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An Investor Education and Awareness Initiative from HDFC Mutual Fund

INVESTOR EDUCATION
AN INVESTOR EDUCATION AND AWARENESS INITIATIVE FROM HDFC MUTUAL FUND



# DIRECT EQUITY INVESTING V/S MUTUAL FUNDS

## THERE ARE VARIOUS BENEFITS OF INVESTING THROUGH MUTUAL FUNDS WHICH MAY NOT NECESSARILY BE AVAILABLE IF ONE INVESTS DIRECTLY IN SHARES

Creating wealth is an exciting proposition, but the process of creating wealth requires skill, knowledge, time and the ability to stomach risk. Investments, may they be in direct equities or through mutual funds, have their advantages and disadvantages. However, direct equity investing, though perceived as more dynamic by investors, is feasible only for those investors who are able to understand the working of equity markets and have the time to track it regularly.

However, how about those investors who are not equally skilled and committed in terms of devoting time and energy towards their investments? For such investors, the best option is to choose the indirect route by investing in mutual funds (MFs).

There are numerous benefits of investing through mutual funds which may not be necessarily available if one invests directly in shares. These include:

**PROFESSIONAL MANAGEMENT:** Individuals may not have the necessary skills to identify the right stocks. Sometimes they cannot dedicate their time to do research. Mutual funds offer investors expert hands at work that aims at achieving investment objective of the scheme.

**LOW TICKET SIZE:** As some shares quote at very high price, they remain inaccessible for small investors. However one can start in mutual funds which invest in various such stocks with as low as ₹ 500.

**ECONOMIES OF SCALE:** The portfolio of an individual is relatively small as compared to a mutual fund portfolio. This leads to costs eating into returns for individuals. However on a large portfolio, mutual funds end up reducing costs.

**FEES AND EXPENSES:** For their services, mutual funds charge fund management fees and expenses which are capped under their regulations.

**LIQUIDITY:** Open-ended funds allow investors exit at the prevailing NAV subject to exit loads. This helps in financial planning. When an individual invests in shares, he is not sure if he can sell the shares in the market at fair value.

**RISK MANAGEMENT:** An individual may get carried away due to sentiment and may go overboard on a particular stock. However a fund manager cannot do so, since there are many risk management guidelines in place. There are limits on how much a fund manager can invest in each stock and each sector. A fund manager's decision to invest in a particular share is backed by strong research conducted by himself and his team members.

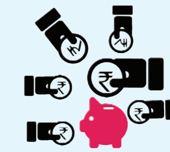
**CHOICE OF FUNDS:** Investors can choose to invest in a scheme that suits their investment needs. For example, an aggressive investor may choose to invest in a diversified equity fund, whereas a bit less risk taker may opt for balanced fund. There are funds catering to almost all needs.

**TAXATION:** When an individual investor buys and sells shares before completing one year, he ends up paying short term capital gains. However the fund managers may keep transacting in shares at varying intervals. If investor remains invested for more than one year in an equity fund, his gains are tax free since securities transaction tax (STT) is already deducted.


ILLUSTRATION :DEBASISH SARMA

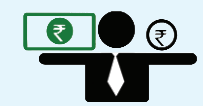
ILLUSTRATION

## HOW VINAY USED THE MF ROUTE TO EARN MORE



Vinay wants to invest ₹ 1000 each in five stocks. Since collective investment – like mutual funds – would work better, he approaches five of his friends – Sachin, Raghav, Manish, Shailesh and Kumar. While the first three were keen to invest ₹ 1,000 each, Shailesh and Kumar agreed to chip in with ₹ 500.

They appoint Santosh as their fund manager



Santosh collects ₹ 5,000 in total and issues units of ₹ 10 to each one of them. This gives Shailesh and Kumar 50 units each whereas others get 100 units each.

As the fund manager, Santosh buys one stock of each of these bluechip stocks on January 1. At the end of the month, the prices of these stocks change and the portfolio value increased to ₹ 5,250. After accounting for expenses at 1.5% charged by Santosh for his services as fund manager, the value of each unit goes up to ₹ 10.3425. This means that the valuation of investments by Vinay and his friends also increased. Of course, had the share prices fallen, the valuation of the investments too would have fallen.

TABLE 1- HOW COLLECTIVE INVESTMENT WORKS

| Stocks Santosh bought | Price (₹) as on Jan 1 | Price (₹) as on Jan 31 |
|---|---|---|
| Technology Limited | 1,700 | 1,800 |
| Soap & Toothpaste Limited | 1,250 | 1,300 |
| Best Car Limited | 450 | 440 |
| Entertainment Limited | 500 | 520 |
| Infrastructure Limited | 1,100 | 1,190 |
| **Total sum** | **5,000** | **5,250** |
| **Units issued** | 500 | 500 |
| **Value per Unit** | 10 | 10.50 |
| Net Asset Value per Unit | | **10.3425*** |

*(post expenses @1.5%)

Returns on Investment

| | Investment (₹) | Valuation (₹) |
|---|---|---|
| Vinay | 1,000 | 1,034.25 |
| Sachin | 1,000 | 1,034.25 |
| Raghav | 1,000 | 1,034.25 |
| Manish | 1,000 | 1,034.25 |
| Shailesh | 500 | 517.13 |
| Kumar | 500 | 517.13 |

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