Chapter 2

MUTUAL FUNDS-THEORY AND BACKGROUND

This chapter presents a brief sketch of the origin of modern Mutual Funds, various types and classifications of Funds, the structure and constituents of Mutual Funds, the appointment and functions of AMCs, various measures for evaluating AMCs and Fund performance and an outline of the current global scenario.

2.1 Origin of Modern Mutual Funds

The concept of the Mutual Fund as it is known and prevailing today finds its roots some 180 years back in Europe when King William I of Germany organised the “Societe Generale de Belgique” in 1827 which embodied a more modern concept of risk sharing. In England, the origin of the modern fund industry can be traced back to 1868, when the Foreign and Colonial Investment Trust (F&CIT) was formed in London. It enabled the investor of moderate means to invest in foreign and colonial government stocks with the same advantages as large capitalists. The F&CIT, still one of the most successful investment trusts in the U.K, introduced the concept of close-ended funds to the world.

The Growth of Mutual Fund concept in the American economy began in the late 19th century and early 20th century. One of the first investment trusts of which there is record was the Boston Personal Property Trust, organised in 1893. However, the first true open-ended Mutual Fund in the US was the Massachusetts Investor’s Trust (MIT) organised in 1924. The Fund which operates even today, paved the way for modern-day open-ended Mutual Fund (Strong, 1994). The establishment of several solidly organised companies in the 1920’s by experienced and competent financiers inspired the rise of many others, not so conservatively constructed.
Though the Fund industry began its journey with close-ended Funds, it came to depend increasingly on open-ended Mutual Funds, which took the world by storm at the end of the 20th century. Though the close-ended Funds were traded actively and outnumbered open-ended Funds in the U.S in the 1920s, the high flying funds were ultimately hit hard during the crash of 1929 and subsequent bear market damaging their reputation with the investors. Only the open-ended Funds survived the 1929 crash and emerged as the winners thereafter. The real reason that the open-ended trusts of the time survived to become a model for a period of reforms and rebirth was the tradition of conservative investment policy followed by those trusts (Fredman and Wiles, 1997). From then onwards it was the open-ended Funds which ruled the Mutual Fund industry in the U.S and the world at large.

After the crash and subsequent bear market, the Securities and Exchange Commission (SEC) launched a study of investment companies in 1936, which culminated in the enactment of the Investment Companies Act of 1940. Its enactment provided a framework within which the Mutual Fund industry in the US grew substantially over the next 65 years.

Along with that, the structural changes in the global economic environment over the years complemented the emergence of a strong market economy which facilitated the growth of Mutual Fund industry in the US and the world over. The Industry began to thrive well not only in the developed countries, but in the newly industrialised and developing economies as well, particularly during the far end of the 20th century and the dawn of the 21st century.

In the US, the total assets of American Mutual Funds reached US $ 2070.067 billions in 1993, which went up to US $ 8905.17 billions by the end of 2005. The total number of Mutual Funds also exhibited a similar trend over the corresponding period. It reached 4537 in 1993 and went up to 7977 by the end 2005. The total assets of Mutual Funds worldwide reached at US $ 4156.451 billions in 1993, which increased to US $ 9293.27 billions in 1998, and rose further to US $ 17769.39 billions by the end of 2005. The number of Mutual Funds worldwide over the same period grew from 24474 in 1993 to 50835 in 1998 and further to 56863 by the end of the year 20051.

2.2 Types and Classifications of Mutual Funds

There are different types and classifications of Mutual Funds.

2.2.1 Types of Funds

There are many types of Mutual Funds available to the investor. However, these different types of Funds can be grouped into three basic categories or classifications, namely,

A. Open-ended and Close-ended Funds
B. Load and No-load Funds
C. Tax-exempt and Non-tax exempt Funds

All Mutual Funds would be either close-ended or open-ended and either load or no-load as well as tax-exempt or non-tax exempt. These classifications are general.

2.2.1.1 Open-ended Vs Close-ended Funds

An open-ended Fund is one that has units available for sale or repurchase at all times. An investor can buy or redeem units from the Fund itself at a price based on the Net Asset Value (NAV) per unit. Therefore the unit capital of an open-ended Mutual Fund is not fixed but is variable.

Unlike an open-ended Fund, the unit capital of a close-ended Fund is fixed, as it makes a one-time sale of a fixed number of units. Later on, close-ended Funds do not allow investors to buy or redeem units directly from the Funds. To provide the much-needed liquidity to investors, the schemes issued by close-ended Funds generally get themselves listed on Stock Exchanges.

The major ways in which open-ended Funds and closed-ended Funds differ are as follows:-

i) An open-ended Fund (scheme) is characterised by:-
   - Unlimited capitalisation
   - No predetermined date of redemption
   - Sale and purchase of units at current NAV
   - No restriction on entry and exit
   - Purchase of units directly from the Funds
   - Sale of units directly to the Funds
ii) A close-ended Fund (scheme) is characterised by

- Constant capitalisation
- Predetermined date of redemption
- Predetermined date for closing of subscription
- Frequent lock-in period
- Purchase and sale of units at the traded prices in the Stock Exchange².

In the US today, it is estimated that only about 7% Funds are close-ended. The open-ended Funds in the US are called Mutual Funds, which are equivalent to the unit trusts in the UK. The British Investment Trusts are an equivalent of the US close-ended Funds. In India, however, no such distinctions are maintained and both the open and close-ended Funds are called Mutual Funds. India's Mutual Fund 'Schemes' are equivalent to the 'Funds' in the UK and the US. The operational and regulatory structures of close-ended and open-ended Funds are different in the UK and the US, but not in India.

2.2.1.2 Load and No-load Funds

Marketing of new Mutual Fund scheme involves initial expenses. These expenses may be recovered from the investors in different ways at different times. These charges made by the fund managers to the investors to cover marketing/sales/distribution expenses are called ‘Loads’. The load charged on investor at the time of his entry into a scheme is called “a front end load or entry load”. The load that the investor pays at the time of his exit is called a 'back-end or exit load'. The load amount charged to the scheme over a period of time is called a ‘deferred load’. The load amount charged on investors, depending upon how many years the investor has stayed with the Fund is called ‘contingent deferred sales charge.’

The front-end load amount is deducted from the initial contribution/purchase amount paid by the incoming investor, thus reducing his initial investment amount. Exit loads would reduce the redemption proceeds paid out to the outgoing investor.

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² In India, additionally, the close-ended funds can be purchased from and sold back to the Funds. (Sadhak, 2003)
Funds that charge front-end, back-end or deferred loads are called load Funds. Funds that make no such charges or loads for sales expenses are called no-load Funds.

2.2.1.3 Tax-exempt and Non-tax exempt Funds

Generally, when a Fund is invested in tax-exempt securities, it is called a tax-exempt Fund. In India, after the 1999 Union Govt. Budget, all the dividend income received from any of the Mutual Funds is tax free in the hands of the investor. However, Funds other than Equity Funds have to pay a distribution tax before distributing income to investors.

2.2.2 Fund classifications

Funds are generally distinguished from each other by their investment objectives, the types of securities they invest in, and the risk profile. Based on these criteria, there are seven major types of funds under the general classification.

2.2.2.1 Money Market Fund

Often considered to be at the lowest rung in the order of risk level, money market funds invest in short-term interest-bearing instruments of less than one-year maturity which include Treasury Bills issued by governments, Certificates of Deposits issued by banks, and Commercial Paper issued by companies. In India, money-market Mutual Funds also invest in the inter-bank call money market. Liquidity and safety of principal are the major strengths of Money Market Funds.

2.2.2.2 Gilt Funds

Gilts are government securities with medium to long-term maturities, typically of over one year. In India, Gilt Funds invest in government paper called dated securities. Since the issuer is the Government of India/ States, these Funds have little risk of default and hence offer better protection of principal.

2.2.2.3 Debt Funds (Income Funds)

Next in the order of risk level, there are the general category Debt Funds. Debt Funds invest in debt instruments issued not only by governments, but also by private sector companies, banks and financial institutions and other entities such as infrastructure companies/utilities. By investing in debt, these Funds target low risk and stable income for the investors as their key objectives. Debt Funds are largely considered as income Funds as they do not target on capital appreciation, but look
for high current income and therefore distribute a substantial part of their surplus to investors. Debt Funds differ with respect to risk profile as follows-

2.2.2.3.1 Diversified Debt Funds

A Debt Fund that is invested in all available types of debt securities issued by entities across all industries and sectors is a properly 'Diversified Debt Fund'. It has the benefit of risk reduction through diversification and sharing of any default–related losses by a large number of investors, hence low risky than a 'narrow focus' Fund.

2.2.2.3.2 Focused Funds

Some Debt Funds have a narrower focus, with less diversification in investments. These include Sector Funds, Specialised Funds and Off-shore Debt Funds. They have a substantial part of their portfolio invested in debt instruments and therefore more income oriented and inherently less risky. Sector Funds' portfolios consist of investments in only one industry or sector of market such as IT, pharmaceuticals etc. Off-shore Funds invest in debts in one or more foreign countries thereby achieving diversification across the country’s borders. Specialised Funds invest in only companies that meet pre-defined criteria such as some well defined social objectives or ethical criteria.

2.2.2.3.3 High Yield Debt Fund

Usually, Debt Funds control the borrower’s default risk by investing in securities issued by borrowers who are rated by credit-rating agencies and are considered to be of “investment grade”. There are, however, funds that seek to obtain higher interest returns by investing in debt instruments that are considered “below investment grade”. They are known as High Yield Debt Funds. (Junk Bonds in the US) and tend to be more volatile than other Debt Funds.

2.2.2.4 Assured Return Funds – An Indian Variant

Usually, the fund manager or the trustees or sponsors of a Fund do not give any guarantee on the minimum return to the investors. However, in India, UTI and other Funds have offered “Assured Return” schemes to investors. Eg. Monthly Income Plan of UTI. Returns are indicated in advance for all of the future years of these close-ended schemes. If there is a shortfall, it is borne by the sponsors.

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3 Anjaria & Dhaivat Anjaria – 2001
2.2.2.5 Fixed Term Plan Series: Another Indian variant

A Mutual Fund scheme would normally be either open-ended or close-ended. But in India, an innovative middle option between the two has been evolved in response to investor needs which offers a combination of both these features to investors and they are termed as Fixed Term plan series. These are close-ended Funds, make only a one-time offering of units, but such offerings are made in a series of plans under one scheme prospectus or offer document.

2.2.2.6 Equity Funds

Equity Funds invest major portion of their corpus in equity shares issued by companies, acquired directly in IPO, or through the secondary market. Though these Funds would be exposed to equity price fluctuation risk at market level or industry or company level, they can appreciate in value in line with the issuers’ earning potentials and therefore, offer the greatest potential for growth in capital.

Equity Funds are generally separated into different categories in terms of their investment styles or strategies and the resulting risk levels.

2.2.2.6.1 Aggressive Growth Funds

Aggressive Growth Funds target maximum capital appreciation, hence may adopt even speculative investment strategies by investing in less researched or speculative shares to attain their objective of high returns for the investor. Consequently, they tend to be more volatile and riskier than other Funds.

2.2.2.6.2 Growth Funds

The primary objective of Growth Fund is capital appreciation over a three to five year span and they invest in companies considered to have a growth potential, whose earnings are expected to rise at an above average rate.

2.2.2.6.3 Equity Income Fund

Usually Income Funds are in the Debt Fund category, however, there are Equity Funds also designed to give the investor a high level of current income, along with some steady capital appreciation. These Funds invest mainly in shares of companies with high dividend yields. These are Funds, less volatile and less risky than nearly all other Equity Funds.
2.2.2.6.4 **Equity Index Fund**

An Index Fund tracks the performance of a specific stock market index. The Fund invests in shares that constitute the index and in the same proportion as the index. Such Funds take only the overall market risk, while reducing the sector and stock specific risk through diversification. They usually offer market rate of return.

2.2.2.6.5 **Value Funds**

Value Funds try to seek out fundamentally sound companies whose shares are currently under-priced in the market. Value Funds will add only those shares to their portfolio that are selling at low price-earnings ratios, low market-to-book value ratios and are undervalued by other yardsticks.

2.2.2.6.6 **Diversified Equity Fund: Equity Linked Savings Scheme**

Diversified Equity Fund seeks to invest mostly in equities only, but is not focused on any one or a few sectors or shares. Coming under this category, in India we have special type scheme called ELSS (Equity Linked Savings Scheme). Investment in these schemes entitles the investor to claim an income tax rebate, but usually has a lock-in-period.

2.2.2.7 **Specialty Funds**

These Funds have a narrow portfolio orientation and have a specific investment focus. Most speciality Funds tend to be concentrated Funds as their holdings might be confined to companies meeting certain ethical criteria or in a particular geographical region or industry. Speciality Funds assume different forms-

i). **Sector Funds**

A kind of Speciality Fund focusing on a specific stock group is called Sector Fund. Typically, the investments are confined to firms within a single industry like healthcare, IT, costly consumer durable goods and the like. They carry higher level of sector and company specific risk than diversified equity risk.

ii). **Off-shore Funds (or Overseas Funds).**

These Funds invest in equities in one or more foreign countries. Offshore Equity Funds may invest in securities in a single foreign country in which case they are termed as ‘Country Funds’ or in securities in many foreign countries, then they are called ‘ International Funds’. A third type of
overseas Fund is known as ‘Global Fund’ which invests in the domestic as well as foreign stocks and bonds.

**iii). Small-Cap Equity or Lilliput Funds**

Also called ‘Mini Funds’ in the US, Lilliput or Small-Cap Funds specialise in companies with a small level of market capitalisation than that of big, bluechip companies.

**iv). Option income funds**

Conservative income funds invest in large dividend paying companies and then sell options against their stock options. This ensures a stable income stream in the form of premium income through selling options and dividends. Though options are viewed as risky instruments they may actually help to control volatility if properly used.

**v). Utility Funds**

Utility Funds are sector funds but these are far more stable than the typical sector products, because utilities are defensive investments since their services are always needed regardless of how the economy is doing. Like bond utilities, they usually generate high income.

**vi). Hybrid Funds: Quasi-Equity/Quasi-Debt**

These are funds that seek to hold a relatively balanced holding of debt and equity securities in their portfolios. Such funds are termed ‘Hybrid Funds’ as they have a dual equity/ debt (or stock/bond) focus. Some of the funds in this category are –

a) **Balanced Funds**

A Balanced Fund is one that has a portfolio comprising debt instruments, convertible securities, preference and equity shares. Their assets are generally held in more or less equal proportions between debt/money market securities and equities. Balanced portfolios strive to achieve these goals: income, moderate capital appreciation and preservation of capital.

b) **Growth and Income Funds**

These Funds seek to strike a balance between capital appreciation and income for the investor. Their portfolios are a mix between
companies with good dividend paying records and those with potential for capital appreciation.

c) **Asset Allocation Funds**

These Funds diversify beyond equities into other asset categories, typically cash equivalents and bonds. Some with a broader orientation include foreign equities, gold stocks, real estate shares, natural resources companies and even non-financial assets. There are two types of Funds in this category:

i. **Stable-allocation portfolios**, which hold relatively fixed proportions of the specific categories, and

ii. **Flexible-allocation portfolios**, which vary in weightage depending on the managers' outlook.

d) **Convertible Funds**

A convertible security is a bond or preferred stock that can be exchanged for a pre-determined number of company’s common shares at the holders' option and Funds investing predominantly in these securities are called convertible Funds. Convertibles have a split personality. They offer the downside protection of a fixed income security and upside potential of equity.

2.2.3 **Other Classes of Funds**

Other than the classes of Funds listed above, there are several innovative Funds in operation and the important among them are the following:

2.2.3.1 **Venture Capital Funds**

Usually these Funds invest in unlisted and unquoted companies. They also invest in start-up business, management buy-outs and new technologies. Investment in such areas is very risky and usually takes longer periods to realise the returns, which of course, may be much higher than those accruing from other types of Funds. Venture Capital Funds seek to provide tax benefits and long-term growth (Sadhak, 2003).

2.2.3.2 **Leveraged Funds**

Leveraged or Borrowed Funds are used in order to increase the size of the value of the portfolio by resorting to borrowed funds and to benefit the shareholders
by gains exceeding the cost of the borrowed funds. Funds are used in speculative and risky investments like short-sales.

#### 2.2.3.3 Fund of Funds

Some Mutual Funds invest the money received by issuing units on other close-ended or open-ended Funds. The investment risk of these Funds are very low as they get spread at two points, but then such Funds also involve a double charge.

#### 2.2.3.4 Emerging Market Funds

The term ‘emerging market’ is used to describe the developing countries which are experiencing rapid economic growth. Over 30 developing countries, including India, have been defined as emerging markets, which offer tremendous scope for capital appreciation. Emerging Market Funds invest in the equities of these developing countries. The objective is to provide long term capital growth.

#### 2.2.3.5 Commodity Funds

While all of the Debt/Equity/Money Market Funds invest in financial assets, the Mutual Fund vehicle is suited for investment in physical assets also. Commodity Funds specialise in investing in different commodities directly or through shares of commodity companies or through commodity futures' contracts. Specialised Commodity Funds may invest in a single commodity, while Diversified Commodity Funds will spread their assets over many commodities. A most common example of Commodity Fund is the Precious Metals Funds. Gold Fund, another Commodity Fund, invests in gold, gold futures or shares of gold mines.

#### 2.2.3.6 Real Estate Funds

Specialised Real Estate Funds would invest in real estate directly or may fund real estate developers or lend to them or buy shares of housing finance companies or may even buy their securitised assets. The Funds may have a growth orientation or seek to give investors regular income.

#### 2.3 Advantages and Benefits of Mutual Funds

Anyone investing in a Mutual Fund can automatically reap the benefits of research and a wider range of low-cost information services. A risk-averse investor can thus expect above the market returns at a lower cost and lower risk. If Mutual Funds are emerging as the favourite investments vehicle, it is because of many advantages they have over other avenues of investments. They are:
Professional Management
Low-cost, High-Value diversification
Convenient record keeping
Easy liquidity
Reduction of transaction cost
Investment protection
Low initial investment
Switching from one Fund to another
Tax benefits
Accessibility
Variety of investments
Retirement benefits
Safety from loss due to unethical practices

2.4 Mutual Fund Structure and Constituents

Mutual Funds, worldwide have a unique structure not shared with other entities such as companies or firms. In the USA Mutual Funds are set up as investment companies, which may be thought of as the ‘Fund Sponsors’. An investment company may be a corporation, a partnership or a Unit Investment Trust. All these legal entities are broadly understood as Mutual Funds in the USA. The investment company in turn, appoints a management company, which may be either a close-ended or an open-ended management company. Only open-ended management companies are technically called "Mutual Funds" in the USA.

In the USA, four different entities are involved in the operation of Mutual Funds and they are the management company, underwriter, management group and the custodian. The management company is the Indian equivalent of an Asset Management Company. Underwriter of a Fund is the distributor or the marketing company that sells the shares to brokers or to the public. A management group is a family of management companies owned by a group of people or a corporation. Custodian is the entity that holds the Funds’ assets on behalf of the management company.
In the UK, Mutual Funds have two alternative structures. Open-ended Funds are in the form of unit trusts, while close-ended Funds are in the form of corporate entities although called Investment Trusts. Separate regulatory mechanisms exist for both types of entities.  

**2.4.1 Structure of Mutual Funds in India**

Like other countries, India also has a legal framework within which Mutual Funds must be constituted. Unlike in the UK, where two distinct ‘trust’ and ‘corporate’ structures are followed with separate regulations, in India, open and close ended Funds operate under the same regulatory structure and are constituted along one unique structure as Unit Trusts. A Mutual Fund in India, thus, is allowed to issue open-ended and close-ended scheme under a common legal structure. Therefore a Mutual Fund may have several different schemes (open-ended and close-ended) under one Unit Trust, at any point of time.

The formation and operations of Mutual Funds in India are guided solely by the Securities and Exchange Board of India (SEBI) Regulations 1996. Here a Mutual Fund comprises four separate entities – Sponsor, Mutual Fund Trust, Asset Management Company (AMC) and Custodian. These are assisted by other independent administrative entities, viz. banks, registrar and transfer agents.

**2.4.1.1 The Fund Sponsor**

The sponsor for a Mutual Fund can be only a entity who, acting alone or in combination with another body corporate, establishes a Mutual Fund and gets it registered with SEBI. The sponsor will form a trust contributing to its initial capital and appoint a Board of Trustees. The sponsor will also generally appoint an AMC as fund manager. The sponsor, either directly or acting through the Trustees, will also appoint a custodian to hold the Fund assets. All these appointments are made in accordance with SEBI Regulations.

For an entity to qualify as a Sponsor, it must contribute at least 40% of the minimum net worth (Rs.10 core) of the AMC. It must also have a sound financial

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4 Before 1st December 2001, Unit Trusts and Investment Trusts in the UK were being regulated by the Securities and Investment Board (SIB) through the SRO (Self Regularity Organisation) System under the Financial Services Act (FSA) 1986.

5 Securities and Exchange Board of India Regulations 1996. SEBI Notification, Dec. 9, 1996. SEBI website- www.sebi.gov.in
track record over five years prior to registration and a reputation for fairness and integrity in all its business transactions.

2.4.1.2 Mutual Funds as Trusts

A Mutual Fund in India is constituted in the form of a Public Trust created under the Indian Trust Act 1882 and the instrument of Trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act 1908, (16 of 1908) executed by the sponsor in favour of Trustees named in such an instrument.

Rights and Obligations of Trustees

Rights

1. The Trustees appoint the AMC with the prior approval of the SEBI
2. They also approve each of the schemes floated by the AMC
3. They have the right to request any necessary information from the AMC concerning the operations of various schemes managed by the AMC, to ensure that the AMC is in compliance with the trust deed and regulations.
4. The Trustees may take remedial action if they believe that the conduct of the Fund business is not in accordance with SEBI Regulations. In certain specific events, the Trustees have the right to dismiss the AMC with the approval of the SEBI and in accordance with the regulations.
5. The Trustees have the right to ensure that, based on their quarterly review of the AMC’s net worth, any shortfall in the net worth is made up by the AMC.

Obligations

1. The Trustees must enter into an investment management agreement with the AMC in accordance with SEBI (MF) Regulations, 1996.
2. They must ensure that the Funds’ transactions are in accordance with the Trust Deed.
3. The Trustees are responsible for ensuring that the AMC has proper systems and procedures in place and has appointed key personnel including fund managers and a compliance officer, besides other constituents such as auditors and registrars.
4. The Trustees must ensure due diligence on the part of the AMC for empanelment of brokers.
5 The Trustees must ensure that the AMC is managing schemes independent of other activities and that the interests of unit holders of one scheme are not compromised with those of other schemes.

6 The Trustees must furnish to SEBI on a half yearly basis, a report on the Funds’ activities and a certificate stating that the AMC has been managing the schemes independently of other activities

7 The Trustees shall periodically review the investor complaints received and the redressal of the same by the Asset Management Company

8 The Trustees shall abide by the Code of Conduct as specified in the fifth schedule.

The Mutual Fund is managed by a Board of Trustees (body of individuals) or a Trustee Company (a corporate body). Most of the Funds in India are managed by Board of Trustees. At least half of the Trustees should be independent persons. The AMC or its employees cannot act as Trustees. The Trustee of a particular Mutual Fund cannot be appointed as Trustee of any other Mutual Fund unless he is an independent Trustee and obtain prior permission from the Mutual Fund in which he is a Trustee. A Trustee can be removed only with the prior approval of SEBI.

2.4.1.3 The AMC – Its Appointment and Functions

Appointment

The Sponsor or if so authorised by the trust deed, the Trustee shall appoint an Asset Management Company, which has been approved by the Board under sub-regulation (2) of regulation 21 of SEBI (MF) Regulations, 1996.

1. The appointment of an Asset Management Company can be terminated by majority of Trustees or by 75 percent of the unit holders of the scheme

2. Any change in the appointment of Asset Management Company shall be subject to prior approval of the Board and unit holders.

Eligibility Criteria for appointment:

For grant of approval of the AMC, the applicant has to fulfil the following:-

a) In the case the Asset Management Company is an existing one, it has a sound track record, general reputation and fairness in transactions.

b) The Asset Management Company is a fit and proper person
c) The Directors of the Asset Management Company are persons having adequate professional experience in finance and financial services-related field and found not guilty of moral turpitude or convicted of any economic offence

d) The board of directors of such company has at least 50 percent directors who are not associated in any manner with the Sponsor or any of its subsidiaries or the Trustees.

e) The Chairman of the Asset Management Company is not a Trustee of any Mutual Fund.

f) The Asset Management Company has a net worth of not less than rupees ten crores.

The role of an AMC is to act as the Investment Manager of the Trust. It would float and then manage the different investment ‘schemes’ as per SEBI Regulation and as per the Investment Management Agreement it signs with the Trustees. The AMC cannot act as Trustee of any other Mutual Funds.

**Obligations of the AMC and its Directors**

The AMC and its Directors must ensure that

1. investment of funds is in accordance with SEBI Regulations and Trust Deed
2. they take responsibility for the acts of its employees and others whose service it has procured
3. they submit quarterly reports to the Trustees
4. they make appropriate disclosure to unit holders including the amount of brokerage or commission paid, if they use the service of the sponsor, associate or employee
5. they do not undertake any other activity conflicting with managing the Funds
6. they float schemes only after obtaining prior approval of the Trustees and SEBI
7. they make the required disclosures to the investors in areas such as calculation of NAV and repurchase price
8. they file details of security transactions by AMC Directors with the Trustees on a quarterly basis (which exceed the value of Rs. 1 Lakh)
2.4.1.4 Custodian and Depositors

Mutual Funds are in the business of buying and selling of securities in large volumes. Handling these securities in terms of physical delivery and eventual safe keeping is therefore a specialised activity. The Custodian is appointed by the Board of Trustees for safe keeping of physical securities. If the securities are in dematerialised form with a ‘Depository’ the dematerialised securities holding will be by a Depository through Depository Participant.

A Custodian must fulfil its responsibilities in accordance with the agreement with the Mutual Fund. The Custodian must be an entity independent of the Sponsors and is required to be registered with SEBI.

2.4.1.5 Other Fund Constituents

a) Bankers:

A Fund’s activities involve dealing with money on a continuous basis with respect to buying and selling units, paying for investments made, receiving the proceeds on sale of investments and discharging its obligations towards operating expenses. A Fund’s bankers, therefore, play a crucial role with respect to its financial dealings.

b) Transfer Agents

Transfer agents are responsible for issuing and redeeming units of Mutual Funds and provide other related service such as preparation of transfer documents and updating investor records. The Fund may choose to carry out this activity in-house and charge the scheme for the service at a competitive market rate or the services of an outside Transfer Agent may be obtained.

c) Distributors

For a Fund to sell units across a wide retail base of individual investors, an established network of distribution agents is essential. AMCs usually appoint Distributors or Agents or Brokers, who sell units on behalf of the Fund. In India, besides brokers, independent individuals are appointed as agents for the purpose of selling the Fund schemes to investors. While individuals constitute the largest segment in the category of Mutual Fund ‘distributors’, other distributors include Banks, Non-Banking Finance Companies, and Distribution Companies.
2.5 Measuring and Evaluating Fund Performance

The investor would naturally be interested in tracking the value of his investments. He, therefore, needs to understand the basis of appropriate performance measurement for the Fund and acquire the basic knowledge of the different measures of evaluating performance of a Fund. An effective investment advisor too, has to know how to measure and evaluate Fund performance.

2.5.1 Different Performance Measures

The various performance measures usually applied by investors, investment advisors and other security analysts and portfolio managers in evaluation of performance of the AMCs and the Funds they operate and the schemes they manage are numerous. One must find the most suitable one depending on the type of the Fund he is looking at, the stated investment objective of the Fund and even depending on the current financial market conditions. The most common measures are briefly explained in the following paragraphs.

I) NAV Returns

a) Change in NAV (Net Asset Value):

If an investor wants to compute the return on investment between dates, he can use the per unit NAV at the beginning and the end periods and calculate the change in the value of NAV between the two dates in absolute and percentage forms-

i) NAV in absolute terms = (NAV at the end of period) - (NAV at the beginning of the period)

ii) NAV in percentage = (Absolute change in NAV/NAV at the beginning) x 100

iii) If period covered is less/more than one year-

For annualised NAV change = {((Absolute change in NAV/NAV at the beginning) / months covered) x 12} x 100

It is the most commonly used measure. It is easily understood and applies to virtually any type of Fund.

However, in cases where the Fund has distributed to investors a significant amount of dividend, this measure may not always give the correct picture, particularly for income plans and Funds with withdrawal plan.
b) Total Returns

This measure corrects the limitation of the NAV change measure by taking account of the dividend, if any, distributed by the Fund between the two NAV dates and adding them to the NAV change to arrive at the total returns.

$$\text{Total Returns} = \frac{\text{Distributions} + \text{Changes in NAV}}{\text{NAV at the beginning of the period}}$$

Total returns measure also is inadequate at times, where dividend gets reinvested if received during the year.

c) Returns on investments (ROI) or TR with dividend reinvested at NAV

The shortcoming of the simple total returns is overcome by computing the Total Returns with reinvestment of dividend in the Fund itself at the NAV on the date of distribution (Ex- dividend date).

$$\text{ROI} = \left(\frac{\text{Units held} + \frac{\text{Dividend}}{\text{Ex-dividend NAV}}}{\text{Begin NAV}}\right) \times \frac{\text{end NAV} - \text{begin NAV}}{\text{Begin NAV}} \times 100$$

II) The Expense Ratios

This important measure helps to shed light on a Fund’s efficiency and cost effectiveness. By definition, it is the ratio of total expenses to net assets. Low numbers are desirable.

Since the expense ratio can fluctuate it is best to compute an average of the last three to five years.

When evaluating expense ratios, compare a given Fund’s current expense ratio with an average of its past values to identify the trend. This value can also be compared with the figures for other portfolios of about the same size. While using expense ratios, the views that markets hold on expense may be gauged. The market holds that –

1. small Funds tend to have higher expense ratios than large ones.
2. expense ratio tends to be higher for Funds that have smaller average account sizes, other things being equal.
3. Funds that invest internationally tend to have significantly higher expense ratios than do domestic portfolios.
III) The Income Ratio

A Fund’s income ratio is its net income divided by its net assets for the period. This measure is akin to dividend yield on a stock. This ratio is a useful measure for evaluating income–oriented funds, particularly debt funds. Like expense ratio, to be more reliable average of the last three or five years can be used.

However, the income ratio cannot be considered in isolation. It shall be used only to supplement the analysis based on expense ratio and total returns.

IV) Transaction Cost

Transaction costs include all expenses related to trading such as brokerage commission paid, stamp duty on transfers, Registrar’s fee and Custodian’s fee. Transaction costs have a significant bearing on Fund performance and the efficiency of the fund managers (AMCs).

V) Portfolio Turn-Over Rate

This ratio measures how many times the fund manager turns over his portfolio by buying or selling of securities in the market. It is computed as the lesser of assets purchased or assets sold divided by the Fund’s net assets. A 100 percent turnover implies that the manager replaced his entire portfolio during the period in question. It is a good indicator of the extent to which the Fund is active in terms of its dealing on the market. However, high turnover ratio also indicates high transaction costs charged on the fund, which affects the net returns of the investor.

VI) Fund Size

Fund size can affect performance. Small Funds are easier to manoeuvre and can achieve their objectives in a focused manner with limited holdings. On the other hand, large Funds benefit from economies of scale with lower expense ratio, superior fund management skill, and greater risk bearing capacity. But they face dangers also. There is the possibility of superfluous diversification. It is hard for a large Fund to beat the market.

VII) Cash Flow

Cash flow refers to net new money invested in a Mutual Fund – the excess of new purchases over redemption. It should be expressed as a percentage of the portfolios’ total assets. A large cash-holding allows the Fund to strengthen its position in preferred securities without liquidating its other portfolios.
VIII) Borrowing by Mutual Fund

In the US there are hedge Funds which seek to enhance per unit earnings by borrowing, thereby enhancing their Fund size or corpus. This strategy holds good when borrowing costs are not high and Fund performance is good. However, if interest rate rise unexpectedly or the value of portfolio declines significantly, the Fund must reduce its dependence on debt quickly.

In India, anyhow, Mutual Funds are not allowed to borrow to increase their corpus.

2.6 Evaluating the Performance of AMCs

A portfolio is only as good as the people who run it or the organisation that manages it. To evaluate the Fund Manager or the AMC, various measures already explained in this section are available which reflect the quality of management. Good fund managers operate with a long term perspective and do not sacrifice investor value by excessive trading which causes a high level of transaction cost. They will turn out more consistent performance which is more valuable than one-time high and otherwise volatile performance. They do a superior job of controlling portfolio risk. Superior fund families show an ability to keep expenses down.

The investor must evaluate the fund managers’ (AMCs) track record. In the final analysis, Asset Management Companies and their fund managers ought to be judged on the basis of:

1. their consistency in the returns obtained
2. their performance record against competing or peer group managers running similar funds
3. their ability in controlling expenses and transaction costs and
4. their ability in managing portfolio risk

2.6.1 Risk Analysis

Risk, in a generic sense, is the possibility of loss, damage or harm. For investments, a more precise definition would include variability, or period-by-period fluctuations in total return. This is the way security analysts and Mutual Fund managers view risk. Risk and return usually go hand-in-hand. To earn above-average gains over the years, one must be willing to tolerate higher levels of volatility.
Total risk of a portfolio can be further identified as:

1. Company risk (diversifiable risk)
2. Sector risk or Industry risk
3. Market risk (non-diversifiable risk)

\[ i). \textbf{Statistical Calculation of Risk - Standard Deviation} \]

Standard deviation is a measure to quantify risk. It reflects the degree to which returns fluctuate around their average. The higher the standard deviation, the greater the risk. The measure is typically calculated using monthly results.

The formula used is –

\[ \sigma = \sqrt{\frac{1}{n} \sum (X - \overline{X})^2} \]

\[ \sigma = \text{Stand deviation} \]
\[ X = \text{Monthly returns over a period} \]
\[ \overline{X} = \text{Average Monthly Return} \]
\[ n = \text{Time period} \]

To be meaningful, standard deviation must be calculated over a sufficiently long period, 36 – 60 months. Many analysts commonly use 36 months.

\[ ii). \textbf{Beta measure} \]

Beta measures the sensitivity of the Funds to fluctuations in the market index and thereby assesses the market risk of the schemes. It is used to test the market timing ability of the fund managers. Beta relates the returns on a stock or Mutual Fund to a market index. This is often done by taking returns for the past 36 months and correlating them with the monthly return of the market index.

Beta is computed as follows:

\[ \beta_{ikl} = \frac{c_{ili}}{\sigma^2} \]

where, \( c_{ili} \) denotes the covariance of the returns on stock and the market index and \( \sigma^2 \) denotes the variance of returns on the market index. It can also be worked out as:

\[ \beta_{ikl} = \frac{T \star (\sum XY) - (\sum X \star \sum Y)}{T \star \sum X^2 - (\sum X)^2} \]

\[ T = \text{Time Period} \quad X = \text{Return on Market index} \quad Y = \text{Return on stock} \]
Beta need not be perfect. Beta value depends on how an investor calculates it. Betas based on data stretching back 36 months differ from another based on data for 60 months. It would also vary depending on the market index that is being used as benchmark.

iii). $R^2$

This statistic indicates how much of Fund’s fluctuations are attributable to movements in the overall market. This measure can help to spot questionable beta.

$R^2$ ranges from 0 to 100. The greater a Fund’s diversification, the higher the $R^2$. It is a measure of how good a fit we get with regression line. $R^2$ is also the square of the correlation between the returns on the security and the market. It is calculated using the formula:

$$R^2 = \frac{\sum Y + b \sum XY - n \bar{Y}^2}{\sum Y^2 - n \bar{Y}^2}$$

- $a = Y − \text{intercept}$
- $b = \text{Slope of the best fitting estimating line}$
- $X = \text{Values of the independent variables}$
- $Y = \text{Values of the dependent variables}$

iv). Risk adjusted Returns:

Sharpe and Treynor Ratios and Portfolio Alpha are ways to gauge risk adjusted performance.

a. Sharpe Ratio:

In Sharpe Ratio, the risk premium or the difference between a Funds’ average return and the average return on a riskless Treasury bill over the same period is divided by the fund’s standard deviation. i.e.,

$$\text{Sharpe Ratio} = \frac{\text{arp} - \text{arf}}{\sigma p}$$

- $\text{arp}$ - Average Return of Fund
- $\text{arf}$ - Average Risk-free return
- $\sigma p$ - Standard deviation of Fund’s return.
b. Treynor Ratio.

In Treynor Ratio, the ‘risk premium’ is divided by the ‘Beta’ of the Fund, i.e,

\[
\text{Treynor Ratio} = \frac{ar_p - ar_f}{\beta_p}
\]

Interpretation: Higher values are favorable as they indicate more return per unit of risk.

c. The portfolio alpha

Another risk-adjusted gauge is the Portfolio Alpha. It compares the actual results of a portfolio with what would have been expected given the Fund’s Beta and the market’s behavior. A positive Alpha indicates superior performance. A negative Alpha is indicative of below-par performance. It is calculated using the formula-

\[
\text{Portfolio Alpha} = \text{arp-CAPM return \ i.e,} \\
\quad = \text{arp} - [\text{arf} + (\text{arm} - \text{arf})\beta] \quad \text{or} \\
\quad = \text{RP} - [\text{RF} + (\text{RM} - \text{RF})\beta]
\]

\[
\begin{align*}
\text{arp} & = \text{average return on fund} \\
\text{arf} & = \text{average risk-free return} \\
\text{arm} & = \text{average market return}
\end{align*}
\]

2.7 Profile of the Mutual Fund Industry

The business of Mutual Funds has caught the imagination of the financial community all over the world and is growing at a rapid pace. The industry has grown tremendously in terms of size and operation over the years of its existence. Since the Mutual Fund industry is a strong pillar of the stock market system, it got a boost with the emergence of a strong market economy. Mutual Funds found increasing acceptance also because they have the capacity to absorb the instability and uncertainties that characterise the stock market system. The increasing volatility, reduction in real interest, and growing complexities in the market provided tremendous opportunities to Mutual Funds.

Investors seeking growth were forced to take recourse to Mutual Funds by the growing incidence of market failure, the complexities of investing in the stock market, the emergence of free pricing and above all, by the cost of investing.
The immediate boost to Mutual Funds, however, was provided by the prolonged economic boom in the U.S which fuelled dynamic growth in the stock market and consequently in the Mutual Fund assets and industry. In India too, the growth of stock market in the early 1990s gave rise to unprecedented growth in the Mutual Funds industry.

2.7.1 Global Scenario

The scenario pertaining to the net assets and number of Funds world-wide, region-wise and among the Top Ten countries of the world and the inter-relationship among them during the period from 1998 to 2005 are examined here. The role of the US and non-US net assets and number of Funds in the Global total and in the Top Ten Countries of the world and the global scenario of net assets by Fund Type also is presented.

2.7.1.1 World-wide Total Net Assets

Mutual Fund assets worldwide reached US $ 17769.39 billion by year-end 2005. This figure includes $ 8905.17 billion in the U.S Fund market and $ 8864.22 billion in 39 other nations, who are members of the International Investment Funds Association, an organisation of National Mutual Funds Associations. Nearly fifty five percent of worldwide Mutual Fund assets or around $ 10,000 billion are held in nations in the American region, with U.S assets composing 91 percent of the total for the region. Europe, if considered as one unified market, holds $ 6000.27 billion or nearly 33 percent of the total worldwide Mutual Fund assets in December 2005. Luxemburg and France with Fund assets of $ 1635.79 billion and $ 1362.67 billion respectively constituted the second and third largest Mutual Fund markets in the world and the largest and second largest in Europe. Investors in the Asia/Pacific and Africa regions held nearly 10 percent of worldwide Mutual Fund assets. Australia and Japan, with Fund assets of $ 700.07 billion and $ 470.04 billion respectively, as on year-end 2005, were the largest and next to the largest Asia/pacific Mutual Fund markets (Table 2.1).

Table (2.1) portrays worldwide Mutual Funds net assets over a period of eight years from 1998 to 2005. It gives an indication of the growth of Mutual Funds across the world.
### Table 2.1 Worldwide Total Net Assets of Mutual Funds (In billions of US dollars)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Countries</th>
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<th>1999</th>
<th>2000</th>
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<td>15.18</td>
<td>20.36</td>
<td>29.80</td>
<td>32.85</td>
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**EUROPE**

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**ASIA & PACIFIC**

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**WORLD TOTAL**

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<td>11234.13</td>
<td>13598.62</td>
<td>16164.31</td>
<td>17769.39</td>
</tr>
</tbody>
</table>

% Incr. in world Total Year on Year: 30.44%
% Growth of World total over the years: 2.86%
% of US to World Total: 56.52%
% of Non-US to World Total: 43.48%
% of Asia Pacific & Africa to World Total: 9.73%
% of India to World Total: 0.16%

As can be seen, the growth of the net assets was unprecedented worldwide particularly during the 1990s. The global net assets, rising from $9293.27 billion in 1998 to $17769.39 billion in December 2005, registered a growth of 91.21 percent in eight years.

A careful perusal of the data helps to shed light on many significant aspects of the global financial landscape. It can be seen that financial market development across the world is highly asymmetric and lop-sided. Table 2.1 reveals that Mutual Fund industry could take root only in 40 countries, ie, less than one fifth of the total number of national financial markets in the world till now. Amongst the countries too, wide disparity can be noticed in the matter of pattern of development. The U.S market alone occupied an average of 56.52 percent of total worldwide net assets. At the same time net assets of the non-U.S Mutual Funds during the corresponding period were only an average of 43.48%. The lop-sided development of the global market is more clearly indicated in Chart 2.1

![Chart 2.1 Share of the U.S and the Non-US in Global Net Assets](chart)

Source: Table 2.1

Chart 2.1 clearly indicates the preponderance of the U.S market over the world market.

In terms of growth in the net assets, though the decade ending in year 2000 presented a lustrous picture, the beginning year of the new millennium was sluggish and lack-lustre. Annual rate of growth in the first two years was lucrative whereas it nosedived in the subsequent years to register even a negative growth rate. Achieving
23.26 percent growth rate the market witnessed an unprecedented recovery in 2003 which, however, dwindled to 9.93% in 2005 [Table 2.1].

### 2.7.1.2 Global Net Assets Region-wise

Table 2.2 and 2.3 present region-wise distribution of global net assets during the period from 1998 to 2005. Imbalance exists in the region-wise development too. While region comprising American Continent occupied an average 59.93 percent of total world wide net assets, the corresponding figure for region comprising Europe was only 30.53 percent. The average share of the net assets of Asia / Pacific region comes to only 9.33 percent during the relevant period, and that of African region is negligible.

<table>
<thead>
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<tr>
<td>ASIA &amp; PACIFIC</td>
<td>720.70</td>
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<tr>
<td><strong>Total</strong></td>
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<td>11324.13</td>
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Source: Compiled from Table 3.1

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<th>2000</th>
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<td>100.00</td>
<td>100.00</td>
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</table>

Average of American Region=59.93%, Europe=30.53%, Asia-Pacific= 9.33%

Source: Compiled from Table 2.2

Chart 2.2 gives a comparative picture of the region-wise distribution of global net assets.
Chart 2.2 Regionwise Net assets in Worldwide Net Assets (Percentage)

<table>
<thead>
<tr>
<th>Percentage</th>
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<th>1999</th>
<th>2000</th>
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<td>59.84</td>
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<td>64.68</td>
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<td>Europe</td>
<td>26.96</td>
<td>28.12</td>
<td>27.17</td>
<td>26.52</td>
<td>29.18</td>
<td>32.90</td>
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<td>Asia-Pacific</td>
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<td>0.15</td>
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<td>10.68</td>
<td>10.84</td>
<td>10.76</td>
<td>10.71</td>
<td>10.70</td>
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</table>

Source: Table 2.3

2.7.1.3 Net Assets of Top Ten Countries

Pattern of growth of Mutual Fund net assets in the top 10 markets world wide, based on 2005 Net Assets is presented in Table 2.4

Table 2.4 Net Assets of Top Ten Nations based on 2005 Data

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<tbody>
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<td>U.S</td>
<td>5525.21</td>
<td>6846.34</td>
<td>6964.67</td>
<td>6974.95</td>
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<td>7414.08</td>
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<td>8905.17</td>
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<td>Luxemburg</td>
<td>508.44</td>
<td>661.08</td>
<td>747.12</td>
<td>758.72</td>
<td>803.87</td>
<td>1104.11</td>
<td>1396.13</td>
<td>1635.79</td>
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<td>France</td>
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<td>713.38</td>
<td>845.15</td>
<td>1148.45</td>
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<td>295.40</td>
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<td>341.96</td>
<td>334.02</td>
<td>356.30</td>
<td>518.41</td>
<td>635.07</td>
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<td>U.K</td>
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<td>316.70</td>
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<td>492.23</td>
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<td>95.17</td>
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<td>360.43</td>
<td>467.62</td>
<td>546.24</td>
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<td>Canada</td>
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<td>269.83</td>
<td>279.51</td>
<td>267.86</td>
<td>248.98</td>
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<td>413.77</td>
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<td>349.15</td>
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<td>Hong Kong</td>
<td>98.77</td>
<td>182.27</td>
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<td>170.07</td>
<td>164.32</td>
<td>255.81</td>
<td>343.64</td>
<td>460.52</td>
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<tr>
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<td>Italy</td>
<td>439.70</td>
<td>475.66</td>
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<td>359.88</td>
<td>378.26</td>
<td>478.73</td>
<td>511.73</td>
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<tr>
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<td>Total</td>
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<td>10435.64</td>
<td>10605.19</td>
<td>10431.33</td>
<td>10029.43</td>
<td>12364.06</td>
<td>14137.55</td>
<td>15568.64</td>
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<tr>
<td></td>
<td>Global Total</td>
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<td>11391.14</td>
<td>11871.06</td>
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<td>11324.13</td>
<td>13958.62</td>
<td>16164.31</td>
<td>17769.39</td>
</tr>
</tbody>
</table>

Proportion of Top Ten in The World Total: 89.97%, Proportions US to Global Total: 59.45, Prop. of Other's in the World Total: 10.02, Shares of US in Top Ten (as Percentage): 66.07, Shares of others in Top Ten: 37.93, Avg. of Top Ten = 89.07%

Source: Compiled from Table 2.1
The gravity of imbalance and the degree of asymmetry become conspicuous, when the net assets of the top ten countries are compared with the worldwide total net assets. It can be seen that these top ten countries held an average of 89.07 percent of the global net assets during the eight year period while all others together occupied only an average of 10.92 percent, during the corresponding period.

Chart 2.3 gives a comparison of net assets of top ten nations and the US

Among the top ten countries too, the US occupied a predominantly high proportion of net assets. US held an average of 62.80 percent of the total net assets invested by the top ten nations. Others in this group occupied only an average 37.20 percent, over the eight years.

A comparison of the US and top ten nations with global total is given in chart 2.4

Source: Table 2.4
2.7.1.4 World-wide number of Mutual Funds

Similarly, there was a significant growth in the number of Mutual Funds world wide. Table 2.5 depicts data on the number of Mutual Funds world wide, by region. The number of Mutual Funds rise from 50835 in 1998 to 56863 by the end of 2005. It registered a growth of 11.86 % over the eight years.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Countries</th>
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ASIA & PACIFIC

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ASIA & PACIFIC

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<td>460</td>
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<th>2004</th>
<th>2005</th>
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<td>54090</td>
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<tr>
<td>% Increase in World Total Year on Year</td>
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<td>2.35</td>
<td>-0.14</td>
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<tr>
<td>% of US to World Total</td>
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<td>14.27</td>
<td>15.78</td>
<td>15.78</td>
<td>15.78</td>
</tr>
<tr>
<td>% of Non- US to World Total</td>
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<td>84.22</td>
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<td>84.80</td>
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<td>% of India to World Total</td>
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<td>0.29</td>
<td>0.45</td>
<td>0.56</td>
<td>0.58</td>
</tr>
</tbody>
</table>

% Growth of World total over the year =11.86; Average of US Funds=14.92%; Average of non-US =85.08%.

The percentage growth in the number of Mutual Funds over the eight year period shows ups and downs of a minor magnitude.

It can be seen from Table 2.5 that the Mutual Fund figures in terms of number do not move in tandem with the net asset figures. The glaring predominance the US had in the matter of net assets is not visible in the case of the number of Funds. Even though rising trend continued in the US with the number increasing from 7314 in 1998 to 7977 in 2005, the share of the US in the total number of world wide Funds was only an average of 14.92 percent. As against this the non-US funds occupied an average of 85 percent in the total number (Table 2.5).

The share occupied by the US and the non-US in the total number of worldwide Funds is graphically presented in Chart 2.5.

![Chart 2.5 Number of Mutual Funds- US & Non-US Compared](chart)

Source: Table 2.5

### 2.7.1.5 Region-wise number of world-wide Funds

The number of Funds, by region also presents a more or less even distribution unlike in the case of net assets. While the Americas held an average of 23.93 percent during the eight year period, Europe held average of 47.82 percent and the Asia/Pacific region composed of 27.57 percent. The share of Africa was, however, negligibly small, holding only 0.67 percent in the total worldwide Fund. (Tables 2.6 and 2.7)
Table 2.6  Region-wise Number Worldwide Mutual Funds

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<th>2001</th>
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<th>2003</th>
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<td>27987</td>
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<td>460</td>
<td>466</td>
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</table>

Source: Compiled from Table 2.5

Table 2.7  Percentage of Region-wise Number of worldwide Mutual Fund

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<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>$\bar{X}$</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMERICAS</td>
<td>20.41</td>
<td>21.80</td>
<td>24.52</td>
<td>25.45</td>
<td>25.63</td>
<td>25.77</td>
<td>25.32</td>
<td>24.21</td>
<td>23.93</td>
</tr>
<tr>
<td>EUROPE</td>
<td>39.55</td>
<td>41.89</td>
<td>49.38</td>
<td>50.75</td>
<td>53.56</td>
<td>51.81</td>
<td>52.81</td>
<td>52.85</td>
<td>47.82</td>
</tr>
<tr>
<td>ASIA &amp; PACIFIC</td>
<td>39.66</td>
<td>35.82</td>
<td>25.45</td>
<td>23.00</td>
<td>19.96</td>
<td>21.55</td>
<td>20.91</td>
<td>21.85</td>
<td>27.57</td>
</tr>
<tr>
<td>AFRICA</td>
<td>0.38</td>
<td>0.49</td>
<td>0.65</td>
<td>0.81</td>
<td>0.85</td>
<td>0.86</td>
<td>0.97</td>
<td>1.09</td>
<td>0.67</td>
</tr>
</tbody>
</table>

Source: Compiled from Table 2.5

The share occupied by the American Region, Europe, Asia-Pacific and the African Region in the total number of world-wide Funds is graphically presented in Chart 2.6.

![Chart 2.6 Region-wise Share of Funds](chart2_6.png)

Source: Table 2.7

2.7.1.6 Number of Mutual Funds among the Top Ten Countries

The top ten countries in terms of net assets held in 2005 do not move in tandem with the toppers in terms of the number of Funds held during the same year. However, no wide variation is noticed in the matter of number of Funds held by top ten nations and
others. It is somewhat in a balanced position (see Table 2.8). While the top ten countries occupied 63% of the total number, others held 37%. (Chart 2.6)

**Table 2.8 Number of Mutual Funds, Investment-wise in Top Ten Countries**

<table>
<thead>
<tr>
<th>Countries</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S</td>
<td>7314</td>
<td>7791</td>
<td>8155</td>
<td>8305</td>
<td>8224</td>
<td>8126</td>
<td>8041</td>
<td>7977</td>
</tr>
<tr>
<td>Luxemburg</td>
<td>4524</td>
<td>5023</td>
<td>6084</td>
<td>6619</td>
<td>6874</td>
<td>6578</td>
<td>6885</td>
<td>7222</td>
</tr>
<tr>
<td>France</td>
<td>6274</td>
<td>6511</td>
<td>7144</td>
<td>7603</td>
<td>7773</td>
<td>7902</td>
<td>7908</td>
<td>7758</td>
</tr>
<tr>
<td>U.K</td>
<td>1576</td>
<td>1618</td>
<td>1766</td>
<td>1749</td>
<td>1787</td>
<td>1887</td>
<td>1915</td>
<td>1695</td>
</tr>
<tr>
<td>Ireland</td>
<td>851</td>
<td>1060</td>
<td>1344</td>
<td>1600</td>
<td>1905</td>
<td>1978</td>
<td>2088</td>
<td>2127</td>
</tr>
<tr>
<td>Canada</td>
<td>1130</td>
<td>1328</td>
<td>1627</td>
<td>1831</td>
<td>1956</td>
<td>1887</td>
<td>1978</td>
<td>1908</td>
</tr>
<tr>
<td>Japan</td>
<td>4534</td>
<td>3444</td>
<td>2793</td>
<td>2867</td>
<td>2718</td>
<td>2617</td>
<td>2552</td>
<td>2640</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>712</td>
<td>832</td>
<td>976</td>
<td>952</td>
<td>942</td>
<td>963</td>
<td>1013</td>
<td>1009</td>
</tr>
<tr>
<td>Italy</td>
<td>703</td>
<td>816</td>
<td>967</td>
<td>1059</td>
<td>1073</td>
<td>1012</td>
<td>1142</td>
<td>1035</td>
</tr>
<tr>
<td>Spain</td>
<td>1866</td>
<td>2150</td>
<td>2422</td>
<td>2524</td>
<td>2466</td>
<td>2471</td>
<td>2559</td>
<td>2672</td>
</tr>
<tr>
<td>Total</td>
<td>29484</td>
<td>30573</td>
<td>33278</td>
<td>35149</td>
<td>35718</td>
<td>35226</td>
<td>35813</td>
<td>35815</td>
</tr>
<tr>
<td>Global Total</td>
<td>50835</td>
<td>52746</td>
<td>51692</td>
<td>52849</td>
<td>54090</td>
<td>54015</td>
<td>55554</td>
<td>56863</td>
</tr>
</tbody>
</table>

Proportion of Top Ten in the World Total
58.00 57.96 56.377 57.96 57.96 57.96 57.96 57.96

Proportions of Other's in the World Total
42 42.04 35.623 33.992 33.992 33.992 33.992 33.992

Proportions US to Global Total

Shares of US in Top Ten (as Percentage)

Average of Top Ten =63.18, Others=36.82

**Source:** Mutual Fund Fact Book-2004, 2005, 2006

Note: Spain is considered as the 10th instead of Australia as its volume details are not available.

Note: Components do not sum to total because of rounding and unclassified Funds

The share occupied by the Top Ten countries and the US in the total number of world-wide Funds is graphically presented in Chart 2.7.

**Chart 2.7 No. of Mutual Funds Worldwide, in Top Ten markets and US- Compared**

Source: Table2.8
The share occupied by the US in the total number of Funds held by Top Ten Countries is graphically presented in Chart 2.8.

![Chart 2.8 Number of Mutual Funds of US Compared with Total of Top Ten countries](image)

Source: Table 2.8

### 2.7.1.7 Global Scenario of Net Assets by Fund type

Global Scenario of Net Assets by Fund type presented in the Table 2.9

#### Table 2.9 Total Net Assets by Fund Type. 1999-2004 Q2 (billions of US dollars)

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>5878</td>
<td>5962</td>
<td>5134</td>
<td>4204</td>
<td>5926</td>
<td>6307</td>
</tr>
<tr>
<td>Bond</td>
<td>2104</td>
<td>2077</td>
<td>2212</td>
<td>2529</td>
<td>3040</td>
<td>2876</td>
</tr>
<tr>
<td>M.M.</td>
<td>2287</td>
<td>2483</td>
<td>2986</td>
<td>3190</td>
<td>3208</td>
<td>3274</td>
</tr>
<tr>
<td>Mixed/Balanced</td>
<td>971</td>
<td>1022</td>
<td>942</td>
<td>923</td>
<td>1205</td>
<td>1233</td>
</tr>
<tr>
<td>Others</td>
<td>55</td>
<td>190</td>
<td>190</td>
<td>229</td>
<td>311</td>
<td>321</td>
</tr>
<tr>
<td>Total of all Reporting Countries</td>
<td>11295</td>
<td>11734</td>
<td>11464</td>
<td>11075</td>
<td>13690</td>
<td>14011</td>
</tr>
<tr>
<td>% of Equity</td>
<td>52.04</td>
<td>50.81</td>
<td>44.78</td>
<td>37.96</td>
<td>43.29</td>
<td>45.01</td>
</tr>
<tr>
<td>% of Bond</td>
<td>18.63</td>
<td>17.70</td>
<td>19.30</td>
<td>22.84</td>
<td>22.21</td>
<td>20.53</td>
</tr>
<tr>
<td>% of MM</td>
<td>20.25</td>
<td>21.16</td>
<td>26.05</td>
<td>28.80</td>
<td>23.43</td>
<td>23.37</td>
</tr>
<tr>
<td>% of Balanced</td>
<td>8.60</td>
<td>8.71</td>
<td>8.82</td>
<td>8.80</td>
<td>8.80</td>
<td>8.80</td>
</tr>
<tr>
<td>% of Others</td>
<td>0.49</td>
<td>1.62</td>
<td>1.66</td>
<td>2.07</td>
<td>2.27</td>
<td>2.29</td>
</tr>
</tbody>
</table>

Source: Mutual Fund Fact Book-2004

Components do not sum to total because of rounding and unclassified Funds.
Table 2.9 sheds light on the structure and composition of the net assets worldwide during the past 6 years. A highly asymmetric structure and composition is displayed in the global arena. It can be seen that equity funds constituted an average of 45.6 percent of the total net assets, Bond funds constituted 20.2 percent, Money Market instruments 23.8 percent, Balanced/Mixed fund 8.60 percent and others 1.7%.

Chart 2.9 gives the graphical presentation of the Global Scenario of net assets by Fund type, (Structural Composition).

2.7.1.8 World-wide number of Funds by Fund type

The number of Funds worldwide by Fund type is presented in Table 2.10.

Table 2.10 Number Of Funds By Fund type 1999-2004 (Structural Composition of Mutual Funds)

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>22453</td>
<td>20381</td>
<td>22348</td>
<td>22975</td>
<td>22738</td>
<td>22188</td>
</tr>
<tr>
<td>Bond</td>
<td>15474</td>
<td>13128</td>
<td>12183</td>
<td>11617</td>
<td>11890</td>
<td>11671</td>
</tr>
<tr>
<td>M.M</td>
<td>6745</td>
<td>4692</td>
<td>4277</td>
<td>4394</td>
<td>4974</td>
<td>5035</td>
</tr>
<tr>
<td>Mixed/Balanced</td>
<td>6375</td>
<td>11110</td>
<td>11155</td>
<td>11229</td>
<td>11499</td>
<td>11603</td>
</tr>
<tr>
<td>Others</td>
<td>612</td>
<td>1000</td>
<td>1195</td>
<td>1310</td>
<td>1571</td>
<td>1614</td>
</tr>
<tr>
<td>Total of all Reporting Countries</td>
<td>51659</td>
<td>50311</td>
<td>51158</td>
<td>51525</td>
<td>52672</td>
<td>52111</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Component</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004Q2</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Equity</td>
<td>43.46</td>
<td>40.51</td>
<td>43.68</td>
<td>44.59</td>
<td>43.17</td>
<td>42.58</td>
</tr>
<tr>
<td>% of Bond</td>
<td>29.95</td>
<td>26.09</td>
<td>23.81</td>
<td>22.55</td>
<td>22.57</td>
<td>22.40</td>
</tr>
<tr>
<td>% of MM</td>
<td>13.06</td>
<td>9.33</td>
<td>8.36</td>
<td>8.53</td>
<td>9.44</td>
<td>9.66</td>
</tr>
<tr>
<td>% of Balanced</td>
<td>12.34</td>
<td>22.08</td>
<td>21.80</td>
<td>21.79</td>
<td>21.83</td>
<td>22.27</td>
</tr>
<tr>
<td>% of Others</td>
<td>1.18</td>
<td>1.99</td>
<td>2.34</td>
<td>2.54</td>
<td>2.98</td>
<td>3.10</td>
</tr>
</tbody>
</table>

Source: Mutual Fund Fact Book-2004

Components do not sum to total because of unclassified Funds.
The structural composition of Mutual Funds over the six year period also revealed a highly skewed pattern where Equity Funds held a major share of 43 percent on an average, Bond Funds 24.6 percent, MM Funds 9.7 percent, Balanced Funds 20.4 percent and Others 2.4 percent.

The composition of Mutual Funds is graphically presented in chart 2.10

Chart 2.10:- Structural Compositions of M.F Worldwide