

MUTUAL FUND DISTRIBUTOR TRAINING

Omnicompounding Enterprises Private Limited



1. INVESTMENT LANDSCAPE



- **Why investments?**
- **Financial goals**
- **Short term needs vs long term goals**
- **Financial goals, time horizon for their achievement and Inflation**
- **Savings or investments**

Factors to evaluate investments

- **Safety**
- **Liquidity**
- **Return**
- **Convenience**
- **Ticket size**
- **Taxability of income**

Different Asset Classes

Investment avenues classified under different asset categories	
Equity	Fixed Income
<ul style="list-style-type: none"> - Bluechip Companies - Mid-sized companies - Small-sized companies - Unlisted Companies - Foreign Stocks - Equity Mutual Funds - Exchange Traded Funds - Index Funds 	<ul style="list-style-type: none"> - Fixed deposit with a bank - Recurring deposit with a bank - Endowment Policies - Money back Policies - Public Provident Fund - Sukanya Samriddhi Yojana (SSY) - Senior Citizens' Savings Scheme (SCSS) - Post office Monthly Income Scheme - Recurring deposit with a post office - Company fixed deposit - Debentures/bonds - Debt Mutual Funds
Real Estate/Infrastructure	Commodities
Physical Asset Residential/ Commercial Financial Asset Real Estate Mutual Funds (REMF) Real Estate Investment Trusts (REIT) Infrastructure Investment Trust (InvIT)	<ul style="list-style-type: none"> - Gold - Silver - Gold Funds - Commodity ETFs
Hybrid asset classes	Others
Hybrid Mutual funds or Multi Asset Fund	<ul style="list-style-type: none"> - Rare coins - Art

Investment risks

- **Inflation risk**
- **Liquidity risk**
- **Credit risk**
- **Market risk and price risk**
- **Interest rate risk**

Risk Measures and Management Strategies

- **Avoid**
- **Take a position to benefit from an event**
- **Diversify**

Behavioral biases in investment decision-making

- **Availability heuristic**
- **Confirmation bias**
- **Familiarity bias**
- **Herd mentality**
- **Loss aversion**
- **over confidence**

- **Recency bias (more people invest in bull market)**
- **Behavior patterns - savers / investors**
- **Interest of investors**
- **Ethical standard and boundaries - more disciplined**
- **Risk profiling - need to take risk / ability to take risk / willingness to take risk**

Understanding Asset allocation

- **Strategic asset allocation - aligned to financial goals / percentage target of various asset categories**
- **Tactical asset allocation - dynamically change based on opportunities**
- **Rebalancing - based on the returns generated rebalancing can be done**

2. Concept and role of a mutual fund



- **Concept of a Mutual fund – in the form of a trust**
- **Role of Mutual funds – mobilize money from investors to different securities**
- **Investment objectives of Mutual funds – meet investor’s needs like safety, liquidity and returns**
- **Investment policy of Mutual funds – based on asset allocation and investment style**

- **Important concepts in Mutual fund**

Units - investments in a scheme translated into units

Face value – Generally face value Rs. 10/-

Unit capital - number of units issued by scheme

multiplied by face value

Recurring expenses – commissions and other charges

Net asset value – net realizable value per unit

Asset under management - number of units

outstanding multiplied by current NAV

Mark to market - done on daily basis, results in

daily NAV fluctuations

- **Advantages of Mutual funds for Investors**

Professional management

Affordable portfolio diversification - even with small investment can get the benefit of diversification

Economies of scale

Transparency - investors can make informed decision using the documents -SID, SAI and KIM

Liquidity

Tax deferral - Mutual funds are not liable to pay tax on income they earn. By staying invested for long, investor can defer tax liability

Tax benefits

Regulatory comfort

Systematic approach to investments - SIP, SWP, STP

- **Limitations of Mutual fund**

- Lack of portfolio customization**

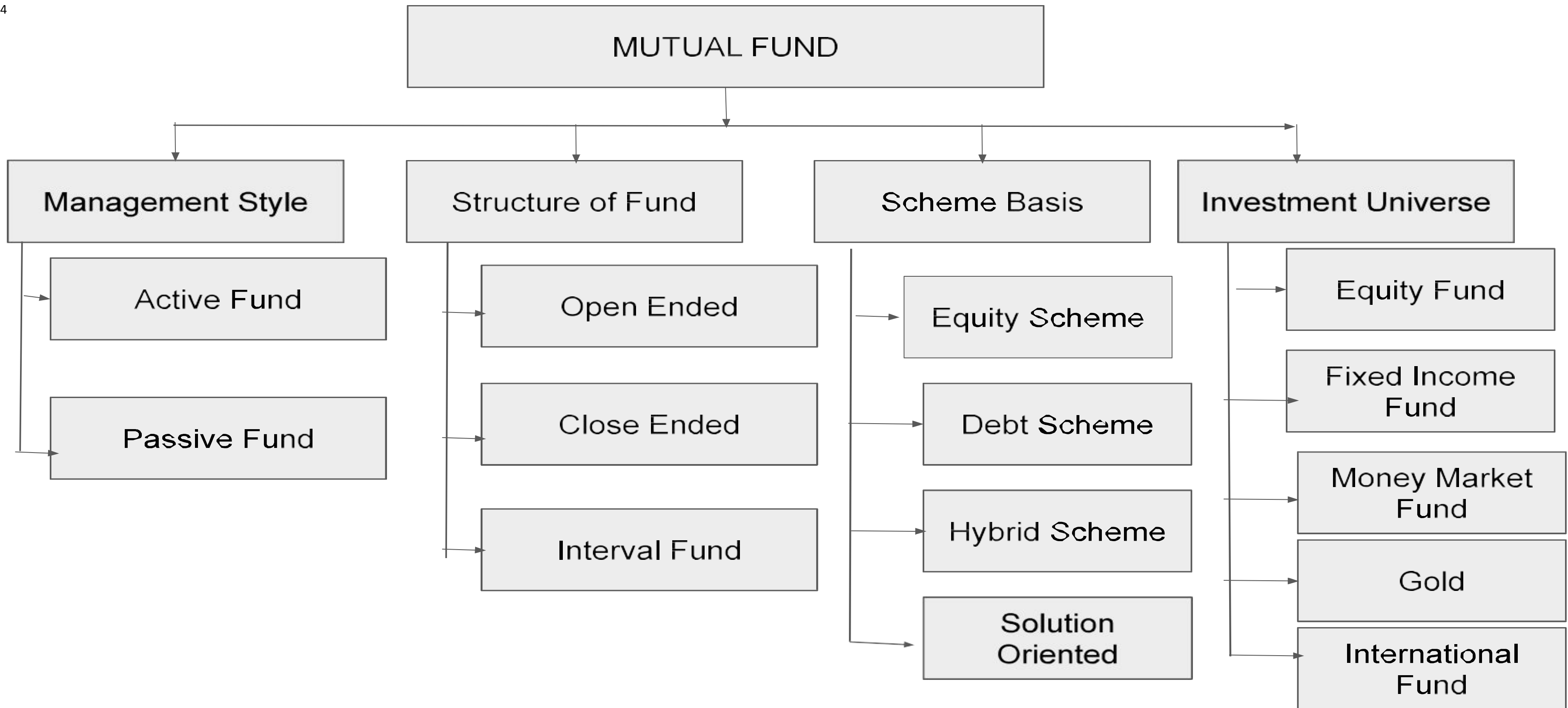
- Choice overload - so many schemes to choose from -**

- SEBI introduced categorization**

- No control over costs - SEBI has imposed**

- certain limits on schemes**

- No guaranteed returns**



- **Classification of Mutual funds**

Close-ended funds - units can be bought during NFO only

To provide liquidity fund lists the units on a stock exchange. Which is compulsory. It's Unit capital does not change

Mutual fund scheme categorization and SEBI regulation

Equity schemes (11 sub-categories)

- **Multi-cap fund - minimum of 75% of total assets in equity (min 25% in Large, min 25% in Midcap, min 25% in Small cap)**
- **Large cap fund - min. 80% in Large cap companies**
- **Large and Mid-cap fund - min. 35% in Large cap**

- **Mid-cap fund - min. 65% in Mid-cap**
- **Small cap fund - min. 65% in Small cap**
- **Dividend Yield Fund - min. 65% in equity. investing in dividend yielding stocks**
- **Value fund or Contra fund - min. 65% in equity & equity related instruments**
- **Focused fund - max. 30 stocks. min. 65% in equity & equity related instruments of total assets**

- **Sectoral / Thematic - min. 80% in equity & equity related instruments of a particular sector / theme**
- **Equity linked savings scheme - lock-in of 3 years and tax benefit. min. 80% in equity & equity related instruments**
- **Flexi-cap fund - min. 65% in equity and equity related investment across large, mid and small cap stocks**

Debt schemes (16 sub-categories)

- **Overnight fund**
- **Liquid fund - debt and money market instruments maturity up to 91 days**
- **Ultrashort duration fund - debt and money market instruments maturity 3 to 6 months**
- **Low duration fund - debt and money market instruments with duration 6 to 12 months**

- **Money market fund - money market instruments maturity up to 1 year**
- **Short duration fund - debt and money market instruments with 1 to 3 years duration**
- **Medium duration fund - debt and money market instruments with 3 to 4 years**
- **Medium to long duration fund - debt and money market instruments with 4 to 7 years duration**

- **Long duration fund - debt and money market instruments with greater than 7 years duration**
- **Dynamic bond - across duration**
- **Corporate bond fund - predominantly investing in AA+ above. min. 80% in such bonds**
- **Credit risk fund - investing in below highest rated corporate bonds. min. 65% in AA and below rated corporate bonds**

- **Banking and PSU fund - investing in debt instruments of banks, PSU, public financial institutions and Municipal bonds. min. 80% in such instruments**
- **Gilt fund - investing in govt. securities across maturity. min. 80% in G-secs**
- **Gilt fund with 10 year constant duration - investing in govt. securities having constant maturity of 10 years. min. 80% in G-secs with duration equal to 10 years**
- **Floater fund - investing in floating rate instruments. min. 65% in floating rate instruments**

Hybrid schemes (6 sub-categories)

- **Conservative hybrid fund - 75-90% in debt instruments and 10-25% in equity**
- **Balanced or aggressive hybrid fund - balanced hybrid - 40-60% in equity and 40-60% in debt**
Aggressive hybrid - 65-80% in equity and 20-35% in debt

- **Dynamic asset allocation or balanced advantage - investment in equity/debt managed dynamically**
- **Multi asset allocation - investment in at least 3 asset classes with min. 10% in all three**
- **Arbitrage fund - min. 65% in equity and equity related instruments investing in arbitrage opportunities**
- **Equity savings - investment in equity, arbitrage and**

Solution oriented schemes (2 sub-categories)

- **Retirement fund - lock-in of 5 years or till retirement age (whichever earlier)**
- **Children fund - lock-in of 5 years or till child attains majority (whichever earlier)**

Other schemes (2 sub-categories)

- **Index funds/ETF - min. 95% in a particular index**
- **Fund of funds (overseas/domestic) - investing in underlying fund. min. 95% in underlying fund**

Fixed maturity plans

- **Close-ended debt fund - duration of investment portfolio aligned to maturity of scheme**

Target maturity date funds

- **Debt fund maturing in 2 to 10 years - for stable and long term investments**

Capital protection oriented fund

- **Close-end hybrid fund - exposure taken in equity through equity derivatives. Portion of fund invested in debt instruments**

Infrastructure debt funds

- **Sponsored by commercial banks and NBFCs. institutional investors like insurance and pension funds invest. close ended mutual fund invests in min. 90% in debt securities of infrastructure companies or spvs**

Real estate mutual fund

- **Invests in min 35% held in physical assets. not less than 75% in real estate assets, equity shares or debentures of real estate development projects**
- **Value of funds assessed every 90 days by 2 valuers accredited by credit rating agency. lower of 2 taken to calculate NAV. REIT and InvLTS are not mutual funds.**

**Environmental, social and
governance investing**

New types of funds

- **Smart beta fund - extension of index of ETFs - equal weightage of index not market cap**
- **Quant funds - rely on data analysis and numbers undertaken by machines**
- **International REITs**

Specialized investment fund

- **Equity oriented investment strategies**

Equity long-short fund - min. 80% in equity and equity related instruments. max. short exposure of unhedged in equity is 25%

- **Equity ex-top 100 long short fund**
 - min. 65% invested in equity and equity related stocks excluding top 100 by market cap. short exposure of unhedged in equity is 25%**
- **Sector rotation long-short fund**
 - min. 80% in equity and equity related in maximum 4 sectors. max short exposure of unhedged is 25%. if fund decided to go short on a sector, all stocks of the sector must be held as short positions**

- **Debt oriented investment strategies**

Debt long-short fund - interval fund investing in debt instruments across duration, including unhedged short exposure through exchange-traded debt derivative instruments

Sectoral debt long-short fund - interval fund investing in debt instruments including short positions in debt instruments of min. 2 sectors. must invest in at least 2 sector debt instruments with max exposure restricted to 75%. max short exposure unhedged is 25%

- **Hybrid investment strategies**

Active asset allocator long-short fund - interval scheme with strategy to dynamically invest across equity, debt, equity derivatives, debt derivative, commodity derivative, REITs and Invlts. max short positions in equity derivative and debt derivatives restricted to 25%

Hybrid long-short fund - interval scheme with strategy to invest in equity, debt, equity derivatives and debt derivatives. min. 25% each in equity, debt. maximum short exposure of



3. Legal structure of mutual funds in India



- **Mutual fund established in the form of a trust - Asset management company to run the business**
- **Key constituents of a Mutual fund - Mutual fund application to SEBI made by sponsors - more than 5 years experience in financial services and net worth is positive in all preceding 5 years and at least 10 crore -**

**Take approval of SEBI to appoint a person as Trustee.
sponsor has to appoint at least 4 trustees. If a trustee
company it would need 4 directors on board
Trustee responsible to protect interest of investors
On quarterly basis review transactions of mutual
fund with AMC and its associates
Periodically review investor complaints
File half-yearly reports to SEBI**

Custodian is appointed by trustee

Custodian has custody of the assets of the fund

Responsible for delivery of securities for purchase

and sale transactions of various schemes of the fund

Trustee enter into an investment management

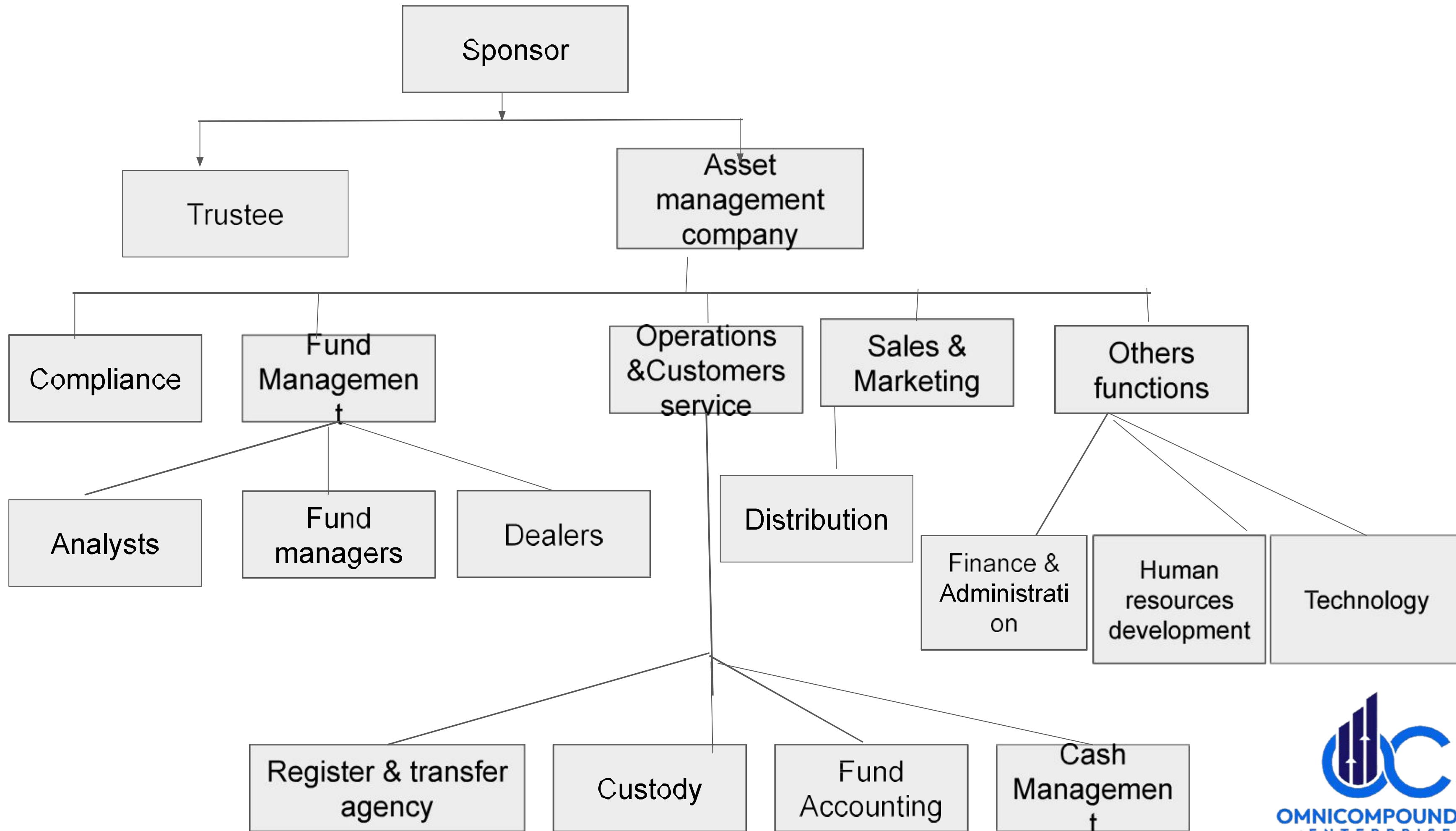
agreement with AMC to handle day to day operations

AMC need to have net worth of more than 50 crore of

assets as specified by the board.

To be maintained all time and monitored by sponsor

AMC maintains infrastructure, employee, sales....



Compliance officer ensures legal compliance

Fund management

Analyst - analyses various opportunities

**Fund managers - responsible for the
performance of the fund**

**Dealers - responsible to place orders based on
fund manager instructions**

AMC appoints RTA which need to be registered with SEBI

Maintains records of investors

Processes the purchase and redemption transactions

Updates unit capital of the scheme

Updates individual folios

Collecting banker/payment aggregators

appointed by AMC

KYC registration agencies

Mandatory for all investors to be KYC compliant under prevention of money laundering act.

Central KYC registry agencies from 2011 to avoid KYC process for each mutual fund

Depository is an institution which holds the securities in de-materialized or electronic form - NSDL, CDSL

Investors can transact through stock exchanges

Open ended also available through special segments

on stock exchanges

BSE - BSE-star MR

NSE - NMF-II

MF Utilities by AMFI

AMFI is association of all registered AMC

To maintain high professional and ethical standards

To interact with SEBI

To represent to Govt. and RBI on matters related to mutual fund industry

Undertake nationwide investor awareness program

To regulate the conduct of distributors and to protect interest of investors

Registration of MFDs and allots AMFI registration number (ARN) which is mandatory to become a mutual fund distributor

4. Legal and Regulatory framework



- **Role of SEBI**

Regulates mutual funds, depositories, custodians,

registrars and transfer agents and credit rating agencies

Protect the interest of the investor and promote the development

of securities market

- **Different types of regulation categories**

Scheme related documents

SEBI mandated to use total return index as against price return index to compare scheme performance

Conversion and consolidation of existing schemes

As per SEBI mutual fund categorization and rationalization conversion of existing scheme done

Risk management system

**SEBI regulates and mandates the exposure limits to get
risk diversified**

**In 2018 credit crisis, SEBI laid down provision for creating
segregated portfolio for protecting interests of the unit
holders.**

Disclosures and reporting norms

**SEBI issued many guidelines for proper disclosures and
reporting norms**

Governance norms

Fund level governance norms

Formation of audit and valuation committee

Role of independent directors and trustees

Benchmarking of the scheme's performance

RBI regulates the money market and foreign exchange market, so mutual funds need to comply with RBI's regulations regarding investment in money market, investments outside the country, investments from other than Indian residents

- **General restrictions**

Scheme will not invest in unlisted or privately placed securities of any associate or group company

of the sponsor

Mutual funds under all its schemes shall not own

more than 10% of a company paid-up capital

A mutual fund shall not invest more than 10% in debt instruments comprising money market instruments and non-money market instruments issued by a single issuer.

This limit not applicable for govt. securities

Parking of funds in short-term deposits with all scheduled commercial banks shall be limited to 15%

Debt funds have to maintain a minimum of 10% of corpus in liquid assets

Mutual funds buy and sell on delivery basis

- **Advertisement guideline for mutual funds**

Disclosing performance

when scheme exists for more than 3 years then performance in terms of CAGR for past 1 year, 3 year, 5 years and since inception shall be provided.

**New fund less than 6 months shall not provide
Incase of money market performance can be advertised by
annualisation of yields.**

Celebrity endorsements at industry level and shall not promote a scheme of a particular mutual fund

Branding and advertisement requirements for Specialized Investment Funds

SIFs should have distinct identification to maintain clear difference between mutual fund and SIF

For 5 years AMC may use sponsor or mutual fund brand name in offer document from SEBI approval of launch of SIF

- **Investors rights and obligations**

Investors have the option to receive allotment of

mutual fund units in their DEMAT account

They can choose beneficial ownership

Investor can choose to change their distributor and

AMC need to comply

Investors can appoint up to 3 nominees and

can also specify the percentage distribution

Investors can pledge mutual fund units

75% unitholder can terminate appointment of an AMC and

can pass a resolution to wind up a scheme

5. Scheme related information



- **Mandatory documents**

Mutual fund returns are subject to market risks, read all scheme related documents, what documents?

Scheme Information Document (SID)

Statement of Additional Information (SAI)

Key Information Memorandum (KIM)

Scheme Information Document (SID)

Details of the particular scheme

Name of the scheme, open-ended/close-ended/interval,

Equity/debt/liquid/hybrid etc.

Risk-o-meter and statement of the suitability

of the scheme are available on the front page

Describes the asset allocation of the scheme

Load structure, fees, expenses, transaction charges

Provides the details of computation of NAV

Within six months from end of 1st half or 2nd half of FY

in which schemes were launched,

SID shall be updated

Statement of Additional Information (SAI)

**Statutory information about the mutual fund or AMC
single SAI is relevant for all schemes offered by AMC
complete details of constituents of the mutual fund
sponsors, AMC and Trustee company and service providers**

**Regular update has to be done by end of
3 months of every FY**

Key Information Memorandum (KIM)

**It is a summary of SID and SAI
Shall be updated at least once in half-year**

Addendum

**interim changes are updated through issuance of
addendum and must accompany the KIM**

- **Other mandatory information/disclosure**

Existing investors in a mutual fund scheme also need

to track the progress of their investment

current value of investment

disclosure of daily NAV at the end of each business day

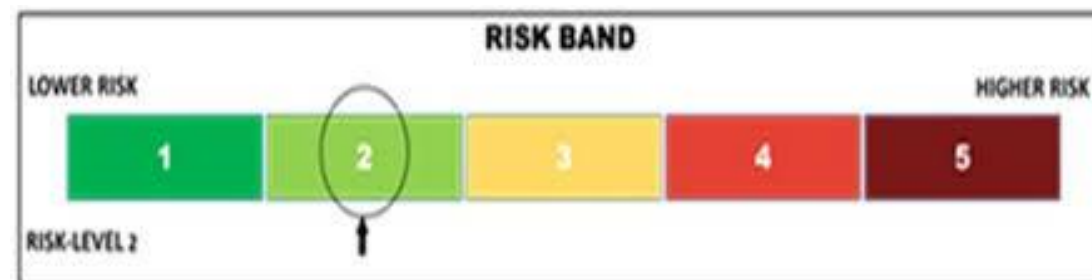
disclosure of total expense ratio

AMCs required to update investors through email

whenever any change in the expense ratio

Risk-o-meter

**pictorial representation of risk to
the principal invested
in a mutual fund depicted using a
risk o meter.**



Risk levels in case of SIFs

risk band level 1 to risk band level

5 assigned at the time of NFO.

It will be evaluated on monthly basis

Portfolio disclosure

shall disclose as on last day of the month

for SIFs disclosed as on last day of every alternative month.

It should also include scenario analysis in their investment

strategy information document (ISID)

Non mandatory disclosures

monthly fund factsheet

contains inception date, corpus size, current NAV.... features

like PE ratio, beta and other

risk measures such as standard deviation and

sharp ratio, credit rating profile....

6. Fund distribution and channel management practices



Investor

Mutual fund distributor

Assess the needs, limitations and financial goals of the investor

Individual distributor

**To become MFD one has to pass NISM series
V-A mutual fund distributors certification exam**

**To promote SIF they need to fulfill
additional eligibility criteria**

KYD requirements - PAN, proof of address

After certification and completing KYD, register with AMFI. AMFI

Registration Number (ARN) will be allotted

**With ARN one can empaneled with any number
of AMCs or can become agents of distributor who
already empaneled with AMCs
MFD earns income as a percentage of assets under
advisory
No commission is payable to distributor for their own
investments
Nomination facility offered by AMCs
to AMFI registered MFDs**

Non-individual distributor

**Regional distributors, national distributors, NBFCs, banks,
stockbrokers, etc..**

**institution distributors need to register with AMFI and
employee of these need to clear NISM V-A and obtain an
Employee Unique Identification Number (EUIIN)**

Stock exchange platforms

MF utilities

Transaction aggregating platform set up by AMFI connects investors, RTAs, distributors, banks, AMCs...

Fund manager

Analyses companies and economy factors and based on that constructs a portfolio in line with the stated objective of scheme

7. NAV, TER and pricing of units



Fair Valuation Principles

Ownership when changes due to buy and sell any investor in the scheme should get a fair price for their

investment

Principle 1 valuation must be fair

Principle 2

investments in new type of securities by MF scheme shall be

made only after valuation methodologies

established and approved by board of AMC

Principle 3

Procedures shall describe process to deal with exceptional events where market quotations are no longer reliable for a

particular security
Principle 4

AMC shall provide periodic review of valuation policies

Principle 5

Valuation policies and procedures approved by board of AMC should seek to address conflict of interest

Principle 6

Disclosure of valuation policy and procedures shall be made in SAI, on website of AMC

Principle 7

Any deviation from disclosed may be allowed with appropriate reporting to board of trustees

Principle 8

AMC shall have policies and procedures to detect and prevent incorrect valuation

Principle 9

Documentation shall be maintained and preserved by AMC

Principle 10

To maintain fairness, AMC shall take into consideration prices of same security or similar security reported at all available public platform

Valuation

**1. Traded securities other than money market and debt securities
valued at last quoted closing price on the stock exchange**

**When traded on more than one stock exchange,
security shall be based on where the security is principally
traded based on closing price
If a security is not traded on any stock exchange more than 30
days it must be treated as a 'non-traded' scrip and
it is valued in good faith by AMC**

2. Value of gold valued based on London Bullion Market Association in USD per troy ounce

3. Value for silver based on LMBA in USD per troy ounce

Computation of NAV

**Example: 20 crore units bought at 10/- means
scheme mobilized 200/- crores**

140 crore in equity appreciated by 10%

60 crore in deposits and money market

**interest and dividend received by scheme 8 crore, scheme
expenses paid 4 crore, while a further expense of 1 crore is
payable**

Profit after expenses 4 crore and capital appreciation is 14 crore. So unit holders fund in the scheme is 218 crore which is called as net assets

NAV calculation for this is

(Total assets - Liabilities) / no. of outstanding units

Mark to market

NAV meant to reflect true worth of each unit of the scheme

Total expenses in mutual fund scheme

Investment and advisory fees - charged by AMC

Recurring expenses

Marketing and selling expenses, brokerage and transaction cost, fees and expenses of trustees, audit fees,

custodian fees, listing fee.....

SEBI has banned entry loads, so sale price need to be

same as NAV

AMC shall not charge investment and advisory fees on segregated portfolio

8. Taxation



As per tax laws, mutual fund's income is exempt from income tax as mutual funds are continued as trusts in India for the benefit of unit holders

If any investor choose Income Distribution cum Capital Withdrawal (IDCW), get income in form of dividends, whereas investors in growth plan would not get dividend Dividend added to taxable income of the assessee

Tax based on

Holding period

Type of mutual fund scheme

More than 65% in equity is equity-oriented fund and others are non-equity. Fund of funds investing in other equity mutual funds considered as non-equity scheme for income tax purpose

Type of investors

**Tax may differ for resident Indian, NRIs and
non-individual investors**

**Incase of a joint holding the capital gains or dividend
would be considered to have been earned by first holder**

Capital gains

short term capital gain - holding period of all listed securities as

well as for equity mutual fund is less than 12 months

long term capital gain - up to 1.25

lakhs no tax

Stamp duty of MF units

**stamp duty @ 0.005% applicable at the time of
issue of units. units will be allotted
post deduction of stamp duty
stamp duty applicable on all transactions. purchase,
dividend reinvestment, SIP, STP..**

Setting off of capital gains and losses under income tax act

Capital loss, short or long term cannot be set off against

any other head of income like salary

Short term capital loss is to be set off against short term

capital gain or long term capital gain

Long term capital loss can only be set off against long

term capital gain

Securities transaction tax

when investor sells units in stock exchange will incur STT. STT not applicable on purchase of units of any equity scheme. not applicable for debt securities.

Tax benefit under section 80C of income tax act

Equity Linked Savings Schemes are eligible for deduction under section 80C under old tax regime

9. Investor services



NFO process

AMC decides to take a scheme to the market based on the inputs from Chief Investment Officer and from Chief Marketing Officer

AMC prepares scheme information document which need to be approved by trustees and board of directors of the AMC

NFO open date

5 to 15 days

NFO close date

scheme re-opening date

**allotment is completed within 5 business days after
closure of NFO**

Direct and regular plans

Monthly and annual account statement

**NRI/POI residents abroad can invest on a repatriable basis
or on a non-repatriable basis**

**application requires additional information under Foreign
Account Tax Compliance Act (FATCA) and
Common Reporting Standards (CRS)**

In case of NRI investments, if payments are through NRO a/c then registered account should be same type.

If payments routed through NRE account, then registered accounts can be NRO or NRE account

If investor choose repatriable mode then the charges of currency related are born by the investor only

Foreign investors can invest in equity schemes of MFs as Qualified Foreign Investors after completing KYC process.

**They must be from member of country of FATF
Non-individual investors**

companies, corporate bodies, trustees, partnership firms

FPI registered with SEBI

NRI to RI once he becomes a resident he cannot hold

**NRO/NRE/FCNR accounts. A Resident Foreign Currency (RFC)
account may be opened and this account can continue receive**

funds in foreign currency

from abroad investments

Switch

Redemption from one scheme and a purchase into another combined in one transaction

National Automated Clearing House (NACH)

It is a web based solution for banks, financial institutions, corporate and governments to facilitate interbank transactions which are repetitive and periodic in nature

ASBA

Through One Time Mandate investors can choose the frequency of debit like monthly, quarterly, half-yearly..

**and fixed amount to be debited
Third party payments**

All payments should be made from the bank account of holder of the folio, if it is a joint account then one of the

joint holder must be first holder of the folio

Payments by parents/grand parents/related person on

behalf of minor value of not more than 50000 SIP allowed.

person who make payment should be KYC compliant and

sign third party declaration form

Cut off time and time stamping

Cut off time 3 pm for Equity oriented funds and debt funds except liquid and overnight funds. Cut off time 1.30 pm for liquid fund and overnight funds

Same day NAV used if received before cut - off time or next business day NAV

KYC documents

PAN & Proof of address

SIP - SYSTEMATIC INVESTMENT PLAN

Helps in rupee cost averaging as investors gets more units in

market fall and less units when market rise

Mutual fund required registration time of 30 days for an SIP

enrollment

SIP top up facility also can be opted

SWP

STP

Unclaimed Assets - RTAs have developed a platform

to trace inactive and unclaimed mutual fund folios.

Mutual Fund Investment Tracing and Retrieval Assistant

(MITRA)

10. Risk, return and performance of funds



General and specific risk factors Scheme Information

Document(SID) contains a list of all these risks

General risk factors - settlement risk, liquidity risk, default risk, possible loss of principal, economic slowdown..

Specific risk factors

Risk related to equity and equity related securities

volatility

Risks associated with mid-cap and small-cap companies
these companies have ability to grow faster, but there is a
risk that such companies may not achieve their expected
earnings

Risk associated with derivatives

these are highly leveraged instruments, even small price
movement could have an impact on the value

Counterparty risk

this risk is mitigated as exchange provides
guaranteed settlement

Risks related to debt funds

**rating migration risk, interest rate risk, credit risk,
spread risk**

Risk factors with REIT and InvIT

price risk, interest rate risk, credit risk, liquidity risk.

Lower than expected distributions

Risk managing

Liquidity risk - managed by creating a portfolio which has adequate access to liquidity.

There is good secondary market liquidity in govt. securities

Credit risk - investing in securities issued by borrowers which have good credit profile

Rating migration risk - invest in high grade/quality securities.

Market risk of equity and equity related securities

Invest in companies based on adequate due diligence and research.

Involve in one-to-one meetings with management of companies.

Study historical and current financial condition of the company

Factors affect mutual fund performance

Market / systematic risk

Risks that impact the entire economy are known

as systematic risks

fund managers cannot reduce systematic risk except by

staying out of the market

scheme may not be able to control the systematic risk

beyond a certain level as SEBI regulations impose certain

limits on permissible cash allocation.

Company specific risk / unsystematic risk

Risks impact the specific company are company specific risk

can be reduced by diversification

Factors affecting performance of equity schemes

to generate superior returns than benchmark, fund manager must construct a portfolio based on security

selection and market timing

Fundamental analysis

Study of business and financial statements of a firm

in order to identify securities suitable for strategy

of schemes as well as high potential for returns

Longer term investment decisions are best taken by this

EPS, P/E ratio, PEG ratio, book value per share, price to

book value

Investment styles

growth style

value style

Technical analysis

It believes that price behavior of a share over a period of time gives future direction of the price

**shorter term speculative decisions,
intra-day trading based on technical analysis**

Factors affecting debt schemes performance

Total return an investor earns or likely to earn on debt securities is called yield.

YTM is return investor gets provided if it held till maturity.

HPR is combination of interest paid and capital gain relative to the price paid to buy security

Generally Gilt yield is lowest in the market for a given tenor and non Gilt may offer higher yields for same tenor.

This difference is called credit spread.

Measures of return

Simple return = (later value - initial value)*100 / initial value

**Annualized return = simple return * 12 /
period of simple return (in months)**

Compounded return = (later value / initial value)^(1/n) - 1

Measures of risk

Variance - measures fluctuation in periodic returns of a scheme as compared to its own average return

Standard deviation - it also measures fluctuation in periodic returns of a scheme as compared to its own average return

it is equal square root of variance

high standard deviation indicates greater volatility in returns and greater risk

Beta

Beta based on Capital Asset Pricing Model (CAPM) which states there are two risks in investing in equities, systematic risk and non-systematic risk.

As non-systematic risk can be diversified away, investors need to be compensated only for systematic risk and this is measured by its Beta

Beta measures the fluctuation in periodic returns in a scheme as compared to fluctuation in period

**return of a diversified stock index
Diversified stock index has Beta of 1.**

If beta is more than 1 are seen as riskier than the market and less than 1 indicative of a company or scheme

**less risky than the market
beta of 0.8 means it moves 8% when market move by 10%.**

It applies to increase as well as fall in value

Weighted average maturity

If a scheme has 70% of its portfolio in a 4 year security and 30% in 1 year security the weighted average maturity is $(70\%*4)+(30\%*1)$ i.e. 3.1 years

11. Mutual fund scheme performance



Benchmarks and performance

Benchmark for a scheme is decided by the

AMC in consultation with the trustees.

**in SID along with past performance of the scheme the
performance of the benchmark during the same period
has to be mentioned**

Price return index or total return index

Earlier mutual fund schemes were benchmarked to price return variant, with effect from 1st Feb 2018 schemes are benchmarked to total return variant of an index.

TRI takes into account all dividends/interest payments in addition to the capital gains

Quantitative measures of fund manager performance

Relative comparison how did a scheme perform vis-a-vis its benchmark or peer group are called

relative return comparisons

If a scheme earned a higher return than the benchmark it means that is out performance by fund manager and in reverse case that is under performance.

Sharp ratio

It is commonly used measure of risk-adjusted returns investment with Govt., returns are risk-free return (R_f).

T-bill index is a good measure of this through investment in a scheme, risk taken and return earned is (R_s)

difference between these two is called risk premium.

$R_s - R_f$

Sharp ratio uses standard deviation as a measure of risk

sharp ratio = $(R_s - R_f) / \text{standard deviation}$

Treynor ratio

like sharpe ratio it is also measure of risk premium per

unit of risk

for risk Treynor ratio uses beta

Treynor ratio = $(R_s - R_f) / \text{Beta}$

higher the Treynor ratio better the scheme

is considered to be

Alpha

the difference between a scheme's

actual return and its optimal return is its alpha,

which is a measure of fund manager's performance

Information ratio

it is mandatory for AMCs to disclose the information ratio

to measure risk-adjusted return of a portfolio. This must

be disclosed on their website on a daily basis

Information ratio (IR) =

(portfolio return - benchmark return)/

std of excess return

Tracking error

beta of market by definition is 1

as index fund mirror the index

the difference between index fund's return and market

return is tracking error

Scheme performance disclosure

SEBI mandated disclosure of performance data by all

AMCs.

SID of each scheme needs to be updated once every year and as part of this exercise the scheme performance numbers have to be updated suitability of the product can be assessed from product labels that provided with product literature. Risk-o-meter identifies the risk to the capital invested and match the investor's risk-taking ability to that of scheme

Fund factsheet

apart from scheme information, AMCs may also provide periodic updates on markets and economy

12. Mutual fund scheme selection


Scheme selection based on

Investor need - investor may need long term appreciation in the value of his investment or he may need periodic income from the investment or parking funds

**with need of high liquidity
Risk profile of the investor**

Need to take risk, ability to take risk and willingness to take risk - understanding of the risk profile and investment risks associated with various schemes would be essential for deciding asset allocation

Asset allocation

Based on the need the asset class which is most suitable for investor is determined. Investment time horizon is equally

important to select suitable asset class

Investor seeking growth and willing to take risk

and if he willing to invest for adequately long term,

equity may be suitable

Investor may prefer to invest and not willing to take risk

associated with equity investing may prefer

lower returns from debt

Age of investor

Generally young investors have potential for taking higher risks compared to old people, however this may not be correct as different

investors have different goals and risk taking ability

Core and satellite portfolio

core portfolio will be invested according to long term

needs and goals

satellite portfolio will be invested to take advantage of

expected short term market movement.

ex. sector funds

Risk levels in mutual fund schemes

risk - return hierarchy of mutual funds

liquid funds - debt funds - hybrid funds - equity funds

risk - return hierarchy of debt funds

overnight funds - liquid funds - ultra short duration funds - low

duration funds - short duration funds -

medium duration funds - medium to long duration funds - long

duration funds

Hierarchy of credit risk in debt funds

**gilt fund - banking and PSU fund - corporate bond fund -
credit risk fund**

risk-return hierarchy of equity mutual fund

**small cap funds - mid-cap funds - multi cap funds- large
and mid-cap funds - large cap funds**

risk-return hierarchy of diversified to concentrated funds

**diversified funds - focused funds -
thematic funds - sector funds**

risk-return hierarchy of hybrid funds

arbitrage fund - equity savings fund - conservative hybrid fund - dynamic asset allocation fund - multi asset allocation fund - balanced hybrid fund - aggressive hybrid fund

Scheme selection based on investment strategy

the portfolio is constructed in line with investment strategy.

Active fund vs passive fund

Index funds are passive funds and expected to offer return in line with the market as they mimic the index.

Cost of index fund is low as there is no research and fund management expenses.

**ETFs are also passive funds
Investor in an active fund is bearing a higher cost for fund management and higher risk to earn returns better than benchmark**

International equity funds

Indian investor taking exposure on international market and exposure to exchange rate of rupee

Gold funds

**gold ETF are different and gold sector funds are different
gold funds invest in shares of gold mining and other gold processing companies, which is linked with profitability of these companies**

Selection of scheme offered by different AMCs

Investor should evaluate whether fund portfolio reflects its investment objective and fund manager should follow the strategy as per SID

Fund manager - he is the one who makes huge difference to the scheme's performance

Fund performance - it is the primary criterion of the selection.

Fund should have ideally out-performed consistently

Fund age - a fund with long history has a track record that can be studied

Fund size - for an equity fund that invest in large caps, a large fund size may be an advantage, while for a sector fund or a mid-cap fund with limited investment options may be disadvantage.

Large fund size will allow better diversification and economies of scale

**Portfolio turnover - frequent churning of the portfolio
would add broking cost and indicates unsteady
investment management**

**Do's and Don'ts while selecting a mutual fund scheme
ensuring suitability
sticking to investor asset allocation**

past performance may or may not be sustained in future

**understanding the investment objective and investment
strategy of the scheme**



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