8.How to choose a mutual fund?

There is no easy answer to this question. Remember that to increase your chances for a satisfying mutual fund pick out funds that match your investment objective and tolerance of risk. There are other benefits. You don't have to bother with the task of keeping a record of your investments. Your investment is liquid, at least for open-ended funds, and you can surrender your units to the fund and get your refund within a few days. Of course, not all funds are equally liquid, which is why choosing a fund is so important. Before you buy units in any mutual fund, it is important that you know exactly how much it is going to cost. All mutual funds charge a management fee. It doesn't matter if you buy from a bank or a broker, you will pay a management fee. These fees are usually given as a percentage of the fund's total assets and pay the administrative costs and the wages and bonuses of fund managers. In addition, some mutual funds charge a "load" when you buy or sell your mutual fund units. A fee when you buy your units is known as a front-load, and if the fee is on redemption, it is known as a back load.

Here are a few guidelines.

- Prepare a list of funds that you feel would match your requirements.
- Look out for the prospectus of such funds. Determine the risk factors, management perception and the goals of the scheme.
- Analyse the performance of the funds in the last three years. Analyse the financial and market performance as well as the redemption payments.
- Assure yourself about the quality of management, its experience, record and capability of the management company.
- Compare the various fee structures, sales charges and the various shareholders services offered.

A wide choice

The investment pages of any pink newspaper will give you the lists for scores of mutual funds. The variety is mind-boggling. You can take your pick from open-ended funds, close-ended funds, debt funds, money market funds, tax planning funds, balanced funds, gild funds et al.

But before you put your money into any of these, there are two important things to remember. These are the fund's investment objectives, and its level of risks. You'll first have to decide what your investment objectives are, and then see which fund matches those objectives.

Investment objectives

Every mutual fund has a specific investment objective. A fund that seeks to provide safety of your principal amount or capital as its main objective will obviously invest very conservatively, preferring safety to risk. Income funds, on the other hand, will aim to provide investors with stable and regular payments in the form of a monthly or quarterly cheque. Funds that have growth as their objective will invest in equities to increase the value of the fund's assets and provide investors with long-term capital gains. Some funds seek to balance the objectives of income and growth in one package.

Risk

Simply speaking, risk is the possibility that an investment may go down in value or not perform as well as expected. Even your savings bank account is subject to erosion on account of inflation. While government securities are free of credit risk, they are exposed to market risk. We take a look here at the varieties of risk:

Credit risk: This is the possibility that the company holding your money will not pay the interest or

dividend due, or the principal amount when it matures.

Interest-rate risk: The possibility that a debt instrument, such as a bond, will decline in value due to a rise in interest rates.

Market risk: The risk that the value of your investment will decrease, as prices fluctuate in the market.

The risk-reward trade-off
Now for the trade-off between risk and reward. The simple rule is: The higher the risk, the bigger the potential reward.

So how much risk should you be taking? It depends. If you're young or can afford to lose money, then you can take more risks. The older you get, or the less financially well off you are, the less risk you can take. Historically speaking, stocks have outperformed other financial instruments over time.

Kinds of funds
There are two broad categories of funds: **open-ended** and **close-ended**. Close-ended funds are those which have a fixed date for winding up. A close-ended fund for five years will, for example, return all its money to unitholders after five years. These funds collect subscriptions at one point of time, run for a fixed period, and are then redeemed. In contrast, an open-ended fund has no fixed redemption date. Instead, these funds will buy and sell units to the public continuously, at a price announced by the funds and linked to its NAV.

Within these two broad categories, you can have several different types of funds.
Money-market funds invest primarily in treasury bills and other very short-term instruments, such as commercial paper. Such funds usually pay a few percentage points more than savings bank deposits and have very little downside risk. UTI's MMMF, for example, has earned a return of 10.67 per cent in the last year.

Fixed income or debt funds invest in some combination of treasury bills, debentures, and bonds. The aim of fixed income funds is to provide high, regular income payments with the possibility of some capital gains.

Gilt funds are those funds which invest only in government securities. Safety is obviously the main objective of such funds. But while there is no question of the government defaulting on its own bonds, it is also a fact that the market prices of these bonds fluctuate. So while you may not be exposed to credit risk, market risk is very much a factor to be reckoned with.

Growth or equity funds invest in ordinary shares of Indian companies and are recommended for investors seeking long-term growth through capital gains. An investment time frame of at least five years is generally recommended for this type of fund.

Balanced funds provide a combination of income and growth by investing in a mixed portfolio of stocks, preferred stock, bonds, and money market instruments.

Index funds are funds whose investments replicate a benchmark market index, including the weightage of different stocks in the portfolio, so that the performance of the fund mimics the movement in the index.

Factors to consider while picking a fund

First, assess the level of risk you are comfortable with and pick a fund which has the same investment objectives.
Second, consider the track record of fund managers. It is important that you check the long-

term track record to eliminate the possibility of a flash in the pan. Third, choose low-cost funds.

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