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B.Com Honours

Semester I

Calicut University

Stock Market Fundamentals

Course Code: COM1FM105 (2) • Module 4 Notes

1. Mutual Fund Investments: Structure and Classification

For retail investors who lack the time or expertise to analyze individual stocks, mutual funds offer a convenient alternative. A mutual fund is a trust that pools savings from thousands of investors and invests those funds in a diversified portfolio of securities (shares, bonds) managed by professional fund managers. This final module covers the organizational structure of mutual funds, types of funds, Systematic Investment Plans (SIPs), and reading fund fact sheets.

Organizational Structure of a Mutual Fund

Under SEBI regulations, a mutual fund operates via a four-tier structure to prevent conflict of interest:

1. **Sponsor:** The promoter who establishes the mutual fund trust (similar to a corporate promoter).
2. **Trustees:** Independent directors who hold the property in trust and ensure the AMC complies with SEBI regulations to protect investor interests.
3. **Asset Management Company (AMC):** The professional company (e.g., HDFC AMC, SBI Mutual Fund) that manages the pooled money, selects stocks, and charges a management fee.
4. **Custodian:** An independent body that holds the physical/digital securities purchased by the AMC, preventing fraud.

Classification of Mutual Funds

Mutual funds are classified on several operational dimensions:

Structure: Open vs. Closed

- **Open-Ended:** Investors can buy or redeem units directly from the fund house at any time at the current Net Asset Value (NAV). Has no fixed maturity.
- **Close-Ended:** Units are issued only during the initial offer (NFO) and have a fixed maturity (typically 3-5 years). Units are traded on stock exchanges for liquidity.

Asset Class & Management

- **Equity Funds:** Invest primarily in shares (high risk, high return).
- **Debt Funds:** Invest in government bonds, corporate debentures (low risk, steady returns).
- **Index / Passive Funds:** Replicate a stock index (like Nifty 50), offering low management fees.
- **Active Management:** Fund managers actively pick stocks to beat the market benchmark.

2. SIPs, NAV, and Reading Mutual Fund Sheets

Understanding mutual fund operations requires familiarity with transaction metrics and investment styles.

Key Mutual Fund Terminology

- **New Fund Offer (NFO):** The launch of a new mutual fund scheme by an AMC, similar to an IPO for stocks.
- **Net Asset Value (NAV):** The market value of a single unit of a mutual fund scheme. Calculated daily at the close of market hours:
$$[\text{NAV}] = \frac{\text{Total Assets} - \text{Total Liabilities}}{\text{Total Outstanding Units}}$$
- **Direct vs. Regular Plans:** A **Direct Plan** has no distributor/agent involvement, resulting in a lower expense ratio and higher returns. A **Regular Plan** involves an agent commission, which is deducted from the NAV.

Systematic Investment Plan (SIP) vs. Lumpsum

A **Lumpsum** involves investing a large sum of money at once. A **SIP** allows investors to invest a fixed amount of money at regular intervals (monthly/quarterly) automatically.

Benefits of SIP:

- **Rupee Cost Averaging:** Investors buy more units when prices (NAV) are low, and fewer units when NAV is high, smoothing out market volatility.
- **Power of Compounding:** Reinvesting earnings over long periods yields exponential wealth growth.

Reading a Fund Fact Sheet

Before investing, SEBI mandates reviewing the **Fund Fact Sheet**, a monthly document detailing:

- **AUM (Assets Under Management):** The total size of the fund.
- **Expense Ratio:** The annual fee charged by the AMC to manage the fund. Lower is better.
- **Risk-o-meter:** A visual gauge showing the risk level (Low, Moderate, High, Very High).
- **Portfolio Disclosure:** A detailed list of companies the fund has invested in.

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