Note: We in Finitor Financial Services Private Limited have tried to put a brief on the mutual funds as per the prevailing structure of various mutual fund schemes based on our understanding and knowledge. We have also put in the new SEBI categorisation of various schemes as per the SEBI Circular dated Oct 6, 2017, SEBI/HO/IMD/DF3/CIR/P/2017/114. We in Finitor do not claim to be an expert on the subject. Please read the Disclaimer & Risk Factors at the end.

FINITOR FINANCIAL SERVICES PRIVATE LIMITED

➡ mark in the article indicates the SEBI categorisation of schemes and respective characteristics;

Like all financial instruments, mutual funds too have some level of risk, though some funds are less risky than others. It is important to understand that no two mutual funds have the same risk and reward profile even if they belong to the same category. Mutual Funds predominantly can be classified based on parameters like fund structure, asset class, investment horizon, objectives etc. Classification of mutual funds helps investors to choose funds based on their own specific risk appetite on the overall risk-return spectrum.

Types of Mutual Funds based on structure

I. Open-Ended Funds

Open ended funds have perpetuity and does not have any maturity. They can be purchased and redeemed freely on the prevailing respective NAVs, liquidity is key unlike close ended funds. Open ended funds are preferred choice than the close ended funds.

II. Close-Ended Funds

Close ended funds are also called fixed maturity plan they can be bought only during the NFO (New Fund Offer) period and the same can be redeemed at the pre-specified maturity date. During the limited life of the fund they cannot be sold back to the issuing mutual funds. They are listed on the stock exchanges to provide exit to the investors, however liquidity in these funds are usually not very encouraging.

A close ended fund has no past track record of funds' performance, no easy exit route, it requires lump sum investment (capital investment), timing is important in close ended funds.

III. Interval Funds

Interval funds are hybrid of open and close ended funds that offer to repurchase units from investors at prevailing NAV periodically at pre-determined intervals. They may also be listed on stock exchanges.

Category of Mutual Funds based on scheme characteristics under each group

I. Equity Funds

Equity funds are the funds that invest principally in equity stocks of various companies mostly listed on stock exchanges and actively traded with large volumes. They could be actively or passively (index funds & ETFs) managed funds. These funds are

classified according to company size (market capitalisation, large, medium and small cap), investment style growth, value and blend (blend is mix bag of value and growth), sectoral (sector and industry specific funds e.g. pharma, infrastructure, banking & finance), thematic (theme based) and geography (country specific, regional and global).

Even a small investment in an equity fund is very well diversified and that is an important attribute that makes equity funds suitable for investors of all kind in comparison to direct stock holdings. There are large number of equity funds available to select from, that commensurate with individual risk-return profile. There are equity funds of every type and characteristic available to match every risk profile and investment objective that investors may have.

Equity funds in India have certain tax advantage over debt funds. Long term capital gain tax with applicable statutory charges (surcharge and cess) works out to 11.44% for equity-based investments, if held for a year (12 months/365 days). Dividends are now taxable(FY 2018-19), no TDS is applicable to resident Indians. The same tax provisions are also applicable to Non-Resident Indian investors except TDS are applicable.

Classification of Equity Funds

The funds discussed below are open ended equity funds.

1. Market Capitalisation based funds – Large, Mid, Small and Multi Cap Funds

➡ As per the recent guidelines of SEBI, 1st – 100th companies in terms of full market capitalisation are categorised as large cap or blue-chip companies and a portfolio comprising of 80% of total assets invested in large cap stocks is categorised as large cap fund. Large companies with proven track record offer stable returns over the period with some exceptions.

➡ 101st – 250th and 251st onwards companies in terms of full market capitalisation are categorised as mid cap and small cap companies respectively and a minimum investment of 65% of total assets of a fund in mid and small cap companies would categorise them as mid cap and small cap fund respectively.

➡ Multi cap funds are the funds that require investment across all categories of companies, large, mid and small. A minimum investment of 65% of total assets is required to be invested in equity and equity related instruments.

➡ Yet another category of fund (large & mid cap fund) based on market capitalisation is combination of Large & Mid Cap companies. A minimum investment of 35% of total assets is required to each category of companies.

Large cap companies are generally less risky and volatile compare to other equity funds and suitable for investors interested in stable returns. Mid cap and small cap funds are more volatile than large cap funds and capable of giving better returns in comparison to the large cap funds. Young and aggressive investors may select small, mid and multi cap funds.

2. Dividend Yield Funds

➡ Dividend yield funds predominantly invest in above average dividend yielding stocks that pay dividend regularly. SEBI has specified that a minimum investment of 65% of total assets should be invested in equity and equity related instruments in dividend paying companies.

Dividend-yield funds are not a new trend, there are quite a few funds of this category and some are existing for more than a decade in the market. There is no fixed method of selecting companies in the portfolio. General perception is that the regularly above-average dividend paying companies have stable cash flow and are less volatile compare to the growth funds. During a market reversal dividend yield could act as a better wealth protector than growth funds. But dividend yield funds tend to underperform growth funds in rising markets.

Aggressive investors looking for higher returns and having the commensurate risk appetite may avoid dividend-yield funds, but those looking for a safety net can consider them.

3. Value and Contra Funds

➡ As per SEBI, for funds to get categorised in these two types, they need to invest a minimum of 65% of total assets in the respective categories of stocks.

A value fund follows a value investing strategy and seeks to invest in stocks that are deemed to be undervalued based on fundamental characteristics. Buying cheap and selling high is fundamental to wealth creation. The principle of looking for good companies that are under-priced is value investing. A stock should reflect the underlying fundamental potential in a company that are its management, homogeneous industry growth prospect, business strategy, technology break through and integration, revenue and earnings growth, and so on, determine its true worth or intrinsic value. When the company specific value is not realised by the market, the stock price will be below par. As and when the market realises this potential, the stock price will move up. A rerating of such undervalued stocks by the market forces can reap huge gains. Identification and acquisition of such potential stocks early is key to performance of value funds.

A contra fund is distinguished from other funds by its style of investing. A contra fund takes a contrarian view of a stock when it is going through an exuberant demand from

investors or is shunned by them at a particular point in time due to short-term downside trigger.

Buying growth companies early when they are under-owned and therefore under-appreciated, buying them when they go through turmoil and lean patches, or buying them when they are hit by company-specific negative news which is temporary in nature enabling a fund to buy them cheap is what would qualify as contrarian investing. Sometimes it is a mistaken belief that contra investing is buying what are perceived to be classical “value stocks”.

The asset's poor-performance or out-performance leads to distortion in valuations, that is where a contra fund seeks to capitalise on.

Diversification is a key reason for investing a part of your portfolio in value and contra funds. These funds lend diversity to the portfolio since majority of portfolios are growth overweight and therefore both value and contra funds offer a good strategic fit. Value funds are less volatile since stocks in the portfolio are already undervalued, is another reason to invest in value funds. In adverse market scenario, they tend to have lower downside. Whereas contra funds act as hedge against growth funds.

4. Focussed Funds

➡ Focussed funds can constitute a portfolio of maximum 30 stocks, and a minimum exposure of 65% of total assets in equity and equity related instruments.

Focussed funds usually have limited stocks and sectoral exposure and thus focussed investment approach. A focused approach ensures that stringent filters are applied to choose stocks as each stock will contribute significantly to the fund's overall performance. Focussed approach is no guarantee for better performance. A focussed fund with concentration of large cap stocks tend to have less risk compare to diversified funds.

5. Sectoral and Thematic Funds

➡ As per the latest SEBI guidelines Sectoral and Thematic funds need to have a minimum investment of 80% of total assets in equity and equity related instruments in a particular sector/industry or theme.

Since both these categories of funds are exposed to a single sector or theme, therefore only a handful of stocks are part of the portfolio. These funds carry higher risk compared with diversified funds.

The main purpose of investing in a sector specific or theme-based fund is to gain from the concentrated exposure to a small segment of the economy—FMCG, banking and financial services, infrastructure, pharma, technology (sectoral), rural India, financial reforms, India growth, gen-next (thematic)—that is doing well and promises growth in the future.

Once one has the core portfolio in place, it can be a good idea to take an exposure to sectoral or thematic funds from a tactical standpoint. The additional exposure can provide a boost to the overall portfolio returns, however it can also lead to a major set-back and turn out to be counter-productive.

Unlike a diversified fund, the fund manager of a sectoral or thematic fund does not have the liberty and option to move away from the specific sector or theme even when the performance of the respective funds deteriorate. Sectoral funds carry huge risks.

A thematic fund operates on a broader spectrum and have wider scope. Theme based funds are sometime mistaken with sectoral funds. Two Thematic funds could be as different as chalk and cheese. Sectoral and Thematic funds are not suited for all the investors unless such investors are well versed with sectoral developments, changing trends, economic growth, technological breakthroughs, market and economic reforms.

6. ELSS (Equity Linked Savings Scheme)

➡ SEBI has specified that a minimum investment of 80% of total assets should be invested in equity and equity related instruments with statutory lock in of three years in accordance with Equity Linked Saving Scheme, 2005 notification by Ministry of Finance.

This is an open-ended diversified equity scheme. They offer tax benefits under the new Section 80C of Income Tax Act 1961. ELSS can be invested using both SIP (Systematic Investment Plan) and lump sums investment options. ELSS offers better Liquidity compared to other options like NSC and Public Provident Fund. ELSS is considered one of the best tax saving instrument.

II. Debt Funds

These are the funds that invest in debt instruments e.g. corporate bonds/ debentures, Government securities like treasury bills, dated securities, money market instruments and other fixed income instruments. Debt securities generally have fixed maturity and pay a fixed coupon (interest) rate at fixed intervals with some exceptions like floating rate bonds. Debt securities except government securities (carry no credit risk) are also assigned a credit rating that helps assess the credit worthiness of an issuer with respect to debt instruments or its general ability to pay back debt over the specified period of time. Each instrument is given a rating as an alphanumeric code that represents a graded structure or creditworthiness. Debt fund returns come from accrued interest and capital appreciation. Like equity funds, debt funds try to optimise returns by diversifying across different types of debt securities. This allows debt funds to distribute risk across various securities held in the portfolio. Debt funds are perceived to be safer avenue for a secured and better than term deposit returns but there is no guarantee of such returns. Debt securities, specifically securities with long maturities are sensitive to change in interest rates. Open ended debt funds offer

steady returns in a more certain interest rate regime, better returns in dovish regime and poor returns in hawkish regime.

In Indian scenario debt funds are more tax efficient than fixed/term/time deposits as they get tax benefits if held by the investors for more than three years. If the debt funds are redeemed within three years, capital gains on debt funds are treated as short term. The capital gains are added to the income and taxed as per applicable tax slab of the investor. Whereas when the same funds are sold after three years are taxed at 20 per cent after indexation.

Like equity mutual funds, debt mutual funds also come in various types. The major factors that differentiate Debt funds are maturity period and issuer of the instruments they invest in. Here are the different types of debt funds.

Types of Debt Funds

1. Liquid Funds / Money Market Funds

Liquid funds invest money in debt market instruments with very short maturity up to 91 days. The actual portfolio may comprise of instruments having average residual maturity below 60 days to avoid mark to market. This makes the funds significantly less vulnerable to changes in interest rates and investors can be assured that in the absence of any extraordinary circumstances returns earned will be more or less equal to the portfolio yield. NAV is mostly as a result of the interest income that accrues. These funds are invested in highly liquid money market instruments, treasury bills and other government securities that provide easy liquidity. The period of investment in these funds could be as short as one day. These instruments are generally held until maturity in the portfolio.

Money market funds can invest in money market instruments having maturity up to 1 year. Money market instruments are call money market, treasury bills, government securities having residual maturity of one-year, commercial bills, commercial papers, certificate of deposits, treasury bills etc.

Overnight Funds: Overnight funds invest in overnight securities having maturity of one day.

They aim to earn money market rates and could serve as an alternative to corporate and individual investors, for parking their surplus cash for short periods. Returns on these funds tend to fluctuate less when compared with other funds and are better than saving bank rates and short-term bank deposit rates (interest earned through demand and time deposits are subject to applicable tax).

2. Ultra-Short-Term Funds and Low duration funds

Ultra-short-term funds are also suitable for short-term investing. But these are one notch higher on the risk chart compared with liquid funds. This is because ultra-short-term funds may invest a portion of total assets in short-term instruments that have a maturity of over three months. The instruments may also be subject to mark-to-market and therefore may fluctuate on daily basis. The NAV may swing in response to market movements, making it a little more volatile. Ultra-short-term funds are earlier known as Liquid Plus Funds. Also referred to as Cash or Treasury Management Funds, Ultra-Short-Term Funds are preferred by investors who have marginal risk appetite with an aim to earn commensurate returns. Investors who have short term surplus for a minimum period of 1 month may consider these funds.

➡ As per the latest SEBI guidelines ultra-short-duration funds may invest in debt and money market instruments such that the Macaulay duration of the portfolio is between 3 months - 6 months.

➡ As recommended by SEBI low-duration funds may invest in debt and money market instruments such that the Macaulay duration of the portfolio is between 6 months - 12 months.

3. Short-Term & Medium-Term Income Funds

These funds invest predominantly in debt securities with a maturity of up to 3 years and sometimes even for longer duration. These funds tend to have an average maturity that is longer than Liquid and Ultra-Short-Term Funds but shorter than pure Income Funds. These funds tend to perform when short term interest rates are high and could potentially benefit from capital gains as liquidity comes back to the market and interest rates go down. These funds are suitable for conservative investors who have low to moderate risk-taking appetite and an investment horizon of 12 months and above.

➡ As per SEBI's latest categorisation circular short-duration and medium-duration funds may invest in debt and money market instruments such that the Macaulay duration of the portfolio is between 1 year - 3 years and 3 years – 4 years respectively.

4. Income Funds, Gilt Funds and other dynamically managed debt funds

These funds comprise of investments made in a portfolio of debt instruments of various maturities & issuers. Gilt funds invest in government securities. These funds are suitable for investors who are willing to take a relatively higher risk as compared to corporate bond funds and have longer investment horizon. These funds are highly sensitive to interest rates (moderation in inflation, liquidity and interest rates have positive impact on the yields and vice versa) and tend to work when entry and exit are timed properly; investors can consider entering these funds when interest rates have moved up significantly to benefit from higher accrual and when the outlook is that interest rates would decrease. As interest rates go down, investors can potentially

benefit from capital gains, a fall in interest rate benefits long-term debt-oriented funds the most.

A. Debt Income funds are not to be confused with equity income funds. Debt income funds invest in corporate bonds, government bonds and money market instruments. Income funds are only for those who can stomach volatility, they are highly vulnerable to the changes in interest rates and are suitable for investors who have a long-term investment horizon and higher risk-taking ability. Entry and exit from these funds needs to be timed appropriately. The correct time to invest in these funds is when the market view is that interest rates have touched their peak and are poised to reduce.

B. Gilt Funds invest in mixed government securities of varying maturities issued by central and state governments. These funds do not have the credit risk also known as default risk since the issuer of the instruments is the government. Net Asset Values (NAVs) of the schemes fluctuate due to change in interest rates and other economic factors. These funds have a high degree of interest rate risk, depending on their maturity profile. The higher the maturity of the instrument, higher the interest rate risk.

C. What differentiates Dynamic Bond Funds from Income Funds is that they are actively managed and the portfolio varies dynamically according to the interest rate view of the fund managers. These funds Invest across all classes of debt and money market instruments with no cap or floor on maturity, duration or instrument type concentration. Income Funds usually concentrates on quality of securities in the portfolio whereas Dynamic Bond Funds on opportunities.

➡ New SEBI circular requires Long Duration Funds to have portfolio investments in Debt & Money Market Instruments such that the Macaulay duration of the portfolio is greater than 7 years. There is no such capping for the Dynamic Bond Funds, they are allowed to have securities across all duration in the scheme.

➡ Gilt Funds require investment in Gsecs-80% of total assets (across maturity). Another category of Gilt Funds with 10-year constant duration require minimum investment in Gsecs-80% of total assets such that the Macaulay duration of the portfolio is equal to 10 years.

5. Corporate Bond Funds

In India, Corporate Bond Funds and Credit Opportunity Funds are used interchangeably. Corporate Bond Funds invest predominantly in debt papers of companies with varying maturities. These instruments are exposed to credit risk, significant volatility and offer higher interest (yield). One type of corporate bond fund may invest significantly in high quality and rated securities such as public sector (PSU), bank and financial institutions bonds and another slightly lower rated corporate bonds and debentures for higher yield. A corporate bond fund is another choice for

investors seeking yields higher than government bonds that are still relatively safe. All such securities are rated securities by credit rating agencies. These funds seek to provide regular income and growth.

Medium term investors can look at these funds with quality papers in the portfolio. Short term investors should keep themselves away from these funds. Any default by an underlying company could set back your fund's net asset value (NAV) significantly and hurt badly.

➡ Corporate Bond Fund/Credit Risk Fund – for category, Corporate Bond Fund a minimum investment in corporate bonds require 80% of total assets (only in highest rated instruments) whereas a Credit Risk Fund requires a minimum investment of 65% of total assets in corporate bonds in below highest rated instruments as per SEBI guideline.

➡ Banking and PSU Fund need a minimum investment of 80% of total assets in debt instruments of Banks, Public Sector Undertakings and Public Financial Institutions.

➡ A minimum investment of 65% of total assets in floating rate instruments is required to be categorised as Floater Fund.

6. Fixed Maturity Plans (FMPs)

FMPs are closed ended Debt Mutual Funds that invest in debt instruments with a specific date of maturity that is less than or equal to the maturity date of the scheme. Securities are redeemed on or before maturity and proceeds are paid to the investors. FMPs are similar to passive debt funds, where the portfolio manager buys and holds the debt securities for the entire duration of the product. FMPs are a good option for conservative investors, as they do not carry any interest rate risk provided the investor stays invested until the maturity of the product. They are also a tax efficient investment option.

III. Hybrid Funds

Portfolio of Hybrid Funds contain both equity (stocks) and debt securities in different proportions. They are also known as asset allocation funds. Varied asset classes help these funds optimise diversification, minimise risks and funds attain set objectives. They bridge the gap between equity and debt schemes by investing in a mix of equity and debt securities. These funds can offer varying levels of risk tolerance ranging from conservative to moderate and aggressive. Target date funds and lifecycle funds are also example of hybrid funds both the funds gradually reduce their aggressive to moderate to conservative over a period of time where time period is either linked with fund's maturity or age of the investor. These funds are more suited for retirement planning.

In India, a hybrid fund is either classified as debt oriented or equity oriented and has different tax implication depending upon their classification. For a hybrid fund to qualify as an equity fund, a minimum investment of 65% of the total assets have to be in equity (stocks). Anything less than 65% equity holding in a funds' portfolio is considered as debt fund.

Types of Hybrid Funds

1. Monthly Income Plans (MIPs)

The objective of an MIP is to offer the benefit of diversification across asset classes by investing a proportion of the portfolio in debt securities (70% to 95%) with a smaller allocation in equity securities (5% to 30%). MIPs are debt-oriented funds, sensitive to both interest rates and equity market. As the correlation between prices of equity and debt is low, this product endeavours to give an investor returns that are relatively higher than term deposits and debt market returns. Monthly income plans intend to generate income from the debt securities, maximise the benefits of long term growth from equity securities and aim for periodic distribution of dividends.

An important point to remember is that in MIPs, monthly-income is not assured and it is subject to the availability of distributable surplus in the fund. An investor may also select the periodical option of his choice for dividend pay-outs from monthly quarterly, half-yearly or annually, growth option is also available with these funds.

- Conservative Hybrid Fund: investment in equity & equity related instruments between 10% and 25% of total assets; investment in debt instruments between 75% and 90% of total assets.

- Balanced Hybrid Fund: investment in equity & equity related instruments between 40% and 60% of total assets; debt instruments-between 40% and 60% of total assets. No Arbitrage is permitted in this scheme.

2. Balanced Funds

Balance funds in India conventionally have minimum exposure of 65% and they get at par treatment with equity funds despite having up to 35% exposure in debt securities. The investor gets the added benefit of tax advantage over debt or debt-oriented funds (MIPs). However, the risk in these funds are considerably high compare to MIPs.

- Aggressive Hybrid Funds: investment in equity & equity related instruments between 65% and 80% of total assets; investment in debt instruments between 20% and 35% of total assets.

- Dynamic Asset Allocation or Balanced Advantage Funds: investment in equity and debt securities are managed dynamically.

➡ Multi Asset Allocation Funds: Invests in at least three asset classes with a minimum allocation of at least 10% each in all three asset classes.

3. Equity Savings Funds

Equity Savings Funds do not have a very long history. The fund has been designed to retain the benefits of tax advantage of equity-oriented funds and simultaneously reduce the exposure in equity by hedging the major portion of equity holdings. These funds generate returns through debt, equity and equity arbitrage (hedged position) trades. On a risk-return axis, equity savings funds are positioned between balanced funds and MIPs. They stand a notch higher than MIP / debt-oriented funds, and one notch lower than balanced funds in their risk-return proposition. Equity savings funds are not meant for wealth creation but a better substitute to replace time deposits and MIPs with tax advantage. Unhedged equity exposure may differ from fund to fund and also on future market outlook. More exposure in unhedged equity indicates more aggressive nature of the fund.

➡ SEBI prescribes that a minimum investment of 65% of total assets required to be in equity & equity related instruments and 10% of total assets in debt. A minimum hedged & unhedged portion of the total assets is to be mentioned in the SID.

4. Arbitrage Funds

Arbitrage is taking counter positions (simultaneous buy & sell) in two different markets in the same underlying assets (financial or commodities) to take advantage of price anomalies and lock risk free return. It refers to trades that are market neutral. Equity arbitrage funds are based on the same concept. These funds ideally should have 100% exposure in equity and equity related instruments. However, the portfolio may comprise of equity and equity related instruments in excess of 65% and balance in debt securities and money market instruments.

➡ As per latest SEBI circular, schemes following arbitrage strategy should have minimum investment of 65% of the total assets in equity & equity related instruments.

IV. Solutions Oriented Funds

Retirement Funds and Children’s Funds are examples of solutions-oriented funds. They are somewhat similar to asset allocation funds. Portfolio allocation of asset class is not defined.

➡ As per the latest SEBI guidelines these schemes should have a lock-in for at least 5 years or till retirement age whichever is earlier in case of Retirement Fund and at least 5 years or till child attains age of majority whichever is earlier in case of Children’s Fund.

V. Other Funds

1. Index Funds or ETFs

An index fund needs to track the returns of a benchmark index. For example, CNX Nifty 50 index fund's objective would be to replicate the returns offered by CNX Nifty 50 index. Index funds could be based on equity, debt and other assets. Index Funds and ETFs are passively managed funds. These funds are passively manged because the fund manager does not have to do his research, analysis, create portfolio and churn them as per his study or choice. In case of index funds, he only needs to ensure that tracking error is kept to bare minimum to mirror the return of the benchmark. The funds' portfolio would hold all the securities of benchmark index in the same proportion or weightage of the index. Index funds can be bought and sold based on the NAV and it adds to the AUM of the fund but ETFs can be traded through out like any other listed security provided the said ETF is liquid enough.

➡ As per SEBI categorisation both a minimum investment of 95% of the total assets required to be invested in the securities of the replicated or tracked index.

2. Fund of Funds (FoF)

As the term suggests Fund of Funds invest in various other mutual funds rather than directly in stocks, bonds and other securities. FoFs are of varied kind with each investing in a different kind of mutual funds of diverse asset categories that enables investors to diversify their risks.

As per SEBI categorisation of FoFs, a minimum investment of 95% of the total assets required to be invested in the underlying fund.

Disclaimer

The information provided in this article/write-up and content of this website is meant only for general reading purposes and the article/write-up and contents are based on individuals' knowledge and understanding of the mutual fund schemes, various financial instruments, economy, industry and market who does not claim to be an expert. The article/write-up and content of this website cannot be considered as guidelines, recommendations or as a professional guide for the readers. Before making any investments, the readers are advised to seek independent professional advice, verify the contents in order to arrive at an informed investment decision. Finitor Financial Services Private Limited, it's directors, employees, affiliates, associates or representatives shall not be liable in any way for any direct, indirect, special, incidental, consequential, punitive or exemplary damages and any financial or other loss arising from the information contained in this material. The viewers / investors should at their discretion, seek latest / updated information from other sources.

Please also read the detailed **Disclaimer and Important Information**mentioned at the bottom of the home page.

Risk Factors

Investors are requested to read the Scheme Information Document, Statement of Additional Information and Key Information Memorandum for Scheme specific relevant details & risk factors. The schemes or funds title and category do not in any manner indicate either its quality or its future prospects & returns.
Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

Summary: All investments/trading activities carry risks and they can be classified under two categories systematic and unsystematic risk. Investors/traders should have complete understanding of both the risks before they undertake investment and trading activities.