of gold and related instruments. (Sometimes in the form of ETF.)

Example: Kotak Gold is an open ended fund of fund which generate returns by investing in units of Kotak Gold Exchange Traded Fund.

h Quant – Funds (Automated investment)

Data driven approach for stock selection and investment decisions based on a pre-determined rules or parameters using statistics or mathematics- based models.

While an active fund manager selects the volume and timing of investments (entry or exit) based on his/her analysis and judgement in this type of fund complete reliance is placed on an automated programme that decides making decision for quantum of investment as well as its timings and action and concerned manager has to act accordingly.

However, it is to be noted it does not mean that in this type of Fund there is no human intervention at all, because the Fund Manager usually focuses on the robustness of the Models in use and also monitors their performance on continuous basis and if required some modification is done in the same.

The prime advantage of Quant Fund is that it eliminates the human biasness and subjectivity and using model-based approach also ensures consistency in strategy across the market conditions.

In addition to that since the Quant Fund normally follows passive strategy their exposure ratio tends to be lower. On the con side Quant Fund are tested based on historical data and past trends though cannot altogether be ignored but also cannot be used blindly as good indicators.

Thus, overall, it can be said that whether it is human or a machine it is not easy to beat the market.

6.3. Ownership Classification

6.4 Direct Plans of Mutual Funds

Direct plans of mutual fund schemes were launched in January 2013. The basic idea behind the concept was to allow well informed investors to buy direct plans of a scheme directly from the mutual fund – via online or through authorized branches. The logic is that a well-informed investor, who has facilities to directly deal with the mutual fund. Need not pay 'unnecessary' commission to the intermediary – and save on commissions. The commissions, saved and invested, would help them to make extra returns on their investment over a long period. Sure, many informed investors made the switch and doing a good job for managing their investments. NAV of direct plans are therefore lower to the extent of commission that is not paid to advisors/ distributors. In their quest to save commissions paid to mutual fund advisors, many mutual fund investors, especially novices to mutual funds, have been investing in direct plans without proper consultation in a big way. It is obvious that investors stand to lose money in the long term. However, as one starts understanding the importance of advisory services, this is likely to reverse.

7. Types of Schemes

I Balanced Funds	II Equity Diversified funds (Funds containing wide range of stocks)		
Strategic allocation to both Debt and Equities	a Flexicap/ Multicap Fund	b Contra Funds	c Index Fund
Debt = Stability Equity = Growth	Invests in combination of Large caps, Mid caps and Small caps.	It is an Equity mutual fund in which fund manager invests mostly in equities of company that are not performing well in the short term.	Seeks to track the performance of a benchmark Market Index like BSE Sensex or S & P CNX Nifty. The fund maintains the portfolio of all securities in the same proportion as stated in benchmark Index and earns the same return as earned by the market.
(Provides Moderate gains with a combination of Risk & Reward.)	Invests in Cos. with pre-determined market capitalization.	The idea is that buying Equity at a lower price today will be profitable in the long term when the business problem is resolved and the stock will witness a strong rally.	

NOTE i	Market Capitalisation	Value of company traded on stock market. (No. of Shares x Stock Market Price per share.)

NOTE ii	Large Cap	Mid Cap	Small Cap
	Companies having a market capital of Rs.20,000 Crores or more. Eg: TCS.	Market Capital between Rs.5000 Crores to Rs.20,000 Crores. Eg: Polycab India.	Market Capital below Rs.5000 Crores. Eg:Ashoka Build Con.

d Dividend Yield Fund

(Invests in shares of companies having high dividend yields.)

Eg: In 2022, Vedanta Ltd. gave dividends 3 times in a year. (9th March, 6th May & 26th July)

- Mutual Fund NAV's are less volatile for Dividend Yield Funds.
- Medium Risky in nature.

$$\text{Dividend yield} = \frac{\text{DPS (Dividend per share)}}{\text{MPS (Market price per share)}}$$

Funds invests in high dividend giving companies.

Basis	Dividend Payout Option	Dividend Re-Investment Option
Meaning	Dividend paid to Unit holders	Dividend accrued on units is reinvested back into the scheme @ ex-dividend NAV.
Impact	NAV of the unit falls to the extent of dividend paid.	Investors receive additional units on their investments in lieu of dividends.

e Equity Linked Savings Scheme (ELSS)

ELSS is one of the options for investors to save taxes under Section 80 C of the Income Tax Act. They also offer the perfect way to participate in the growth of the capital market, having a lock-in- period of three years. Besides, ELSS has the potential to give better returns than any traditional tax savings instrument. Moreover, by investing in an ELSS through a Systematic Investment Plan (SIP), one can not only avoid the problem of investing a lump sum towards the end of the year but also take advantage of "averaging".
Example: Mirae Asset Tax Saver Fund.

f Sector Funds

These funds are highly focused on a particular industry. The basic objective is to enable investors to take advantage of industry cycles. Since sector funds ride on market cycles, they have the potential to offer good returns if the timing is perfect. However, they are bereft of downside risk protection as available in diversified funds.
Sector funds should constitute only a limited portion of one's portfolio, as they are much riskier than a diversified fund. Besides, only those who have an existing portfolio should consider investing in these funds.
Example: Real Estate Mutual Funds invest in real estate properties and earn income in the form of rentals, capital appreciation from developed properties. Also some part of the fund corpus is invested in equity shares or debentures of companies engaged in real estate assets or developing real estate development projects. REMFs are required to be close-ended in nature and listed on a stock exchange.

g Thematic Funds

- Equity Mutual Funds that invest in stock tied to a theme.
- These are broader based then sectoral fund; as they pick companies and sectors united by an idea.
- **Example:** An infra theme fund will invest in cement, power, steel among other sectors.

h What are Arbitrage Funds?

Arbitrage is the process of buying stocks or shares in one market and selling it in another to exploit the price difference. An Arbitrage Fund is a type of hybrid fund which aims to capitalize on portfolio arbitrage opportunities (price differential in a stock) between cash and derivatives segments of the equity market. Thus opportunity lies in generating a good return between these differences.
Example: JM Equity & Derivatives / ICICI Equity & Derivatives.

Features of Arbitrage Funds

- Endeavor to generate positive returns during market volatility.
- Tax-efficient, as tax treatment is similar to equity funds.
- Offer relatively risk-free returns among equity investments.
- Aims to generate returns through fully hedged exposure to equities.
- Used by investors to save taxes v/s SOC of the Income Tax Act.
- Lock in Period = 3 Years.
- Potential to give better returns than any traditional tax saving instrument.

Eg:	BSE	NSE
Reliance	61.01	61.85

(For above; Buy BSE and sell in NSE.)
Resulting in Risk Free Profit.

i Hedge Fund

A Hedge Fund is a lightly regulated investment fund that escapes most regulations by being a sort of a private investment vehicle being offered to selected clients.
The big difference between a hedge fund and a mutual fund is that the former does not reveal anything about its operations publicly and charges a performance fee. Typically, if it outperforms a benchmark, it takes a cut off the profits. Of course, this is a one way street; any losses are borne by the investors themselves. Hedge funds are aggressively managed portfolio of investments which use advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). It is important to note that hedging is actually the practice of attempting to reduce risk, but the goal of most hedge funds is to maximize return on investment.

j Cash Fund

Cash Fund is an open ended liquid scheme that aims to generate returns with lower volatility and higher liquidity through a portfolio of debt and money market instrument.
The fund will have retail institutional and super institutional plans. Each plan will offer growth and dividend options.

k What is an Exchange Traded Fund (ETF)?

An ETF is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund.
In the simple terms, ETF's are funds that track indexes such as CNX Nifty or BSE Sensex, etc. When you buy shares/ units of an ETF, you are buying shares/units of a portfolio that tracks the yield and return of its native index. The main difference between ETF's and other types of index funds is that ETF's don't try to outperform their corresponding index, but simply replicate the performance of the Index. They don't try to beat the market, they try to be the market.
Unlike regular mutual funds, an ETF trades like a common stock exchange. The traded price of an ETF changes throughout the day like any other stock, as it is bought and sold on the stock exchange.
The trading value of an ETF is based on the net asset value of the underlying stocks that an ETF represents. ETF's typically have higher daily liquidity and lower fees than mutual funds schemes, making them an attractive alternative for individual investors.

Passive Management

An investor in an ETF do not want fund managers to manage their money i.e, decide which stocks to buy/sell/hold), but simply want the returns to mimic those from the benchmark index. Since buying all scripts that are a part of say, the NIFTY (which has scrips) is not possible, one could invest in an ETF that tracks Nifty.

ETFs are cost-efficient

Because an ETF tracks an index without trying to outperform it, it incurs lower administrative costs than actually managed portfolios. Typical ETF administrative costs are lower than actively managed fund, coming in less than 0.20% per annum, as opposed to the over 1% yearly cost of some actively managed mutual fund schemes. Because they have lower expense ratio, there are fewer recurring costs to diminish ETF returns.

Following types of ETF products are available in the market:

- **Index ETF's** – Most ETF's are index funds that hold securities and attempt to replicate the performance of a stock market index. (BSE Sensex, Nifty)
- **Commodity ETF's** – Commodity ETF's invest in commodities, such as precious metals and futures.
- **Bond ETF's** - Exchange- traded funds that invest in bonds are known as bond ETF's. They thrive during economic recessions because investors pull their money out of the stock market and into bonds (for example, government treasury bonds or those issues by companies regarded as financially stable.) Because of this cause and effect relationship, the performance of bond ETFs may be indicative of broader economic conditions.
- **Currency ETFs** – The funds are total return products where the investor gets access to the FX spot change, local institutional interest rates and a collateral yield.

Open Ended Funds vs. Close Ended Funds vs. ETFs

Parameter	Open Ended Fund	Closed Ended Fund	Exchange Traded
1. Fund Size	Flexible	Fixed	Flexible
2. NAV	Daily	Daily	Real Time
3. Liquidity Provider	Fund itself	Stock Market	Stock Market/Fund itself
4. Sale Price	At NAV plus load, if any	Significant Premium/ Discount to NAV	Very close to actual New Scheme
5. Availability	Fund itself	Through Exchange where listed	Through Exchange with Fund itself
6. Portfolio Disclosure	Monthly	Monthly	Daily/Real-time
7. Uses	Equitising cash	- - -	Equitising Cash, hedging, Arbitrage
8. Intra-Day Trading	Not possible	Expensive	Possible at low cost

I Fixed Maturity Plans

Fixed Maturity Plans (FMPs) are closely ended funds in which an investor can invest during a New Fund Offer (NFO). FMPs usually invest in Certificates of Deposits (CDs), Commercial Papers (CPs), Money Market Instruments and Non-Convertible Debentures over fixed investment period. Sometimes, they also invest in Bank Fixed Deposits (FD).

In NFO, during the course of which FMPs are issued, are later traded on the stock exchange where they are listed. But, the trading in FMPs is very less. So, basically FMPs are not liquid instruments.

The main advantage of FMPs is that they are free from any interest rate risk because FMPs invest in debt instruments that have the same maturity as that of the fund. However, they carry credit risk, as there is a possibility of default by the debt issuing company. So, if the credit rating of an instrument is downgraded, the returns of FMP can come down.

Presently, most of the FMPs are launched with tenure of three years to take the benefit of indexation. But, because of the longer maturity period they find it difficult to provide good returns in the form of interest to the investors in highest rated instruments. They, therefore assign some portions of the invested funds in AA (Credit Rating) and below rated debt instruments to earn higher interest. The reason is that lower rated instruments carry higher coupon rates than higher rated instruments.