

MUTUAL FUND MANAGEMENT

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Introduction to Mutual Funds

EVOLUTION AND MEANING

► A mutual fund is a type of financial vehicle made up of a pool of money collected from many investors to invest in securities like stocks, bonds, money market instruments, and other assets. A mutual fund has a common objective. Generally, they are run by AMC (Asset Management Companies) who place a professional to manage the pool of money. The investment may be in equity or debt instruments. The investment is made keeping in mind the objective of the fund in view. The profits so generated is distributed amongst the investors after deducting the charges. Mutual funds are denoted in units and valued as per (daily) NAV

► The first modern-day mutual fund, Massachusetts Investors Trust, was created on March 21, 1924. In India the first company that dealt in mutual funds was the Unit Trust of India. It was set up in 1963 as a joint venture of the Reserve Bank of India and the Government of India. The objective of the UTI was to guide small and uninformed investors who wanted to buy shares and other financial products in larger firms. The first non UTI mutual fund was set up in Nov, 1987. Soon Canara Bank, PNB, Indian Bank, LIC & GIC set up their own MFs

► In 1993 the AUM was Rs 44000 crores. 11 private players were allowed between 1993 to 1996. Subsequently observing the growth in MF industry regulations were spelled out by SEBI Regulation Act, 1996. In 1999 dividends received from MFs were declared tax exempt to increase volume of MFs. Thereafter the growth was steady. Global economic crisis hit financial markets in 2009. As returns nosedived, people's confidence was shaken in MFs. Situation toughened with SEBI abolishing entry load. In order to popularize MFs in tier 2 and tier 3 cities, SEBI began undertaking a series of initiatives to stabilize the industry, investor confidence and penetration of MFs. From 2014, foreign inflows increased and again MFs became attractive investments. Today MFs are managing assets in the tune of Rs 23 lakh crores. This figure may look attractive but considering annual domestic savings of 20-30 lakh crores, a lot more opportunities are in the way

Main characteristics of a mutual funds are:

- 1. Managed by a qualified expert
- 2. Open ended and close ended funds according time frames of investment
- 3. Investments possible in both lumpsum and SIP route
- 4. No fixed returns
- 5. Operate with huge IT infrastructural support, fast acting by market information
- 6. Pooling of investment
- 7. MF investments are valued by NAVs and expressed in units. They change daily as per market.
- 8. Regulated by SEBI

▶ 9. Charges are deducted upfront and include fund manager's fees, marketing expenses, transaction cost, regulatory costs, distributor's fees etc. Expense ratio is declared to make it transparent.

- ▶ 10. Variety of investment options
- ▶ 11. No TDS is deductible. ELSS schemes give tax deductions also.
- ▶ 12. Withdrawal and reinvestment options.
- ▶ 13. Transparent Advantages/ Disadvantages

Advantages

- ▶ 1. Expert's guidance and decisions, close monitoring, fast churning of portfolios and disciplined investment
- ▶ 2. Liquidity. It's very easy to sell off (at any valuation) and receive money fast.
- ▶ 3. Investment risk minimized through diversification by investing in a range of companies/sectors ▶ 4. Flexibility of investing (SIP or lumpsum), investing in very small amounts possible (Rs 500)
- ▶ 5. Less cost for bulk transactions
- ▶ 6. Transparent Before investing possible to get idea about fund performance, expense ratio, fund manager
- ▶ 7. Safe investment as it is overseen by SEBI, AMFI
- ▶ 8. Receiving maturity proceeds and investment from bank very easy and hassle free with no conditionalities

Disadvantages / Limitations

- ▶ 1. MFs are subject to market risks, so financial planning may go wrong.
- ▶ 2. Change in fund manager/ resignation may disrupt performance and efficiency
- ▶ 3. Exit load and lock in periods are barriers to liquidity
- ▶ 4. Expenses may be higher and substantial for small investments
- ▶ 5. Diversification may dilute your profit earning capacity.

Ethics:

▶ There are several MFs that try to maintain an ethical standard while investing in companies. They avoid liquor and tobacco companies, those that have poor record of employee relations, environment pollutants, weak corporate governance, workplace discrimination etc. They exert their social responsibilities. However, they form a barrier to efficient usage of resources and their returns suffer. However, investors are showing great interest in financial instruments that display ethical criteria within their structure and operation. Financial instruments incorporating can shun short-term trends in an effort to achieve long-term growth. Mutual funds pursuing ethical standards represent an important sign of the restoration and reaffirmation of ethical and social values by the financial world.

Some mutual funds pursue a goal of a more social nature with investments established based on the premise of transparency, trust, and social responsibility. By following ethical standards, mutual funds might be able to reduce conflicts of interest and provide allocative efficiency within the financial markets.

► **Socially responsible investing:** Here, typically, fund houses run several filters to check a company's responsibility quotient, chiefly towards society at large or towards environment. Another branch of SRI investing—albeit not straying too far from it—is ethical investing. There's actually a thin line between ethical investing from SRI investing. E.g., ICICI Bank was under fire for using coercive and unethical ways of debt recovery.

► **Shariah investing:** The third branch of ethical investing is Shariah investing guided by Islamic laws. Muslims are required to follow strict dos and don'ts as part of their lifestyle. Shariah-specific MFs invest in companies that conform to the Shariah norms and are shortlisted by Shariah advisory firms such as Parsoli. At present, there are two Shariah funds in India—Taurus Ethical Fund (TEF; actively managed) and Benchmark Shariah BeES (SB; passively managed). Shariah laws prohibit investments in companies whose debt to market capitalization ratio is less than 33%. A company whose net receivables (the money that is due to the company) is at least 45% of its gross net worth is also avoided.

► **Structure of mutual fund Sponsor, Trustee, AMC**

► The sponsor is the promoter of the mutual fund. The sponsor brings in capital and creates a mutual fund trust and sets up the AMC. The sponsor makes an application for registration of the mutual fund and contributes at least 40% of the net worth of the AMC. In other words, every MF needs a sponsor before it can commence operations. Among other requirements, the sponsor should also have a 5-year track record in the financial services business and should have made profit in at least 3 out of the 5 years. However, SEBI approved a proposal in DEC 2020 that for AMCs having net worth Rs 100 crores, the criteria of profitability has been relaxed. The sponsors could be a bank, a corporate or a financial institution. The net worth of the sponsor in the immediate last year has to be greater than the Capital contribution of the AMC. It must have a positive net worth in last 3 years of applying as a sponsor. A sponsor is quite vital and must carry highest amount of credibility. The strict and rigorous norms define that the sponsor must have adequate liquidity as well as faithfulness to return the money of investors in case there is any financial crisis or meltdown.

► After SEBI approval, the sponsor has to appoint the board of trustees. Every fund house must have at least four trustees. If a trustee company has been appointed, then that company would need to have at least four directors on the board. Two-thirds of the trustees should be independent. Trustees can be formed by two ways – a Trustee Company or a Board of Trustees. The primary objective of the trustees of the mutual fund is to hold its property for the benefit of the unit-holders. The board acts as a protector of unit-holders' interests: it appoints a custodian for safe-keeping of assets and closely monitors the AMC. The trustees also have to spell out the responsibilities of the AMC, monitor any new scheme introduced and ensure full compliance with regulatory guidelines. The trustees work to monitor the activities of the Mutual Fund and check its compliance with SEBI (Mutual Fund) regulations. They also monitor the systems, procedures, and overall working of the asset management company. Without the trustees' approval, AMC cannot float any scheme in the market. The trustees have to report to SEBI every six months about the activities of the AMC. Also, SEBI

has established tightened transparency rules to avert any type of conflict of interest between the AMC and the sponsor.

▶ Asset Management Companies are the third layer in the structure of Mutual Funds. Registered under SEBI, it is a type of company that is created under the Companies Act. An AMC is meant to float a variety of mutual fund schemes that are in compliance with the requirements of investors and the nature of a market. The asset management company acts as the fund manager or as an investment manager for the trust. A small fee is paid to the AMC for managing the fund. The AMC is responsible for all the fund-related activities. It initiates various schemes and launches the same. Furthermore, it also creates mutual funds with the sponsor and the trustee and regulate its development. The AMC is bound to manage funds and provide services to the investor. It solicits these services with other elements like brokers, auditors, bankers, registrars, lawyers, etc. and works with them by getting into an agreement together. To ensure that there is no conflict between the AMCs, there are certain restrictions imposed on the business activities of the companies.

▶ A custodian is one such entity that is responsible for the safekeeping of the securities of the Mutual Fund. Registered under SEBI, they manage the investment account of the Mutual Fund, ensure the delivery and transfer of the securities. Also, custodians allow investors to upgrade their holdings at a specific point of time and assist them in monitoring their investments. They also collect and track the bonus issue, dividends & interests received on the Mutual Fund investment. Registrar and Transfer Agents (RTAS)

▶ RTAs act as an essential link between investors and fund managers. To the fund managers, they serve by keeping them updated with the details of investors. And, to the investors, they serve by delivering the advantages of the fund. Even they are registered under SEBI and execute a variety of tasks and responsibilities. These are the entities who provide services to Mutual Funds. RTAs are more like the operational arm of Mutual Funds. Since the operations of all Mutual Fund companies are similar, it is economical in scale and cost effective for all the 44 AMCs to seek the services of RTAs. CAMS, Karvy, Sundaram, Principal, Templeton, etc are some of the well-known RTAs in India. Their services include:

- ▶ Processing investors' application,
- ▶ Keeping a record of investors' details,
- ▶ Sending out account statements & periodic reports to the investors
- ▶ Processing the pay-outs of the dividends
- ▶ Updating the investor details i.e., adding new members and removing those who have withdrawn from the fund. Major Fund Houses in India
- ▶ Aditya Birla Sun Life Mutual Fund.
- ▶ Axis Mutual Fund.
- ▶ BNP Paribas Mutual Fund
- ▶ Canara Robeco Mutual Fund.
- ▶ DSP Mutual Fund.

- ▶ Edelweiss Mutual Fund.
- ▶ HDFC Mutual Fund.
- ▶ ICICI PRUDENTIAL Mutual Fund
- ▶ KOTAK MAHINDRA Mutual Fund
- ▶ L&T Mutual Fund
- ▶ MIRAE ASSET Mutual Fund LEGAL FRAMEWORK
- ▶ SEBI
- ▶ All mutual funds, sponsors, trustees, AMCs, custodians must be registered under SEBI.
 - ▶ Mutual funds must set up AMC with 50% independent directors, a separate board of trustee companies with minimum 50% of independent trustees and independent custodians to ensure an arm's length relationship between trustees, fund managers, and custodians.
 - ▶ Mutual Funds must have a minimum of Rs. 50 crores for an open-ended scheme, and Rs. 20 crore corpus for the closed-ended scheme. Within nine months, mutual funds must invest money raised from the saving schemes. This protects the mutual funds from the disadvantage of investing funds in the bullish market and suffering from poor NAV after that.
 - ▶ Mutual funds can invest a maximum of 25% in money market instruments in the first six months after closing the funds and a maximum of 15% of the corpus after six months to meet short-term liquidity requirements.
 - ▶ The particulars of schemes are required to be vetted by SEBI and have to send a seven-year compliance reports to SEBI.
 - ▶ Cash investments up to INR 50,000 per investor, per mutual fund, per financial year can be made in mutual funds. However, any repayment (redemption/dividend) is made only through bank channel.
 - ▶ SEBI frames rules for foreign investors, FIIs, FPIs, OCBs, PNs investing in capital markets.
 - ▶ SEBI frames guidelines on advertisement of mutual funds.

RBI

- ▶ Investment in MFs by banks, setting up of AMC/MFs by banks are regulated by RBI.
- ▶ RBI acts as a regulator of Sponsors of bank-sponsored mutual funds, especially in the case of funds offering guaranteed returns. In order to provide a guaranteed returns scheme, a mutual fund needs to take approval from RBI
 - ▶ Money market is regulated by RBI. So MFs who wish to invest in debt instruments like CPs, CDs, G-sec, T bills needs to be registered with RBI.
 - ▶ RBI regulations for NRIs investing in India are: A mutual fund other than deposits and bank accounts must be invested in units of domestic mutual funds. All the other investments must be invested in units of money market mutual funds and domestic mutual funds in India.

- ▶ RBI frames the KYC and AML rules. Without adhering to them no investor can invest in MFs as they have to use the banking channel either for investment or redemption.
- ▶ In 2020 RBI reduced the risk capital that banks need to set aside against investment in debt mutual funds and exchange-traded funds (ETFs). A general market risk charge of 9% will continue to be applied
- ▶ RBI used to control Money Market Mutual Funds, but now under purview of SEBI Recent change in RBI guidelines
- ▶ In August,2020 RBI had decided to “harmonise the differential treatment existing currently” on the capital charge attracted under Basel III norms for investments by banks into a debt instrument directly compared with an investment into the same debt instrument through a mutual fund or exchange traded fund. Basel III norms on capital adequacy require banks to have a certain amount of capital so that they can absorb losses in loans advanced or investments made. Under norms so far, a bank would be required to allocate lower capital when investing directly into a debt instrument rather than through a mutual fund or ETF. So up until now, debt funds were classified from a capital adequacy perspective, very similar to equity funds or equity securities, it had a very significant capital charge and consequently banks would typically not invest for long periods of time in fixed income mutual funds. With the new change, the RBI, has effectively ensured the capital charge will be applicable based on the quality of the underlying portfolio with some market risk added on. This makes debt funds more attractive for banks, because the penalty of a very high capital charge is removed According to the RBI notification, the risk capital charge on investments into debt mutual funds and ETFs, which hold a mix of central, state and foreign central government bonds, bank bonds, and corporate bonds, will be computed based on the lowest rated debt instrument. The investment will also attract a general market risk.
- ▶ This will make the asset class more attractive for banks, and in the long term only aid liquidity and development of the bond market. This will also prevent banks from pulling out of mutual funds every quarter to maintain capital adequacy. MFs will now be an attractive place to park short term funds. Laws in action in recent times
- ▶ Franklin Templeton’s decision on 23 April 2020 to shut down six debt schemes amid severe redemption pressures and illiquidity, impacting 300,000 investors and assets under management (AUM) of ₹26,000 crore.
- ▶ Securities market regulator SEBI has directed that top management of AMC’s will now be paid 20% of their compensation in units of schemes that they have a role in or oversight of. This will “align the interest” of key employees of AMC’s with unit holders of their schemes, the regulator said in an April 28 circular. This new SEBI rule comes soon after the Franklin Templeton Mutual Fund fiasco — in which six debt schemes were wound down on account of investments gone bad. A subsequent audit investigation reportedly showed redemptions by fund insiders just before the announcement on schemes’ closure. It sparked a debate on insider trading in mutual funds. As also on ‘skin in the game’ — or direct financial exposure to performance outcomes. SEBI has brought changes in reporting formats. Details of AMC related information, related to investment, product, risk management, valuation of investments, investor, among others need to be submitted to trustees within 21 days from the end of respective quarters.

▶ The Karnataka high court observed (2020) that Franklin Templeton India's trustees should have taken the consent of unit holders before winding up the six debt schemes of the fund manager has created a new reason for concern for trustees. The court also said that the trustees can be subjected to scrutiny by high courts.

▶ AMFI (Association of Mutual Funds in India)

▶ This non-profit association came into effect in 22nd August 1995. The sole purpose of AMFI is to work for the benefit of investors by offering them transparency in mutual fund practices. AMFI restores the faith of the investors in case they face any monetary issue in the Indian Mutual Fund Industry. Currently, AMFI comprises of 44 members out of which 42 are SEBI-registered AMCs.

▶ It seeks to oversee the operations of AMCs and mutual fund agents and ensure that they follow the code of conduct, as well as encourage effective business practices

▶ Intermediaries like brokers and advisors are also required to be registered with AMFI.

▶ It ensure the ethical standard of mutual fund operations in India. Undertakes research work and updates the industry with valuable inputs and insights. It also plays an important role in spreading investor awareness and education. It has devised several audio and video campaigns regarding MFs ▶ Every fund house, company or fund expert should seek permission from AMFI if they are involved in mutual fund operations and management

▶ Issues NISM certificates which is required for generating the ARN number

▶ Ministry of Finance (MoF)

▶ Ministry of Finance is the body that helps both the SEBI and RBI in formulating the policies for mutual fund regulations. SEBI and RBI being quasi-legislative bodies have a limited law-making power. Hence, they both require the MOF to legislate on certain critical matters. Ministry of Finance through their notifications or circulars, regulate the mutual funds and aid in protecting the investors. ▶ The Ministry of Finance acts as a supervisor of RBI and SEBI and appellate authority under SEBI regulations. Mutual funds can appeal to the Ministry of finance on the SEBI rulings.

▶ SRO (Self-Regulatory Organisations)

▶ As the name suggests these entities can govern without any government regulations. The stock exchanges are a prime example of SRO. The stock exchange is governed by SEBI. However, they implement their own regulations in addition to the SEBI regulations, which the mutual fund schemes have to adhere. Depository Participants also play a part in SRO and govern the demit accounts.

▶ Company Law Board / Registrar of Companies/ Department of Company Affairs

▶ They play an important role in bringing transparency in a company's functioning. They ensure all disclosure requirements are followed, company's financial statements are audited and published timely and registered, the appointment of directors and other corporate governance issues are adhered to and registered. All details of company, memorandum & articles of association, directors, nature of activities, financial statements, are registered and

can be assessed easily from the ROC website. So, an investor can know about the MF company or any investment destination company

► Mutual Fund Guidelines on advertisements (SEBI)

a) Advertisements shall be accurate, true, fair, clear, complete, unambiguous and concise.

(b) Advertisements shall not contain statements which are false, misleading, biased or deceptive, based on assumptions/projections and shall not contain any testimonials or any ranking based on any criteria

c) Advertisements shall not be so designed as likely to be misunderstood or likely to disguise the significance of any statement. Advertisements shall not contain statements which directly or by implication or by omission may mislead the investor

d) Advertisements shall not carry any slogan that is exaggerated or unwarranted or any slogan that is inconsistent with or unrelated to the nature or the risk and return profile of the product.

e) No celebrities shall form part of the advertisement

(f) Advertisements shall not be so framed as to exploit the lack of experience or knowledge of the investors. Extensive use of technical or legal terminology or complex language and the inclusion of excessive details which may detract the investors should be avoided.

g) Advertisements shall contain information which is timely and consistent with the disclosures made in the Scheme Information Document, Statement of Additional Information and the Key Information Memorandum.

h) No advertisement shall directly or indirectly discredit other advertisements or make unfair comparisons.

I) Advertisements shall be accompanied by a standard warning in legible fonts which states 'Mutual Fund investments are subject to market risks, read all scheme related documents carefully'. No addition or deletion of words shall be made to the standard warning.

(j) In audio-visual media-based advertisements, the standard warning is to be displayed visually and the accompanying voiceover reiteration must be audible, clear and understandable. For example, in standard warning both the visual and the voiceover reiteration containing 14 words running for at least 5 seconds may be considered as clear and understandable.

MF GUIDELINES on Accounting

► The accounting policies followed by a fund's management team can significantly impact the returns from a scheme. Aggressive accounting policies can artificially inflate the NAVs, which creates an unjustifiable premium to the fair value. The examples of aggressive accounting include valuing investments higher than their realisable value, not accounting for expenses or losses that have incurred in the scheme or recognising income that does not really belong to the scheme. An investor who possesses insider information on such aggressive accounting policies will benefit by redeeming the units at NAVs higher than the intrinsic value. This will cause losses for the genuine investors who continue in the scheme.

Similarly, if a scheme follows conservative accounting policies, its NAV will be deflated relative to its fair value. This will provide the buyers an undue benefit as they can buy the units at a price lower than the intrinsic value. To overcome such biases, SEBI has come out with detailed guidelines on accounting.

► Accounting for gains/ losses

► MFs invest in equity and debt instruments. In case of income from debt securities, the accretion has to be made every day. For example, a bond with a coupon of 10% payable semi-annually will pay interest only twice during a year. However, the scheme will keep accruing the interest income on a daily basis including Sundays and holidays. This ensures a gradual change in NAV during the year. In case of equity securities, the income is received in the form of dividends. However, there is a time lag between the day a company declares dividend and the day it is actually received by the scheme. According to Sebi regulations, a scheme will recognise dividend as income on the day the shares become ex-dividend. As regards the capital gains/losses on the investments, the scheme will keep accounting them on mark-to-market basis (MTM), that is, if the market goes down, the scheme will consider it as a gain and increase its NAV. Though the gains or losses are realised only when the scheme sells these investments, MTM valuation ensures that the NAV reflects the realisable value of investments.

► Accounting for expenses

► AMCs incur expenses while operating a scheme. These include management fees, registrar and transfer agent fees, custodian fees, audit fees and marketing & distribution expenses. Say, a fund has a corpus of ₹100 crore and an expense ratio of 1%. If the scheme follows an accounting principle to charge the entire expenses on a single day, the NAV will suddenly pull down by 1% in one day. It also implies that the scheme's NAV remained inflated prior to the expense ratio charge. To avoid such situations, SEBI has stipulated that expense ratio needs to be accrued proportionately daily or weekly when the NAV is calculated. In the example, the expenses work out to ₹27,397 a day. Daily provision for expenses ensures that there is no sudden decline in the NAV in a single day

► Other rules

► Mutual funds cannot distribute unrealised gains as dividends to its unit holders. This is because such gains are notional profits and will become real only when the investments are sold. Therefore, the amount available for dividend distribution is restricted to the amounts lying in realised profits and equalisation reserve. Taxation norms

► MFs are subject to capital gains tax. It's paid on the profit we make while redeeming / selling our Mutual Fund holdings (units). The gain is the difference in Net Asset Value (NAV) of scheme on the date of sale and date of purchase (Selling Price-Purchase Price). Capital gains tax is further classified depending on period of holding. For equity funds (funds with equity exposure $\geq 65\%$), holding period of one year or more is considered long-term and subjected to Long-Term Capital Gains (LTCG) tax.

► LTCG tax of 10% is applicable on equity funds if the cumulative capital gain in a financial year exceeds INR 1 lakh. While doing financial planning remember your gains remain tax-free up to INR 1 lakh. It's applicable for all investments made after 31st Jan 2018.

Profits on holdings of less than a year are subject to 15% Short-Term Capital Gains (STCG) tax in equity funds.

▶ Long-term is defined as holding period of 3 years (36 months) or more in case of non-equity funds (debt funds) and 20% LTCG tax is applicable on such holdings with indexation i.e., purchase price is adjusted upwards for inflation while computing capital gains. Profits on holdings of less than 3 years are subject to STCG tax, which is the highest income tax slab individuals fall into.

▶ Short term capital gains on units held for 36 months or less are added to the income of the individual and taxed as per the applicable slab rate.

▶ Indexation is a process by which the purchase price of an asset is adjusted in a way to factor in inflation over the years. Indexation brings up the purchase price, reducing the overall gains on the investment for the purpose of taxation, which in turn results in lower taxes. Indexation reduces the tax outgo.

▶ DDT (Dividend Distribution Tax). Previously up to 31.03.2020 (from 1997), dividend was tax free in the hands of investors, but a DDT @ 15% was payable by the domestic company declaring dividend. Now the provisions have been reversed and dividend that is paid on or after 1.4.2020 is taxable in the hands of recipients and consequently DDT has been abolished. Also, the tax paid on dividend is allowed as a deductible expense (up to 20 % of the gross dividend).

▶ For instance if dividend received is 10,000/-, maximum interest deduction allowed will be 2000/-. If he is in the 10% tax bracket, tax payable on dividend is 1000/- (so allowed deduction is 1000/-). If he is in 20 % tax bracket, tax payable on dividend income is 2000/- (so allowed deduction is 2000/-). If he is in the 30% tax bracket, tax payable is 3000/- (allowed deduction is 2000/-)

▶ TDS is deductible @ 10 % (current year 7.5% due to COVID19) if dividend exceeds Rs 5000.

▶ For instance, Mr Ravi received dividend amounting to Rs 6,000 from an Indian company on 15 June 2020. Since his dividend income exceeds Rs 5,000, the company will deduct a TDS @7.5% on the dividend income which is Rs 450. Mr Ravi will receive the balance amount of Rs 5,550. Further, the dividend income is the taxable income of Mr Ravi taxed at the slab rates applicable for FY 2020-21 (AY 2021-22).

▶ Dividend received from a foreign company is taxable. It will be charged to tax under the head “income from other sources.” Valuation of securities

▶ Equity and Equity Related Securities: Traded Equity and Equity Related Securities – Traded securities, including Cumulative Convertible Preference Shares, Normal Preference Shares, Partly Paid-up Equity Shares and Rights, are valued at the closing price that has been quoted in the Stock Exchange.

▶ Valuation of Suspended Security: The last traded price will be taken into consideration for valuation of an equity that has been suspended for not more than 30 days.

► Valuation of Unlisted Securities: Net worth per share is calculated as follows: [Share Capital + Free Reserves (Except revaluation reserves) – Miscellaneous expenditure] / Number of Paid-up Shares. Or ► Share Capital + Consideration on exercise of Warrants/Options receivable/received by the company + Free Reserves (Except revaluation reserves) – Miscellaneous expenditure and Debit Balance in P&L Account] / Number of Paid-up Shares; whichever is the lowest.

► Valuation of Debt Securities: Debt Securities with maturity above 60 days – The valuation of Debt Securities will be based on the Scrip level prices/average of prices that has been provided by ICRA and CRISIL. When a new security is bought, ICRA and CRISIL offer scrip level prices from T+1 date and these are valued based on the weighted average yield of the securities. Debt Securities with maturity less than 60 days – Debt Security Instruments are valued based on last valuation price or on an amortization basis, from maturity to cost. The condition to this rule is that the value taken is one that is the most recent and it should be within $\pm 0.10\%$ of the reference price.

► Valuation of Gold Exchange Traded Funds: Valuation depends upon gold prices declared by London Bullion Markets Association Guidelines for purchase

► Investors can contact the agents and distributors of mutual funds (AMFI registered) who are spread all over the country for necessary information and application forms. SEBI has mandated mutual funds to compulsorily launch a direct plan for direct investments, i.e., investments not routed through a distributor, from 01 January 2013. Such separate plan has a lower expense ratio excluding distribution expenses, commission, etc., and no commission is to be paid from such plans. The plan also has a separate NAV. Investment can be made in lump sum, i.e., a onetime payment, or through a Systematic Investment Plan (SIP). So, investors have the option to invest directly with the mutual fund either by visiting the mutual fund branch or online through Mutual Fund website.

► An investor should take into account his risk-taking capacity, age factor, financial position, etc. Schemes invest in different type of securities as disclosed in the offer documents and offer different returns and risks. Investors may also consult financial experts before taking the decision to purchase. ► Based on prevailing NAV the investor will be allocated units. He will be appraised of his allocation, statements, plan details by the RTAs. A mutual fund is required to dispatch to the unitholders the dividend warrants within 30 days of the declaration of the dividend and the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase request made by the unit holder Guidelines to purchase MFs (recent developments)

► As per SEBI circular no. SEBI/HO/IMD/DF2/CIR/P/2020/175 dated September 17, 2020 read with circular no. SEBI/HO/IMD/DF2/CIR/P/2020/253 dated December 31, 2020, effective from February 1, 2021, the applicable NAV in respect of purchase of units of mutual fund scheme shall be subject to realization & availability of the funds in the bank account of mutual fund before the applicable cut off timings for purchase transactions, irrespective of the amount of investment, under ALL mutual fund schemes. (The above rule is already applicable for purchase transactions under Liquid funds and Overnight Funds).

a) Lump Sum purchase transaction for say, ₹50,000 received (time stamped) before cut-off time of 3.00 p.m. on Thursday 11-Feb-2021. If the funds are received in the mutual fund's

account before cut-off time of 3.00 p.m. on 11th February 2021, the investor will be allotted closing NAV of 11-Feb-2021. However, if the funds are received in the mutual fund's bank account at say 5.00 p.m. on 11th February 2021, i.e., after the cut-off time of 3.00 p.m., the allotment of units will be done at the NAV of Friday 12-Feb-2021. However, if the funds are received in the mutual fund's bank account at say 4.00 p.m. on Friday 12-Feb-2021, the units will be allotted at the closing NAV of Monday 15-Feb-2021 (Feb. 13 & 14 being Saturday & Sunday i.e., non-business days) In short, the units are allotted at the NAV of the business day on which the funds are received into the mutual fund account before applicable cut-off time.

b) SIP Transaction Assuming an investor has signed up for SIP transaction of say, ₹5,000 to be debited on 10th of every month. Hitherto, the investor would have been allotted SIP units at the NAV for 10th the month (assuming the same is a business day) irrespective of the date on which the money was received / credited to the Mutual Fund's bank account. As per the new Rule, the investor would be allotted the SIP units at the NAV for 10th only if the money is received/credited to the Mutual Fund's bank account before 3.00 p.m. on 10th. Else, the SIP units will be allotted units at the NAV of the next business day on which funds are received before the cut-off time. In view of the above, investors are encouraged to avail electronic payment modes for remittance of funds to the mutual fund bank account to facilitate speedy fund transfers.

- ▶ Switching of schemes are subject to cut off time criteria.
- ▶ Labelling norms for dividend options- April 1, 2021
- ▶ SEBI introduced labelling norms for the dividend options of mutual funds which will come into effect from 1st April 2021. Under the new norms, mutual funds will have to rename dividend options as income distribution cum capital withdrawal.
- ▶ Currently, the dividend options available are:
 - ▶ Dividend pay-out: Where the dividend is credited to our accounts, Dividend reinvestment: Where the dividend paid out is reinvested into the plan and Dividend transfer plan: Where the dividend earned will be automatically reinvested into another scheme. Only certain fund houses have this facility.
 - ▶ Under the new norms, mutual funds will have to rename dividend options as income distribution cum capital withdrawal effective April 1, 2021.
 - ▶ SEBI has introduced riskometer tool and introduced a category "very high risk". MFs will be labelled according to the tool parameters and disclose their position by 10th day of every month. They will be displayed on AMFI's website. Any change in riskometer category change will be communicated to individual investors and each AMC needs to disclose the number of times a change in riskometer ratings has been changed for each scheme.
 - ▶ SEBI has changed investment rules for MULTICAP Funds. Minimum investment for equity has been fixed at 75% from earlier of 65%. Also at least 25% should be invested in each of large cap, mid cap, and small cap funds. The list of the different categories is released by AMFI. This has been effective from 1 set Feb 2021. Following this there has been a rise of FLEXICAP funds Investor protection: SEBI

► Investor education and awareness: To protect oneself one must be knowledgeable. So, SEBI has been undertaking investor awareness programmes since Jan 2003. It has conducted 2000 workshops in 500 cities till now. The programme covers major subjects like portfolio management, Mutual Funds, tax provisions, Investor Protection Fund, Investors' Grievance Redressal system of SEBI. SEBI makes everything of interest accessible in public domain. SEBI guarantees that the market has frameworks and practices which make exchanges safe.

► Investor protection legislation is implemented under the Section 11(2) of the SEBI Act. Measures: ► Stock Exchange and other securities market business regulation. SEBI registers and regulates the intermediaries of the business-like brokers, transfer agents, bankers, trustees, registrars, portfolio managers, investment consultants, merchant bankers, the work of custodians, depositors, participants, foreign investors, credit rating agencies, etc. Individual MF schemes are registered and monitored. It keeps a check on frauds and unfair trading methods related to the securities market. SEBI is constantly observing and regulating major transactions and take-over of the companies. On a regular basis SEBI is inspecting and auditing the security exchanges (SEs) and intermediaries. Assessment of fees and other charges are also done. SEBI advocates transparency by making information handy and easier to understand for investors

► A fund called, Investor Education and Protection Fund (IEPF) under the 1956 Company Act has been set up. According to the act, the company which has completed seven years in the business should hand over all the unclaimed fund dividends, matured deposits, and debentures, share application money etc. to the Government through IEPF. This money is utilized in compensating claims of investors. Grievance redressal

► Investors would find the name of contact person in the offer document of the mutual fund scheme who they may approach in case of any query, complaints or grievances. Trustees of a mutual fund monitor the activities of the mutual fund. The names of the directors of AMC and trustees are also given in the offer documents. Investors should approach the concerned Mutual Fund / Investor Service Centre of the Mutual Fund with their complaints. If the complaints remain unresolved, the investors may approach SEBI for facilitating redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with it regularly. Investors may send their complaints to: Securities and Exchange Board of India Office of Investor Assistance and Education (OIAE) Plot No.C4-A, "G" Block, 1st Floor, Bandra-Kurla Complex, Bandra (E), Mumbai – 400 051. Phone: 26449199-88-77

► Investors can also lodge their complaint on scores.gov.in: SEBI takes up complaints against Mutual Funds registered with it and related issues. SCORES facilitates an investor to lodge his/her complaint online with SEBI and subsequently view its status.

CLASSIFICATION OF MUTUAL FUNDS

TYPES OF MUTUAL FUNDS

▶ Equity or growth funds

▶ These invest predominantly in equities i.e., shares of companies. The primary objective is wealth creation or capital appreciation. They have the potential to generate higher return and are best for long term investments. Equity Funds are either Active or Passive. In an Active Fund, a fund manager scans the market, conducts research on companies, examines performance and looks for the best stocks to invest. In a Passive Fund, the fund manager builds a portfolio that mirrors a popular market index, say Sensex or Nifty Fifty

▶ Examples would be

▶ “Large Cap” funds which invest predominantly in companies that run large established business ▶ “Mid Cap funds” which invest in mid-sized companies. funds which invest in mid-sized companies. ▶ “Small Cap” funds that invest in small sized companies

▶ “Multi Cap” funds that invest in a mix of large, mid and small sized companies.

▶ “Sector” funds that invest in companies that are related to one type of business. For e.g., Technology funds that invest only in technology companies

▶ “Thematic” funds that invest in a common theme. For e.g., Infrastructure funds that invest in companies that will benefit from the growth in the infrastructure segment

▶ Tax-Saving Funds

▶ Debt Funds - A debt fund is a Mutual Fund scheme that invests in fixed income instruments, Government Securities or Bonds, Commercial Papers and Debentures, Bank Certificates of Deposits and Money Market instruments like Treasury Bills, Commercial Paper, etc. that offer capital appreciation. Debt funds are also referred to as Fixed Income Funds or Bond Funds. Debt funds investing in money markets are needed to be registered with RBI.

▶ A few major advantages of investing in debt funds are low-cost structure, relatively stable returns, relatively high liquidity and reasonable safety. Government Securities or Bonds, Commercial Papers and Debentures, Bank Certificates of Deposits and Money Market instruments like Treasury Bills, Commercial Paper, etc.

▶ Debt funds are ideal for investors who aim for regular income, but are risk-averse. Debt funds are less volatile and, hence, are less risky than equity funds. They give a better return than bank FDs and are more tax efficient.

▶ Examples would be Liquid Funds, Short Term, Floating Rate, Corporate Debt, Dynamic Bond, Gilt Funds, etc.

▶ Investors looking for short-term risk-free investments prefer these funds. However, it is advisable to check the offer document and inquire in which instruments the investments are being made.

▶ Hybrid Funds / Balanced Funds - These invest in both Equities and Debt instrument (60-40 ratio), thus offering the best of both, growth potential as well as income generation. The equity part takes care of the earnings and debt part diversifies the risk. The debt investment is

primarily in bonds and G-Secs. Tax treatment will be as per the percentage investment in equity markets. Examples would be Aggressive Balanced Funds, Conservative Balanced Funds, Pension Plans, Child Plans and Monthly Income Plans, etc.

▶ Benefits of these funds are:

▶ Taxation benefits with this investment scheme, fund managers have the option to migrate between debt and equity without presenting investors with a tax liability. If investors were to move between the funds themselves, they would be subject to taxation under capital gains. This could have resulted in a high taxation amount of about 30% if investors chose to move out from debt funds within 36 months of investing in it.

▶ Risk reduction Investing solely in equity funds can be extremely risky. For instance, during the financial crisis of 2008, there was a 50% decline in the NIFTY index from 6000 levels to 2500 levels, leading equity fund investors to incur sizeable losses. Thus, in hybrid funds, the debt instruments help to balance out the risk presented by equity funds.

▶ Re-balancing of funds There are times when the equity market is overvalued in comparison to the debt market and vice versa. In this case, with hybrid funds, investors can move between the two asset classes.

▶ Diversification of investment portfolio These funds are excellent options when it comes to diversifying one's investment portfolio. Since these funds help to maximise returns and yet provide a safety net against market-related risks, they present investors with the perfect option to limit their investment liabilities.

▶ Protection from inflation Since a portion of hybrid funds consists of debt assets, they can act as an inflation hedge. Especially if the investment includes international bonds, they can help to protect investors from inflation by giving them access to countries that have not been affected by it. Therefore, the diversity in one's portfolio makes for a cushion against the sustained rise in market prices.

▶ Apart from these, these funds also allow investors to withdraw money from the funds periodically without any alteration to asset allocation.

▶ ELSS Funds - An ELSS is an Equity Linked Savings Scheme, that allows an individual or HUF a deduction from total income of up to Rs. 1.5 lacs under Sec 80C of Income Tax Act 1961.

▶ Thus if an investor was to invest Rs. 50,000 in an ELSS, then this amount would be deducted from the total taxable income, thus reducing her tax burden.

▶ These schemes have a lock-in period of three years from date of unit's allotment. After the lock-in period is over, the units are free to be redeemed or switched. ELSS offer both growth and dividend options. Investors can also invest through SIP, and investments up to ₹ 1.5 lakhs, made in a financial year are eligible for tax deduction

▶ Index Funds - Index Funds are passive mutual funds that mimic popular market indices. The Fund Manager doesn't play an active role in selecting industries and stocks to build the fund's portfolio but simply invests in all the stocks that make up the index to be followed. The weightage of the stocks in the fund closely matches the weightage of each of the stock in

the index. This is passive investment i.e.; the fund manager simply copies the Index while building the fund's portfolio and tries to maintain the portfolio in sync with its index at all times. For example, if an index fund follows the BSE Index as the replicating index and if it has a 20% weightage in let's say Stock A, then the index fund will also invest 20% of its assets in Stock A. If the weight of a stock within the index changes, the fund manager must buy or sell units of the stock to have its weight in the portfolio aligned to that of the index. While passive management is easier to follow, the fund doesn't always produce the same returns as that of the index due to tracking error.

► Tracking error occurs because it is always not easy to hold the securities of the index in the same proportion and transaction costs are incurred by the fund in doing so. Despite tracking error, index funds are ideal for those who don't want to take the risk of investing in mutual funds or individual stocks but would like to gain from exposure to the broader market.
Open ended funds

► Open ended funds: These funds are introduced to investors as an NFO. Thereafter it continues to remain as an investment destination. Investors can invest at any date after the fund is launched. Similarly, the investors are free to redeem the investments at their choice of time and quantum. The number of outstanding units goes up or down every time the fund house sells or repurchases the existing units. The fund values the investment portfolio daily/weekly and any fresh investments/redemptions are done at prevailing NAVs.

► These funds thus provide high liquidity to the investors. Open ended funds provide a track record of performance and hence investors are able to choose according to historical returns. These funds continue for many years and are rarely discontinued. However, an open-ended fund is not obliged to keep selling new units all the time. For instance, if the management thinks that it cannot manage a large-sized fund optimally, it can stop accepting new subscription requests from investors. However, it has to repurchase the units at all times.

The fund manager and trustees are able to ascertain the success of the investment from the returns, valuation and size of the AMC. SIP is available for open ended schemes.

► The limitations of an open-ended fund are volatility, risk of investment and unpredictability of returns. Sometimes retail investors are unable to decide whether to redeem their investment or reinvest. Close ended funds

► The mutual fund is launched through a New Fund Offer which can be open for a maximum of 30 days. The funds are then traded in the open market like shares. The price of the fund is regulated by demand and supply as it is possible to trade the fund at a price that is above or below its real value. Units are allotted according to the decided NAV to investors investing through the NFO. They can be traded at premiums or discounts to their NAVs. The units can be redeemed only after the maturity of the fund which is typically between 3 to 7 years. SEBI allows redemption before maturity if the funds are listed on a stock exchange or the fund house allows the investor to sell the units to the fund house through periodic repurchase at the Net Asset Value related prices.

► Advantages of close ended funds are:

Stability: Redemption of the fund is only allowed on the expiry of the maturity period. This helps the portfolio managers to build a steady asset base and devise the right investment

strategy. Investment in a close-ended mutual fund means that there is no unexpected inflow or outflow of investment due to the stable asset base.

- ▶ **Enhanced flexibility:** These funds can be liquidated as per the norms of the fund house. The investors are allowed to sell these units based on the real-time prices available during the trading day.
 - ▶ **Maximum possible returns:** By staying committed to the mutual fund, they enhance their chances of taking home the maximum possible returns offered by the fund.
 - ▶ **Unique Portfolio:** These funds allow the fund manager to create a unique portfolio that can give great returns. Due to the extended lock-in period, the fund manager can explore undervalued equity and debt instruments which would otherwise not feature in the portfolio.
 - ▶ **Limitations:** The performance of a close-ended mutual fund depends on the investment style and skills of the fund manager, the sector in which the investment is made, and the prevailing market conditions, etc
 - ▶ **Close ended funds are ideal for investors looking to invest long term and in a lumpsum.** However before investing, track record of AMC, similar funds' performance and risk profile.
- Interval Funds**

▶ Interval funds are a type of mutual fund, where the units can be purchased or sold during a particular predetermined time period only. They may invest in both debt and equity securities, but they are mostly observed to park money in debt instruments. Interval schemes combine the features of closed-end funds and open-ended funds. The units may be traded on the stock exchange or may be open for sale or redemption during pre-decided periods at NAV-related prices.

▶ Interval schemes typically invest in illiquid assets, and are best-suited for entities looking for unconventional assets. Investments are generally made in assets like forestry tracts, commercial property and business loans, among others. Investors with short-term financial goals and low-to-moderate risk tolerance are often advised this route for wealth creation.

▶ **Advantages:** The returns on interval funds are often more than that of open-ended mutual funds. Retail investors will be provided access to institutional-grade alternative investments with low minimums. Periodic offers may be made by the fund to the investor to repurchase shares at NAV.

▶ **Limitations:** They are highly illiquid in nature, given that their units can only be redeemed at specified time intervals. The expense ratio of interval schemes is generally more than other MFs.

▶ Some of the interval schemes available in the market include: Aditya Birla Sun Life Quarterly Interval Fund - Series IV-Direct Plan (G), IDFC Yearly Series Interval Fund - Series I (G), Kotak Quarterly Interval Fund - Series I - Direct Plan (D), Axis Yearly Interval Fund - Series 1-Regular Plan (G), Money Market Mutual Funds (MMMFS)

▶ These MFs are investing in money market instruments. They hence are required to be registered with RBI as well apart from SEBI. They are investing for short periods. They are categorized as open-ended debt MFs. They invest in TREPS, CDs, CPs, T-bills, Sacs with

residual maturity less than 1 year. They earn from interest from bonds and capital appreciation. The primary aim of money market funds is to minimize the fluctuation of the Net Asset Value (NAV) of the fund.

► Advantages: 1. Risk very low. 2. Better returns than Bank deposits 3. Highly liquid 4. Investors do not need to stay invested for long.

► Limitations: 1. STCG makes taxation rate higher and post-tax returns are less 2. Reinvestment risk 3. Credit risk of investment in CPs 4. Since residual maturity is 1 year or less, scope of high capital appreciation is less.

► Investors having surplus cash parked in bank accounts, prefer these MFs for short term (3 months to 1 year) risk free investments earning more returns than bank deposits or liquid funds. Offshore Mutual Funds

► Offshore funds, also called international funds, are mutual fund schemes that invest in international markets. These schemes invest in equities of a foreign country or region, or fixed income securities of foreign countries.

► In India there are country specific schemes, region-specific schemes, and thematic schemes. For example, there are funds that invest in the US, Brazil or Europe. Apart from this, there are theme-based funds investing in sectors such as consumption, energy, gold and real estate. The investors in INDIA invest in Indian Rupees in these MFs either through distributor or directly (branch/online). The MSFs then can invest it directly in foreign capital markets or invest in foreign MFs, i.e., in the form of fund of funds, also called a feeder route. International mutual funds are usually treated as a non-equity scheme for taxation, whereby they are taxed like the general debt mutual funds.

► Advantages: 1. Taking advantage of economic development of foreign country when domestic markets are not performing. 2. Inflation being low in developed countries, real returns are not affected much. 3. Favourable exchange rates 4. Participate in growth stories of famous international companies like Apple, Walmart, etc 5. Fund manager's fees are relatively lower.

► Disadvantages: 1. Exchange rate risks. 2. Regulatory compliances may change. 3. Returns can also be impacted by the market fluctuations, tax laws, policies, and other developments in both the offshore country and home country. 4. Political risks: tension between home country and foreign country

► International investment inflows to India are collected and managed by offshore authorities as the fund managers who are based in India are not allowed to manage offshore mutual funds as per the guidelines issued by the RBI and SEBI. As a result, many asset managers who were employed to handle the offshore funds of Indian investors had to move to offshore sites. This posed a challenge in the way of growth of offshore funds in India. Industry experts suggest that the above challenge can be curbed by adopting 2 solutions. The first one where funds houses should be permitted to manage offshore mutual funds from India itself without any tax being levied on them. The second solution is to allow overseas investors to invest in offshore funds set up in India directly. This has been approved by RBI in November 2015

► Domestic MF news: The asset under management (AUM) of local funds stood at ₹14.8 lakh crore at the end of March. Of this, 65% was contributed by pure equity funds, 19% by index funds and ETFs and the remaining by balanced funds and arbitrage funds. Insurers' portfolio value was ₹12.3 lakh crore in March, which was 13.1% of the total institutional holding. Foreign investors investing in India are investing in domestic mutual funds.

TAX SAVING FUNDS Current income tax structure

► An Equity Linked Saving Scheme (ELSS) is a tax saving mutual fund scheme that helps investors to save taxes under Section 80C of the Income Tax Act. It has better returns potential with SEBI mandate of minimum 80% investment in equity & equity related instruments. Ideal for seeking long term capital appreciation in spite of 10% Long Term Capital Gains (LTCG) Tax. ELSS has a lock-in period of three years

► Advantage of ELSS

- a. ELSS funds are the only tax-saving funds within the Rs 1.5 lakh limit which has the additional advantage of giving equity-linked returns.
- b. Investing into ELSS allows you dual benefits – you get capital appreciation and tax benefits.
- c. ELSS has the shortest lock-in period of three years when compared to other tax-saving instruments like PPF and NSC.
- d. Since they are equity market linked, ELSS funds can bring in good returns over the long term, especially if retained after the lock-in period is over.
- e. good investment funds for those with moderate to high risk-appetite.
- f. Dividends from ELSS funds are tax-free during the investment period.
- g. Profits from sale of ELSS fund units are considered long-term capital gains
- h. ► The best way of investing into ELSS funds is through monthly SIPs
- i. ► Reasons that make ELSS the attractive choice for tax saving instrument:
 1. Lowest lock in period of 3 years. In comparison Tax Saving Bank FDs have lock in period of 5 years, PPF have lock in period of 15 years and life insurance policies usually have a tenor of 20 years.
 2. Returns are equity linked and hence give highest returns in comparison to other instruments
 3. The capital gain if below Rs 1 lakh will not attract any taxes. This can be matched only with PPF & LIC
 4. Investment may be done through SIPs
 5. No commitment to invest regularly for long periods as in case of PPF & insurance premiums. ► Limitations:
 1. Market risk of equity market does not guarantee capital protection.
 2. Lock in period. So even when you see the market in a bearish sentiment investment in ELSS can be withdrawn.
 3. Confusion in choosing among the options.

► Investment guidelines: To understand if an ELSS is performing well, you need to look at its parameters such as past returns, expense ratio and financial ratios. You may start with analysing the fund's performance over the last five years. A good fund shows stable performance and offers consistent returns. Look how well the fund performed when the markets were subdued. A top-performing fund is not impacted much by the market turbulence. The returns generated by the fund must be backed by its expense

ratio. A higher expense ratio indicates that there are frequent changes in the fund's constitution, which is not a good indication. Exchange Traded Funds

► Exchange Traded Funds are essentially Index Funds that are listed and traded on exchanges like stocks. Until the development of ETFs, this was not possible before. Globally, ETFs have opened a whole new panorama of investment opportunities to Retail as well as Institutional Money Managers. They enable investors to gain broad exposure to entire stock markets in different Countries and specific sectors with relative ease, on a real-time basis and at a lower cost than many other forms of investing.

► Characteristics:

1. Buying / Selling ETFs is as simple as buying / selling any other stock on the exchange.
2. ETFs allow investors to take benefit of intraday movements in the market, which is not possible with open-ended Funds.
3. With ETFs one pays lower management fees. As ETFs are listed on the Exchange, distribution and other operational expenses are significantly lower, making it cost effective. These savings in cost are passed on to the investor.
4. ETFs have lower tracking error due to in-kind creation and redemption.
5. Due to its unique structure, the long-term investors are insulated from short term trading in the fund.

For Retail or Wholesale Investors with a long-term horizon, it allows diversification of portfolio with one single investment. It insulates them from short term trading activity of other investors in the Fund as ETFs have a unique in-kind creation / redemption mechanism. Lower costs of ETFs enhance net returns in the long term. For FIIs, Institutions and Mutual Funds, it allows easy Asset Allocation, Hedging and Equitizing Cash at a low cost. For Arbitrageurs, it provides ease with low Impact Cost to carry out arbitrage between the Cash and the Futures market. For investors with a shorter-term horizon, ETFs provides access to liquidity due to the ability to trade during the day and at values near to NAV. Open ended vs Close ended vs ETFs Fund Size Flexible Fixed Flexible NAV Daily Real-Time Liquidity Provider Fund Itself Stock Market Stock Market / Fund Itself Availability Fund Itself Through Exchange were listed Through Exchange where listed / Fund itself. Portfolio Disclosure Disclosed Monthly Disclosed Monthly Daily/Real-time Intra-Day Trading Not Possible Expensive Possible at low cost

► Cash Equitization: Investors typically seek exposure to equity markets, but often need time to make investment decisions. ETFs provide a "Parking Place" for cash that is designated for equity investment. Because ETFs are liquid, investors can participate in the market while deciding where to invest the funds for the longer-term, thus avoiding potential opportunity costs.

► Hedging Risks: ETFs are an excellent hedging vehicle because they can be borrowed and sold short. The smaller denominations in which ETFs trade relative to most derivative contracts provides a more accurate risk exposure match, particularly for small investment portfolios.

► ETFs are beneficial over Index Futures in many situations:

1. When investors cannot or prefer not to trade Index Futures.
2. When cash flows are small and investors do not have enough capital to invest in index futures, as the minimum investment amount required in index futures is very large as compared to ETFs.

3. For longer-term horizons, Index Futures need to be rolled over every month /quarter which has its own risk and costs
4. If regulations prevent investors from investing in Futures;
5. Taxation issues: With Index Futures investors can avail of only short-term capital gains while with ETFs, investors can avail long-term capital gains.
6. If the discount in ETFs is greater than the discount in futures Fixed term Plans
 - ▶ Fixed maturity plans (FMPs), commonly referred to as FMPs, are a class of debt funds that primarily invest in fixed income instruments such as a certificate of deposit or bonds that lock in the yields that are currently available. This is done to eliminate interest rate fluctuation faced by debt markets.
 - ▶ Fixed maturity plans are close-ended mutual fund schemes with a pre-defined maturity. The tenure varies from 30 days to 5 years. The most commonly available tenures range from thirty days to 180 days, 370 days and 395 days.
 - ▶ Characteristics:
 1. Fixed Tenure. FMPs are invested for a fixed period. The investment is done at time of NFO. Investors get a fair idea about their returns after a fixed period. No premature redemption is allowed.
 2. Close ended. They cannot be invested at any time apart from NFO. SIP is not available. There is an option though, where unit holders who have units held in Demat mode, can sell their units on the stock exchange which have units of a fixed maturity plan scheme listed. This way, they can exit the fixed maturity plan ahead of its tenure.
 3. Investment Strategy. FMPs invest in commercial papers (CP), certificate of deposits (CD), corporate bonds, money market instruments, government-issued securities, and non-convertible debentures (NCD) of high rated and reputed companies. The instruments chosen have tenure matching the maturity period of FMPs
 4. Interest rate risks. Since they are held for a period matching the debt instruments, they continue to receive fixed interest rates.
 5. Credit Risk is low as instruments chosen have either sovereign guarantee or highly rated corporates.
 6. Tax implications. These investments are in the debt market. If the plans are held for more than 3 years, it is qualifying as LTCG. So, investors can benefit from indexation to leverage their tax liability against inflation
 - ▶ Risks:
 - 1 Credit risk. Although lowest among other asset classes, the corporate bonds do carry an element of risk, especially when held for a long period.
 2. Reinvestment risk. Since these funds are held for a fixed tenure with debt instruments proving fixed returns, there is no intermediate change, although there may be a decrease in market returns. When they mature, the prevailing rates may be lower than invested rates and thus remains reinvestment risks.
 3. Liquidity risks. The instruments invested before may go out of market and holding them may risk illiquidity.
 - ▶ FMPs are comparable to FDs. Both are made for a fixed period in mind. FMPs provide better returns than FDs and tax benefits in form of indexation is available. However, FDs are more liquid than FMPs and carry negligible risks such as credit risks and liquidity risk. Net Asset Value ▶ (NAV) represents the per unit/share market value of a particular mutual fund. Net asset value is the price at which an investor can buy

mutual fund units from the AMC/fund house and even sell it back to the AMC/fund house. A NAV of a mutual fund is calculated by dividing the total market value of the mutual fund's assets, minus the fund's existing liabilities.

► The formula of NAV is as follows:

Net asset value = market value of the mutual fund scheme + other assets – the fund's existing liabilities (per unit share) / Number of outstanding units at the end of the day. It can be also calculated as:

► $NAV = \frac{Assets - (Liabilities + Expenses)}{Number\ of\ units\ outstanding}$

► Where the assets include the value of securities and liquid cash. The securities in which the scheme has invested include both equity, debentures, bonds, bills of exchange, commercial paper. It also includes the interest accrued and dividend earned

► The liabilities and expenses include the money payable, interest payable, fund management expenses.

► The net asset value of any given mutual fund is impossible to calculate during the market running hours since this NAV has a tendency to fluctuate every single minute, depending on the scheme's market performance. Hence, the net asset value of the mutual fund is calculated at the end of the day, and its closing market price is taken into account.

► A higher NAV indicates you can buy fewer units for the same price than you can buy from a scheme with a lower NAV. As an illustrative example, let's assume an investor chooses to invest ₹1,00,000 in two separate schemes A and B. Scheme A has a net asset value of ₹10, while scheme B has a NAV of ₹50, and both schemes return 10% per month. Though Scheme A appears cheaper as 10,000 units can be acquired while only 2000 of scheme B's units can be acquired for the same price, but it's not the case. Let's see how.

► Every month, due to the 10% return, the NAV increases. Next month, A's NAV is ₹11 and B's is ₹55. In both cases, the value of your ₹1,00,000 investment has grown to ₹1,10,000 in one month. Hence, high or low NAV is not related to the returns you can generate from a mutual fund scheme. As long as the schemes deliver the same returns the difference in their NAV is not significant. The difference between schemes A and B is that the investor gets more units in the first case than in the latter case. Pricing

► A mutual fund unit does not represent ownership of any specific security like stocks or bonds. It denotes a collection of all the elements within a fund in precisely the proportion in which it has been constructed at large. Example: Fund ABC comprises 10% of stock A, 20% of stock B, 20% of government bonds, 20% of corporate bonds, 5% in stock C, 10% in stock D, 10% in cash derivatives, and 5% in treasury bills. So, a unit of this mutual fund will represent the ownership of all these securities precisely in this percentage. The fund manager of ABC commits Rs.10 lakh in stock A, Rs.20 lakh of stock B, Rs.20 lakh of corporate bonds, Rs.20 lakh of government bonds, Rs.5 lakh of stock C, Rs.10 lakh of stock D, Rs.10 lakh of cash derivatives, and Rs.5 lakh of treasury bills. The MF also carries a liability of Rs.10 lakh. Therefore, ABC fund's total value stands at – Rs. (10 + 20 + 20 + 20 + 5 + 10 + 10 + 5 – 10) lakh, or, Rs. 90 lakhs. Now, let's assume that at the end of 22nd June 2020, the number of unit-holders stood at 1 lakh. Ergo, NAV of ABC fund is equal to Rs. (90,00,000 / 1,00,000) or Rs.90. At the end of 22nd June 2020, ABC's NAV is Rs.90. Mr. Ashok puts in an order of Rs.9000 on 23rd June. By the listed NAV, Mr. Ashok should be able to procure 100 mutual fund

units of ABC. However, at the end of 23rd June, the price increased to Rs.92. Therefore, if Mr. Ashok invests Rs.9000, he will be acquiring 97.8 units of ABC fund and not 100. Fair value pricing is the process by which fund managers estimate the value of a security within a fund where a current price isn't readily available. Fund managers may act in good faith to determine the fair market value of a security if they feel it more accurately reflects its current value.

Situations that warrant FMV calculations:

- ▶ Significant world and market events – Events occurring all around the world can potentially interrupt the normal trading environment. The 9/11 attacks on the World Trade Centre are a good example of this. Hard-to-value securities – Some securities trade very infrequently. This can make it difficult to obtain current pricing when no recent trade data is available. Fair value pricing can establish a more reasonable estimate of the current value.

- ▶ Investments in private companies – Companies that don't trade publicly present challenges in establishing fair value. While establishing an accurate price may be difficult, fair value pricing can help put a sensible estimate on the investment.

- ▶ Technical glitches on the exchanges – Technical issues sometimes interrupt trading in single securities or an entire exchange. SIP (Systematic Investment Plan)

- ▶ Mutual Fund SIP accounts stood at 4.02 CRORE! And the total amount collected through SIP during June 2021 was ₹ 9,156 crore

- ▶ Systematic Investment Plan (SIP) is an investment plan (methodology) offered by Mutual Funds wherein one could invest a fixed amount in a mutual fund scheme periodically, at fixed intervals – say once a month, instead of making a lump-sum investment.

- ▶ The SIP instalment amount could be as little as ₹500 per month. SIP is similar to a recurring deposit where you deposit a small /fixed amount every month. Advantage over FD is that SIP may continue as long as you wish. A FDs give a fixed interest however SIP may give higher returns depending upon market performance.

- ▶ SIP is a very convenient method of investing in mutual funds through standing instructions to debit your bank account every month, without the hassle of having to write out a cheque each time. ECS also ensure that same day NAV is received irrespective of the time when it is credited to MF account.

- ▶ SIP has been gaining popularity among Indian MF investors, as it helps in Rupee Cost Averaging and also in investing in a disciplined manner without worrying about market volatility and timing the market. Systematic Investment Plans offered by mutual funds are easily the best way to enter the world of investments over the long term.

- ▶ Common sense suggests that “Buying low and selling high” is perhaps the best way to get good returns on your investments. But this is easier said than done, even for the most experienced investors. There are many factors at play when it comes to any market - debt or equity, and all of them are inextricably linked.

- ▶ SIP is a simpler approach to long term investing is disciplining and committing to a fixed sum for a fixed period and sticking to this schedule regardless of the conditions of the market.

- ▶ RUPEE COST AVERAGING - Rupee cost averaging, as this practice is called, in a way ensures that you automatically buy more units when the NAV is low and fewer when the NAV is high...e.g., an SIP of ₹1000 gets you 50 units when the NAV is Rs.

20, but gets you 100 units when the NAV is Rs.10. The average cost for buying those 150 units would be Rs. 2000/150 units i.e., ₹ 13.33.

► However, please remember that the Rupee cost averaging does not assure profit, nor does it protect one against investment losses in declining markets. It merely ensures disciplined & regular investment in stock markets, which helps overcome the natural impulse to stop investing in a falling or a depressed market or investing a lot, when markets are buoyant and euphoric.

► **THE POWER OF COMPOUNDING** - There is a great advantage with long-term investments, namely, compounding which is considered one of the greatest mathematical discoveries.

► To put it in simple words, compounding is when the interest (or income) you earn is reinvested in the original corpus and accumulated corpus continues to earn (& grow). Every time this happens, your investment keeps growing, paving the way for a systematic accumulation of money, multiplying over time.

► To illustrate, a small amount of ₹1000 invested every month at an interest rate of 8% for 25 years would give you ₹ 9.57 Lakh! That means your investment of just ₹ 3 Lakh would have grown three times over!

► **STARTING EARLY PAYS WELL** - To get the best out of your investments, it is very important to invest for the long-term, which means that you should start investing early, in order to maximize the end returns. Let's understand this better through an illustration – Let's assume that two friends, both aged 25, decide to invest ₹ 2000 every month for a period of 5 years and earn 8% p.a. on a monthly compounding basis. The only difference is that while one starts investing promptly at the age of 25 itself, the other starts investing 10 years later at the age of 35 years. Both decide to hold on to their investments till they turn 60. So, while both of them would accumulate principal investment of ₹1.2 Lakh over a period of 5 years, the investment of the person who started early at the age of 25 appreciates to over ₹ 14 Lakh, the investment of the second person who started later grows to only about ₹ 6 Lakh.

► SIP also gives advantage of tax saving if investments are done through ELSS funds.

► **Limitations:** 1. Quantum of investment low. So, at time of requirement does not provide huge liquidity.

2. Missed opportunity of investing much at the right time. automated way of moving (transferring) money from one mutual fund (ideally debt and equity) to another. This plan is chosen when one wants to invest a lump sum amount but wants to avoid the marketing-timing risk.

► The most common advantage of doing STP is to derrick the market timing risk. STP (with single instalment) can be used to invest a lump sum amount in equity funds on the same day. Otherwise, one has to first apply for redemption, receive funds and then retransfer the funds to the AMC for reinvesting in a different MF. This has a time lag of 2 to 3 days and is subject to market risks.

► In case of a volatile market, STP helps the investors to periodically transfer funds from one scheme (source scheme) to another (target scheme). Transfers are usually made from debt funds to equity funds if the market is doing well and vice versa if the market is not performing well.

► If a fixed sum is transferred from the source to the target scheme, then it's called Fixed STP. If the sum transferred is not fixed, then it is an example of Flexi STP. If the

sum transferred is the profit part of the investment of source scheme, then it's called Capital Appreciation STP.

► Earlier, fund houses allowed only debt to equity fund transfer within the same company. Now, you can transfer from an equity fund of one AMC to that of another. To apply for an STP, there needs to be at least six capital transfers from one mutual fund to another. While you are free from entry load, SEBI allows fund houses to charge exit load. However, the exit load cannot exceed 2%. There is no entry/ exit load for STPs between same AMC.

► From taxation angle, each switch is considered as an exit / redemption and hence STCG/ LTCG is applicable according to the investment period in the original fund.

► Advantages: 1. Diversifications of risk

2. Rupee cost averaging

3. Taking benefit of a growing equity market.

► STP is ideal for:

1. Investors who have invested in debt funds through SIP and now wants to take benefit of equity markets through capital appreciation

2. Equity fund investors have taken benefit of capital appreciation and now nearing retirement wants to ensure steady returns will shift to debt funds.

► P-E STP: Instead of transferring a fixed amount from your debt to the equity fund, it transfers a higher amount when the market valuations are low and the pre-determined amount—which you would have ordinarily invested through a normal STP—when the valuations are high.

► The fund house has created three market zones, which determine how much money gets transferred: When the P-E ratio of S&P BSE Sensex is below 16 (called the green zone) between 16 and 19 (yellow zone) greater than 19 (red zone).

► When markets are in the red zone (in other words, when valuations are high), the default STP amount gets invested. When markets are in the yellow zone, twice your default STP gets invested. When the markets are in the green zone, 5 times the default STP amount gets invested. In short, you buy more units when the markets are low.

► Apart from channelling the investments into an equity fund in a disciplined manner—like in any other STP, the PE STP ensures that you invest more during falling markets. It takes a more scientific approach and accounts for valuations of the stocks and the market, rather than looking at just the absolute market levels, which don't always mean much.

► Portfolio maturity: Mutual funds usually invest in a number of bonds and gilts, with each instrument having a different maturity. The maturity is the length of the period at the end of which the principal amount is returned to the security-holder or bond-holder. Since a debt fund invests in a number of such instruments, each of these instruments would have a different maturity. So, the fund calculates a weighted average maturity, which gives a fair idea of the fund's maturity period. For example, if a fund owns three bonds of 2-year (Rs 30,000), 3-year (Rs 10,000) and 5-year (Rs 20,000) maturities, its weighted average maturity would be 3.17 years.

► Average maturity tells you how sensitive a bond fund is to change in interest rates. When interest rates move down, bond prices move up, thus boosting debt funds' return and vice versa. Thus, a change in interest rates will impact different maturities differently. The price of long-term debt securities generally fluctuates more than that of

short-term securities when the interest rate changes. Consequently, mutual funds with several long-maturity papers in its portfolio are more sensitive to NAV fluctuations.

▶ As a debt security approaches its maturity date, the length of time to maturity becomes shorter. Thus, even if a fund buys and holds a debt portfolio, the average maturity of a fund keeps on decreasing till the security held reaches its maturity date

▶ As gilt funds usually have a relatively higher average maturity, they are the most volatile among all debt funds. Cash funds (debt ultra-short-term funds), on the other hand, usually have the shortest average maturity and are the least volatile. But since higher risk also means higher returns, gilt funds are capable of delivering higher returns than cash funds.

FUND SELECTION CRITERIA

Rating of mutual funds

- ▶ Investing money in mutual funds is a big decision an investor takes. It is an investor's duty to know all the details about the scheme he's going to invest, the terms and conditions, and about the interest he will earn from the investment. Mostly, when investors plan to invest their money in such schemes, confusion is created about in which company to invest when the companies offer similar schemes. The best way to avoid this confusion is to check the Mutual Fund Ratings from the mutual fund rating agencies
- ▶ Mutual fund ratings are increasingly popular with today's investor base - especially the ones who are picking their mutual funds. With hundreds and thousands of mutual funds that exist today, ratings offer simplicity in selecting the right fund/stock. Ratings help simplify investment decision-making by creating a simple metric that allows investors to select the right fund for their portfolio. For example, a 5-star rated fund is superior to a 4-star fund and so on. So, this helps investors make quick decisions based on simplified market data.
- ▶ Mutual Fund Rating is done to compare the schemes from different companies which offer similar schemes. It helps the investors to choose the best suitable scheme. Mutual Fund Rating agencies help the investors by rating the mutual funds based on their past performances, performance consistency, the skills of the fund's manager, cost adjusted returns. These factors help investors to choose the best scheme for their investment portfolio.
- ▶ If a company perceives to have undergone a downturn in fortunes and its rating is lowered, investors might ask for higher returns to lend to it, thereby judging it to be a riskier bet. Similarly, if the economic and political policies of a country look gloomy, its ratings are downgraded by global credit agencies thereby influencing the flow of investments in that country.
- ▶ On a macroscopic level, these changes affect economic policies of a nation. An endorsement from a convincing rating agency makes life easier for countries and financial institutions issuing bonds. It basically tells investors a firm has a track record and indicates how likely it is to be able to pay back the money.
- ▶ A credit rating issued by a rating agency is an assessment of the creditworthiness of securities issued by corporations, governments and other entities. The ratings given to such securities are mostly represented as AAA, AAB, Ba3, CCC etc. It is very similar to a marking system wherein the highest rating AAA is given to a borrower who has the highest probability of paying back. In that way, AAA is considered to be one of the safest debt securities to buy.
- ▶ These ratings and rankings are calculated based on relevant factors and are not random. Since considerable research is done for ratings/rankings, they help investors choose funds with confidence. Also, the history of the fund is considered before it is rated/ranked. The time frames chosen to calculate risk-adjusted returns are 3-year, 5 year and 10-year trailing returns. These period-based risk adjusted returns are combined to provide rating/ranking of the fund. So, the ranking/rating is a reflection of the fund's functioning in the long term.
- ▶ Investing in Mutual Funds means willing to take a risk, risk of high return. It is clear that when investors compare schemes of different companies, they expect high returns. We cannot surely say that high ratings mean high returns but high ratings mean that it is obviously better

than the lower ones. But sometimes there are exceptions too, lower-rated mutual funds may perform better than the high rated ones or give more returns than the schemes which are rated more. The chances of a 5-star rated mutual fund going out of rating is very low compared to a 1-2 star rated one.

▶ Mutual funds are market-linked investments and past performance doesn't guarantee high returns in the future. Mutual funds get rerated from time to time based on their performance. So, a 5-star fund could get easily downgraded over the coming year because of its poor performance.

▶ It is important to note is that rating changes happen after good/poor performance of the fund. For instance, a 4-star fund gets promoted to a 5-star fund after it has done well in the past year. So, those who are buying only 5-star funds will not have an edge against those who buy 3-star and 4-star funds in the long run.

▶ The most important flaw with rankings/ratings is that they are overly simplistic in determining which is the good and bad funds. All good funds may be suitable for all the investors' portfolios. Investors could be young and old, rich or poor, salaried or entrepreneurs etc. So, the risk profile of every investor is different. So, choosing 5-star funds will not be right for every other investor.

▶ However, mutual fund ratings are not completely free of risk and bias. They must not be used as the only criterion for you to invest in a mutual fund. You should look at other factors such as investment philosophy and track record of fund house. Make sure that you choose your investments based on your own unique requirements.

▶ One should not invest money only in the top-rated mutual funds but should invest in the categories which complete your financial goals and objectives. Choosing inappropriate funds due to ratings would be of no use rather than choosing a suitable mutual fund scheme with little low ratings.

▶ Basis of ratings They only rate open-ended schemes, and they rank mutual funds based on a set of parameters as listed below.

▶ Superior Return Score (SRS): SRS denotes the fund's returns and risks in comparison with other similar portfolios. Example, you cannot compare a large-cap fund with a mid-cap fund. The only apple to apple comparison works here.

▶ Portfolio Concentration Analysis: Concentration, here, means the risks faced due to over-diversification. For example, if one invests in too many funds to diversify the portfolio, you might end up having similar stocks, which defeats the purpose.

▶ Mean Return & Volatility: CRISIL considers only mean return and volatility for equity funds, short-term debt funds and credit opportunities funds. Mean return is the average daily returns based on the NAV, while volatility is the degree of fluctuations in returns.

▶ Quality of Assets: Asset quality calculates the possibility of default by the debt security issuer to honour the timely debt repayment.

- ▶ **Exposure to Sensitive Sector:** For debt funds, CRISIL takes industry risks into account and give the fund an Industry Risk Score (IRS). This score analyses the effect of different variables on industry and the debt repayment capacity of organizations in a given time horizon.

- ▶ **Liquidity Analysis (LA):** It assesses the ease with which a MF can liquidate a portfolio. The lower the score, the more liquid the fund is. For instance, the LA of equity funds is based on the number of days it takes to liquidate CRISIL

- ▶ CRISIL has CRISIL Research, a division of CRISIL, is India's largest independent integrated research house and is registered as a Research Analyst with SEBI. CRISIL uses the CMFR (CRISIL Mutual Fund Ranking) tool for rating MFs. It was launched in June 2000 and since then it has gained high acceptance among investors, intermediaries and asset management companies.

- ▶ CRISIL rating for mutual fund allows investors to compare and evaluate the best performing funds in the market at a given point of time. The credit score of the mutual funds helps to make investment decisions. The score allows investors to decide when to buy, sell or hold a mutual fund unit. A high credit rating indicates the credibility of a unit, as well as lets the investors know risks associated with it.

- ▶ The agency evaluates mutual funds on two parameters that include qualitative and quantitative. These ratings are not just useful for investors; it is also beneficial for asset management companies and intermediaries that allows them to offer the best scheme to prospective investors. The Securities and Exchange Board of India (SEBI) regulates all the rating agencies, including CRISIL

- ▶ CMFR covers various categories across equity, debt and hybrid asset classes. Unlike most other ranking models, which are based purely on returns or net asset value (NAV), CMFR uses a combination of NAV and portfolio-based attributes for evaluation. This provides a single point analysis of mutual funds, taking into consideration key parameters such as risk-adjusted returns, asset concentration, liquidity and asset quality.

- ▶ CRISIL Mutual Fund Ranking includes ranking for different funds such as debt, equity, and hybrid category. CRISIL uses portfolio-based attributes and NAV of the fund to rank the funds. The agency ranks mutual funds from a scale of 1 to 5. In each category, CRISIL ranks top 10 percentile for funds under rank 1, while the top 20 percentile falls under rank 2.

- ▶ **Eligibility criteria**
 - Only open-ended funds are considered, both regular and direct plans ranked separately
 - NAV history – Three years for equity, hybrid, gilt, dynamic, medium to long and medium duration funds – One year for arbitrage, banking & PSU, corporate bond, credit risk and other short duration funds, including liquid funds
 - AUM cut-offs: Equity 10 crore, Debt and Hybrid 50 crores, Debt funds less than 1 year 250 crores, Liquid 1000 crores

- ▶ **Parameters of CRISIL rating for Mutual funds:**

Portfolio Concentration Analysis: This involves the risks faced due to improper or over-diversification. For debt funds, the concentration is analysed at the individual level, while the diversification score analyses the industry and company concentration.

Liquidity Analysis: Using this parameter, the rating agency measures the liquidity level of a mutual fund scheme. CRISIL takes into consideration the portfolio liquidity score for the past three months. ► In case of corporate debt funds, the agency classifies the security into categories including semi-liquid and illiquid. The agency analyses fund's liquidity based on the exposure of the scheme to these categories. A low score means more liquidity.

Mean Return and Volatility: CRISIL uses mean returns to determine the average daily returns of the fund's NAV, while volatility helps to know the deviation of the returns. As mentioned in the eligibility criterion, the period of the analysis is three-years for equity hybrid & debt fund. At the same time, it is one year for corporate bonds, credit risk, PSUs and other short-duration categories.

Active Return: CMFR (CRISIL Mutual Fund Ranking) incorporates this parameter for equity fund categories that include mid-cap, large-cap, multi-cap, large and mid-cap and focused and value/contra funds. The active returns are the percentage of loss or profits made by an investment portfolio as a result of active investment decisions by the fund manager.

Tracking Error: This measures the variations of a scheme's performance by comparing it with the index that it tracks. CRISIL uses this factor for index schemes. A low tracking error indicates a better performing scheme.

Count of negative returns: This parameter is mainly used for arbitrage mutual funds, wherein the agency measures the downside risks of the funds.

Exposure to the sensitive sector: The CRISIL Mutual Fund Ranking analyses the risk factor of fund schemes depending on industry risk scores (IRS) for various sectors. The score assesses the credit risk associated with the industry on a uniform scale. IRS captures the industry influence on the repayment ability of the companies.

EQUITY Parameters
 Large cap, large & mid cap, multi cap, flexi cap, mid cap, value/contra, focused, small cap, ELSS
 Index / ETFs
 Mean return (%) 55 -- Tracking error (%) -- 100
 Volatility (%) 25 -- Company concentration (%) 5 -- Industry concentration (%) 10 -- Equity - liquidity (%) 5 -- Time (years) 3 3

HYBRID CATEGORY Parameters
 Aggressive hybrid
 Conservative hybrid
 Arbitrage
 Mean return (%) 50 50 60
 Volatility (%) 25 10 25
 Company concentration (%) 5 5
 Industry concentration / exposure to sensitive sector (%) 5 5
 Equity - liquidity (%) 10% of equity component in hybrid schemes 7.5 % of equity component in hybrid schemes
 Debt - asset quality (%) 5% of debt component in hybrid schemes 17.5
 Debt liquidity (%) 5% of debt component in hybrid schemes 7.5 % of debt component in hybrid schemes
 Modified duration (%) 5
 Count of Negative Returns (%) 15
 Time (years) 3 3 1

DEBT Parameters
 Gilt
 Dynamic, medium to long, medium duration
 Banking and PSU, corporate bond, credit risk, short duration, low duration, money market, ultra-short
 Liquid
 Mean return (%) 50 50 50 50
 Volatility (%) 25 10 10 10
 Company concentration (%) 5 5 5
 Exposure to sensitive sector (%) 5 5 5
 Debt - asset quality (%) 17.5 10 15
 Debt liquidity (%) 15 7.5 15 15
 Modified duration (%) 10 5 5
 Time (years) 3 3 1 1
 CRISIL ratings

► Long term ratings

- ▶ CRISIL AAA (Highest Safety): Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
- ▶ CRISIL AA (High Safety) Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
- ▶ CRISIL A (Adequate Safety): Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk
- ▶ CRISIL BBB (Moderate Safety) Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
- ▶ CRISIL B (High Risk): Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
- ▶ CRISIL C (Very High Risk): Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
- ▶ CRISIL D: Instruments with this rating are in default or are expected to be in default soon.
- ▶ ICRA's Long-Term Debt Mutual Fund Rating Scale -This scale largely applies to debt funds with a weighted average maturity of more than one year.
- ▶ Aam's- Schemes with this rating are considered to have the highest degree of safety regarding the timely receipt of payments from the investments made by them.
- ▶ AAmfs- Schemes with this rating are considered to have a high degree of safety regarding the timely receipt of payments from the investments made by them.
- ▶ Amfs- Schemes with this rating are considered to have an adequate degree of safety regarding the timely receipt of payments from the investments made by them.
- ▶ BBBmfs- Schemes with this rating are considered to have a moderate degree of safety regarding the timely receipt of payments from the investments made by them
- ▶ BBmfs- Schemes with this rating are considered to have a moderate risk of default regarding the timely receipt of payments from the investments made by them
- ▶ Bmfs- Schemes with this rating are considered to have a high risk of default regarding the timely receipt of payments from the investments made by them.
- ▶ Cmfs- Schemes with this rating are considered to have a very high risk of default regarding the timely receipt of payments from the investments made by them
- ▶ ICRA's Short-Term Debt Mutual Fund Rating Scale - this scale applies to debt funds with a weighted average maturity up to one year. Such funds would generally include liquid funds and cash funds. The benchmark maturity for this scale is 12 months.

▶ A1mfs-Schemes with this rating are considered to have a very strong degree of safety regarding the timely receipt of payments from the investments made by them

▶ A2mfs - Schemes with this rating are considered to have a strong degree of safety regarding the timely receipt of payments from the investments made by them

▶ A3mfs - Schemes with this rating are considered to have a moderate degree of safety regarding the timely receipt of payments from the investments made by them

▶ A4mfs - Schemes with this rating are considered to have a minimal degree of safety regarding the timely receipt of payments from the investments made by them CARE

▶ CARE's capital protection-oriented scheme (CPS) ratings assess the degree of certainty with which the portfolio structure is sufficient to achieve the objective of capital protection on maturity of the scheme. Capital protection here means that the NAV should be at equal to or greater than the face value of the scheme on maturity.

▶ CARE's CPS (Capital Protection Scheme) ratings are based upon fulfilment of certain minimum conditions by the AMC under which the scheme will operate. The AMC needs to ensure that these minimum conditions are met at all times during the life of the scheme, as a violation of any of these conditions may adversely affect the structure of the scheme and the rating.

▶ The rating process takes about two to three weeks, depending on the complexity of the assignment and the flow of information from the client. Ratings are assigned by the Rating Committee.

▶ AAAmfs- Schemes with this rating are considered to have the highest degree of safety regarding the timely receipt of payments from the investments made by them.

▶ AAmfs- Schemes with this rating are considered to have a high degree of safety regarding the timely receipt of payments from the investments made by them.

▶ Amfs- Schemes with this rating are considered to have an adequate degree of safety regarding the timely receipt of payments from the investments made by them.

▶ BBBmfs- Schemes with this rating are considered to have a moderate degree of safety regarding the timely receipt of payments from the investments made by them

▶ BBmfs- Schemes with this rating are considered to have a moderate risk of default regarding the timely receipt of payments from the investments made by them

▶ Bmfs- Schemes with this rating are considered to have a high risk of default regarding the timely receipt of payments from the investments made by them.

▶ Cmfs- Schemes with this rating are considered to have a very high risk of default regarding the timely receipt of payments from the investments made by them

▶ Short-Term Debt Mutual Fund Rating Scale

▶ A1mfs-Schemes with this rating are considered to have a very strong degree of safety regarding the timely receipt of payments from the investments made by them

▶ A2mfs - Schemes with this rating are considered to have a strong degree of safety regarding the timely receipt of payments from the investments made by them

▶ A3mfs - Schemes with this rating are considered to have a moderate degree of safety regarding the timely receipt of payments from the investments made by them

▶ A4mfs - Schemes with this rating are considered to have a minimal degree of safety regarding the timely receipt of payments from the investments made by them Factors affecting Fund selection

▶ SIZE

▶ Asset Under Management (AUM) of a fund is nothing but the fund size. The size of a fund shows the potential of the fund due to which investors are investing majorly in that fund over other funds. the biggest large-cap fund, HDFC Top 200, has an AUM of Rs 10,692 crore and the smallest fund, Sahara Super 20, has an AUM of only Rs 1.31 crore. Besides, small investors also seem to believe that the larger the fund, the better it is. For them, a large corpus is usually a symbol of investors' confidence in the fund scheme.

▶ A large fund has some obvious cost benefits. As a fund grows bigger, the fixed costs relating to the fund become a smaller proportion of the expenses, which improves the efficiency of the fund. Also, a large fund means increased revenue for the fund house as it brings in more management fees. These benefits, if utilised effectively, can be passed on to the investors.

▶ A large fund also provides its manager the flexibility to improve its performance through his expertise as well as the number of independent bets he can take. Also, if the fund house has a larger fund size or assets under management, it helps in negotiating better with the debt issuers courtesy the size. ▶ If the investment management process can be applied to a wide variety of market segments, then an increase in the fund size will improve its performance.

▶ Debt mutual funds rely highly on their AUM to manage their returns and dividends to investors. A debt mutual fund that has a high fund size or larger assets under management is in a better position to distribute fixed fund expenses across its investors. A large fund size would mean a lower expense ratio per person which in turn gets reflected in the fund returns.

▶ The impact of a large AUM affects mid cap and small cap companies. The main reason behind this, is that small cap funds invest in high growth potential companies, which are still growing. Small cap funds have a tendency to restrict cash influx beyond a certain level. Such

a situation arises when the assets under management for the given mutual fund rises beyond a certain mark. The primary reason behind this restriction is that a greater fund size would imply that the fund has become a major shareholder in the company leading to restrictions in share trading when the market fluctuates.

► **Limitations:** If a mid-cap fund becomes too large, it can't invest solely in mid-caps due to concentration risk in individual stocks. This defeats the investment mandate and hinders the performance. Also, mid-cap stocks can be illiquid.

► This is because large scale buying or selling by the fund can lead to a massive impact on the price of mid-cap stocks. A significant liquidity risk could lead to a negative price impact and, thereby, hurt performance. This is felt even more when the markets are uncertain.

► AUM is hardly an important factor to consider while choosing a fund. What is more important is the consistent performance of the fund across market cycles and the ability of the fund manager to deliver good returns despite varying AUMs. Investors should stay away from funds that deviate heavily from the mandate and churn aggressively in the garb of active fund management, you should also stay away from funds where the asset base is shrinking persistently.

► **STABILITY** - Stability is extremely important for any successful investor. There are mutual funds that provide stable returns. These funds are recommended for investors who are more interested in preserving their assets, as opposed to growth. It does not necessarily mean growth, however in the long run volatility may result in lower CAGR. Example: Let's say investor A an aggressive investor invests in stock markets Rs 1 lakh. The returns in 5 years are 25%, 25%, 25%, 25% and -40 %. Accordingly, the valuation over 5 years are Rs 1.25 lakhs, 1.56, 1.95, 2.44, 1.46 lakhs, thus giving a 5-year CAGR of 7.93 %. Now X invested in XYZ stable mutual fund of Rs 1 lakh. The fund gave returns in 5 years as 15%, 13%, 14%, 12% and -8%. The valuations in 5 years are Rs 1.15 lakhs, 1.30, 1.48, 1.65 and 1.53 lakhs resulting in a 5-year CAGR of 8.82%

► When investors say they are seeking safety, they often mean that they want stability in price or minimized value fluctuation. The types of mutual funds for stability will usually be balanced funds

► Sometimes called "funds of funds," balanced funds and target-date funds can diversify the holdings in such a way that losses are rare, but long-term returns are higher than most bond funds. This lower relative volatility is achieved through diversification and higher allocation to low-risk assets, like bonds, and lower allocation to high-risk assets like stocks.

► Stability removes the element of volatility and increases the future predictability of returns. So, it depends upon the objective of the investor, whether to give priority to growth and risk or stability. ► <https://www.youtube.com/watch?v=v1EKDcpJCVc>

► The credit portfolio or the investment portfolio of the fund is indicated by the offer document. The offer document discloses where the funds intend to invest and which instruments will be preferred. It is an indicator of the risk the fund is taking. The returns are expected to be commensurate with the risk. Another aspect of risk is the risk tolerance of the investor. Risk tolerance refers to the amount of risk an investor is willing to take with his/her invested money. SEBI in 2015 made it mandatory for all mutual fund houses to display

a riskometer which consists of 5 levels of risk associated with the invested principal amount. The five risk levels are – low, moderately low, moderate, moderately high, and high.

► Risk is associated with the instruments chosen, sector chosen and time horizon. The markets always have a cyclical pattern. So, it depends upon how much time an investor is remaining invested in the funds. This in turn depends upon his financial goals, liquidity requirement and exigencies.

► The credit portfolio of the fund is a mix of different types of equities and debts

► Hence portfolio of the mutual funds should play a role in investor's selection of MFs depending upon the credit risk reflected in the portfolio, time horizon and investor's objective and financial planning

Time Horizon/Risk Low Risk Medium Risk High Risk Short Duration (up to 3 years) Liquid Funds, Ultra Short-duration Funds Short-duration Funds Arbitrage Funds Medium Duration (3 years – 5 years) Short-duration Funds Balanced Advantage Funds Equity Hybrid Funds Long Duration (5 years and above) Large Cap Funds Multicap Funds Mid Cap Funds, Small Cap Funds Selection criteria

► **PERFORMANCE** Performance is the returns received by the investors. It is undoubtedly is the principal factor for selecting a mutual fund. Investing in mutual funds has an inherent risk assumed upon the ownership. However, performance of the mutual funds can be quantified with the mathematical calculation of the historical returns. The correlation of the potential risk and the potential returns constantly put forth the opportunities to invest in mutual funds and drive maximum potential returns with minimum underlying risk. The performance may be evaluated by following criteria:

► Risk adjusted returns - Risk adjusted returns are the calculative returns your funds make compared to the risk indicated over the period of time. If compared, a couple of mutual funds which drive the same percentage of returns over the same period of time, the lesser risk funds have a higher Risk Adjusted Returns. As per risk-return trade-off, a higher degree of risk should be compensated by a higher level of returns. The risk is measured with the help of standard deviation. ► Using the Sharpe ratio helps to ascertain whether the fund is giving higher returns on every additional unit of risk taken. The fund having Sharpe ratio higher than the category average shows that the fund manager delivered higher returns for the extra risk taken.

► Sharpe Ratio Formula: $\text{Sharpe Ratio} = (\text{Portfolio return} - \text{Risk-free rate of return}) / \text{Standard deviation of the portfolio}$. If two different mutual funds offer similar returns the one with the higher Sharpe Ratio has a better risk-adjusted return.

► Consider two equity funds A and B having a standard deviation, i.e., 12% and 15% respectively. If the Sharpe Ratio of A and B is 0.48 and 0.60, then go for fund B because it's a better bet for the risk taken. However, if B's Sharpe Ratio was around 0.50, then you could even have gone for A. It is because a mere 0.02 extra return isn't worth it for assuming an extra 3% risk

. ► **Benchmarking** ► Benchmarking is the measurement of quality of the funds against the standard measurements. It is a point of reference compared to the funds peer markets.

Irrespective of the objectives of investment in mutual funds, benchmark helps you gauge the performance of your investment against the market competition. Considering historical returns against the market conditions will help you determine the relevance of the performance benchmark for your investments. However, historical return is not a reliable indicator of future results.

▶ A mutual fund's real worth can be understood only during unfavourable market phases, and a fund history can validate that. A relatively longer fund history says 5 to 10 years to compare fund performance across different time intervals and business cycles.

▶ Relative Performance with peers

▶ Relative performance with peers is a yardstick of the effectiveness of your mutual fund of the same category. Mutual Funds actively try to top the ranking of the fund universe. Intended towards a higher return for the determined period of value learning, the relative peer performance is recommended.

▶ Track record and competence of the fund manager

▶ The fund manager is an important person who makes investment decisions and stock selection in the portfolio. Understand your fund manager's competence according to his/her fund management knowledge and ability. Your fund manager's past performance would be a good parameter to track his/her record and could turn to be of a great value for your investments

▶ Consistency ▶ A historical data is needed to be found. Longer the time period chosen, a better judgement may be formed. A fund that consistently outperforms its benchmark and one that has withstood a few market downturns. These numbers likely illustrate the superior abilities of the mutual fund managers. Sometimes, however, when the market crashes, not even the best managers can save a portfolio from a loss. For this reason, also compare the fund's upside and downside data against comparable funds.

▶ Compare Fund Expense Ratio - Expense Ratio is the annual fee charged by the fund for managing your investment. As per SEBI guidelines, the fund houses cannot charge more than 2.5% of the fund's average asset under management (AUM). You need to check the expense ratio of mutual funds before finalising on a given fund. Expense ratios are charged out of the fund returns. So, the higher the expense ratio, the lower would be your take-home returns. Always look for a fund that offers similar returns at relatively lower expense ratio.

▶ The same mutual fund is available as a direct plan and a regular plan. Direct plans of mutual funds come at a lower expense ratio; which translates into higher returns. Investing in direct plans of mutual funds, instead of regular plans, can save you loads on commissions.

▶ Compare Average Maturity and Duration

▶ These are essentially used to evaluate debt funds. Average maturity relates to the period after which the securities held by a debt fund will mature. The longer the maturity, the higher is its sensitivity to interest rate movements and higher are chances of a fall in the fund NAV due to a rise in interest rates.

► Duration means how long does each underlying security of the debt fund take to reach a break-even point, i.e., point of no profit no loss. The shorter the duration, the quicker will it returns your original investment. In such a scenario, you will be able to accumulate money to reach your goals.

► Compare fund's Alpha and Beta

► Alpha measures the number of extra returns generated by the fund in excess of the benchmark returns. Beta measures the riskiness of a fund. Moreover, it shows whether the fund loses/gains more/less than the benchmark. If the beta value is more than one, it shows that the fund gains/losses more than the benchmark. A beta value of one indicates that the mutual fund's returns move the same as the benchmark. If the beta is less than one, then the fund gains/losses less than the benchmark. Consider two funds A and B which have the same level of bet

a, i.e., 2. If alpha of A and B is 2 and 1.75 respectively, then you may go for fund A. It's because, for the same level of risk, the fund manager is able to generate higher return

s than the benchmark. ► Compare Portfolio Turnover Ratio (PTR)

► The portfolio turnover ratio tells you how often the fund manager buys/sells securities in the portfolio. In case of equity funds, it shows the level of trading taking place in the fund. You need to know that whenever an equity share is bought/sold, it attracts transaction charges like the brokerage. Frequent trading going on in a portfolio ultimately increases the expenses and is reflected as a higher expense ratio. It might reduce your take-home returns from the fund. Thus, PTR is an important criterion for fund selection. While choosing a fund, look for one with a lower PTR.

► Entry & Exit loads - Entry & exit loads are the cost components that impact an investor directly. Entry load refers to the fee charged by a fund house from an investor when an investor starts investing in the fund. Exit load refers to the fee charged by the fund house upon exiting the scheme. It is a fraction of the NAV that you receive as an investor, you must look out for mutual fund schemes that have zero or minimal entry and exit load. However, it only comes into play in case of selling the units early. When you invest for the long term, the exit load automatically becomes nil. Investing for the long term is the best way to reap good returns from any fund.

► Best Debt Mutual Fund Guide for Beginners | How to Invest in Debt Funds? | What is Debt Fund? - YouTube Rolling Returns Rolling return is the annualized average return for the selected period beginning at a given start date and advancing one day sequentially till the last available date. This method provides a more accurate and in-depth picture of a portfolio's performance as return is calculated every day for the period under observation rather than being dependent on any specific time frame. Rolling returns of mutual funds are a better way to analyse the past performance of mutual funds than using the traditional point-to-point returns.

► <https://www.youtube.com/watch?v=y3v2nRLQLno>

▶ <https://www.youtube.com/watch?v=tjdNrB2AsLo>

▶ <https://www.youtube.com/watch?v=qIVXszZOYmQ>

▶ Technically speaking, rolling returns are the average annualised returns taken for a given timeframe on every day/week/month and taken till the last day of the duration. It measures the fund's absolute and relative performance over some time at regular intervals. For example: Between periods at various intervals: Return every three months 2010-2015 or returns every six months from 2008-2018.

▶ Rolling returns take several such blocks of 3, 5 or 10-year periods at various intervals and see how the fund has performed over that period which makes this return more indicative of the actual performance of the fund. Due to different periods, the return consistency of the fund over the period can be analysed as it considers both upside and downside market trends.

▶ For example, if you have a three-year investment horizon (holding period) and want to see rolling returns of a mutual fund scheme from 1/1/2006 to 1/1/2016, you start by calculating the annualised return from 1/1/2006 to 1/1/2009 (change in NAV between 1/1/2006 to 1/1/2009, annualised). Next, calculate the annualised return from 2/1/2006 to 2/1/2009, then from 3/1/2006 to 3/1/2009, and so on.

▶ Advantages of Rolling Returns

▶ An effective measure to evaluate the performance of mutual funds ▶ Accurate ▶ Not biased towards any period

▶ Provides proper insights to an investor ▶ Suitable for a recurring (monthly or quarterly) or a SIP investor ▶ Used for computing the mean return of the mutual fund

16-Aug-2016 to 13-Aug-2021 Return Statistics (%)	Return Distribution (% of times)	Fund Name	Average	e	Maximo	m	Minimum	m	Less than 0%	0 - 10%	10 - 20%	20 - 30%	More than 30%				
Tata Large & Mid Cap Fund(G)	11.34	26.24	-5.02	3.13	38.29	50.30	8.27	0.00	Miraa Asset Emerging Blue-chip-Reg(G)	20.25	46.80	-3.16	0.87	12.62	43.69	25.07	17.75

Rolling Return Statistics - 3 Year Benchmarking

▶ A benchmark is a reference point against which the performance and stock allocation of a mutual fund scheme are compared. It is also known as the benchmark index of the scheme. Selection of a benchmark is decided basis investment objective and asset allocation pattern of the scheme.

▶ If a scheme is a benchmark against CNX MID CAP 200, simply it indicates the kind of stock holdings and risk involved with that scheme. Not only this, it also measures the skill set of a fund manager and his teams. Signifying the performance, comparing a portfolio return with the benchmark is a critical thing to do and it should be known to the investors.

▶ The comparison of returns with a benchmark would be meaningful only if the latter reflects the fund's investment philosophy.

▶ The fund houses select benchmark indices on the basis of market capitalisation and sectoral or thematic strategies of the respective funds. For example, large-cap funds would have large cap indices, such as BSE SENSEX, BSE100, Nifty 50 or Nifty 100 as their

benchmark indices. Similarly, mid-cap funds would have Nifty Midcap 100 or Nifty Midcap 150 as their benchmark indices while infrastructure funds would use Nifty Infrastructure or BSE India Infrastructure India.

- ▶ Since 2012 SEBI has made it mandatory for fund houses to declare benchmark index for each of their mutual fund schemes to allow investors to compare their fund performances with that of the broader market.
- ▶ Large-cap companies have lower downside risk, funds with large-cap indices as their benchmark would suit investors with low-risk appetite. Similarly, funds with mid or small-cap indices with suit those having higher risk appetite. Thus, benchmark indices give investors a fair idea about the portfolio composition of the fund and thereby, take optimum investment decisions after considering their risk appetite and return expectations
- ▶ A mutual fund scheme delivers significantly higher returns than its benchmark index or falls lesser than its benchmark index during a market downturn, then it is considered to have outperformed its benchmark index. Similarly, a mutual fund scheme consistently outperforming its benchmark index over several periods indicate consistency in its performance. Thus, benchmark indices can be highly useful in deciding whether to make fresh investments, remain invested or redeem a mutual fund.
- ▶ An equity scheme might have given 12% annualized returns over the last couple of years and the market index too would have moved up by a similar rate during this period. In such a case the scheme has not generated additional returns over and above the market index. This serves as an important parameter while choosing which scheme to invest.
- ▶ When comparing a scheme with its benchmark, ensure that you consider the performance of the fund over longer time frames and not just short time frame. Look at data for one, three, five and even 10-year returns. When a fund consistently outperforms its benchmark indices, it indicates consistency in performance. Yield to maturity

FINANCIAL PLANNING

Financial Planning Introduction

► Financial planning is a process by which an individual, under the guidance of an expert, charts a roadmap to meet expected and unforeseen needs in life. Anyone earning an income must have a concrete plan to spend the money in a productive manner. He must consider financial planning to set himself up for success in life.

► Micro level: Current planning ► Budgeting ► At the very basic level of personal finance, you should understand the need for, and value of, a budget. A budget or spending plan is a road map for telling your money what to do each month. At its simplest, a budget lists how much income you have coming in compared to what's going out each month. The simplest way to create a budget is on paper. If it's your first-time budgeting, consider testing out different approaches each month to find the one that best fits your needs and style.

► Expenses control

After you've successfully created a basic budget, you'll have a much better understanding of where your money goes and where you can trim expenses. Expense control is required for 3 reasons. First, it can free up more money in your budget, so you're less inclined to rely on credit cards or loans to cover spending gaps. Second, if you have debt, adding extra money back into your budget can help you pay it off faster. And third, having extra money can help you boost your emergency fund or grow retirement savings. ► Debt reduction ► Using credit and taking on some debt itself isn't necessarily a bad thing, but when you can't keep up with the payments or borrow more than you can afford to pay back, you could be in trouble. Getting out of debt becomes even more difficult when you're facing a high-interest rate on credit cards or loans. One of the most important steps in getting out of debt is to pay more than the minimum amount due each month. The high interest loans can be replaced by low interest loans. Unused assets could be leveraged for getting low-cost loans like mortgage loans, etc. ► Saving for Retirement ► Retirement savings needs to become a priority instead of an afterthought. The regular income is expected to stop. With increasing life expectancy, nuclear families, and steady inflation retirement planning is more a necessity.

► Insurance. ► To prevent the financial plans getting disrupted by unforeseen exigencies like accidents, loss of property or other assets, damage to business assets, impairment of income or death to principal earning member, it is always preferable to be prepared for contingencies. Insurance give not only an assurance of continuity and financial security but protects your long-term financial goals. Diversion of accumulated savings is avoided. ► <https://www.youtube.com/watch?v=Xgjk10FtpAc>

<https://www.youtube.com/watch?v=zgTfYLVqVnw>

► FINANCIAL PLANNING - LIFE CYCLE APPROACH

► The lifecycle approach to financial planning places all of a client's financial activity into distinct time periods, or stages, with retirement acting as the final phase in the financial lifecycle. According to experts the power of this approach is that it provides a clear framework for evaluating different decisions in terms of the impacts on the sustainable lifetime standard of living by mapping goals to each lifecycle stage.

► There are five standard financial life stages encompassed in the lifecycle approach.

- ▶ 1. EARLY CAREER: Ranging in age from 25 to 35 years old, early career phase clients are starting to build a foundation for a strong financial future. Clients in this stage may be planning to start a family, if they have not done so already. If they do not yet own a home, they might be saving for one. At this stage, keeping income in step with expenses is a struggle, but it's important to lay the groundwork for retirement saving now.
- ▶ 2. CAREER DEVELOPMENT: From ages 35 to 50, earnings rise, but so do financial demands. Keeping expenses in line with income is a challenge in this stage. Many families are concerned with covering college costs and paying for ongoing expenses while also increasing the pace of saving for retirement
- ▶ 3. PEAK ACCUMULATION: In this stage, from the early 50s into the early 60s, clients typically reach their maximum income level. It may be a time of relative freedom for clients whose children have graduated from college. But this stage can also be a time of financial strain, as late age, or "silver" divorce, is on the rise. Without college tuition and with lower expenses thanks to their empty nests, they can accelerate savings rates to position themselves for a more secure retirement
- ▶ 4. PRE-RETIREMENT: About three to six years before winding down professionally, clients start restructuring assets to reduce risk and increase income. By this point, mortgages are usually paid and children are independent. This is the time to evaluate retirement plan distribution options and the tax consequences of investments.
- ▶ 5. RETIREMENT: The final financial lifecycle phase occurs for clients in their mid-60s and beyond. Once clients stop working, their focus shifts from wealth accumulation to income preservation. In this stage, the goal is to help clients preserve purchasing power and enjoy their desired lifestyle. Legacy considerations and estate planning also gain prominence as clients age.

▶ FINANCIAL PLANNING: WEALTH CYCLE CONCEPT

Stage 1: Wealth Creation: In your 20's you may find yourself launching a career, managing various debts – from student loans to big purchases, developing a budget, and learning about saving. Making well-informed decisions at this time in your life can help you achieve financial success and avoid expensive mistakes.

Stage 2: Wealth Accumulation: Accumulating wealth takes discipline and strategic investments. During your 30's, next mile stones may include buying your first home and/or saving for your children's college education. Helping you reach your goals is more than just relying on stocks and bonds. It is about understanding what matters most to you and prioritizing your investments. No one can predict the future, but we can at least prepare ourselves financially.

Stage 3: Wealth Growth Management: From your 40's to Retirement, strategic investment and risk management is imperative. This is the critical period, to assess where you are, correct past mistakes, and ensure that your retirement savings will be able to last you the rest of your life. Many people spend more time planning their next big purchase than they do focusing on their financial health. This could spell financial ruin when you're ready to retire if your assets won't support your current lifestyle.

Stage 4: Wealth Preservation: You've finally made it, retirement is here. Now you must shift to taking distributions and ensuring that the assets you have accumulated last. You may be scared because you've spent your whole life working and saving.

► Items to address include:

► What are your intentions for your assets – Do you intend to leave an inheritance or spend them down? What should your budget be based on current assets? Determine how much money can be withdrawn to ensure your assets outlast your longevity. Ensure your investments are structured in a manner to minimize the effect of market downturns. Risk profiling

► Investing in the financial market carries some inherent risk – which can be classified under systematic and unsystematic risk. Systematic Risk comes from the influence of external factors on an organisation – those which are not under the control of the organization (inflation, govt policy changes, technological disruptions, etc). Unsystematic Risk refers to the internal risks that an organisation is exposed to which are usually within the control of the organization (business risk such as management decisions, financial risk such as profits and losses and operational risk.

► Risk profiling is important for determining a proper investment and asset allocation for a portfolio. Every single person has a different risk profile as the risk appetite depends on psychological factors, loss bearing capacity, investor's age, income & expenses and many such other things. ► Suggested risk profiling may be: ► Conservative: Conservative risk profile refers to a significantly low-risk aptitude. Investors with this risk profile will lean towards investment options that provide the safety of the corpus more than anything. The scale of returns is a secondary factor to conservative investors as long as it is not negative. Typically, a conservative risk profile accounts for a short period horizon.

► Investment options most suited for conservative or low risk-takers are treasury bills, corporate bonds, sovereign bonds, debt-based mutual funds, etc.

► Moderately Conservative -Willing to take small level of risk for potential returns over medium to long term

► Moderate -Moderate risk-takers usually strive to strike a balance between returns and risk. These types of individuals will go for high returns scaled to an agreeable level of risk. Therefore, a moderate risk-taker's portfolio will constitute a moderate share of equities with debt instruments for adequate risk dilution. Such risk-takers can also singularly invest in equity-based mutual funds

► Moderately Aggressive -Seeking to maximise returns over medium to long term with high risk

► Aggressive -This risk-profile exhibits the most willingness for withstanding market volatilities in the expectation of earning exponential returns. Usually, these investors are seasoned and well conversant in the ways of stock markets. Apart from that, such investors also have a long-term investment horizon. These investors predominantly go for equities and usually have a healthy asset-liability balance.

► Usually, financial advisors and robot-advisors create the risk profile of investors by means of questionnaires. These questionnaires aim to fit the subjective risk-appetite of an individual in numeric terms or any objective field.

► Asset allocation - Asset allocation refers to an investment strategy in which individuals divide their investment portfolios between different diverse asset classes to minimize investment risks.

► Factors Affecting Asset Allocation Decision

Goal factors -Goal factors are individual aspirations to achieve a given level of return or saving for a particular reason or desire. Therefore, different goals affect how a person invests and risks.

► 2. Risk tolerance - Risk tolerance refers to how much an individual is willing and able to lose a given amount of their original investment in anticipation of getting a higher return in the future. For example, risk-averse investors withhold their portfolio in favour of more secure assets. In contrast, more aggressive investors risk most of their investments in anticipation of higher returns.

► 3. Time horizon - The time horizon factor depends on the duration an investor is going to invest. Most of the time, it depends on the goal of the investment. Similarly, different time horizons entail different risk tolerance. For example, a long-term investment strategy may prompt an investor to invest in a more volatile or higher risk portfolio since the dynamics of the economy are uncertain and may change in favour of the investor. However, investors with short-term goals may not invest in riskier portfolios.

► Strategies of asset allocation

1. Age-based Asset Allocation - In age-based asset allocation, the investment decision is based on the age of the investors. Investors to make the stock investment decision based on a deduction of their age from a base value of a 100. The figure depends on the life expectancy of the investor. The higher the life expectancy, the higher the portion of investments committed to riskier arenas, such as the stock market. Example Parthiv is now at 50 years and he is looking forward to retiring at 60. According to the age-based investment approach, his advisor may advise him to invest in stocks in a proportion of 50%, then the rest in other assets. This is because when you subtract his age (50) from a hundred-base value, you'll get 50.

2. Life-cycle funds Asset Allocation - In life-cycle funds allocation or targeted-date, investors maximize their return on investment (ROI) based on factors such as their investment goals, their risk tolerance, and their age. This kind of portfolio structure is complex due to standardization issues. Example: Let's say Parthiv's original investment mix is 50/50. After a time, horizon of five years, his risk tolerance against stock may increase to 15%. As a result, he may sell his 15% of bonds and re-invest the portion in stocks. His new mix will be 65/35. This ratio may continue to change over time based on the three factors: investment goals, risk tolerance, and age.

► Constant-Weight Asset Allocation The constant-weight asset allocation strategy is based on the buy-and-hold policy. That is, if a stock loses value, investors buy more of it. However, if it increases in price, they sell a bigger proportion. The goal is to ensure the proportions never deviate by more than 5% of the original mix.

▶ **Tactical Asset Allocation** The tactical asset allocation strategy addresses the challenges that result from strategic asset allocation relating to the long-run investment policies. Therefore, tactical asset allocation aims at maximizing short-term investment strategies. As a result, it adds more flexibility in coping with the market dynamics so that the investors invest in higher returning assets.

▶ **Insured Asset Allocation** For investors averse to risk, the insured asset allocation is the ideal strategy to adopt. It involves setting a base asset value from which the portfolio should not drop. If it drops, the investor takes the necessary action to avert the risk. Otherwise, as far as they can get a value slightly higher than the base asset value, they can comfortably buy, hold, or even sell.

▶ **Dynamic Asset Allocation** The dynamic asset allocation is the most popular type of investment strategy. It enables investors to adjust their investment proportion based on the highs and lows of the market and the gains and losses in the economy.

▶ **Contingency planning - Financial contingency planning** is the art of planning for broader risk management. This means preparing ahead of time for a potential negative event such as an economic recession, natural disaster, fraudulent activity or a terrorist attack.

▶ Common ways of dealing with contingencies include purchasing insurance policies that will pay out if a particular set of contingencies strike – for example, protecting your earnings if you get sick. Other methods include hedging strategies or asset diversification, apart from setting aside significant reserves of cash

▶ The purpose of contingency planning is to ensure continuity of business operations or financial stability. It can help individuals, families and businesses recover from disaster and can ensure that damage or injury to personnel and property is effectively contained.

▶ The main goal of a contingency plan is to restore normal operations at a minimal cost and with the least amount of disruption to normal business activities or lifestyle after an unexpected event has occurred.

▶ **Eligible investors:** KYC compliant, individuals, corporates, NRIs

▶ **KYC or Know Your Customer** is a customer identification process. SEBI has laid down guidelines under the Prevention of Money Laundering Act 2002, which makes it binding for financial institutions and financial intermediaries like mutual funds to acquaint themselves with their customers.

▶ **KYC process** helps prevent money laundering and other suspicious transactions. With effect from January 1, 2012 all categories of investors irrespective of number of investments Mutual Funds are required to comply with KYC for carrying out any transactions in Mutual Funds. Thus, all applicants investing into mutual funds would be required to be KYC compliant by any KYC Registration Agency (CAMS, KARVY, CVL, NSE or NSDL) without which the transactions may be liable to be rejected by the respective mutual fund houses.

▶ **FATCA:** The FATCA agreement enhances tax transparency and accountability in matters of financial reporting and payment of taxes which are legitimately due to various governments.

▶ The basic purpose of FATCA is to prevent US persons from using banks and other financial institutions outside the USA to park their wealth outside US to avoid US taxation on income generated from such wealth. Alike FATCA, Indian Government has further committed to implement a Common Reporting Standard (CRS) as part of

reciprocal exchange of information on financial accounts on an automatic basis with other countries.

▶ KYC records are maintained by Sebi-registered entities known as KYC registration agencies (KRA). It is important to keep the information like address, mobile number and bank details in KYC records updated. In case of video KYC, the investor needs to upload scanned images of proof of identity, address and signature along with a photograph. In case of a physical KYC, a KYC form needs to be filled up and submitted along with address and identity proof. In case of key, the maximum amount that can be invested per annum per mutual fund is restricted to Rs 50,000.

▶ Institutions need to give the registration documents, current proof of business, KYC of directors,

▶ Micro SIP - Many investors are keen to start SIPs of small amounts for their household helps, drivers or other small investors. However, these investors may not have a PAN card or other documentation required for mutual fund investments. Also, NRIs do not have PAN card. In order to facilitate such small-ticket investments, Sebi has withdrawn the requirement of PAN for SIPs that do not exceed Rs. 50,000 in a financial year.

▶ A copy of a photo identification document, such as the Aadhar card, voter ID or driving licence, issued by the government, needs to be submitted and verified with the originals. The documents provided as identity proof have to be current and valid, self-attested by the investor and also attested by an ARN holder registered with Amfi as a mutual fund distributor.

▶ Micro SIPs can be opened by individuals, NRIs (not PIOs), minors and sole proprietorships. It is to be noted that : 1 If the micro-SIP documents are found to be defective or incomplete, the investor will receive a deficiency memo and the application will be cancelled. 2 If the fund deposits the cheque of a defective application, the investment will be redeemed at the applicable NAV. No fresh investments will be accepted.

▶ Long bond funds : Bonds with a long maturity period e.g., 30 years

▶ Sort bond funds : short-term bonds fall on the safer end of the debt securities risk spectrum due to their short duration and subsequent near-cash status. A shorter duration or maturity date leads to less credit risk and less interest rate risk.

▶ Ultra Short Duration Fund : These mutual funds select bonds/debt for investment such that average maturity (remaining) period for portfolio is between 3 to 6 months (Macaulay duration). Shorter duration funds may provide lower returns but are lesser risky to interest rate changes.

▶ They are suitable for : Investors who want to invest for very short term and are looking for alternative to bank accounts/deposits.

▶ Difference between distributor and advisor

▶ A person or group that facilitates the purchase and sale of mutual funds, and earns a commission for the sale of each scheme, is called a mutual funds distributor.

▶ Unlike mutual fund distributors, the services provided by investment consultants extend to other finance and investment advice. Investment advisors can be individuals or groups who evaluate your assets, income, expenses and liabilities and help you plan your investments accordingly for a fee

► Advisors must explain to investors the benefits of mutual funds, their different types, and risks.

► A mutual funds plan bought directly from a distributor is called direct plan, whereas a regular plan is bought through a broker, advisor or other intermediaries

► Mutual funds distributors are regulated by the Association of Mutual Funds in India (AMFI) and investment advisors under the Securities and Exchange Board of India (SEBI).

► Recent SEBI guidelines on the following :

1. Distributors may often indulge in "mis-selling" of mutual fund products. This refers to the sale of a mutual fund scheme that is not suitable to an investor simply for earning a commission. In order to check this malpractice, asset management companies (AMCs) have been instructed by SEBI to pay only trailing commissions to distributors.

2. Traditionally, a trailing commission is a fee paid to advisors each year that you have an investment in your possession. In doing so, SEBI aims to increase the number of registered investment advisors (who earn fees for their services) in comparison to distributors (who make commissions).

3. Meanwhile, in order to clear any confusion regarding the roles of advisors and distributors, SEBI has also asked distributors to refrain from identifying themselves as "wealth advisors" or "independent financial advisors" unless they are registered investment advisors. Mutual fund distributors are likely to discuss the provisions of their products with you with the intention of selling them. Investment advisors, on the other hand, will discuss your income, expenses, long- and short-term goals, tax obligations and income to tailor your investment plan in an unbiased manner.

► As far as the risk factor is concerned, investment advisors will discuss your capacity for it and scrutinize your mutual fund scheme performance over the years. Meanwhile, mutual fund distributors will primarily be concerned with meeting their own financial needs. Need for financial advisor

1. perfect knowledge of investing
2. help investors in allocating funds
3. disseminate knowledge in a professional manner and analyse the financial information
4. wealth creation and preservation
5. financial advisor understands your investment needs and they give us proper knowledge about financial plan as per our income
6. counselling investors uninformed about investment vehicles
7. help implement financial strategies
8. monitor investments made and advise proper timely correction
9. advise better returns even in subdued markets or falling markets
10. investors being made aware of financial policies, financial world and jargons
11. help with tax savings
- 12 adjust goals with reality, SHOW RISKS INVOLVED in investments
14. affordability of advice
15. Rebalancing your investments

► Colour coding ► Investment decisions are typically based on the investor's risk appetite. Hence SEBI has introduced a standard labelling system of giving colour codes to mutual fund products. These colour codes will depict the level of risk that the MF scheme is likely to have and to be depicted promptly in adv.'s

► **Blue:** The blue colour coded box will be used to indicate low risk. Instruments such as fixed maturity plans, gilt funds and income funds will carry a blue colour code as these are the safest MF instruments. These instruments are ideal for anyone looking for a fixed and safe source of income.

► **Yellow:** The yellow colour coded box will indicate medium risk. All hybrid products such as monthly income plans (MIPs), balanced funds and unit-linked insurance plans which typically invest in both equity and debt products will be given a yellow colour. These instruments are ideal for those who seek diversification between debt and equity; a reduction in risk without a substantial reduction in the returns.

► **Brown:** The brown colour coded box indicates that one's money is being put into a high-risk instrument. All equity funds such as diversified funds, sectoral funds, index funds, large-cap funds and small-cap funds will carry a brown colour code as these have a significant risk component and are prone to market fluctuations. Any person who wishes to benefit from potentially higher returns and has the risk appetite for the same can invest in such instruments. On the other hand, the brown colour serves as a warning to anyone who is risk averse. Bank FD and MFs ► Liquidity ► Safety ► Returns ► Benchmarks ► Floating / Fixed ► Volatility ► Time period ► Taxation ►

Intermediaries ► Regulators ► Charges/ fees Dividend vs Growth option Differences Dividend Option Growth Option Profits booked by fund manager Distributed to investors Re-invested in the scheme Net Asset Value (NAV) Dividends paid are deducted from the NAV. So ex-dividend NAV is lower NAV will be higher because profits re-invested may earn profits (compounding) Total Returns Total returns will be lower compared to growth option in the long term due to periodic pay-outs Total returns will usually be higher compared to dividend option over sufficiently long investment horizon Taxation Taxed as per the income tax slab rate of the investor Short term and long term capital gains tax applies depending on when you redeem Who should invest If you need regular cash-flows from your investment then you can invest in dividend option If you do not need regular cash-flows, invest in growth option since your total returns may be higher

► In case of a dividend option, profits made by the scheme are not reinvested in the scheme. Instead, gains will be distributed among the investors by way of dividends; on a quarterly, half-yearly or annual basis.

► Suppose you invest Rs 10 in an equity MF. The NAV of the fund increases to Rs 15 and the fund manager declares a dividend of Rs 2. After the payment of dividend, the NAV of the fund falls to Rs 13

. ► A growth option is like a cumulative option. The profits made by the scheme are not paid by way of dividend. Instead, these get accumulated and form part of the scheme via reinvestment. ► whenever the scheme makes a profit, its NAV rises automatically. Conversely, when the scheme suffers a loss, the NAV falls. The only way to get back profits is to sell units of the scheme. Suppose you buy 100 units of an equity fund at a NAV of Rs 40. Under the growth option, the NAV of the scheme rises to Rs 50 in one year. You sell the units and receive a sum of Rs 5,000. Hence, your profits from the investment are Rs 1,000 (Rs 5,000-Rs 4,000).

► Dividend option works best when markets are at all-time high. As the NAV of the fund rises consistently, the likelihood of fund declaring dividends is higher. Moreover, if investors are dependent on your investments for a regular income, the dividend option

might work for them. ► Growth option can be suitable for investors having a long-term investment horizon. It will help them in accumulating corpus for retirement

. ► Taxation : There is no incidence of taxation in growth option unless you redeem. In equity funds, short term capital gains (held for less than 12 months) are taxed at 15% and long-term capital gains (held for more than 12 months) of up to Rs 1 lakh are tax exempt and thereafter, taxed at 10%. In debt funds, short term capital gains (held for less than 36 months) are taxed as per the income tax slab of the investor and the long-term capital gains (held for more than 36 months) are taxed at 20% after allowing indexation benefits.

► It is possible to switch from dividend option to growth option or vice-versa. It would entail sale of old units and purchase of new units. Model Portfolio

► In the myriad way of finance, investors want to invest in mutual funds but don't know which schemes to buy They may have already invested in mutual funds but not sure if they are appropriate. They may hold a large number of schemes and want to cut them down to a manageable number, but confused about which one to choose. In short sometimes although having a plan, investors seem lost as they are unable to review properly.

► We may design five model fund portfolios for investors of different risk profiles and financial situations. cover almost the entire spectrum of the investing population, ranging from aggressive investors who are willing to live with volatility to conservative investors who want reasonable growth with minimal risk.

► Investments through SIP is a good way of starting small and building up over a number of years. While this is easy to convince investors, keeping them invested is the challenge. Patience is the key.

► I. Wealth Maximiser: For the young and the restless

► Wealth Maximiser portfolio is for aggressive investors who don't mind taking risks. This portfolio has been designed for investors who want high returns even if it means taking high risks. It has two mid-cap funds, one small-cap fund and one multi-cap fund. A large cap fund may be included to diversify the equity risks.

► Volatility is inherent to stocks. It is here that the SIP approach proves beneficial for investors. Even if the market corrects and the funds slip, the investor stands to benefit because he can get more units with the same SIP sum. Still, only investors who have the stomach for volatility should go for this portfolio. They should also be prepared to remain invested for at least 5-7 years to earn good returns from this portfolio.

► Investments through SIP is a good way of starting small and building up over a number of years. While this is easy to convince investors, keeping them invested is the challenge. Patience is the key. ► Here , one may consider the ELSS funds to get tax advantage. The investments qualify for a deduction from gross income earned annually.

► Although equity is a volatile and riskier asset class, however risk may be diversified through investment in different type of funds, check for consistency of returns, rating provided by CRISIL, etc, and also compare the returns against benchmark of indices for last 3 to 5 years.

► Suggested exposure : large cap 44 % , midcap 36 % , small cap 17 % , debt 3 %

► II. Wealth Builder: Cautiously optimistic on markets Wealth Builder suits those who want to invest in stable large-cap stocks. Small- and mid-cap funds might have zoomed, but even large-cap funds have not done badly. The large-cap category rose 26% in the past one year, though the returns have not been very high in the past 3-5 years. Even so,

this portfolio of large-cap equity funds has the potential to churn out decent returns for the long-term investor.

► We may choose funds that score high on consistency and the risk-reward matrix. The ELSS scheme in the portfolio could also chip in here.

► Suggested exposure : large cap 74 %, midcap 21 %, small cap 2 %, debt 3%

► III. Stable Wealth: Get the best of both worlds Stable Wealth is for investors who want a balanced mix of debt and equity. Even though they might be optimistic, not everyone is willing to bet big on the stock markets. The Stable Wealth portfolio is designed to give investors reasonable growth without too much risk. Balanced funds divide their corpus between debt and equity, giving investors the best of both worlds. The equity portion generates returns when markets are doing well, and the debt portion acts as a cushion when equities are headed southwards.

► Balanced funds divide their corpus between debt and equity, giving investors the best of both worlds. The equity portion generates returns when markets are doing well, and the debt portion acts as a cushion when equities are headed southwards.

► Suggested portfolio : large cap 36 %, midcap 20%, small cap 4%, debt 40%

► IV. Wealth Secure: When safety is paramount Wealth Secure is designed for investors who don't want to risk their money in stocks. Some investors just can't stand the prospect of losing money. For them, the Wealth Secure can be an ideal option. The equity exposure is only 24% of the corpus, while the rest is in the safety of debt. Though debt funds are not as volatile as equity schemes, it is a misconception that they can't lose money. Debt funds are sensitive to interest rate movements and will lose money if interest rates go up. Short term debt funds should be included rather than long term debt funds, to reduce volatility.

► V. Income Generator: Regular income in the golden years Income Generator is for retirees looking for a monthly income from their investments. Unlike the SIP inflows in other portfolios, income generator starts with a lumpsum investment and withdraws monthly sum for the investor. Bank deposits are the main competitors. However, these funds score more than bank deposits as the latter is having a downward trend whereas are giving consistent returns.

► But the real benefit comes from the tax advantage that debt funds have over fixed deposits. The income from bank deposits is fully taxable. In debt funds, the gain is only a thin sliver of the redemption proceeds. A big part of the redemption is the principal amount which is not taxable. It keeps getting better as years go by. Income Generator Meant for investors who are looking for regular income in retirement. Step by step model portfolio build-up

- a. Enable your investor identify his investment needs and goals.
- b. Understand the various financial products – their risk, return, liquidity and maturity profile.
- c. Combine the features of financial products with the investors' financial needs and determine appropriate mix of investments, technically referred to as asset allocation.
- d. Suggest suitable mutual fund schemes within the asset choices.

► Step 1 Define financial needs and goals: Setting clear objectives is fundamental to all successful investment programmes. The starting point in financial advising is to determine the financial needs of your clients. All investment needs can be translated into short-term (less than one year), medium term (one year to about 5 year) and long-term

(five year and above). E.g., A client just obtaining Rs 10 lakhs from VRS may have a certain need arising in next 3 months. Accordingly, his suggested investment are short term investments. Now if the same person wants to have his investment maturing after a long time say 5 years, he will be suggested long term or equity investments sometimes the clients are not sure off their requirement end ends up either keeping the money in low yielding bank deposits or locking in for a long period. In this case we should break up the amount and keep partially into liquid funds and partially into open ended equity mutual funds.

► If the person is retiring and requires a steady flow of income it is better to suggest an annuity scheme in this way, he will be meeting his goals

► Different investors have quite different and legitimate perceptions and concerns about risk, depend on among other things their time horizon goals, financial situations, other investments in their portfolio and basic attitude.

► In the case of an investor concerned about potential short-term loss, money market funds may rightly be characterized as low risk and aggressive growth stocks as just the opposite.

► Conversely, for an investor defining risk as the potential long-term loss of purchasing power (inflation) aggressive growth stocks could be considered low risk and money market funds as high risk. Short-term fluctuations are not relevant for long-term investors who have the discipline, patience and understanding to deal with them.

Step 2 Understanding the available investment products: At the most aggregate level all the investment product can be classified into debt and equity. They are termed as the basic asset classes. The key to investment success is to understand how these asset classes perform over various investment time horizons and make choices within each category. We have to understand that at the point of making an investment decision what are the debt instruments available and what returns they will be giving within their residual maturity, also we need to find out which equities are more consistent with lesser volatile returns compared to similar asset class.

► Insurance products are also available. They serve not only as a medium of investment but also as a medium of contingency planning for a longer period of time.

► To be successful in Step 2 an investment manager needs to be very updated about the investment products available and that are getting introduced and also the returns on those investment products any regulatory restrictions and likewise.

Step 3 Asset allocations: ► The asset allocation may be done depending upon various factors like age, profession, liquidity needs, dependents, risk profile, time horizon, amount available for investment and the financial goals. The liabilities (existing and expected) should also be taken into account so that there should not be any cash flow mismatches. ► It is generally believed that younger you are the more your portfolio should be allocated to equity stocks. Time allows market cycles to complete the cycle and leaves room to absorb the volatility. So over time there is substantial wealth accumulation. Also, lower income in the early years makes it more imperative to save more. ► Equity investing is also important for many older individuals. People today are living longer than ever before, and they need some protection to guard against inflation. ► A well-managed stock portfolio can provide a dependable long-term inflation hedge. Income oriented stock funds often work well for retired people, especially when combined with some cash holding.

Step 4 Suggesting Suitable Investment Opportunities with each Asset Category: ► Many of the investors do not have the time, the inclination or the expertise to make or manage investments in complex equity or debt market directly. For each asset class, suitable mutual fund scheme can be recommended. Too many stocks are to be avoided. Building wealth takes understanding, time and patience. The key to investment success is earning a good return over sufficiently long period. Time is extremely powerful in investment world. Wealth builds up steadily, bit by bit.

► **Step 5 : Reviewing** ► No decision is perfect . Hence all the decisions regarding asset allocations needs to be reviewed over periods of time to track if any deviations from expected returns are taking place. This will help adjust the investment being made and adjust for course corrections over periods of time. This will make the financial planning more realistic. The relationship with the clients become long lasting and returns will match expectations . ► While selecting a mutual fund scheme for clients' portfolio, the following guide lines can be used to make certain that we are providing for high levels of safety, diversification and performance in the funds:

- a. Invest in funds that are in operation for quite some time.
- b. Choose funds with lower expense ratio in the same performance category.
- c. Check the funds track record. Pick funds, which have better than average track record over a period of years.
- d. Buy funds, which are large enough in size to offset sudden sell-offs.
- e. Explain the downside risks associated with the investments suggested and other options available.