AVENUES OF INVESTMENT

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Investment is the employment of funds with the aim of achieving additional income or growth in value. The essential quality of an investment is that, it involves 'waiting' for a reward. It involves the commitment of resources which have been saved or put away from current consumption in the hope that some benefits will accrue in future. Mr Warren Buffet says "Never depend on a single income, make an investment to create a second source."

In India, many types of investment media or channels are available for making investments. A sound investment program can be constructed if the investor familiarizes himself with the various alternative investments available.

Following are the different kinds of investment media -

Direct Investment Alternatives

- Fixed Deposits
- Savings Account
- Savings Certificate
- Government Bonds
- Corporate Bonds and Debentures

Indirect Investment Alternatives

- Mutual Fund
- Portfolio Management Services
- Alternative Investment Fund (AIF)
- National Pension Scheme (NPS)

Variable Principal Securities

- Equity Shares
- Convertible Debentures or Preference Securities

Non Security Investments

- Real Estate
- Mortgages
- Commodities
- Art, Antiques and other valuables

A. Direct Investment Alternatives

Direct investments are those where the individual makes his own choice and investment decision. We all are aware about investment in Fixed Deposits, Saving Account and Saving Certificates. We also have Government Bonds and Debentures.

- **Government Bonds –** A government bond or sovereign bond is a bond issued by a national government, generally with a promise to pay periodic interest payments and to repay the face value on the maturity date. A Government bond in a country's own currency is, strictly speaking, a risk-free bond, because the government can, if necessary, create additional currency in order to redeem the bond at maturity. Average tax free yield of these kinds of bonds isapproximately between 6 to 6.5% p.a.

- **Corporate Bonds or Debentures (NCD)** - Corporate bonds/Debentures are issued by companies and offer interest rates higher than the bonds issued by public sector units and other financial institutions. The interest rate on these bonds is governed by their credit rating. Higher the rating, lower is the interest rate offered by them. Hence, an investor needs to be careful before investing in them. Average yield of these kinds of instruments is approximately between 8 to 10%.

B. Indirect Investment Alternative

Indirect investments are those in which the individual has no direct hold on the amount he invests. Nowadays investors generally prefer for indirect investment as the funds are professionally managed by experts. Various indirect investment media are as follows

- **Mutual Funds** – A mutual fund collects money from investors and invests the money on their behalf. It charges a small fee for managing the money. Mutual funds are an ideal investment vehicle for regular investors who do not know much about investing. Investors can choose a mutual fund scheme based on their financial goal and start investing to achieve the goal. There are three types of Mutual Fund namely Equity, Debt & Hybrid.

I. Equity Mutual Fund– These fundshave their major exposure in equity. They are subcategorized as below:

1. **Multi Cap Fund** - These funds invest in stocks across market capitalization. That is, their portfolio comprises of large cap, midcap and small cap stocks. They are relatively less risky as compared to a pure mid cap or a small cap fund and are suitable for not-so-aggressive investor.Five years CAGR of top ten schemes of this category have given returns between 17.26% to 22.56%*.

2. **Large Cap Fund** - The criteria for large cap companies may vary. However, these are generally the ones with huge market capitalization. Large cap funds are known to offer stable and sustainable returns over a period of time, but might be outperformed by small and mid-cap funds, which have higher risk exposure.Five years CAGR of top ten schemes of this category have given returns between 13.53% to 17.55%*.

3. **Large & Mid Cap Fund**-These funds invest in a mix of large cap and midcap stocks. The ratio in which the investment is diversified, between large and mid-cap companies, may differ from fund to fund. Due to their exposure in both, large and midcap funds, these funds are positioned on a higher risk return tradeoff plane as compared to a pure large cap fund. Five years CAGR of top ten schemes of this category have given returns between 28.1% to 28.7%*.

4. **Mid Cap Fund** -These funds invest instocks that are ranked from 101 to 250 by market capitalization. Due to their exposure in high beta stocks, they are positioned on a high risk return trade-off plane as compared to a large cap fund. Five years CAGR of top ten schemes of this category have given returns between 24.81% to 25.55%*.

5. **Small Cap Fund** - These funds invest in stocks that are ranked above 250 by market capitalization. These funds invest in small-cap companies which not only offers more room for growth to the investors, but also confer greater risk and volatility than large-cap companies. Five years CAGR of top ten schemes of this category have given returns between 26.4% to 31.84%*.

6. **Contra Fund**–These funds are distinguished from other funds by their style of investing. The asset's poor performance or outperformance leads to distortion in valuations, which is what these funds seek to capitalize on. The underlying assumption is that the asset will stabilize and come to its real value in the long term once the short-term concerns plaguing it either become irrelevant or are mitigated. The idea is to buy assets at a cost lower than its fundamental value in the long term. Investors must take note of the fact that these funds may not perform in the short term because of the kind of assets they invest in. These funds may pick up stocks that are out of flavors or invest in sectors that are witnessing a slump.

7. **Value Fund**–These funds invest in companies which it determines to be underpriced by fundamental measures. Assuming that a company's share price will not remain undervalued indefinitely, the fund looks to make money by buying before the expected upturn. Value funds tend to focus on safety rather than growth, and often choose investments providing dividends as well as capital appreciation. They invest in companies which have low P/E ratios, and stocks which have fallen out of flavor with mainstream investors, either due to changing investor preferences, a poor quarterly earnings report, or hard times in a particular industry. Five years CAGR of top ten schemes of this category have given returns between 18.20 to 22.4%*.

8. **Focused Fund–** These funds hold large positions in a small number of stocks. While most mutual funds hold 100-200 positions, a focused fund will usually hold only 10-30 positions. They emphasize quality over quantity, and would rather hold just the stocks they have the most confidence in, than diversifying across a large number of holdings. Theoretically, this should enable them to more thoroughly research and track their holdings, although they lose the benefits of diversification and tend to be more volatile than other mutual funds.

9. **Sector/Thematic Fund -** Sector-specific funds are considered to be relatively more risky as compared to a diversified fund. As these funds take exposure in a single sector, the concentration risk is high. Their performance is aligned with the performance of the sector in which they are investing. As the exposure is not broad based, it carries a high degree of risk. This type of funds is normally suitable for highly aggressive investor. Some of the sector-specific funds are Banking Fund, Pharma Fund, Technology Fund, FMCG Fund etc.

10. **ELSS –**These funds have tax deduction u/s 80C attached to it. These funds have a lock-in period of 3 years. These funds are quite same as a diversified equity fund. They invest in equity shares of companies across sectors and market capitalisations.Three years CAGR of top ten schemes of this category have given returns between 8.26% to 14.24%*.

II. **DEBT Fund -** These funds have major exposure in debt instruments. They are subcategorized as follows:

1. **Liquid Funds / Money Market Funds** - These funds invest in highly liquid money market instruments and provide easy liquidity. The period of investment in these funds could be as short as a 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 lesseras compared with other funds.Three years CAGR of top ten schemes of this category have given returns between 7.24% to 7.32%*.

2. **Ultra Short Term Funds** – Earlier known as Liquid Plus Funds, these funds invest in very short term debt securities with a small portion in longer term debt securities. Most Ultra short term funds do not invest in securities with a residual maturity of more than 1 year. Also referred to as Cash or Treasury Management Funds, Ultra Short Term Funds are preferred by investors who are willing to marginally increase their risk with an aim to earn commensurate returns. Investors who have short term surplus for a time period of approximately 1 to 9 months should consider these funds. Three years CAGR of top ten schemes of this category have given returns approximately 8.69%*.

3. **Floating Rate Funds** - These funds primarily invest in floating rate debt securities, where the interest paid changes in line with the changing interest rate scenario in the debt markets. The periodic interest rate of the securities held by these products is reset with reference to a market benchmark. This makes these funds suitable for investments when interest rates in the markets are increasing. Three years CAGR of top ten schemes of this category have given returns approximately 7.83%*.

4. **Short Term & Medium Term Income Funds** - These funds invest predominantly in debt securities with a maturity of upto 3 years in comparison to a Regular Income Fund. These funds tend to have an average maturity which 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 can 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 9 to 12 months. Three years CAGR of top ten schemes of this category have given returns between 7.38% to 7.92%*.

5. **Income Funds** – These funds invest in corporate bonds, government bonds and money market instruments. However,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 such that the interest rates have touched their peak and are poised to reduce.

6. **Gilt Funds** – These funds invest in government securities of medium and long term maturities issued by central and state governments. These funds do not have the risk of default 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 profile of the instrument, higher the interest rate risk.Three years CAGR of top ten schemes of this category have given returns between 8.03 to 9.46%*.

7. **Dynamic Bond Funds** – These funds invest in debt securities of different maturity profiles. These funds 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.Three years CAGR of top ten schemes of this category have given returns of 8.33%*.

8. **Corporate Bond Funds** - These funds invest predominantly in corporate bonds and debentures of varying maturities that offer relatively higher interest, and are exposed to higher volatility and credit risk. They seek to provide regular income and growth and are suitable for investors with a moderate risk appetite with a medium to long term investment horizon.Three years CAGR of top ten schemes of this category have given returns of 6.68%.

9. **Fixed Maturity Plans (FMPs)** – These 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. These are also a tax efficient investment option.

III. **Hybrid Fund -** These funds have a mix exposure of equity and debt instruments. They are subcategorized as below

1. **Balance Hybrid Fund** - This fund will invest around 40-60 percent of its total assets in both debt and equity instruments. The beneficial factor of a balanced fund is that they provide equity comparable returns with a lower risk factor. Five years CAGR of top ten schemes of this category have given returns between 14.72 to 15.92%*.

2. **Dynamic Asset Allocation or Balanced Advantage Fund** - This scheme would dynamically manage its investments in equity and debt instruments. This fund tends to increase the allocation in debt securities and reduce the weightage to equities when the market becomes costly. Also, it focuses on providing stability at a low-risk.

3. **Multi Asset Allocation** - This scheme can invest in three asset classes, which means that it can invest in an extra asset class apart from equity and debt. The fund should invest at least 10 percent in each of the asset classes. Foreign securities will not be treated as a separate asset class.

4. **Arbitrage Fund** - This fund will follow the arbitrage strategy and will invest at least 65 percent of its assets in equity-related instruments. Arbitrage funds are Mutual Funds that leverage the differential price between the cash market and derivative market to generate mutual fund returns. The returns generated by arbitrage funds are dependent on the volatility of the stock market. Arbitrage mutual funds are hybrid in nature and in times of high or persistent volatility, these funds offer relatively risk-free returns to investors.

5. **Equity Savings** - This scheme will invest in equity, arbitrage and debt. Equity savings will invest at least 65 percent of the total assets in stocks and a minimum 10 percent in debt. The scheme would state the minimum hedged and unhedged investments in the scheme information document.

If investor has alumpsum amount andhasdecided to invest the entire sum into equity mutual funds, looking at the current market situation which is very volatile, he may feel unsure to invest the entire amount in one go. So investor should go for STP in this situation. Systematic Transfer Plan (STP) is a mechanism by which an investor is able to transfer a fixed or variable amount from one mutual fund scheme to another mutual fund scheme. For example - An investor can park a lump sum amount in a liquid fund that can be transferred in a staggered manner into another scheme, say an equity fund of the same mutual fund house (AMC) at regular intervals.

- **Portfolio Management Services(PMS)**– They provide services for investment portfolio in stocks, fixed income, debt, cash, structured products and other individual securities, managed by a professional money manager that can potentially be tailored to meet specific investment objectives. When you invest in PMS, you own individual securities unlike a mutual fund investor, who owns units of the fund. You have the freedom and flexibility to tailor your portfolio to address personal preferences and financial goals. Although portfolio managers may oversee hundreds of portfolios, your account may be unique. Minimum investment under PMS is 25 Lakhs.
    1. **Discretionary** - Under these services, the choice as well as the timings of the investment decisions rest solely with the Portfolio Manager.
    2. **Non- Discretionary** - Under these services, the portfolio manager only suggests the investment

ideas. The choice as well as the timings of the investment decisions rest solely with the investor. However the execution of trade is done by the portfolio manager.

3. **Advisory** - Under these services, the portfolio manager only suggests the investment ideas. The choice as well as the execution of the investment decisions rest solely with the investor.

Note: In India majority of Portfolio Managers offer Discretionary Services.

- **Alternative Investment Fund (AIF)** - AIF as an investment vehicle, was established to pool in funds for investing in real estate, private equity and hedge funds. Till now, in India, pooling of capital was allowed only for Indian investors, and investment was done according to a pre-determined policy. However, selectively approval route for investment was used by overseas investors and non-resident Indians (NRIs). AIFs are primarily aimed at high net worth individuals, and according to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, the minimum investment from an individual is Rs.1 crore.

  There are three categories of AIFs depending upon on their effect on the economy. Categories-I AIFs have a positive spillover on the economy and may get concessions from the regulator or the government. These include venture funds, social venture funds and infrastructure funds, among others. Category-II includes private equity funds and debt funds and do not get any concessions. These cannot raise debt for investment purposes, but can do so to meet their day-to-day operational requirements. Category-III includes hedge funds, and are usually traded to make short-term returns.
- **National Pension Scheme (NPS)** - Under this scheme, the savings of every individual are pooled in the pension fund, which is then invested by professional fund managers of PFRDA. As per the approved investment guidelines, the funds are invested in the diversified portfolio including, government bonds, bills, corporate shares and debentures.It is designed to encourage systematic saving during the subscriber's working life with an aim to offer old-age income or fixed retirement income to all the citizens of India, even NRIs. Tax deduction is also attached to it.

C. Variable Principle Securities – This category consists of investing directly into equity, convertible debentures and preferences securities. While investing directly in such securities,we must try to follow basic principles stated by Mr. Warren Buffet which are as follows:

a) Invest in Businesses which we can understand

b) Invest in Businesses with favorable long term prospects

c) Invest in Businesses operated by honest and competent people and

d) Invest in Businesses available at a very attractive price.

D. Non-Securities Investment –'Non-Security Investments' differ from securities in other categories. Real estate may be the ownership of a single home or include residential and commercial properties. The terminal value of real estate is uncertain but generally there is a price appreciation, whereas depreciation can be claimed in tax. Real estate is less liquid than corporate securities. Mortgages represent the financing of real estate. It has a periodic fixed income and the principal is recovered at a stated maturity date.

Commodities are bought and sold in spot markets; contracts to buy and sell commodities at a future date are traded in future markets. Business ventures refer to direct ownership investments in new or growing business before firms sell securities on a public basis. Art, antiques and other valuables such as silver, fine china and jewels are also another type of specialized investments which offer aesthetic qualities too.

All the features mentioned above should be consistent with the investors' objectives and their respective risk appetite and in addition, should have additional conveniences and advantages. Risk tolerance is an important component in investing. Investors should have a realistic understanding of their ability and willingness to stomach large swings in the value of their investments; if they take on too much risk, they might panic and sell at the wrong time. Investors should define goals and plan an investment strategy that helps them to meet their current as well as future goals so that they can optimally allocate their resources.

“Don't work for money; make it work for you.” Robert Kiyosaki

HAPPY INVESTING!!!

**Sources: Value Research*