Wealth Creation Using Mutual Funds

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ABSTRACT

Wealth has the ability to control human's emotions. A person's happiness will be fulfilled withexcess wealth. For building excess wealth a person must be prepared to invest for a very long time. With wealth creation, we will be gaining financial security, will be having the ability to create jobs and improve our quality of life. Investing in the right financial product like mutualfunds will pave us the way for financial freedom. When it comes to investment, two things aremandatory one is consistency and the other one is time. With these two factors we will be ableto compound our wealth. This article covers about the ideas for wealth creation using mutual funds, the ideas have been established with statistical and mathematical analysis

Keywords: Index funds, Standard Deviation, Sharpe Ratio, Annual Step-up

INTRODUCTION

Mutual fund is the most important investment vehicle across the globe. With a common objective kept in mind between a mutual fund manager/Asset management company and an investor, investments will be made across various money instruments like equities, bonds andother related securities.

Usually, a fund manager from an asset management company will manage the portfolio of mutual fund profiles. The one very important rule is to assist the investors in building an incomestream or increasing their wealth by using the opportunities available in the mutual fund market. Mutual Fund is the key player in the capital market of our economy being a solid market stabilizer by large foreign investor inflows and outflows. It has also been a saviour in terms of creating good amount of job opportunities for many employees and crucial service providers.

There are lot of mutual fund schemes available. Every scheme has an investment objective. The reason for many schemes is due to many investors with different investment thoughts andgoals. With the help of New Fund Offer (NFO), a new scheme comes up for an investment option. An investor makes his or her investments in a particular scheme with the help of Units.After an investor invests, the money will be converted to scheme's units.

A mutual fund investment portfolio is considered to be profitable if the portfolio's interest income, valuation gains, dividend income and realized capital gains are on the positivemonetary side. The mutual fund's proportion size is calculated using Asset Under Management(AUM). In simple terms it means money collected and pooled from various investors

The mutual fund industry has a tremendously grown over a long period of time. The Asset under Management (AUM) of Indian Mutual Fund industry was Rs.**5,87,000** Cr on 31st March2012. Now, the value is **Rs.47,80,422** Cr as on 31st October 2023. The growth percentage is around **714%**

INDEX FUND POWER

Index Fund is a Passive fund investment. In this, the benchmark index is replicated. The proportion of shares that are bought for an investment are same as the top benchmark indices proportion.

Going back to the history, the first Index fund was launched on the year 1976 by Mr. John Bogle, founder of the Vanguard Group. In the initial years the fund was on the inactive side will less evaluation value, but on the year 1990 the Vanguard S&P 500 Index Fund touched 1-billion-dollar mark.

Index Fund investment is always a people's investment. Passive investors can build an effective retirement portfolio without complex algorithmic trading techniques. Usually, a Low-cost Index scheme option is a natural choice for many investors

Table 1: Indian Market's Top Indices

Indian Indices	31st October 2022	31st October 2023	Variation %
Nifty 50	18012.2	19079.6	5.925
Sensex	60746.6	63874.9	5.149
Nifty Midcap 50	8690.35	11068.85	27.369
Nifty Smallcap 100	9686.10	12649.90	30.598
BSE Midcap	25359.02	31245.1	23.210
BSE Smallcap	28817.59	36919.1	28.113

Source: NSE, BSE

FLEXI CAP FUND

In Flexi cap fund, the investments can be made in different schemes and instruments. It is a very open scheme for many moderate appetite investors.

LARGE CAP FUND

An open equity scheme which mostly, invests in large cap stocks. Large cap stocks include first100 companies which are ranked based on their market capitalization. Using this investment, there are records of good wealth generation over a period of time. A person's capital would appreciate if he or she is ready to provide the time, in addition to this people should also havethe right risk appetite to understand the market conditions during stock volatility.

The investment should be in equity and equity related instruments of large-cap companies which must account to 80 percentage of the total assets according to the SEBI rules.

EVALUATING RATIOS AND FINANCIAL PARAMETERS

There are numerous numbers of mutual funds available in the Indian Financial markets. Many schemes are present to give us too much of information which will consume a lot of our time to fix an investment decision. Every Mutual Fund has some degree of risk associated to it. Using key risk parameters like the financial ratios and compounded annual returns we can assess a fund's future performance and current risk. When Risk is measurable, we can go for more firm investment decisions, based on comparing various measures

Variation in the returns is used as a measure of risk.

i. STANDARD DEVIATION

Standard Deviation is one of key statistical concepts used in finance for measuring the fluctuation in periodic returns of a mutual fund or a relevant financial product with respectto its own average return. Measures the total risk in an investment portfolio. Using this measure, we won't be able to predict future performance. High standard deviation means that the particular fund is having big volatility in returns and higher risk has been associatedwith the fund. Comparatively, choosing a low standard deviation mutual fund will be apt.

ii. ALPHA (α)

With this parameter we can measure the risk adjusted return in comparison with the overallmarket average return. In short, it is the fund manager's ability to beat the market

$$Alpha\ (\alpha) = Actual\ returns\ \% - Expected\ returns\ \%$$

Choosing a mutual fund with higher Alpha is recommended.

iii. BETA (β)

Beta is really instrumental in measuring the fluctuation of a mutual fund or financial security with respective to dynamic market movements. Measures relative volatility with respective to the bench-mark index

$$Beta\ (\beta) = \frac{Portfolio's\ return\ \% - Risk\ free\ return\ \%}{Benchmarch\ Index\ \% - Risk\ free\ return\ \%}$$

Less risk-taking investors or conservative investors can consider a low beta portfolio foravoiding high volatility

iv. SHARPE RATIO

Sharpe ratio is a very common way to measure risk-adjusted returns. It considers systematicand non-systematic risks.

$$Sharpe\ Ratio = \frac{Portfolio's\ return\ \% - Risk\ Free\ Return\ \%}{Standard\ Deviation}$$

The numerator is also considered as the excess return %

Higher Sharpe ratio indicates that an investor is receiving a higher return for the amount ofrisk taken

v. TREYNOR RATIO

Precisely this ratio helps in calculating the amount of risk premium gained per unit riskIn this ratio only systematic risk is considered.

$$Treynor\ Ratio = \frac{Portfolio's\ return\ \% - Risk\ Free\ return\ \%}{\beta}$$

Risk free return is the return we get when we invest in government securities like bonds orbills.

Treasury Bill index will be a strong measure to calculate risk free return

Higher Treynor Ratio will be correct for choosing a mutual fund

i. SORTINO RATIO

This parameter helps in overcoming the limitation of Sharpe ratio by correction of its standard deviation. In Sortino ratio standard deviation of negative returns will be considered

$$Sortino\ Ratio = \frac{Portfolio's\ return\ \% - Risk\ Free\ Return\ \%}{Standard\ deviation\ of\ negative\ returns}$$

Standard deviation of negative returns is also called as the down-side standard deviation
Higher Sortino ratio indicates that there is a lesser chance in the down-side deviation

ii. EXPENSE RATIO

Asset management companies charge a management fee for managing the mutual fund Portfolio. This fee will be essential as cover the expenses that are caused by the mutualfund like the agent fees, registrar's fee, auditor's auditing fees and many more.
Comparatively, low expense ratio should be always considered as the management fees willbe less as well

$$Expense\ Ratio = \frac{Fund\ Management\ Fees}{Total\ Investment\ in\ the\ Fund}$$

OVERVIEW OF MUTUAL FUNDS AND ITS TERMS

Starting a mutual fund investment demands the opening of a Demat account. A Demat accounthelps an investor hold their investments in terms of proper digital record. Usually mutual fundsare held in terms of units. KYC documentation must be done in the first stage to open our account. The Demat account facilitation will be done with the help of the services provided bythe National Securities Depository Ltd and Central Depository Services Ltd.

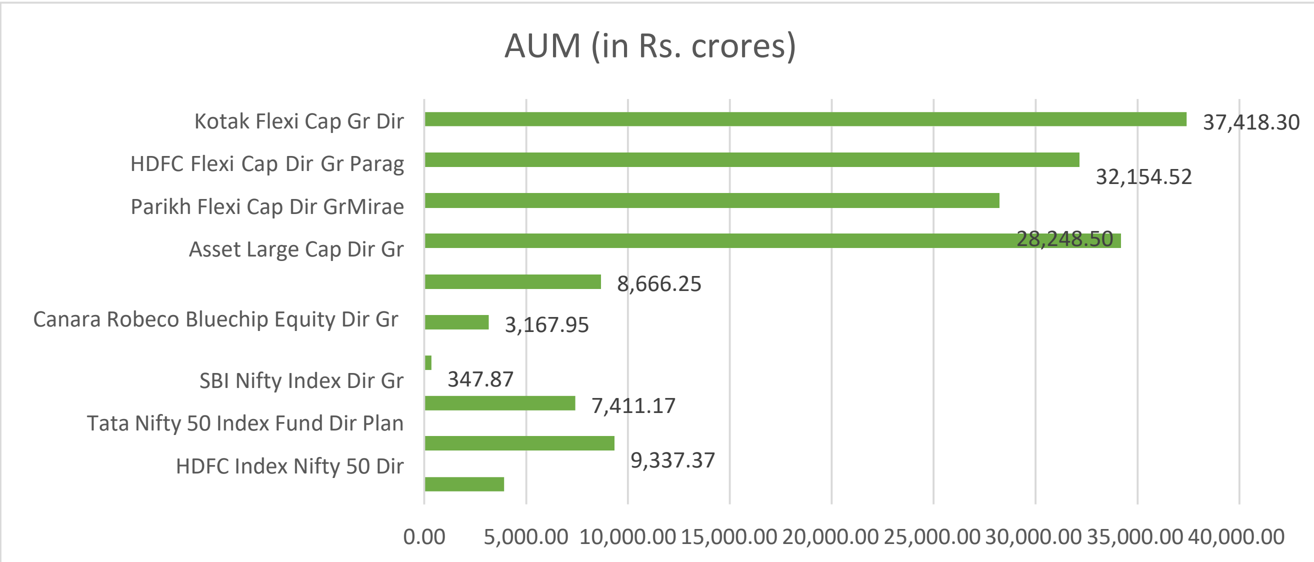
When it comes to mutual fund investment, two very important criteria must be noted. One is the Plan of the Purchase and the other one is the way of transaction.

In terms of Plan, there are two types of Plans that are Direct and Regular Plan. In direct plan, investors invest directly in a mutual fund by buying their units. It is called the direct plan because there is no distributor involved in the transaction. On the contrary, in a regular plan aninvestor will invest via a distributor/advisor. In a regular plan as a distributor is involved the expense ratio of the mutual fund would be higher compared to the expense ratio of a direct planmutual fund.

In transaction types we have three important sub-divisions that are SIP, SWP and STP.

In Systematic investment plan (SIP), an investor regularly invests in a regular period of time, this will help in regulating the volatility of the market, an investor has good possibilities to capture the peak and make profits in a long term. In Systematic Withdrawal Plan (SWP), an investor can repurchase a constant value of units over a time period. A constant amount will bepaid to the investor at the pre-specified frequency. This plan is helpful in minimising the risk of redemption, providing liquidity support at the right time. In Systematic Transfer Plan (STP)the amount withdraw will be re-invested in a different scheme of the same mutual fund. A Switch occurs between two schemes. When it is switched to the second scheme, SIP transactionwill become active. This type will be helping in balancing the portfolio and transferring the profits of the scheme during required time.

Figure 1: AUM of the considered mutual funds



Source : Groww

Table 2: Ratio Analysis of the Mutual Funds

S.No	Name of the MutualFund	Alpha	Sharpe Ratio	Beta	S.D	Expense Ratio	Sortino Ratio
1	ICICI Pru Nifty 50 Index FundDir	-0.83	0.65	1	22.21	0.17	0.79

2	UTI Nifty50 Index Dir Gr	-0.87	0.65	1.01	22.3	0.2	0.79
3	HDFC Index Nifty50 Dir	-0.96	0.65	1.01	22.28	0.2	0.78
4	Tata Nifty50 Index	-0.7	0.66	0.98	21.82	0.16	0.8

	Fund DirPlan						
5	SBI NiftyIndex DirGr	-1.11	0.64	1.01	22.38	0.18	0.77
6	Canara Robeco Bluechip Equity DirGr	2.66	0.82	0.86	19.51	0.42	0.97
7	Mirae Asset Large CapDir Gr	-0.55	0.66	0.96	21.42	0.53	0.74
8	Parag Parikh Flexi CapDir Gr	6.89	1.02	0.78	19.38	0.76	1.09
9	HDFC Flexi CapDir Gr	1.62	0.77	1.04	24.21	1.01	0.92
10	Kotak FlexiCap Gr Dir	-2.31	0.63	0.94	21.46	0.67	0.65

Source: Groww. *This platform is a SEBI registered trading platform; The ratios can slightly differ with different pre-defined values.

SHORTLISTED MUTUAL FUNDS BASED ON RATIOS

a) TATA Nifty 50 Index Fund Direct Growth

This fund's AUM is very small compared to other funds. The date of fund's allotmentwas on February 25 2003. The current NAV is Rs.**115.9874.** This fund is only holdingon to Large Cap funds. The Top three sectors of this fund are financial services (36.75 %), Information Technology (14.68%) and Oil Gas (12.16%). Its Benchmark is Nifty 50 TRI

b) Canara Robeco Bluechip Equity Direct Growth

The date of fund's allotment was on August 20 2010.The current NAV is Rs.**41.10.** ThisFund hold 93.38 % of large cap stocks and 6.62 % of mid cap stocks. This fund has beaten its benchmark in a period of 5 years.

c) Parag Parikh Flexi Cap Direct Growth

The date of fund's allotment was on May 24 2013. The fund's benchmark index will be NIFTY 500 TRI. The current NAV is Rs.**52.5308.** The fund has invested its AUM in different securities like core equity(68.15%), arbitrage, certificate of deposit, commercial paper and Overseas securities (16.35%)

CONCLUSION

Wealth creation is one of most important financial aspects of our lives. Usually, wealth in theend will be useful for fulfilling our dreams or for our close relations. Consistently saving money for a very long period of time help us accumulate impeccable monetary wealth. Time is a very important factor in this process. As you see the difference created with the increase in the amount of time. Annual Step-up percentage is mandatory because of inflation. Inflation has the ability to consume our money in regular period of time, to beat the inflation percentage we must be investing consistently.

For short term profits, we can do intraday trading, futures and options, derivatives and many more. Without getting into the complexity of big algorithms, using our precious time and investing habits we can be able to make huge profits in our lives.

Investment will give you the right financial advantage, so make use of your time and start early.

Table 3: Wealth Compounding Values

Investing Amount per month	Annual Stepup %	Average Annual Growth rate	10-yearperiod	15-year period	20-yearperiod
Rs.2000	10%	12%	Investment:Rs. 3,82,497 Total Value: Rs.6,88,270 Return: **Rs.3,05,773**	Investment:Rs. 7,62,541 Total Value: Rs.17,42,254 Return: **Rs.9,79,713**	Investment: Rs. 13,74,610 Total Value: Rs.39,22,875 Return: **Rs.25,48,265**
Rs.3000	10%	12%	Investment:Rs. 5,73,754 Total Value: Rs.10,32,413 Return: **Rs.4,58,659**	Investment: Rs.11,43,834 Total Value: Rs.26,13,415 Return: **Rs.14,69,581**	Investment: Rs.20,61,965 Total Value: Rs.58,84,411 Return: **Rs.38,22,446**

Rs.5000	10%	12%	Investment :Rs. 9,56,246 Total Value: Rs.17,20,675 Return: **Rs.7,64,429**	Investment : Rs. 19,06,356 Total Value: Rs.43,55,635 Return: **Rs.24,49,279**	Investment : Rs. 34,36,521 Total Value: Rs.98,07,179 Return: **Rs.63,70,658**

Source: SEBI Calculator

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