**[Frequently Asked Questions]**

**Mutual Funds (Part-2)**

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| **Subject:** | Business Economics |
| **Course:** | B. A. (Hons.), 5th Semester, Undergraduate |
| **Paper No. & Title:** | Paper – 511<br>Investment Management |
| **Unit No. & Title:** | Unit – 4<br>Mutual Funds |
| **Lecture No. & Title:** | Lecture – 2<br>Mutual Funds (Part-2) |

## Frequently Asked Questions:

1. **What is Net Asset Value?**

It refers to the market value of assets minus its liabilities. The NAV is divided by the number of units outstanding on the valuation date. It is computed as follows:

$$NAV = market\ value\ of\ funds'investments + receivables$$
$$+ accrued\ income - liabilities$$
$$- accrued\ expenses/number\ of\ units\ outstanding$$

2. **Which statistical measure is used for calculation of risk and volatility associated with mutual funds?**

**Standard deviation:** It refers to the funds volatility in terms of rise and fall in its returns. It measures the risk by measuring the degree to which the fund fluctuates in relation to its mean return.

**Beta:** It measures its price volatility relative to a particular stock market index.

3. **List the popularly used ratios for evaluation of mutual fund performance.**

They are a) Sharpe ratio b) Sortino ratio c) Treynor ratio d) Jensen's Alpha e) Modigliani risk adjusted ratio (M2 ratio) f) Information Ratio (IR) e) S&P’s Risk adjusted capital ratio

4. **Define Sharpe ratio.**

This ratio, proposed by William Sharpe describes how much return is receiving for the extra volatility that an investor endure for holding a riskier asset. He needs to be properly compensated for the additional risk he undertakes for not holding a risk free asset. The risk adjusted return is called ‘Sharpe ratio’. It is also called ‘reward to variability ratio’. A fund with higher Sharpe ratio gets a better rank.

5. **Define Treynor ratio.**

This ratio developed by Jack Treynor, measures returns earned in excess of that which could have been earned on a risk less investment per each unit of market risk. It adjusts excess return for systematic risk. It is computed by dividing a portfolio’s excess return, by its beta. It is also called reward to volatility ratio.

6. **What is tracking error?**

Tracking error is the standard deviation of the difference between returns of the portfolio and the returns of the index.

**7. List common portfolio management strategies.**

a)Tactical Asset allocation b) Portfolio rebalancing c)Core Satellite portfolio framework d)Asset Allocation e)Diversification

8. **What is the difference between 'core' and satellite investments?**

A 'core' is a long term investment which forms the base of an investor's investment portfolio. It tracks major indices and hence is passively managed.

A 'satellite' is an investment which is actively managed in order to add excess returns to the current portfolio returns. The investor takes risks to get the advantage of the market movements without affecting his long term financial goals.

**9. What is bench marking with respect to mutual funds?**

In every half yearly results, the performance of mutual funds needs to be disclosed, along with the performance of a benchmark index. In India, the benchmark is BSE Sensex AND NSE Nifty for large cap funds. In April 2002, SEBI made benchmarking mandatory for mutual funds. The reason why benchmarking is important is to assess the customer's need for value for money.

**10. What are portfolio management services (PMS)?**

The PMS are entities which are registered with regulators, offer customized portfolio services to investors with large pool of funds and specific financial goals. On behalf of the investors, they hold stocks, unlike mutual funds where the investor is a unit holder. These stocks are invested in equity and debt options. The investor holds the stocks in his own de-mat account but the fund manager operates on his behalf. Secondly he needs to invest a minimum of Rs.25 lakhs a PMS.