Chapter 5

Investment Pattern
### CHAPTER 5

**Investment Pattern**

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CHAPTER 5
INVESTMENT PATTERN

5.1 Financial planning

Every individual has some financial objectives for which he does financial planning meaning proper planning and implementation of well co-ordinated plans to achieve these financial objectives. The savings and investments made today will meet future financial goals. Financial planning is an ongoing process to fulfill one's changing goals and needs. If done wisely and timely, it will provide the following rewards in the long term:

1. Standard of living improves by planning effectively one's income and expenses and then do investment to meet future exigencies.
2. Spending the money judiciously by foregoing one's current needs in order to save for the future.
3. Striking a balance between his/her current expenses and future requirements.
4. Taking care of future needs as the financial planning will allocate a part of the current income for saving or investment, irrespective of the current income.
5. Wealth accumulation will take place and the individual will be able to form tangible as well as intangible assets if proper financial planning is done with current income.

For effective financial planning, financial goals must be clearly defined, listed, priorities, goals to be specified, realistic target listed and oriented, adjusted with changing environment and situations, divided into long term, short term and also intermediate goals.

5.2 Financial Instruments

In general, any financial security such as a bond, stock, money market securities (such as a Treasury Bill, Certificate of Deposit or commercial paper) and capital market securities (such as a mortgage or long-term bonds) are referred to as financial instruments. These are physical or electronic documents that have intrinsic monetary value or transfer value.

Financial instruments can be categorized by form depending on whether they are cash instruments or derivative instruments:

- **Cash instruments** are financial instruments whose value is determined directly by markets. They can be divided into securities, which are readily transferable and other
cash instruments such as loans and deposits, where both borrower and lender have to agree on a transfer.

- **Derivative instruments** are financial instruments which derive their value from the value and characteristics of one or more underlying assets. They can be divided into exchange-traded derivatives and over-the-counter (OTC) derivatives.

Alternatively, financial instruments can be categorized by "asset class" depending on whether they are equity based (reflecting ownership of the issuing entity) or debt based (reflecting a loan the investor has made to the issuing entity). If it is debt, it can be further categorized into short term (less than one year) or long term (more than one year).

**Foreign Exchange instruments** and transactions are neither debt nor equity based and belong to their own category.

It has been seen that the banks have been advertising about their saving products and the services being offered for a very long time. LIC and the general insurance companies have also been advertising their schemes for the last many years to attract the investors towards their schemes. The Government of India has also been instrumental in making the savers aware about the so called post office saving schemes through the National Savings Organisation (NSO) for which it has been using the various promotion media. The mutual fund industry has also seen many players in promoting their schemes and informing the investors about investing in their schemes. As the mutual funds are bound by SEBI regulations with respect to the advertising code, they have been advertising their products alongside with risk factors. In the recent past it has been observed that the Association of Mutual Funds in India (AMFI) is also educating the investors at large, through TV advertisements to apprise them of the benefits of investing in mutual funds. AMFI is an organisation representing all mutual fund houses in India. If it, on behalf of all their members is advertising about the schemes the mutual fund offers then it indicates that the advertisement of mutual fund products will definitely make people think about these products and make them inquisitive about them.

**5.2.1 Basic types of financial instruments**
Several financial instruments are available in the Indian capital market. These are government securities, preference shares, commercial paper, equity shares, certificate of deposits, call money market and industrial securities. These are discussed below:

**Government Securities:** In India, mainly the institutional investors buy the government securities. The government, both State and Central, and the government authorities, for example, state electricity boards, municipalities etc issue them. The commercial banks are the biggest investors to buy the G-secs. The government collects money through the G-secs to finance its several new infrastructure development projects or to meet its present needs.

**Preference Shares:** These carry a fixed dividend rate and a special right to dividends over the ordinary equity holders. Currently, all the preference shares in the Indian market have a fixed period of maturity. Therefore, sometimes they are termed as 'hybrid variety'.

**Commercial Paper (CP):** These are issued mainly by the companies to fund their working capital needs. These are issued generally for short-term, maturities are not secure and subject to market risks. Those corporate bodies that have a good credit history are only able to use this financial instrument.

**Equity Shares:** These are high-return, high-risk instruments. Equity shares don't have any fixed return rate and thereby, no period of maturity.

**Certificate of Deposit (CD):** These are very similar to the commercial papers. But these are issued mainly by the commercial banks.

**Call Money Market:** The loans made in the call money market are mainly short term in nature. Call money market mainly deals with the interbank markets. Those banks that are suffering from a short-term cash deficit borrow money from the call money market. The interest rate varies with the market rate and depends upon the banking system.

**Industrial Securities:** Normally the big corporate bodies issue these securities to fulfill their long-term requirements regarding working capital. The debentures, equity shares fall under this category.

**Mutual Funds:** A mutual fund is generally a professionally managed pool of money from a group of investors. A mutual fund manager invests the funds in securities, including shares and bonds, money market instruments or some combination of these, based upon the fund’s investment objectives. By investing in a mutual fund we can diversify, thereby sharply reducing our risk. Most mutual funds charge fees.
5.3 Stock markets in India

The history of stock markets in India originated in 1800 in a rudimentary form and has passed through many phases. The stock exchange in Mumbai, called BSE was established in 1875 and today enjoys the status of premier stock exchange in India, also has the distinction of being the oldest exchange in Asia. The next exchange was set up in Ahmedabad in 1894. Seven stock exchanges were functioning in the major cities in the country at the time of independence. The present number of exchanges in the country are 23 and more than 10,000 companies are listed on all these exchanges.

5.3.1 Role and functions of a stock exchange

A stock exchange plays the following major roles in the country:-

1. A stock exchange provides a market place for sale and purchase of securities. It ensures transfer of securities among the investors. The companies raising capital from the public depend fully on stock exchanges for marketing their securities at any time.

2. The stock exchange provides the market quotation of the prices of shares and bonds. These prices are based on the collective judgment arrived after interaction of many buyers and sellers at a time. It serves as a barometer of the state of health of individual companies and also a nation’s economy as a whole.

3. A stock exchange provides the linkages between the savings of the household sector and the investment in the corporate sector.

4. One more important function is to provide a market for gilt-edged securities, issued by the Government.

A stock exchange facilitates trading of financial securities. The company issuing its securities has to seek permission of the exchange for allowing trading in their exchange. This is called listing of securities, for which the company has to pay the listing fee annually, alongwith filing the listing documents.

5.3.2 Regulation of Stock Exchanges in India

All stock exchanges working in India were subject to self regularization from their own management bodies i.e. Board of Governors till 1956. Since then, it has changed to three tier regulations:-

1. The constitution of India lists the subject of stock exchanges and future markets under the exclusive authority of the Central Government. Through the Ministry of Finance, the Central Government regulates the stock exchanges primarily through Securities Contract (Regulation) Act 1956 (SCRA).
2. The Securities and Exchange Board of India (SEBI) also regulates the stock exchanges in order to protect the interests of investors and to promote the development of securities market in India.

3. All stock exchanges also have their own separate rules, bye laws and regulations which are exercised through their Governing councils.

5.3.3 Stock markets and financial development in India

The role of stock markets as a source of economic growth is great. The stock markets influence economic activity through the creation of liquidity and remain an important conduit for enhancing economic development and growth. If equity markets remain liquid and active, they make investments less risky and more attractive. The companies enjoy permanent access to capital raised through equity issues. By making investments relatively less risky, stock market liquidity can also lead to more savings and investments.

The Indian capital market has seen a significant structural transformation over the years. It now compares well with those in developed markets. Due to the gradual opening of the economy and the need to promote transparency in alternative sources of financing, the regulatory and supervisory structure has been overhauled with most of the powers for regulating the capital market vested with the Securities and Exchange Board of India (SEBI). In India, two most important factors having a significant bearing on the behavior of stock prices since 1990s have been the net investments by FIIs and trends in the international stock exchanges, especially NASDAQ.

5.4 Investor's Investment Pattern

The investment pattern is a long-term perspective and investing one's hard earned money is a serious subject that can have a major impact on investor's future wellbeing. In fact, everyone makes savings and investments. For any investor who invests money in various financial instruments, there will be varying degree of risks involved. Every investor has to appraise his risk-appetite, understand his financial goals and make investments. It is also important to analyse the risk-return trade off and then make investment decision.

The investment is the employment of funds with the aim of achieving additional income or growth in value. The essential quality of an investment is that it involves "waiting" for a reward. It involves the commitment of resources, which have been saved or put away from current consumption in the hope that some benefits accrue in future. Broadly speaking, an
investment decision is a trade-off between risk and return. All investment choices are made at points of time in accordance with the personal investment ends and in contemplation of uncertain future.

Choice of Investments

The choice for an investment is generally influenced by:-

1. Investor's personal profit, age, marital status and family responsibilities.
2. Financial status, income, savings, financial commitments and tax position.
3. One's attitude towards risk or risk appetite.

An investor’s plan for investment is developed on the following parameters:-

a. **Liquidity needs**: The liquidity is the conversion of the investments into cash for meeting urgent expenses or commitments. An investor may invest his surplus money into various kinds of investment instruments with an objective of encashing an instrument at the earliest when needed. The investment in a savings bank account is highly liquid and in a bond illiquid.

b. **Appropriate time horizon**: The money saved by the investors is used for fulfilling future needs and the investor earns the returns on different financial instruments as per their features. The investor chooses the savings and investment instruments in view of his plans for future needs. Thus, investments in money market instruments for short term and in fixed deposits/bonds for long term are made.

c. **Regular income and capital appreciation requirements**: The need for getting a regular income is one of the important criteria for some investors. An old-aged investor may be more inclined to invest in a monthly income scheme to have regular income for fulfilling his regular daily needs. Another investor may put the money in a fixed deposit for 3-5 years since his need is to get cumulative returns. Some investors are not satisfied with moderate returns and thus invest in equity shares. This enables them to earn capital appreciation along with good returns which are not available in banks.

d. **Need for diversification**: A wise investor always likes to invest the savings in a diversified portfolio. This helps in balancing out the inherent risks of investments. The diversification helps in minimizing the risks, if not eliminating it totally. An investor may invest in a basket of securities and also in many company shares if equity investments is the only option chosen.
e. **Minimize tax liability**: Some financial instruments provide tax benefits and many plan their investment options to minimize their tax liability. The investors normally in higher tax brackets choose to invest in LIC schemes or PPF accounts to avail tax benefits and rebates, thus their tax liability gets reduced. The Income Tax Act 1961 provides such benefits under various sections.

The mutual fund industry in India presents an interesting scenario of a large number of investors, a large variety of product offerings and co-existence of private, public and foreign Asset Management Companies. The investors, at large, in the mutual fund industry make investments in the various schemes of mutual funds, in view of their risk-appetite and their investment goals. Since the risk diversification is one of the unique features of mutual fund investments, the investment pattern of the investors is guided by the scheme objectives and one’s financial goals. It has been largely observed that the Corporates are the dominant investor group in the Indian Mutual Fund Industry and they account for almost 48% of the total investment (AUMs) in the industry and they are more oriented towards non-equity funds which offer high security & liquidity and hence their propensity towards Liquid/Money Market and debt-oriented funds; The second dominant group in the industry is the Retail investors’ group which accounts for almost 24% of the total investment (AUMs) in the industry, while they account for 98% of the total investors in the industry. The portfolio of this group is highly skewed towards equity oriented schemes (almost 80%) which offer high return, capital appreciation coupled with high risk and 18% of the portfolio accounts for debt-oriented and balanced funds.

In this study, the most preferred savings instruments of the respondents are as follows:

<table>
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<tr>
<th>Saving Instrument</th>
<th>% age</th>
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<tbody>
<tr>
<td>Post office Schemes</td>
<td>22</td>
</tr>
<tr>
<td>Equity Shares of Co.</td>
<td>23</td>
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<td>Mutual Funds</td>
<td>28</td>
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<td>Bank Deposits</td>
<td>24</td>
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<td>Bonds</td>
<td>3</td>
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The Table 5.1 and pie chart 5.1 reveal that investors want to invest in a wide variety of savings instruments keeping in view their risk appetite. 22% invest in Post Office schemes which provide sovereign guaranteed fixed rate of return. The mutual funds have attracted 28% of the respondents, 24% have been attracted to bank deposits and 23% invest in equity shares of companies. This shows that investors have their own most preferred saving instrument according to their need, choice and return expectations.

Investors buying behavior related to mutual funds was analyzed on the basis of prime objective of making savings and investment.

<table>
<thead>
<tr>
<th>Prime Objective</th>
<th>% age</th>
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<tbody>
<tr>
<td>Safety of capital</td>
<td>31</td>
</tr>
<tr>
<td>Higher returns</td>
<td>38</td>
</tr>
<tr>
<td>Capital appreciation</td>
<td>18</td>
</tr>
<tr>
<td>Tax benefits</td>
<td>13</td>
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The different investors have different prime objectives for their savings. As per Table 5.2 and pie chart 5.2, it is revealed that 38% of the investors consider earning higher returns as the
prime objective of their investments. The safety of the capital is the prime objective of 31% of the respondents. 18% of the respondents have capital appreciation as their major objective. Tax benefits are the prime objective with only 13% investors in this study. The majority of the investors want to earn higher return which is possible only in MF schemes as compared to other saving instruments like bank deposits, bonds & post office saving schemes.

<table>
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<tr>
<th>Risk Appetite profile</th>
<th>%age</th>
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<tbody>
<tr>
<td>High Safety, low returns</td>
<td>26</td>
</tr>
<tr>
<td>Moderate returns</td>
<td>44</td>
</tr>
<tr>
<td>High Risk, high returns</td>
<td>20</td>
</tr>
<tr>
<td>Market linked returns</td>
<td>10</td>
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</tbody>
</table>

The Table 5.3 and pie chart 5.3 reveal that majority 44% respondents expect moderate returns from their investments. As they are more concerned with safety of capital, are happy earning moderate returns. Further 26% respondents want high safety and are comfortable with low returns. 20% are ready to take high risk with high returns. There is also a segment of about 10% who are willing to move with the market. They are ready to earn market related returns.

5.4.1 Factors affecting investor's investment pattern

The savings and investments have been an integral part of human existence. As the future always remain uncertain, the money saved today comes handy tomorrow or whenever required. The investors may have their own individual objectives for investment.

The options for savings & investments are continuously increasing. It is possible for an investor to have more than one of these objectives, the success of one must come at the expense of others. The basic objectives of making savings and investment are:
Basic Objectives

Safety
As a matter of fact, there is no such thing as a completely safe and secure investment. On the one hand, one may see his savings eroding in a financial instrument and on the other, one can have ultimate safety of the investment funds by the purchase of government securities or through the purchase of the highest quality corporate bonds issued by the blue chip companies. Such securities are the best means of preserving principal while receiving a specified rate of return. Even the bank deposits provide greatest safety.

The safest investments are found in the money market and include such securities as Treasury bills, certificates of deposit, commercial paper or in the fixed income (bond) market in the form of municipal and other government bonds and in corporate bonds.

Income
The safest investments are also the ones that are likely to have the lowest rate of income, return or yield. The investors must inevitably sacrifice a degree of safety if they want to increase their income. There is an inverse relationship between safety and yield: as yield increases, safety generally goes down, and vice-versa.

In order to increase their rate of investment return and take on risk above that of money market instruments or government bonds, investors may choose to purchase the corporate bonds. Most investors, even the most conservative ones, want some level of income generation in their portfolios.

Growth of Capital
The investor also wishes to have a rate of return from an increase in value of investment, often referred to as a capital gain. The capital gains are entirely different from yield as they are only realized when the security is sold for a price that is higher than the price at which it was originally purchased. In the growth objective, the investor seeks the possibility of long-term growth.

The growth of capital is mostly concerned with the purchase of shares, which may offer low yields but considerable opportunity for increase in value. The blue-chip shares offer the best of all worlds by possessing reasonable safety, modest income and potential for growth in capital generated by long-term increases in corporate revenues and earnings as the company matures.
Secondary Objectives

Tax-Benefits

An investor may have some investments to have tax benefits as part of his or her investment strategy. A highly-paid executive may want to seek investments with favorable tax benefits in order to lessen the overall income tax burden, e.g. investment in PPF or LIC policy.

Marketability / Liquidity

Many of the investments are reasonably illiquid, meaning that they cannot be immediately sold and easily converted into cash. Achieving a degree of liquidity, however, may require the sacrifice of a certain level of income or potential for capital gains.

The shares are often considered the most liquid of investments, since they can usually be sold within a day or two. The bonds can also be fairly marketable, but some bonds are highly illiquid, or non-tradable, having a fixed term. Similarly, money market instruments may only be redeemable on the precise date at which the fixed term ends. If an investor seeks liquidity, non-tradable bonds should not be held in portfolio. It is seen from each of the five objectives discussed above that the advantages of one often comes at the expense of the benefits of another. If an investor desires growth, for instance, he or she must often sacrifice some income and safety.

The choosing of a single strategic objective and assigning weights to all other possible objectives depends on such factors as the investor's temperament, stage of life, marital status, family situation, and so on. Each investor is sure to find an appropriate mix of investment opportunities. One needs to be concerned with spending the appropriate amount of time and effort in finding, studying and deciding on the opportunities that match one’s objectives. Each mutual fund describes its investment objective in its prospectus along with the strategy the fund manager follows to meet that objective. The mutual fund investors often look for funds whose stated objectives are compatible with their own goals.

5.5 Investment Pattern of Mutual Funds in India

The Investor's Behavior has dramatically changed over the years and the investors are now leaving behind the sacred investment options like the fixed deposits, company deposits etc. The investors are now looking towards equity linked investment options. Like most developed and developing countries the mutual fund cult has been catching on in India. There are various reasons for this. The mutual fund makes it easy and less costly for investors to
satisfy their need for capital growth, income preservation. In addition to this, a mutual fund brings the benefit of diversification and money management to the individual investor, providing an opportunity for financial success that was once available only to a select few.

Many individuals find investments to be fascinating because they can participate in the decision making process and see the results of their choices. Not all investments will be profitable, as investor will not always make the correct investment decisions over the period of years; however, one should earn a positive return on a diversified portfolio. In addition, there is a thrill from the major success, along with the agony associated with the stock that dramatically rose after it is sold or was not bought. Investing is not a game but a serious subject that can have a major impact on investor's future well being. Virtually everyone makes investments.

The people often invest in various asset classes to:

* To check Inflation
* To fulfill future needs
* To meet contingency requirements
* To maintain standard of living after retirement

All these factors matter a lot to the investors and the mutual fund route is one way through which people can meet these needs.

Mutual funds have become one of the most attractive ways for the average investor to invest their money. A mutual fund pools resources from thousands of investors and then diversifies its investment into many different holdings such as stocks, bonds, or government securities in order to provide high relative safety and returns. Mutual Funds now represent perhaps the most appropriate opportunity for most investors. The Indian mutual fund industry has already started opening up many exciting investment opportunities to Indian investors. There are an endless variety of mutual fund investment choices depending on the degree of risk one feels comfortable with. Mutual Funds have emerged as professional intermediaries. Besides providing the expertise in stock market investing, these funds allow investing in small amounts and yet holding a diversified portfolio to a limit.

The fund manager of a mutual fund has a wide choice to invest the pooled funds in various financial investments including shares, bonds, money market instruments, Govt. securities etc. The investment in all these instruments is made in view of the scheme objectives. The
fund manager in bound to create a portfolio, as per the scheme objectives and returns expectations of the investors. He has also to manage the investments in view of the volatility of the markets. The mutual funds provide market related returns.

The most important activity in a mutual fund operation is management of funds. The fund managers acquire skills and expertise over a period of time. They need to have knowledge in the areas of working of markets, spectrum of instruments, macro-economic performance, Industry and industry cycles, historical record of stock market performance, and above all, the money psychology or psychology of the market for ensuring maximum possible return to investors. The fund manager's Investment refers to acquisition of some assets. It also means the conversion of money into claims on money and use of funds for productive and income earning assets. In essence, it means the use of funds for productive purposes, for securing some objectives like income, appreciation of capital or capital gains, or for further production of goods and services with the objective of securing profits. The investment activity involves the use of funds or savings for further creation of assets or acquisition of existing assets.

5.5.1 Risk, Return and Portfolio mix

In India, a mutual fund invests in a basket of investment instruments as per the objectives of the scheme. The fund manager builds up a portfolio for a scheme by investing in the following kind of instruments:-

1. Certificate of Deposits (CDs)
2. Commercial Papers (CPs)
3. Treasury Bills
4. Governments Bonds or Gilts
5. Corporate Debentures
6. Zero Coupon Bonds
7. Convertible Corporate Bonds / Debentures
8. Equity shares

The fund manager constructs, monitors and reshuffles portfolio according to the objectives of scheme as well as the prevailing market conditions. Each investment is viewed with respect to safety of principal, stability of return, protection against inflation and return. For the purposes of evaluating the risk returns and building the portfolio for schemes, the following investment instruments are considered:
1. **Certificates of Deposits (CDs)** – As the CDs are issued by banks, probability of failure is always very remote. Since return on CDs is fixed and decided at the time of issue and if any mutual fund goes for pre-mature disposal of CDs, then only loss of return may occur. In an open end mutual fund, where lot of liquidity is required to be maintained by fund managers, the cash flow is adjusted by investments in CDs. The investment in CDs is very appropriate for cash surplus mutual fund, an open-end fund or where redemption period is likely to finish earlier. The most important benefits of CDs are safety of principal, stability of return.

2. **Commercial Papers (CPs)** – The CPs are issued by cash needing companies and carry high safety rate. As the return on CPs is fixed and decided at the time of issue, if any mutual fund does pre-mature disposal of CPs from its portfolio, then only loss of return occurs. Where lot of liquidity is required to be maintained by fund managers, the cash flow can be adjusted by investments in CPs. Any inflationary tendency would also be resisted by investments in CPs since market rate prevails over indicating the rate of return. CPs are suitable instruments for cash surplus mutual funds, an open-end fund or a money market mutual fund scheme. The safety of principal, stability of return are the two important highlights of investing in CPs.

3. **Treasury Bills** – The treasury bills are auctioned by RBI and backed fully by faith and credit of the Central Government. The treasury bills are purchased at a discount and redeemed on short term maturity at par. Being a short term security, mutual funds invest in Treasury bills to maintain liquidity to fulfill, open-end scheme commitments. Till, the fund awaits for any long-term investments, temporarily mutual funds can park their funds for a fixed period of say 90 days or / and 180 days to avoid depreciation in the value of funds collected. In order to avoid idle cash, a mutual fund can invest in treasury bills most likely to be encashed before, the units are due for redemption. The safety of principal, stability of return are the main features of Treasury bills.

4. **Government Bonds or Gilts** – The gilts securities are backed by the financial support and sovereignty of the Government with no chance of default in servicing and repayment. The return on gilts is fixed and mutual funds keep on receiving the committed returns if the bond is retained for full period. An income fund normally invests in gilt securities to get fixed rate of return with guarantee by the Government for repayment. In bear market, portfolio mix with fairly good weightage of gilts, gives advantage of a fixed return. The Government securities provide safety of principal and stability of returns.
5. **Corporate Debentures** – One of the very important investment avenues for a mutual fund managers is corporate bonds. The risk level of company debentures and bonds is higher and the market liquidity very poor. As the risk with such debentures and bonds is more than gilts, the companies pay higher interest. The return is fixed, pre-determined and carried over till redemption. The net return received in the long run, net of inflation is very low. Purchase of bonds at discount from secondary market may fetch handful capital gains on redemption at par. In an income fund, the predetermined fairly higher rate of return on bonds and debentures, work as a cushion in the portfolio and help reducing volatility with consistency in return. The mutual fund managers who are not aggressive should invest about 25% to 40% of their fund for investments in debentures and bonds which carry highest safety rate to compensate any loss of capital occurring out of bear market. The safety of principal and the stability of return are main features in the bond investment.

6. **Zero Coupon Bonds** – These are bonds which pay interest only once on redemption but income accrues for a very long time 10-15-20 years. Rs.1000/- may become Rs.50,000/- in 20 years accumulating and reinvesting entire interest earned. The return on zero coupon bonds is fixed and pre-decided. The net return may slide since inflationary trends eat away the benefits. This security is useful as a cushion for long term commitments for assured maturity schemes. The mutual fund gives assurance of return to unit holders when investments are made in such bonds.

7. **Convertible Bonds / Debentures** – It is a hybrid security, carrying features of a bond and a common stock. The convertible bonds are converted to equity shares after a specified period. After conversion the safety of capital and the fixed returns in not available. Everything now is related with the market conditions. If the company does not do well, the investor may loose the capital itself. In this investment instrument, the return depends on the prices of equities. If the share prices are good, the capital appreciation could be substantial and if not after conversion the investor looses even the capital. In multi crore mega projects, growth mutual funds may invest sizeable proportion of their corpus after going through equity research and withhold investments for a long period of 5-7 years. The award may prove to be very good in terms of total return. The safety of principal and stability of return may not be good here.

8. **Equity Shares** - The equity shares are ownership capital. In mutual fund investments, equity investment is the most flexible instrument which discounts in itself all technical and fundamentals in pricing mechanism. The market conditions, inspite of company on a
strong base may cause heavy loss. In case of equity investment, continuous surveillance and restructuring of portfolio is a necessity to minimize risk without loss of return. An income fund should invest marginally in equities to appreciate capital, in case the fundamentals are strong. In growth funds, aggressive investing in equity shares is preferred by the fund manager. The fund manager should take note of the fact that the higher returns paid once will raise the expectations of the unit holders. The safety of principal and stability of return, both are low in case of equity investment.

The investment pattern of mutual fund schemes emerges on the basis of scheme’s objectives. The growth funds with main objective of substantial capital appreciation invests majority of funds in equity shares. About 20 – 30% is also invested in debentures and bonds. Being equity oriented schemes having high risks, investment in debt securities is required for sufficient liquidity for the purpose like redemption. To meet redemption, they either maintain idle cash or have reasonable debt component or money market instruments. In case of income funds, bulk of investment (more than 60% normally) is in bonds and debentures. To provide some capital appreciation in these schemes about 10-15 % investment is also made in equity shares. The balanced schemes having the objective of both income and growth with reasonable safety, have investment pattern which is normally balanced. In sector funds, the entire corpus is invested in the securities of companies representing a particular sector and the portfolio churned by the fund manager as per his strategy. In case of Index Funds, the investment is made in 30 stocks of BSE or 50 stocks of NSE, based on the type of Index to be tracked. In these funds, the fund manager’s strategy remains passive. The objective is to provide returns, as per the movements of BSE or NSE.

5.6 Evaluation of Investor’s Behaviour in Investment in Mutual Funds

Academic studies find only modest and short-term persistence in the performance of successful funds. For the individual investor, there are at least two potential drawbacks to chasing past performance. First, if one sells an existing unit of fund to buy a winner, this will increase the chances of capital gains, thus imposing a tax penalty. Second, top performing funds tend to charge higher operating expenses and to have higher turnover. It is also clear that high operating expenses and high turnover will affect the fund’s gross performance, while high turnover further increases the chances of capital gains. Thus, if the fund’s superior gross performance fails to persist, its performance, net of fees, expenses, and taxes is likely to be below par.
While a particular investor may benefit from chasing performance, investors in aggregate do not. If investors over-estimate their ability to identify superior funds based on past performance, this will lead to over-investment in active managed funds. It is also a fact that the investors react differently to various fund expenses. The investors are less likely to buy funds that charge brokerage commissions or front-end loads. However, their purchases are relatively insensitive to a fund’s operating expenses. Neglecting a fund’s operating expenses when purchasing a fund is clearly counterproductive, since it is well documented that mutual funds with low operating expenses tend to earn higher net returns than funds with high operating expenses. To find out whether mutual fund investors sell winners more readily than losers, it is not sufficient to look at the number of funds sold for gains versus the number sold for losses.

Then in an upward-moving market when they will have more winners in their portfolios and will tend to sell more winners than losers even though they had no preference for doing so. To test whether investors are disposed to selling winners and holding losers, we must look at the frequency with which they sell winners and losers relative to their opportunities to sell each. To understand the investor’s behavior on investment, some responses with their analysis, are as follows:

<table>
<thead>
<tr>
<th>Understand ‘Conditions apply’</th>
<th>%age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>79</td>
</tr>
<tr>
<td>No</td>
<td>12</td>
</tr>
<tr>
<td>Can't say</td>
<td>9</td>
</tr>
</tbody>
</table>

Table 5.4: Understanding of ‘Conditions apply’

Table and pie chart 5.4 reveal that majority of the respondents (79%) do understand the term “conditions apply” that appear in the advertisement of Mutual Fund schemes. Only 12% say that they do not understand this term. Based on this observation it can be said that the
investors do watch/read the advertisements of Mutual Fund schemes carefully and collect the knowledge about conditions as they have to make investment of their hard earned money. As most of the people investing in MFs are aware of the nature of securities like equity and bonds in which pooled savings are invested, it cautions them to understand the cautioning meaning of "conditions apply" in the advertisement of MF schemes.

<table>
<thead>
<tr>
<th>Option for Type of fund</th>
<th>% age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public sector MFs &amp; Why</td>
<td>53</td>
</tr>
<tr>
<td>Private sector MFs &amp; why</td>
<td>24</td>
</tr>
<tr>
<td>Both &amp; why</td>
<td>23</td>
</tr>
</tbody>
</table>

Pie Chart 5.5: Choice of Mutual Fund type

It is observed from Table & pie chart 5.5 that 53% respondents want to invest in public sector MFs, with the perception of having more trust and safety while 24% want to invest in Private Sector MFs. 23% are comfortable in investing in both public and private sector Mutual Funds. MFs, whether public or private sector, can only give market related returns.

<table>
<thead>
<tr>
<th>Option</th>
<th>% age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>48</td>
</tr>
<tr>
<td>No</td>
<td>52</td>
</tr>
</tbody>
</table>
As per Table & pie chart 5.6, 48% respondents in the study invest repeatedly in the same MF scheme, may be based on the returns. On the other hand 52% do not invest repeatedly in the same MF scheme. This may be due to various factors, like not satisfied with the returns, poor after-sale services etc.

<table>
<thead>
<tr>
<th>Option</th>
<th>% age</th>
</tr>
</thead>
<tbody>
<tr>
<td>January-March</td>
<td>57</td>
</tr>
<tr>
<td>April-June</td>
<td>17</td>
</tr>
<tr>
<td>July-September</td>
<td>13</td>
</tr>
<tr>
<td>October-December</td>
<td>13</td>
</tr>
</tbody>
</table>

The Table & pie chart 5.7 show that the investments in various financial instruments in general are not evenly spread throughout the year. This particular study also reveals the same. 57% of the respondents invest their savings in MF schemes during January-March quarter to avail the tax benefits. It may be so as during this quarter only, many investors finalise their investments for the financial year. Around 17% respondents invest during the quarter April-June. This may also be due to the practice of investing by Systematic Investment Plans every month and also reviving the habit of investing right from the first month of the new financial
year. The quarters of July to September & October to December have same 13% of investments done by these respondents.

The mutual fund investors invest in MF schemes to seek professional management of their funds through professional fund managers. In such schemes, the risk also gets diversified due to funds being invested in a basket of securities. However, it is advisable for MF investors to monitor the performance of their schemes by simply watching the movement of NAV of a scheme.

Table 5.8: Tracking the Mutual Fund schemes

<table>
<thead>
<tr>
<th>Tracking the fund</th>
<th>%age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>55</td>
</tr>
<tr>
<td>No</td>
<td>9</td>
</tr>
<tr>
<td>Occasionally</td>
<td>36</td>
</tr>
</tbody>
</table>

In this study, as per Table & pie chart 5.8, it is found that 55% of the respondents do track the performance of MF schemes in which they invest. 9% do not do the same as they believe in the performance given by the fund Manager and the market. About 36% respondents monitor the performance sometimes. This may be due to paucity of time with them and having a belief that Mutual fund investments made by them are comparatively safer than direct investments made in equity shares of companies.

5.7 Challenges for mutual fund industry in India

The investors trust and confidence is very important for the mutual fund industry. This industry in the last about four decades, has not been fully able to gain the confidence of the investors. The challenges before the mutual fund industry in India are:-

1. A mutual fund investor is always concerned about the safety of his investments, in view of the investments made in this industry. The schemes floated have not yet fully suited to the needs of large number of investors in India. The SEBI & RBI should advise the
mutual fund players to launch some successful international investment schemes for Indian investors.

2. Professional management of mutual fund schemes is a very big challenge in view of changing economic & financial changes, taking place periodically.

3. Another challenge for the growth of this sector is the proper services to the investors. With the presence of large number of investors all over India, customer service is a real challenge. The use of upgraded technology can only meet this challenge.

4. In view of the nature of investments being made from the pooled savings of the people, investor education is a very crucial area. The fluctuations of the stock markets make it more challenging for the fund managers to educate about the investment strategy being followed.

5. In the asset allocation area there should be judicious mix of assets in view of scheme’s objectives and undue importance should not be given to one asset only.

6. Providing liquidity to investors, as most of the mutual fund schemes are open ended, is a challenge for the managers of mutual funds.

7. As mutual fund investors invest small amounts and can do it regularly, diversification of portfolio should always be availability to them.

8. The mutual funds must offer several products as per the needs and risk appetite of the investors. These schemes should include income, growth, balanced, index, sector, money market funds to suit all kinds of investors. In case of investors objective getting changed, the mutual funds must permit investors to switch over at little or no extra charges.

9. The investor must receive regular information & updates on the current value and portfolio of his investments. The scheme must also disclose all the information about the scheme, its performance, proportion of the investments made in each class of assets, fund manager’s, investment strategy and outlook.

The mutual fund investors display systematic patterns when they buy and sell the units in different schemes. They tend to purchase funds with strong past performance, while generally neglecting operating expenses charged by the fund. The investors also tend to sell funds that have posted strong returns. Many investors believe that recent performance is overly representative of a fund’s future prospects. Thus, they predominantly chase past performance; over half of all purchases occur in funds that have been top performers in the past. This behaviour may be reasonable, since there is empirical evidence that top-performing mutual funds tend to repeat. When selling mutual funds, the disposition effect -- the tendency to hold
losers too long and sell winners too soon—dominates investors' decisions. In contrast to their buying of mutual funds, when selling mutual funds, the investors do not behave as though past returns predict the future. As is the case for many other investments, the mutual fund investors hold their losers and sell their winners.

Finally, it can also be argued that the framing of mutual fund expenses affects investor behaviour. The investors ignore the purchase of funds with high fees, such as front-end load, fees or brokerage commissions. In contrast, investors generally neglect a fund's operating expense ratio when buying funds. This result raises the possibility that the more salient disclosure of mutual fund operating expenses could affect investor behaviour. Though buying past winners can be reasonably justified, selling one's winners rather than losers and neglecting a fund's operating expenses when buying a mutual fund cannot. The Mutual funds with high operating expenses earn lower net returns than funds with low operating expenses. Thus, investors should buy funds with low operating expenses and sell their losing fund investments.

Lastly, every investor has to appraise his risk-appetite, understand his financial goals and make investments. It is also important to analyse the risk-return trade off and then make investment decision. The investors, at large, in the mutual fund industry make investments in the various schemes of mutual funds, in view of their risk-appetite and their investment goals. Since the risk diversification is one of the unique features of mutual fund investments, the investment pattern of the investors is guided by the scheme objectives and one's financial goals. The responses of the respondents regarding the most preferred saving instrument, prime objective for making investment, risk-appetite have been analysed. Some other responses for understanding the term "Conditions apply", choice of type of mutual funds, preference for investing during a particular period, tracking the performance of the scheme have also been analysed in this chapter.