

# Company Analysis

Company analysis is a study of variables that influence the future of a firm both

- qualitatively and
- quantitatively.

It is a method of assessing the competitive position of a firm:

- its earning and profitability,
- the efficiency with which it operates its financial position and
- its future with respect to earning of its shareholders.

The fundamental nature of the analysis is that each share of a company has an intrinsic value which is dependent on the company's financial performance.

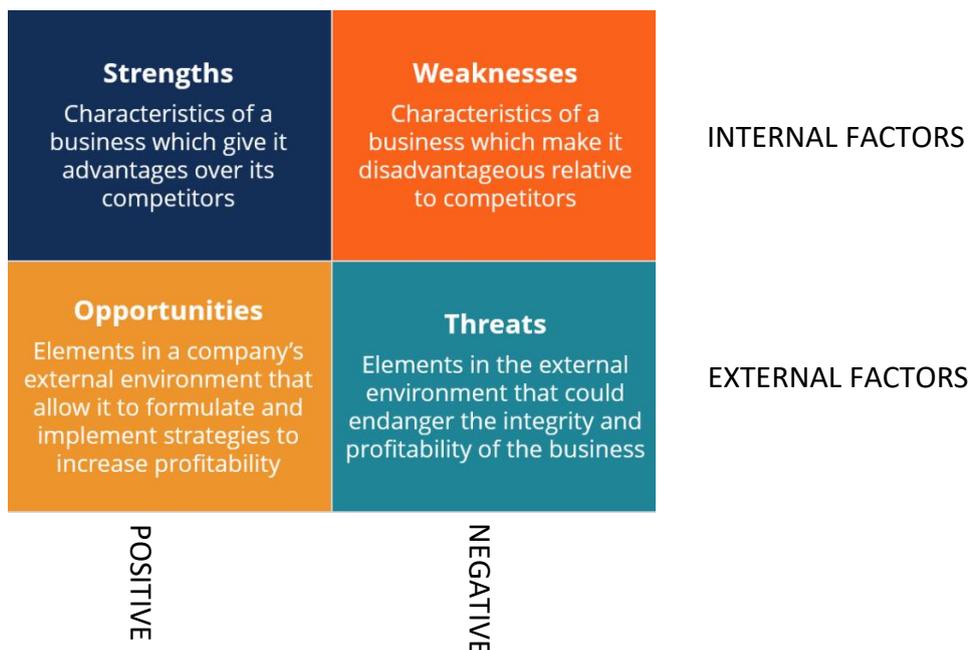
If Market Value of a share is  $<$  than Intrinsic Value as evaluated by fundamental analysis, then the share is supposed to be undervalued and vice versa.

The basic approach is **analysed** through the **financial statements** of an **organization/company**.

The company or corporate analysis is to be carried out to get answer for the following two questions:

- How has the company performed in comparison with the similar company in the same Industry?
- How has the company performed in comparison to the early years?

Before making investment decision, the business plan of the company, management, annual report, financial statements, cash flow and ratios are to be examined for better returns.



### **Measuring Earnings:**

- Internal Information: Relating to enterprise
- External Information: Out side the company

### **Financial Indicators:** - Analyze the financial position of the company – Tools:

- Income statement - It gives past records of the firm that forms a base for making predictions of the firm.
- Balance sheet - It shows the assets and liabilities of a firm along with shareholder s equity.
- Statement of Cash flows - It shows how a company's cash balance changed from one year to the next.
- Ratio Analysis - It makes intra firm and inter firm comparisons.

### **APPLIED VALUATION TECHNIQUES:**

Although the raw data of the Financial Statement has some useful information, much more can be understood about the value of a stock by applying a variety of tools to the financial data.

1. Earnings per Share EPS
2. Price to Earnings Ratio P/E
3. Projected Earnings Growth PEG
4. Price to Sales P/S
5. Price to Book P/B
6. Dividend Payout Ratio
7. Dividend Yield
8. Book Value per share
9. Return on Equity

References:

<http://www.sasurieengg.com/e-course-material/MBA/II-Year-Sem-3/BA7021%20SECURITY%20ANALYSIS%20AND%20PORTFOLIO%20MANAGEMENT.pdf>

# Technical Analysis

- ❖ Technical analysis focuses on the movement of the prices and the trade volume and tries to forecast the future movement of the prices. It concentrates on the change of the prices, and therefore you would know the timing of buying and selling, but not on the intrinsic value, and therefore you would not know whether you were properly investing. Both fundamental and technical analysis have their own pros and cons.

## Dow Theory

- ❖ Dow formulated a hypothesis that the stock market does not perform on random basis but is influenced by three distinct cyclical trends: Primary Trend, Secondary Trend
- ❖ **Significance of Dow Theory** – Theory gave birth to concept of higher top-higher bottom and lower top-lower bottom formations which are the basic foundation of Technical Analysis. This helps investors to improve their understanding on the market so that they could succeed in their investment/trading decisions.
- ❖ **Drawback of Dow Theory** - Theory considered only two indexes namely Industrial and Transportation averages in determining the market position which is not major part of today's economy.

## Elliott Wave Theory

- ❖ **The theory was developed by Ralph Nelson Elliott (1871-1948)** and is successfully being used by market participants to analyze stock market to forecast market trends. It is based on the hypothesis that stock prices move between optimism and pessimism of all market participants' psychology and wide swings in the participants' psychology makes stock prices move in a certain patterns/trends. **It suggests that stock prices move in clear trends which can be classified in two parts i.e. Dominant trend (Five wave pattern) and Corrective trend (Three wave pattern).**

## Bar charts

- ❖ Bar chart is the most popular method traders use to see price action in a stock over a given period of time. Such visual representation of price activity helps in spotting trends and patterns.

- ❖ Bar charts can be created for any time period – daily, weekly and monthly. A bar shows the high price for the period at the top and the lowest price at the bottom of the bar. Small lines on either side of the vertical bar serve to mark the opening and closing prices.
- ❖ The opening price is marked by a small tick to the left of the bar; the closing price is shown by a similar tick to the right of the bar.
- ❖ Many investors work with bar charts created over a matter of minutes during a day's trading.

### Point & Figure Charts

- ❖ A point-and-figure chart plots price movements for stocks, bonds, commodities, or futures without taking into consideration the passage of time.

### Moving Averages

- ❖ It is one of the methods to extract a trend after eliminating the trifle and meaningless change of the market is called “smoothing out the unevenness of prices. Such small changes can be eliminated by calculating an average of a certain period of the price data.
- ❖ **How to use moving average** – If the moving average line is rising from bottom left to top right, it means the upward trend. If the price crosses up through the rising moving average line, this means the acceleration of paces of rising. If the price crosses down through the moving average line, this means the slowing down of paces of rising. After that, if the moving average line turns to downward-sloping, this means entering the downward trend.



- **The 200-Day Moving Average** - It is one of the most reliable and easily read technical indicators available. Here, the closing price of the stock market observations are added up for the most recent 200 days and average is computed. The objective is to obtain a smooth curve and cancel random and erratic variations.
- **Exponential Moving Average** –An exponential moving average provides a short cut method of weighting. This method also provides more weightage to the recent data.

## Candlestick Charts

- ❖ **Candlestick** charts are used by traders to determine possible price movement based on past patterns as they show four price points (open, close, high, and low) throughout the period of time the trader specifies.

## Oscillators

An oscillator is an indicator that fluctuates above and below a center-line or between set levels as its value changes over time. Oscillators are used to discover short-term overbought or oversold conditions.

## Moving Average Convergence Divergence (MACD)

- ❖ MACD is the difference between the 12-day EMA (Exponential Moving Average) and 26-day EMA of a security.

## Relative Strength Index (RSI)

- ❖ RSI is an oscillator that measures the extent of recent price changes to determine overbought or oversold conditions in the price of a stock.

## References:

- ❖ [https://ifta.org/wp-content/uploads/2018/05/technicalhandbook\\_2018\\_NTAA.pdf](https://ifta.org/wp-content/uploads/2018/05/technicalhandbook_2018_NTAA.pdf)
- ❖ [https://zerodha.com/z-connect/wp-content/uploads/2014/06/TA\\_wrkbnk.pdf](https://zerodha.com/z-connect/wp-content/uploads/2014/06/TA_wrkbnk.pdf)
- ❖ [www.emarkets.com](http://www.emarkets.com)
- ❖ <https://chartink.com/pointfigure/nifty.html>
- ❖ [www.investing.com](http://www.investing.com)
- ❖ [www.fidelity.com](http://www.fidelity.com)

# **Efficient Market Hypothesis**

The Efficient Market Hypothesis (EMH) essentially says that all known information about investment securities, such as stocks, is already factored into the prices of those securities.

## **Variations/Forms of the Efficient Markets Hypothesis**

There are three variations of the hypothesis – the weak, semi-strong, and strong forms – which represent three different assumed levels of market efficiency.

Efficient Market Theory implies that market prices factor in all available information and as such it is not possible for any investor to earn consistent long term returns from market operations.

Although price tends to fluctuate they cannot reflect fair value. This is because the future is uncertain. The market springs surprises continually and as prices reflect the surprises they fluctuate.

Inability of institutional portfolio managers to achieve superior investment performance implies that they lack competence in an efficient market. It is not possible to achieve superior investment performance since market efficiency exists due to portfolio managers doing this job well in a competitive setting.

The random movement of stock prices suggests that stock market is irrational. Randomness and irrationality are two different things, if investors are rational and competitive, price changes are bound to be random.

### **CHALLENGES OF THE EFFICIENT MARKET THEORY.**

- a. Limited information processing capabilities
- b. Irrational Behaviour
- c. Monopolistic Influence

## **MARKET EFFICIENCY**

**Weak form of efficiency:** According to the Weak form Efficient Market Theory current price of a stock reflects all information found in the record of past prices and volumes. This means that there is relationship between the past and future price movements. This is affirmed through Serial Correlation Test, Runs Test and Filter Test.

**Semi Strong Efficiency:** According to Semi-strong form efficient market theory stock prices adjust rapidly to all publicly available information. By using publicly available information, investors will not be able to earn above normal rates of return after considering the risk factor.

**Strong Efficiency:** According to Strong form efficient market theory stock prices adjust rapidly to all publicly and privately available information.

### **References**

-C.A final module- strategic financial Management-Security and portfolio analysis

Investment valuation- Damodaran

Corporatefinanceinstitute.com

<https://sfmguru.in/>

<http://people.stern.nyu.edu/adamodar/pdfiles/valn2ed/ch6.pdf>

<https://www.thebalance.com/efficient-markets-hypothesis-emh-2466619>

# Options

## **Introduction**

An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an underlying asset at a specific price on or before a certain date.

## **Options Terminology**

1. **Buyer of an option:** The option buyer is the person who acquires the rights conveyed by the option: the right to purchase the underlying futures contract if the option is a call or the right to sell the underlying futures contract if the option is a put. In other words, the buyer of an option is the one who by paying the option premium, buys the right but not the obligation to exercise his option on the seller/writer.
2. **Writer of an option:** The option seller (also known as the option writer or option grantor) is the party that conveys the option rights to the option buyer. In other words, the writer of a call/put option is the one who receives the option premium and is thereby obliged to sell/buy the asset if the buyer exercises on him.
3. **Option Class:** All calls and puts on a given underlying security or index represent an "option class." In other words, all calls and puts on XYZ stock are one class of options, while all calls and puts on ZYX index are another class.
4. **Option Series:** All options of a given type (calls or puts) with the same strike price and expiration date are classified as an "option series." For example, all XYZ June 110 calls would be an individual series, while all XYZ June 110 puts would be another series.
5. **Contract Size of Equity Options:** The contract size of an option refers to the amount of the underlying asset covered by the options contract. For each unadjusted equity call or put option, 100 shares of stock (usually, but this may differ from stocks to stocks) will change hands when one contract is exercised by its owner. These 100 shares of underlying stock are also referred to as the contract's "unit of trade."
6. **Contract Size of Index Options:** The contract size of a cash-settled index option is determined by its multiplier. The multiplier determines the aggregate value of each point of the difference between the exercise price of the option and the exercise settlement value of the underlying interest.  
  
For example, a multiplier of 100 means that for each point by which a cash-settled option is in the money upon exercise, there is a \$100 increase in the cash settlement amount.

7. **Option price:** Option price is the price which the option buyer pays to the option seller. It is also referred to as the option premium.
8. **Expiration date:** The date specified in the options contract is known as the expiration date, the exercise date, the strike date or the maturity.
9. **Strike Price(K):** Also known as the "exercise price," this is the stated price at which the buyer of a call has the right to purchase a specific futures contract or at which the buyer of a put has the right to sell a specific futures contract. The exchanges decide the strike price at which call and put options are traded. Generally, to simplify matters, the exchanges specify the strike price interval for different levels of underlying prices, meaning the difference between one strike price and the next strike price over and below it.
10. **American options:** American options are options that can be exercised at any time upto the expiration date. Most exchange-traded options are American.
11. **European options:** European options are options that can be exercised only on the expiration date itself. European options are easier to analyze than American options, and properties of an American option are frequently deduced from those of its European counterpart.
12. **Index options:** These options have the index as the underlying. Some options are European while others are American. Like index futures contracts, index options contracts are also cash settled.
13. **Stock options:** Stock options are options on individual stocks. Options currently trade on over 500 stocks in the United States. A contract gives the holder the right to buy or sell shares at the specified price.
14. **Option Premium:** The "price" an option buyer pays and an option writer receives is known as the premium. Premiums are arrived at through open competition between buyers and sellers according to the rules of the exchange where the options are traded. A basic knowledge of the factors that influence option premiums is important for anyone considering options trading. The premium cost can significantly affect whether the investor realize a profit or incur a loss.
15. **Moneyness:** In finance, moneyness is a measure of the degree to which a derivative is likely to have positive monetary value at its expiration, in the risk-neutral measure. There are three positions in an option: In-the-money; At-the-money; and Out-of-the money.

16. **Intrinsic value of an option:** The option premium can be broken down into two components – intrinsic value and time value. The intrinsic value of a call is the amount the option is ITM, if it is ITM. If the call is OTM, its intrinsic value is zero. Putting it another way, the intrinsic value of a call is  $\text{Max} [0, (S_t - K)]$  which means the intrinsic value of a call is the greater of 0 or  $(S_t - K)$ . Similarly, the intrinsic value of a put is,  $\text{Max} [0, (K - S_t)]$  i.e. the greater value of 0 or  $(K - S_t)$ .  $S_t$  is the spot price at time  $t$ ;  $K$  is the strike price.
17. **Time value of an option:** The time value of an option is the difference between its option premium and its intrinsic value. Both calls and puts have time value. An option that is OTM or ATM has only time value. Usually, the maximum time value exists when the option is ATM. The longer the time to expiration, the greater is an option's time value, all else being equal. At expiration, an option should have no time value.

### **Types of Options**

There are two basic types of options-call options and put options.

1. **Call option:** A call option gives the holder the right but not the obligation to buy an asset by a certain date for a certain price.
2. **Put option:** A put option gives the holder the right but not the obligation to sell an asset by a certain date for a certain price.

Source : John C Hull E book

[https://www.google.com/search?ei=Q5MJX9C9M7rhz7sPwviNqAY&q=john+c+hull+pdf&oq=john+c+hull+pdf&gs\\_lcp=CgZwc3ktYWIQAzoECAAAQzoCCABQhU1YsGdg7WtoAHAAeACAAd4BiAGJBpIBBTauMy4ymAEAoAEBqgEHZ3dzLXdpeg&sclient=psy-ab&ved=0ahUKEwiQ69fa\\_cTqAhW68HMBHUJ8A2UQ4dUDCAw&uact=5](https://www.google.com/search?ei=Q5MJX9C9M7rhz7sPwviNqAY&q=john+c+hull+pdf&oq=john+c+hull+pdf&gs_lcp=CgZwc3ktYWIQAzoECAAAQzoCCABQhU1YsGdg7WtoAHAAeACAAd4BiAGJBpIBBTauMy4ymAEAoAEBqgEHZ3dzLXdpeg&sclient=psy-ab&ved=0ahUKEwiQ69fa_cTqAhW68HMBHUJ8A2UQ4dUDCAw&uact=5)

# **Futures**

A future contract is a standardized agreement between the seller (short position) of the contract and the buyer (long position), traded on a futures exchange, to buy or sell a certain underlying instrument at a certain date in future, at a pre-set price. The future date is called the delivery date or final settlement date. The pre-set price is called the futures price. The price of the underlying asset on the delivery date is called the settlement price.

Thus, futures are a standard contract in which the seller is obligated to deliver a specified asset (security, commodity or foreign exchange) to the buyer on a specified date in future and the buyer is obligated to pay the seller the then prevailing futures price upon delivery.

## **Characteristics of Futures Contracts**

Following are the salient features of futures contracts:

1. Futures are highly standardised contracts that provide for performance of contracts through either deferred delivery of asset or final cash settlement;
2. These contracts trade on organized futures exchanges with a clearing association that acts as a middleman between the contracting parties;
3. Contract seller is called 'short' and purchaser 'long'. Both parties pay margin to the clearing association. This is used as performance bond by contracting parties;
4. Margins paid are generally marked to market-price every day;
5. Each futures contract has an associated month that represents the month of contract delivery or final settlement. These contracts are identified with their delivery months like July- Treasury bill, December \$/DM etc.
6. Every futures contract represents a specific quantity. It is not negotiated by the parties to the contract. One can buy or sell a number of futures contracts to match one's required quantity. Because of this feature, 100% hedging is not possible. There may be over or under-hedging to some extent.

These and other differences between forwards and futures are summarized below

Criteria/Factors		Forwards	Futures
1.	Trading	Traded by telephone or telex (OTC)	Traded in a competitive arena( recognized exchange)
2.	Size of contracts	Decided between buyer and seller	Standardized in each futures market
3.	Price of contract	Remains fixed till maturity	Changes everyday
4.	Mark to Market	Not done	Marketed to market everyday
5.	Margin	No margin required	Margins are to be paid by both buyer and sellers
6.	Counter Party Risk	Present	Not present
7.	No.of contracts in a year	There can be any number of contracts	Number of contracts in a year is fixed.
8.	Frequency of Delivery	90% of all forward contracts are settled by actual delivery.	Very few future contracts are settled by actual delivery
9.	Hedging	These are tailor -made for specific date and quantity. So, it is perfect	Hedging is by nearest month and quantity contracts. So, it is not perfect.
10.	Liquidity	Not liquidity	Highly liquid
11.	Nature of Market	Over the Counter	Exchange traded
12.	Mode of Delivery	Specifically decided. Most of the contracts result in delivery	Standardized. Most of the contracts are cash-settled.
13.	Transactional Costs	Costs are based on bid-ask spread	Include brokerage fees for buy and sell others

Source : John C Hull E book

[https://www.google.com/search?ei=Q5MJX9C9M7rhz7sPwviNqAY&q=john+c+hull+pdf&oq=john+c+hull+pdf&gs\\_lcp=CgZwc3ktYWlQAzoECAAAQzoCCABQhU1YsGdg7WtoAHAAeACAA d4BiAGJBpIBBTauMy4ymAEAoAEBqgEHZ3dzLXdpeg&scient=psy-ab&ved=0ahUKEwiQ69fa\\_cTqAhW68HMBHUIJ8A2UQ4dUDCAw&uact=5](https://www.google.com/search?ei=Q5MJX9C9M7rhz7sPwviNqAY&q=john+c+hull+pdf&oq=john+c+hull+pdf&gs_lcp=CgZwc3ktYWlQAzoECAAAQzoCCABQhU1YsGdg7WtoAHAAeACAA d4BiAGJBpIBBTauMy4ymAEAoAEBqgEHZ3dzLXdpeg&scient=psy-ab&ved=0ahUKEwiQ69fa_cTqAhW68HMBHUIJ8A2UQ4dUDCAw&uact=5)

## **Mutual Funds in India**

### **What are Mutual Funds?**

A mutual fund is essentially a common pool of money in which investors put in their contribution. This collective amount is then invested according to the investment objective of the fund.

### **How is a mutual fund set up?**

A mutual fund is set up in the form of a trust, which has a sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor who is like the promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. The custodian, who is registered with the Securities and Exchange Board of India (SEBI), holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over the AMC. They monitor the performance and compliance with SEBI Regulations.

The AMC employs professional money managers, having expertise in investing in equity, debt or both, who then invest the collected amount from investors and manage it on their behalf. The AMC may have several mutual fund schemes with their specific investment mandates. An investor can choose which scheme he or she wants to invest in, based on the given mandate or objective.

All AMCs are governed by a Board of Directors and come under the SEBI (Mutual Funds) Regulations, 1996. The regulator or SEBI has set clear mutual fund regulations and requires all mutual fund schemes of an AMC to clearly spell out the fund's objectives in its prospectus that an investor must read before he/she invests in a mutual fund.

### **What is the benefit of investing in mutual funds?**

One of the key advantages of investing in a mutual fund is that each investor (even with a small investment) gets access to professional money management and expertise. Also, it would be very difficult for an investor to create a diversified portfolio of investments on his own with a small amount of money. With mutual funds, each investor participates proportionally in the return the scheme generates.

Each unit gets a proportional share of gain (or bears loss) from the fund. There is a portfolio report generated for each investor, which tracks all investments and the returns generated by the mutual fund. Mutual funds give small or individual investors access to diversified, professionally managed portfolios at a low price.

### **Net Asset Value (NAV)**

The basic understanding of [mutual funds](#) would be incomplete if one does not understand the accounting principles behind it properly which comprises among other things the valuation of schemes and calculation of net asset values. “**NAV is the price per unit value of the mutual fund.**”

### **New Fund Offer**

A **new fund offer** (NFO) is the first time subscription **offer** for a **new** scheme launched by the asset management companies (AMCs). A **new fund offer** is launched in the market to raise capital from the public in order to buy securities like shares, govt. bonds etc. from the market.

### **Open ended Mutual Fund Schemes**

Open-ended mutual funds are those that people synonymously use with mutual funds. Open-ended funds can be bought or sold in demand on a daily basis at their Net Asset Value (NAV). The NAV changes daily and there is no restriction on the number of units the fund has.

### **Closed ended Mutual Funds Schemes**

Closed-ended mutual funds are those who have a fixed asset base and a fixed number of units. These units are traded on a stock exchange. The Net Asset Value (NAV) of the fund doesn't change on a daily basis. Investors do not have an option to buy the units of a closed-ended fund after the NFO closes. Existing investors also cannot exit from the fund until the term of the closed-ended fund ends. However, to ensure liquidity the fund is traded on a stock exchange and investors can buy or sell units on the exchange. Also, a closed-ended fund has a fixed maturity period.

## **Equity funds**

An equity fund is a mutual fund scheme that invests predominantly in equity stocks. In the Indian context, as per current SEBI Mutual Fund Regulations, an equity mutual fund scheme must invest at least 65% of the scheme's assets in equities and equity related instruments.

Under the tax regime in India, equity funds enjoy certain tax advantages (such as, there is no incidence of long term capital gains tax on equity shares or equity funds which are held for at least 12 months from the date of acquisition). As per current Income Tax rules, an "Equity Oriented Fund" means a Mutual Fund Scheme where the investible funds are invested in equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund.

An Equity Fund can be actively managed or passively managed. Index funds and ETFs are passively managed. Equity mutual funds are principally categorized according to company size, the investment style of the holdings in the portfolio and geography. The size of an equity fund is determined by market capitalization, while the investment style, reflected in the fund's stock holdings, is also used to categorize equity mutual funds.

Equity funds are also categorized by whether they are domestic (investing in stocks of only Indian companies) or international (investing in stocks of overseas companies). These can be broad market, regional or single-country funds. Some specialty equity funds target business sectors, such as health care, commodities and real estate and are known as Sectoral Funds.

In many ways, equity funds are ideal investment vehicles for investors that are not as well-versed in financial investing or do not possess a large amount of capital with which to invest. Equity funds are practical investments for most people.

The attributes that make equity funds most suitable for small individual investors are the reduction of risk resulting from a fund's portfolio diversification and the relatively small amount of capital required to acquire shares of an equity fund. A large amount of investment capital would be required for an individual investor to achieve a similar degree of risk reduction through diversification of a portfolio of direct stock holdings. Pooling small investors' capital allows an equity fund to diversify effectively without burdening each investor with large capital requirements.

The price of the equity fund is based on the fund's net asset value (NAV) less its liabilities. A more diversified fund means that there is less negative effect of an individual stock's adverse price movement on the overall portfolio and on the share price of the equity fund. Equity funds are managed by experienced professional portfolio managers, and their past performance is a matter of public record. Transparency and reporting requirements for equity funds are heavily regulated by the federal government.

Equity funds are very popular amongst the retail investors among various categories of mutual fund products. Whether it's a particular market sector (technology, financial, pharmaceutical), a specific stock exchange (such as the BSE or NSE), foreign or domestic markets, income or growth stocks, high or low risk, or a specific interest group (political, religious, brand), there are equity funds of every type and characteristic available to match every risk profile and investment objective that investors may have.

### **Different categories of equity funds**

There are different types of equity mutual fund schemes and each offers a different type of underlying portfolio that has different levels of market risk.

1. Large Cap Equity Funds invest a large portion of their corpus in companies with large market capitalization are called large-cap funds. This type of fund is known to offer stability and sustainable returns, over a period of time. Large Cap companies are generally very stable and dominate their industry. Large-cap stocks tend to hold up better in recessions, but they also tend to underperform small-cap stocks when the economy emerges from a recession. Large-cap tend to be less volatile than mid-cap and small-cap stocks and are therefore considered less risky.
2. Mid-Cap Equity Funds invest in stocks of mid-size companies, which are still considered developing companies. Mid-cap stocks tend to be riskier than large-cap stocks but less risky than small-cap stocks. Mid-cap stocks, however, tend to offer more growth potential than large-cap stocks.
3. Small Cap Funds invest in stocks of smaller-sized companies. Small cap is a term used to classify companies with a relatively small market capitalization. However, the definition of small cap can vary among market intermediaries, but it is generally regarded as a company with a market capitalization of less than ₹ 100 crores. Many small caps are young companies with significant growth potential. However, the risk

of failure is greater with small-cap stocks than with large-cap and mid-cap stocks. As a result, small-cap stocks tend to be the more volatile (and therefore riskier) than large-cap and mid-cap stocks. Historically, small-cap stocks have typically underperformed large-cap stocks during recessions but have outperformed large-cap stocks as the economy has emerged from recessions.

4. The smallest stocks of the small caps are called micro-cap stocks. While the opportunity for these companies to experience extreme growth is great, the risk to lose a large amount of money is also possible
5. Multi Cap Equity Funds or Diversified Equity Funds invests in stocks of companies across the stock market regardless of size and sector. These funds provide the benefit of diversification by investing in companies spread across sectors and market capitalisation. They are generally meant for investors who seek exposure across the market and do not want to be restricted to any particular sector. They invest in companies across different market caps and hence reduce the amount of risk in the fund. Diversification helps prevent events that could affect a single sector for affecting the fund, and hence reduce risk.
6. Thematic Equity Funds: These funds invest in securities of specific sectors such as Information Technology, Banking, Service and pharma sector etc., which is specified in their scheme information documents. So, the performance of these schemes depends on the performance of the respective sector. These funds may give higher returns, but they also come with increased risks.
7. Equity linked savings scheme (ELSS): It is an equity mutual fund investment that invests at least 80 per cent of its assets in equity and equity-related instruments. ELSS can be open-ended or close ended. Investments in an ELSS qualify for tax deductions under Section 80C of the Income Tax Act within the overall limit of ₹1.5 lakh. The amount you invest in ELSS is deducted from your taxable income, which helps you lower the amount of income tax you are liable to pay. Investments in ELSS are subject to a three-year lock-in period and the returns from the scheme, i.e. dividends and capital gains, are tax-free.

### **Debt funds**

A debt fund is a mutual fund scheme that invests in fixed income instruments, such as Corporate and Government Bonds, corporate debt securities, and money market instruments

etc. that offer capital appreciation. Debt funds are also referred to as Income Funds or Bond Funds.

Debt funds are ideal for investors who want regular income, but are risk-averse. Debt funds are less volatile and, hence, are less risky than equity funds. If you have been saving in traditional fixed income products like Term Deposits, and looking for steady returns with low volatility, debt mutual funds could be a better option, as they help you achieve your financial goals in a more tax efficient manner and therefore earn better returns.

Debt funds invest in either listed or unlisted debt instruments, such as Corporate and Government Bonds at a certain price and later sell them at a margin. The difference between the cost and sale price accounts for the appreciation or depreciation in the fund's net asset value (NAV). Debt funds also receive periodic interest from the underlying debt instruments in which they invest. In terms of return, debt funds that earn regular interest from the fixed income instruments during the fund's tenure are similar to bank fixed deposits that earn interest. This interest income gets added to a debt fund on a daily basis. If the interest payment is received, say, once every year, it is divided by 365 and the debt fund's NAV goes up daily by this small amount. Thus, a debt scheme's NAV also depends on the interest rates of its underlying assets and also on any upgrade or downgrade in the credit rating of its holdings.

A few major advantages of investing in debt funds are low cost structure, stable returns, high liquidity and reasonable safety. Debt funds also score on post-tax return. Dividends from debt funds are exempt from tax in the hands of investors.

Debt funds invest in a number of debt instruments, all of them having a varying maturity. That's where the average maturity comes handy. As the name suggests, it basically indicates the average maturity of all the securities in a portfolio, giving you the freedom to compare.

Debt funds also allow you to take advantage of investing in equity market along with growth on your principal amount through Systematic Transfer Plan (STP). With an STP, you can transfer amounts in parts/tranches from one mutual fund scheme to another, within the same fund house at regular intervals. Such a transfer averages the cost of purchase, mitigating some market-related risks. Typically, an investor first parks his funds in a liquid or a floating-rate debt fund and then transfers them via STP to the scheme (usually equity or balanced) of his choice at regular intervals.

Systematic withdrawal plan (SWP) is a payment option in a mutual fund that lets you redeem units worth a pre-specified amount at a specific intervals (monthly, quarterly, half-yearly or annually). This is suitable for the investors who desire periodic income.

### **Different types of schemes in the debt fund category**

There are various types of schemes in the debt fund category, which are classified on the basis of the type of instruments they invest in and the tenure of the instruments in the portfolio, as explained below:

- 1. Liquid & Money Market Funds:** Savings bank deposits have been the retail investors' preferred investment option to park surplus cash. Most investors regard these as the only avenue while some believe parking surplus cash elsewhere can erode their capital and does not provide liquidity. Liquid Funds, as the name suggests, invest predominantly in highly liquid money market instruments and debt securities very short tenure and hence provide high liquidity. They invest in very short-term instruments such as Treasury Bills (T-bills), Commercial Paper (CP), Certificates Of Deposit (CD) and Collateralized Lending & Borrowing Obligations (CBLO) that have residual maturities of up to 91 days to generate optimal returns while maintaining safety and high liquidity. Redemption requests in these funds are processed within one working (T+1) day.
- 2. Income funds:** They invest primarily in debt instruments of various maturities in line with the objective of the funds and any remaining funds in short-term instruments such as Money Market instruments. These funds generally invest in instruments with medium- to long-term maturities.
- 3. Short-Term funds:** Short-term debt funds primarily invest in debt instruments with shorter maturity or duration. These primarily consist of debt and money market instruments and government securities. The investment horizon of these funds is longer than those of liquid funds, but shorter than those of medium-term income funds.
- 4. Gilt Funds:** The word 'Gilt' implies Government securities. A gilt fund invests in government securities of various tenures issued by central and state governments. These funds generally do not have the risk of default, since the issuer of the instruments is the government. Gilt funds invest in Gilts which have both short-term and/or long-term

maturities. Gilt funds have a high degree of interest rate risk, depending on their maturity profile. The longer the maturity profiles of the instruments, the higher the interest rate risk. (Interest rate risk implies that there is an effect on the market price of debt instruments when interest rates increase and decrease. Market prices of debt instruments rise when interest rates fall and vice-versa.)

**5. Fixed Maturity Plans (FMPs):** FMPs, as the name indicates, have a pre-determined maturity date (like a term deposit) and are close-ended debt mutual fund schemes. FMPs invest in debt instruments with a specific date of maturity, lesser than or equal to the maturity date of the scheme, also enjoy the status of debt funds. After the date of maturity, the investment is redeemed at current NAV and the maturity proceeds are paid back to the investors. The tenure of an FMP may range from as low as 30 days to 60 months. Since the maturity date and the amount are known beforehand, the fund manager can invest with reasonable confidence, in securities that have a similar maturity as that of the scheme. Thus, if the tenure of the scheme is one year then the fund manager would invest in debt securities that mature just before a year. Unlike in other open ended funds, where one can buy and sell units from the mutual funds on an ongoing basis), no pre-mature redemptions are permitted in FMPs. Hence, the units of FMPs (being close ended schemes) are compulsorily listed on a stock exchange/s so that the investors may sell the units through stock exchange route in case of urgent liquidity needs.

**6. Capital Protection-Oriented Funds:** As the name suggests, Capital Protection-Oriented Funds (CaPrOF) are mutual fund schemes that aim to protect at least the capital, i.e., the initial investment, providing an opportunity to make additional gains, as per the investment objectives of the fund. In short, a CaPrOF aims to safeguard the principal amount while offering a potential equity-linked capital appreciation. However, it is important to note that there is no guarantee of returns or guaranteed capital protection. CaPrOF are closed-ended debt funds that typically invest a major portion (say 80%) of the corpus in AAA-rated bonds, and the remaining amount in riskier securities like equity. Some funds may even take exposure to equity derivatives to protect against the downside risk. It is this very structure that is oriented towards protecting the principal. By the end of the stipulated term, the debt portion of the fund grows to give you back the principal, while the equity portion brings the potential upside. Thus, even if the equity market crashes, the principal amount is protected.

## **Balanced funds**

A balanced fund combines equity stock component, a bond component and sometimes a money market component in a single portfolio. Generally, these hybrid funds stick to a relatively fixed mix of stocks and bonds that reflects either a moderate, or higher equity, component, or conservative, or higher fixed-income, component orientation

These funds invest in a mix of equities and debt, giving the investor the best of both worlds. Balanced funds gain from a healthy dose of equities but the debt portion fortifies them against any downturn.

Balanced funds are suitable for a medium-term horizon and are ideal for investors who are looking for a mixture of safety, income and modest capital appreciation. The amounts this type of mutual fund invests into each asset class usually must remain within a set minimum and maximum.

Although they are in the "asset allocation" family, balanced fund portfolios do not materially change their asset mix. This is unlike life-cycle, target-date and actively managed asset-allocation funds, which make changes in response to an investor's changing risk-return appetite and age or overall investment market conditions.

Investors who have dual investment objectives favour Balanced Funds. Typically, retirees or investors with low risk tolerance prefer these funds for growth that outpaces inflation and income that supplements current needs. While retirees generally scale back risk as age advances, many individuals recognize the need for equity exposure as life expectancies increase. Equities prevent erosion of purchasing power and help ensure long-term preservation of retirement corpus

The bond component of a balanced fund serves two purposes: creating an income stream and moderating portfolio volatility. Investment-grade bonds such as AAA corporate bonds and Money market instruments interest income from periodic payments, while large-company stocks offer dividend payouts to enhance yield. Retired investors may take distributions in cash to bolster income from pensions and personal savings.

Secondarily, bonds hold much less volatility than stocks. Bondholders have a claim against assets of a company while stocks represent ownership, bearing all inherent risk if bankruptcy occurs. Hence, debt security prices do not move in lockstep with equities, and their stability prevents wild swings in the share price of a balanced fund.

Equity-oriented Balanced funds have a larger portion of their corpus (at least 65%) invested in stocks and qualify for the same tax treatment as equity funds. This means any capital gains are tax-free, if the investment is held for more than one year. However, these funds are more volatile due to the higher allocation to stocks.

Debt-oriented balanced funds are less volatile and suit those with a lower risk appetite. However, they offer lower returns and the gains are not eligible for tax exemption. If the investment is held for less than three years, the capital gains are treated as short term and taxed at the normal rates. But if the holding period exceeds three years, the gains are considered as long term and are taxed at 20% after indexation benefit, which can significantly reduce the tax.

### **Fund of funds (FOF)**

A 'Fund Of Funds' is an investment strategy of holding a portfolio of other investment **funds** rather than investing directly in stocks, bonds or other securities. An FOF Scheme of a primarily invests in the units of another Mutual Fund scheme. This type of investing is often referred to as multi-manager investment

### **Liquid funds**

Liquid Funds, as the name suggests, invest predominantly in highly liquid money market instruments and debt securities of very short tenure and hence provide high liquidity. They invest in very short-term instruments such as Treasury Bills (T-bills), Commercial Paper (CP), Certificates Of Deposit (CD) and Collateralized Lending & Borrowing Obligations (CBLO) that have residual maturities of up to 91 days to generate optimal returns while maintaining safety and high liquidity. Redemption requests in these Liquid funds are processed within one working (T+1) day.

### **Sources:**

<https://www.amfiindia.com/investor-corner/>