Mutual Funds, SIPs, SWPs and More

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Abstract: *This report dives into the basics of investing with mutual funds and explains Systematic Investment Plan (SIPs) and Systematic Withdrawal Plans (SWPs), both of which are popular among retail investors. The report touches upon the development of the Indian mutual industry and comments on the various regulatory milestones that have helped make the mutual fund industry a Rs. 40 trillion industry in over 40 years. The report also discusses the benefits and drawbacks of these investment options and how they fit into the overall investment strategy of an individual. It also highlights the risks associated with mutual fund investments and provides recommendations for mitigating them. Overall, this report is an essential guide for investors looking to invest in mutual funds and provides valuable insights into the nuances of mutual fund investments.*

1. Introduction

Learning to invest is like learning a new language, and yes, learning a new language as an adult. Even the humble alphabets pose a massive challenge. Investing is similar in a sense. Without proper context, it is a messy jungle of jargon. Mastering certain basic investing principles will adequately equip one to understand the best avenues for their hard-earned capital.

The field of investing is large, and there is virtually an infinite number of things to learn about investments. The best, most successful investors will tell you that they are continually learning and continually honing and expanding their skills at making money in the financial markets. One cannot learn everything there is to know about investing or even just investing for beginners in one day. Still, fortunately, one need not do that to begin a career as a successful, profitable investor.

One of the most successful traders in history once remarked, “If I’d only been taught in high school what I later managed to learn on my own about investing, I likely could have retired wealthy by age 35.” Put simply, investing is setting aside a portion of one’s money while they carry on with their daily life, hoping that this money will work for them and grow. On the flip side, saving does not give one the liberty of growth.

2. Mutual Funds...Sahi Hai!

This term – Mutual Funds gets thrown around a lot. And while a lot of people are familiar with its utility, it is still highly crucial to equip all readers with the know-how of what and why Mutual Funds.

Throughout this report, we refer to Rahul, a fictitious character who will help us in understanding certain concepts better

2.1. What is a Mutual Fund?

A Mutual Fund is, in essence, a pool of investor's money managed by professional fund managers who invest this pool in various assets such as stocks, bonds or even gold.

These funds are comparable to stocks and have a price associated with them known as NAV (Net Asset Value): An average price of all the constituents in the specific mutual fund. Say, when Rahul invests in a mutual fund, he get units corresponding to the NAV of that mutual fund on that day. Now when the prices of the constituents of his mutual funds rise, his mutual fund NAV increases, and here is where he makes money.

The investing is indirect, but the rewards are direct. These funds are taxable, of course, but there are other charges. For instance, the expense ratio. This is the money charged by the Mutual Fund Company (AMC) for managing your fund and providing their expertise, and this is automatically adjusted every day in the NAV of the mutual fund.

2.2. How does this all work?

Rahul decides to purchase Rs. 10,000 worth of Mutual Fund units today, translating to approximately 143.45 units. He invests this money on Tuesday, The funds are now transferred to Quant Money Managers AMC, which will allot him units based on the closing NAV of that day. There are some technicalities here, but let's ignore them for the time being. He has now invested Rs. 10,000 into the Mutual Fund, and the AMC will allocate those units in his name within 1-2 days. he can now relax and wait for his Fund manager to do the actual work.

Every mutual fund has a fund manager, who is like the CEO of the fund. Like Rahul, lakhs of people invest in mutual funds, which makes up the AUM (Assets under Management). The fund manager will now use this money to buy and sell stocks on the Indian stock exchanges; she has an entire team that does all of the research before purchasing any stock

Assets Under Management (AUM) of the Indian Mutual Fund Industry as of November 30, 2022, stood at Rs. 40,37,561 crore. The AUM of the Indian MF industry has grown from Rs. 7.93 trillion as of November 30, 2012, to Rs. 40.38 trillion as of November 30, 2022, more than a 5x increase in 10 years.

Planning and execution is a lifelong skill and takes years to master. Investment is a similar skill that requires precise planning and execution. The decisions one takes today have a significant impact on their future returns. The easiest way to ease this panning process is by investing via mutual funds. People are misinformed that mutual fund investments require no investor effort as the capital is managed by a highly qualified fund manager who has years of experience. Though the latter is often true, mutual funds require no investor effort is a marred concept.

As *Shikhar Dhawan* keeps telling us in between overs, "Mutual funds Sahin Hai"; is he telling us the truth? Are all mutual funds worth investing in?

2.3. Criteria to analyse Mutual Funds

Before investing, one must lay out their investment goals and gauge their risk-bearing capacity. All investments carry a degree of risk, and one must perform adequate due

diligence before putting in their money. Risk and returns go hand in hand, and a proper balance must be maintained. Goals could range from long-term capital gains to saving up for college or buying a house, or maybe even planning for one's retirement. One should look at the following characteristics of a mutual fund before deploying capital:

- Assets Under Management (AUM)
- Expense ratio
- Fund Performance v/s Benchmark Performance
- Fund house and Fund manager

2.3.1. Assets Under Management (AUM)

Assets Under Management refers to the total market value of the assets that a mutual fund manages at a given time. AUM includes the returns a mutual fund has made on its investment and the capital a manager has at its disposal to make new investments.[3] AUM is an indicator of mutual fund performance as well as its size. An increasing AUM may indicate positive fund performance or new customers who have brought in additional funds to be invested, or both. A decreasing AUM means poor performance or a large redemption, which may or may not be linked to the fund's performance. A fund's AUM can be compared to establish its credibility and success.

2.3.2. Expense Ratio

Under SEBI (Mutual Funds) Regulations, 1996, Mutual Funds are permitted to charge certain operating expenses for managing a mutual fund scheme – such as sales marketing/advertising expenses, administrative expenses, transaction costs, investment management fees, registrar fees, custodian fees, audit fees – as a percentage of the fund's daily net assets.

2.3.3. Fund Performance v/s Benchmark Performance

A benchmark is a standard or measure that can analyse a given portfolio's allocation, risk, and return. Individual funds and investment portfolios will generally have an established criteria for legal analysis. Investors often use the Nifty 50, Nifty 500, etc., as benchmarks. Benchmarks have several measures used to evaluate portfolio risk and reward, including the following:

- **Standard Deviation:** It is a statistical measure of volatility that calculates the variance in price moves of an investment to the mean or average return over a period. In other words, a higher standard deviation indicates more volatility and greater risk.
- **Beta:** It is used to measure volatility against a benchmark. For example, a fund with a beta of 1.2 is expected to move 20%, up or down, for every change in the standard or benchmark. A portfolio with a lower beta would be expected to have less up and down movement than the benchmark.

- **Sharpe Ratio:** The Sharpe Ratio is a widely used measure of risk-adjusted return. The Sharpe ratio is the average return earned more than a risk-free investment, such as an Indian government bond. A higher Sharpe ratio indicates a superior overall risk-adjusted return.

2.3.4. Fund Performance and Fund Manager

The mutual fund industry is highly regulated. The Securities and Exchange Board of India, also known as SEBI, and the Association of Mutual Funds of India, are responsible for regulation. When people invest their hard-earned money, hoping that it will grow in the future, trust is of utmost importance.

The Rs. 40.38 trillion mutual fund industry has had the trust of 10 crore folios for generations now, and with time, this trust is expected to grow. When novice investors want to invest in mutual funds, they are tasked with the problem of finding a good AMC that has historically beaten the benchmark and produced stellar returns for its unit holders. One can differentiate between a good fund manager and an average one by looking at factors such as:

- Has the fund manager succeeded in outperforming the benchmark in perpetuity?
- Does the manager keep track of the other institutional investors (DII or FII) buying and selling stocks?
- Are they able to identify scripts way ahead of their peers?

The trust in the regulators that the voice of an individual investor will be heard, confidence in the mutual fund house that it will respond to grievances and provide adequate redressals and trust in the fund manager that they will manage the capital well and not deviate from the investment philosophy of the scheme (fund).

3. Creating wealth with SIP

3.1. What is an SIP?

SIP, or the Systematic Investment Plan, is a mode of investment where you can invest a fixed amount at specific intervals in mutual fund schemes. SIP investment is one of the best ways to invest in mutual funds as anyone with a regular income can invest and earn steady returns. Today SIPs are not just limited to mutual funds only. One can have SIPs in stocks, gold, crypto, etc. A disciplined approach to investing, especially in mutual funds, has several benefits, especially in the long run. Regularly investing could become a habit if you include it as part of your monthly household budget and manage your monthly income accordingly.

3.2. Who should opt for an SIP?

- **When one wants to invest but does not have a large corpus:** With an SIP, one can start investing a small amount, as low as | 500 every month, in a mutual fund scheme. One can support a small portion of mutual funds through SIP whenever you have a steady income.

- **When one wants to invest in mutual funds but is cautious:** SIP is suitable for those who want to test if mutual funds are suitable. By investing small amounts regularly and tracking returns, one can find if the investment is helping them with their financial objectives.
- **When one does not wish to take a risk:** Mutual funds and risk go hand-in-hand, but SIPs spread out the risk over a period, mitigating the potential risk. The longer one's investment, the lesser the risk. Hence, the best time to start an SIP is when one wants to invest in an instrument with a lower risk profile.

3.3. Benefits of SIP Investing

- Rupee Cost Averaging: Rupee cost averaging is a concept where one purchases more units when the Net Asset Value (NAV) of the fund is low and lesser units when the NAV is high. Essentially, it averages out one's purchasing costs over the tenure of the investment period. One need not worry about how to time the market when they invest through an SIP.
- Convenience: SIP can be a convenient mode of investing. Like most investors, one may not have the time for extensive market research and analysis to adjust or balance their portfolio. So, once one picks a good fund, one can give standing instructions to the bank and let the SIP take care of their monthly investments.
- Power o f Compounding: Compounding occurs when the returns one earns on their investments start making returns. When one regularly invests through SIPs, their returns get reinvested. Over time, this results in a snowball effect that may increase their potential returns manifold. An ideal way to maximise this gain is to invest for an extended period. This also means one may benefit by investing as early as possible. Even a ten-year head-start can have a significant impact on ones returns.

4. SWPs and more

A systematic withdrawal plan (SWP) is a type of investment strategy that allows investors to regularly withdraw a fixed amount of money from their investment portfolios on a regular basis. This can be a useful tool for investors who want to generate a steady stream of income from their investments, such as retirees who want to use their investments to supplement their retirement income.

In an SWP, the investor specifies the amount of money they want to withdraw each period, as well as the frequency of the withdrawals (e.g. monthly, quarterly, annually). The investment manager then automatically makes the specified withdrawals from the investor's portfolio, using a predetermined investment strategy to try and maximize the value of the remaining portfolio.

One benefit of an SWP is that it can provide investors with a predictable source of income from their investments. This can be especially useful for retirees who want to ensure that they have a regular stream of income to cover their living expenses.

Another benefit of an SWP is that it can help investors manage their tax liability. By regularly withdrawing a fixed amount of money from their portfolio, investors can spread out the realization of their investment gains over time, potentially reducing the amount of taxes they owe in any given year.

However, there are also some potential drawbacks to using an SWP. For example, if the investments in an investor's portfolio perform poorly, the fixed withdrawals may deplete the portfolio faster than anticipated, potentially reducing the overall value of the portfolio over time. Additionally, an SWP may not be suitable for investors who need access to their money on short notice, as the fixed withdrawal schedule may make it difficult for them to withdraw money from their portfolio on demand.

In conclusion, a systematic withdrawal plan can be a useful investment strategy for investors who want to generate a steady stream of income from their investments. However, it is important for investors to carefully consider the potential drawbacks of an SWP and consult with a financial advisor before implementing this strategy.

5. Bottom Line

The simplicity of SIP and ease of understanding has the potential to ride over market cycles for disciplined investors to create long-term wealth. An ideal way to make money in equities is to buy more when the markets are low and buy less when the needs are high.

In an SIP you automatically end up doing so and saving yourself from the volatility of the markets. One must also realise that time spent in the market is more important than timing the market. Pullbacks and corrections are part of the market cycle, they are bound to come and you as an investor should be happy that you can buy more in these opportunities and not get scared of the short-term uncertainty.