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An Investor Education and Awareness Initiative from HDFC Mutual Fund

INVESTOR EDUCATION
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ADVERTORIAL

MUTUAL FUND MYTHS

Many investors have benefited by using mutual funds to fulfill their goals over the past few years. As they become popular the number of retail investors using mutual funds as an investment vehicle increases. However, due to low awareness levels there are some misconceptions that prevent investors from making the most that mutual funds have to offer. Through this article, we debunk some of the common myths that investors have.

MYTH 1

I should invest in a fund with a lower NAV (net asset value)

Many investors feel that the NAV of a mutual fund is similar to market price of stocks and therefore buying funds at low NAV is better. They believe that because the NAV is low you can buy more units and hence there is a higher potential for appreciation, as compared to a fund with a higher NAV. In reality, a mutual fund's NAV represents the market value of all its investments. Any appreciation in the NAV will depend on the price movement of its portfolio of companies. Say, you invest Rs 10,000 each in fund A (whose NAV is Rs 10) and fund, B (whose NAV is Rs 25). You will get 1000 units of fund A and 400 units of fund B. Let us assume both schemes have invested their entire corpus in exactly same stocks in same proportions. If these stocks combined together move up or appreciate by 10%, the NAV of the two schemes will also rise by 10%, to Rs 11 and Rs 27.5, respectively. In both cases, the value of your investment increases by 10% to Rs 11,000. The reason why Fund B's NAV is higher than fund A's could be merely because it was launched much before fund A and had bought the stocks in the portfolio much earlier, which itself saw some appreciation. Any subsequent rise and fall in the NAVs of both these funds will depend on how the underlying securities perform.

Hence the level of a scheme's NAV should not be considered at the time of purchase.

MYTH 2

Dividends are an extra income. A scheme that pays dividends is better than a scheme that doesn't.

Dividend income from stocks and Mutual funds are different. When a Mutual fund announces dividend, the NAV is adjusted accordingly. If you opt for the dividend option, a part of the profits made by the scheme are distributed to investors. The dividend is substracted from the NAV of the scheme on the record date and accordingly the NAV drops to the extent of dividend and dividend distribution tax paid. For Example Consider a scheme with Current NAV of Rs 100. The scheme announces a dividend of 100%. Since dividend is calculated on the face value (Rs 10,) the dividend per unit will be Rs. 10. Post dividend the NAV reduces to Rs 90. So a fund which pays dividend is in no way better or worse than one that doesn't pay dividends.

MYTH 3

I need to open a demat account or online account to start investing in a mutual fund

To invest in a mutual fund you do not need any demat account. You need to be KYC compliant. Then all you need to do is fill up the relevant application form, attach a cheque of the amount you wish to invest and submit the form at the mutual fund office, its registrar office directly or through your advisor/distributor. Once your investment is processed you will get a statement showing details of your investments.

MYTH 4

Mutual Funds invest only in equities

Investors need to understand that there are various kinds of mutual funds. While some invest their corpus in equity, others invest the money into debt schemes, such as government bonds and bonds issued by companies and financial institutions. There are some funds that also invest in money market instruments such as treasury bills issued by the government, call money market used primarily by banks and short-term paper issued by companies. Mutual Funds, therefore, invest in all kinds of instruments and do not confine themselves to equity. Your choice of a fund, in this context, needs to be based on the risk you are willing to take and the time duration of your investment.

MYTH 5

Markets are at a peak, I should defer my investment

Research shows that any time is good to invest, provided you invest for the long term. You could also invest using the Systematic Investment Plans (SIP) method which helps you accumulate units in good bull and bear markets thereby optimizing your returns over a long period of time and creating wealth for you.

MYTH 6

Mutual funds with good performance in last 1 year are best choice

This is a common misconception among the Mutual funds investors that funds which have performed very well in the past one year are the best choice. People believe that if ABC mutual fund has given 50% return in past year and XYZ has given 30% return, then ABC is a better fund to invest in. Past performance is one of the things to look at when investing, however it makes sense to look at performance across market cycles and for longer durations of 7 - 10 years or even more and not just recent past. In addition investors should also consider the fund manager's experience, his track record and the fund house's track record.

ILLUSTRATION: DEBASISH SARMA

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