

# **5 must know** concepts for a new mutual fund **investor**



## Net Asset Value (NAV)



**W**hen you invest in a mutual fund you get allotted units based on the prevalent price of the scheme on that day. This price is called NAV or Net Asset Value. All open ended schemes (schemes that are open all the year around and thus one can buy or sell on a daily basis) declare NAV on a daily basis.

Thus if you invested ₹12000 in a scheme where the NAV is ₹12 you will get  $12000/12 = 1000$  units. It's the same when you want to sell (or redeem your units). You just multiply the NAV by the units to get the redemption (sale) value.

## Open ended funds

**M**any funds are open ended. That is you can buy or sell units on any business day at the prevalent NAV. An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity. There is no compulsory lock-in (other than ELSS etc.) mandated in these funds however they can have exit loads which are nothing but penalties introduced to ensure that investors adhere to the ideal holding pattern of the scheme.



## What is the Investment objective?



**I**nvestment objectives give you a flavor of the kind of instruments that the scheme would invest in. For example there could be funds that invest in equity, debt or both. The investment objective also indicates a broadly worded investment time frame. This term therefore is critical as it decides the fate of your investment. As a thumb rule over the longer term one needs to shield against inflation and in the short term against volatility.

Consequently in the risk pecking order, liquid funds are the least volatile as they continuously invest in instruments that are extremely short term nature (that mature in a day/ few days) and at the extreme other hand we have equity funds where the returns are not even remotely predictable over the short term and can be really volatile.

Within debt funds too, funds having a lower average maturity are ideal for short-term holdings as they are well protected from the fluctuating interest rate movements. However, holding them for more than their average maturity may not get you the optimal results. There can be various types of debt funds based on the average maturity of the instruments invested in. Although debt funds are less risky than equity funds, they are still subject to market volatility. The level of volatility therefore depends on the average maturity of the specific portfolio.

The higher the average maturity, the greater the uncertainty in the short term, which is what results in greater volatility. Conversely, the lower the average maturity, the greater the certainty, which in turn lowers volatility.

## Start small. Open a Sleep in Peace account



**E**mbracing risk is easier said than done. For this not just depends on your personality but also your risk taking capacity (like prior commitments, loans, dependents).

If you are a first time investor and are skeptical of investing big sums of money, start a Sleep in Peace account wherein you commit to a series of monthly payments over a period of 3-5 years. It ensures that your acquisition cost is averaged through market highs and lows and second more importantly it disciplines you- you actually spend less when you have less to spend.

You can invest amounts as low as ₹ 1000 with no limits on the maximum in most schemes. There are no monthly or annual maintenance charges even if you don't transact further. No wonder we call them Sleep In peace accounts.

This discipline in a way suppresses the natural instinct to stop investing in a falling or a depressed market or invest a lot when markets are rising and buoyant. However do remember that rupee cost averaging does not assure a profit, however, and it does not protect against investment losses in declining markets.

It just ensures that by disciplining your entry into markets you override sentiments and thus may reduce the risk of committing a one fixed sum when markets are higher.

## Don't look at the NAV alone. Look at past performance and other features

**W**hilst choosing fund don't focus on a fund with a "low NAV " in the hope that you will get more numbers of units for what matters is the percentage return on your invested amount. For example, given a similar performance level of 10% appreciation, a ₹10 NAV will rise to ₹11 whereas a fund with a NAV of ₹100 will rise to ₹ 110. It is worthwhile to consider other factors (performance track record, fund management, volatility) that determine the portfolio return.

A mutual fund displays the portfolio of each scheme on its respective website. A portfolio is nothing but a detailed disclosure on various instruments and companies that the scheme has invested in.

In fact in all probability the NAV is high on account of good performance of the scheme over the years. Imagine two schemes, one a new scheme A with NAV of ₹ 15 and another old scheme B with a NAV of ₹ 150. Also further assume that both these schemes hold shares of the same companies and in the same proportion.

If the holdings of both these schemes increase by 10%, the NAV of the both the schemes will go up by 10% that the NAV of scheme A will be ₹ 16.5 and that of scheme B by ₹ 165. Thus a NAV of ₹ 15 or ₹150 does not matter at all.



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