# Value orientation, important differences between the mutual fund investment flow and Indian stock market results

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**Abstract**

Researchers and academicians from all over the world have become interested in the study of the causal relationship between mutual fund investment flow and stock market returns in recent years. But there is currently a contradictory body of empirical data on this matter. Additionally, there are a few studies that take the case of India into account. In order to better understand the dynamics of the relationship between mutual fund investment flow and stock market returns in India from January 2000 to May 2010, the following article will do just that. The Granger causality tests are applied using the Toda and Yamamoto approach, which yields evidence of a one-way causal relationship between stock market returns and mutual fund investment flow. This suggests that the expansion of stock market activity in India draws mutual funds to the stock market. Therefore, the government and monetary authorities should take the necessary actions to reduce the volatility and increase the efficiency of the capital market. By gathering money from households and investing it in the stock and debt markets, mutual funds enable portfolio diversification and relative risk aversion. In India, a specific type of mutual fund called fixed-income funds invests in debt securities that have been issued by businesses, banks, or the government. In India, fixed-income funds are also referred to as debt funds and income funds. The goal of the current study is to assess the performance of a few selected debt or income mutual fund schemes in India based on their daily NAV using various statistical measures. In the past ten years, income schemes have become more and more popular. The portfolio of the fund refers to the securities that were acquired. Money market and (short-term) bond funds may have emerged as a result of limitations on competing products. This study compared and analyzed the performance of various mutual fund types in India and came to the conclusion that equity funds performed better than income funds. The study also found that institutional fund managers can time their investments and that equity fund managers have significant market timing ability, but broker operated funds did not demonstrate this ability. Additionally, empirical research has shown that fund managers possess significant timing ability and can time their investments to match market conditions.

**Keywords:** Mutual funds, stock market returns, investment, debt markets, portfolio diversifications

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**Introduction:**

In recent years, investors' preference for mutual funds as a source of investment has grown significantly. However, the Mutual Fund Industry is also contributing significantly to the expansion and improvement of the Economy. Mutual funds are professionally managed funds that pool the savings of many different investors and invest those funds in a variety of investment options, including government securities, debt, and equities. Due to their unique characteristics like diversification, low transaction costs, liquidity, and expert knowledge, mutual funds have become very popular. Due to their superior returns and capital growth compared to other investment options, equity funds are very well-liked by Indian investors. When compared to other fund schemes, equity funds likely offer a higher return, but they also come with a higher risk. The risk-return analysis of the funds is crucial because investors are now very concerned about their investments. A managed collection of securities from various corporations is referred to as a mutual fund. On the shares they own, these corporations receive dividends, and when their securities are traded, they experience capital gains or losses. Shares of the mutual fund are bought by investors just like any other individual security. The earnings (dividends, capital gains or losses) of the mutual fund are distributed to the investors in proportion to the amount of money invested, after operating expenses have been covered. Investors anticipate that a gain on one holding will offset a loss on another. Following the advice to "Don't put all your eggs in one basket," owners of mutual fund shares can collectively benefit by diversifying their investments, which may be outside of their individual financial capabilities. There are two types of mutual funds: open-end and closed-end. An open-end mutual fund is a type of fluid capital stock because it has no fixed number of shares. As shareholders buy or sell shares, the total number of shares changes. Shares of the company may be purchased and sold by investors at any time at a market price. The economic activity centered on mutual funds has recently been gradually increasing on a global scale. In India right now, mutual fund assets under management (AUMs) are also rising quickly. The striking growth of funds and schemes, the apparent increase in fund folios, and the historically high number of trades executed by fund managers are all evidence of the expansion of the mutual fund industry in India. Although it is still believed that investments in this private investment vehicle depend on current stock market trends as well as the past performance of the funds, Stock market returns and mutual fund investments have historically been found to be highly correlated. There is a compelling case to be made that every stock market "bull phase" will lead to rising mutual fund AUMs, and every stock market "bear phase" will result in decreasing mutual fund AUMs. The association between stock market performance and mutual fund flows is also of great interest to investors, asset management companies, and researchers. It is critical to look into the connection between share market returns and the flow of investments in mutual funds in India's emerging market economy to see if stock market results have an impact on the flow of cash into mutual funds. Although some of the earlier studies supported the existence of the association, other researchers have reached the opposite conclusion, making the results of the various studies conducted in this field contradictory and ambiguous. However, other studies have only been able to show unidirectional causation relationships, whereas some research findings have shown bidirectional causal linkages. Thus, the current paper's main objective is to determine whether this association holds true in the emerging Indian stock market, which is a different type of stock market.

**LITERATURE REVIEW:**

Alka Solanki's 2016 study, "A Study of Performance Evaluation of Mutual Funds," came to the conclusion that, with the exception of one fund, Reliance Focused Large Cap Fund, all mutual fund schemes considered for the study had outperformed the benchmark return.

According to Md. Qamruzzaman ACMA (2014), growth-oriented mutual funds have not outperformed their volatility in terms of performance.

Preeti Sehgal Chawla and Dr. Vikas Choudhary (2014) compared the performance of equity-diversified mutual funds. In other words, 75% of the funds have performed better than average in terms of returns. 62% of the funds are less risky than the market in terms of SD. According to the study by Mohamed Zaheeruddin, Pinninti Sivakumar, and K. Srinivas Reddy (2013), investors can choose to invest in ICICI mutual funds because they carry the lowest risk compared to other intermediaries.

Poonam M. Lohara (2013) came to the conclusion that all of the funds' returns exceeded the return of the market index. Across the board, the Reliance Banking Fund scored poorly on all three performance metrics. The market benchmark was outperformed by the IDBI fixed maturity funds and the Kotak Gold Fund.

The mutual fund schemes that were ranked number one by CRISIL were evaluated by M.S. Annapoorna and Pradeep Gupta in 2013. It was discovered that all of the schemes' performance appeared erratic during the study period, and it was challenging to identify a single one that consistently outperformed the others.

Dr. K. Mallikarjuna Rao and Ranjeeta Rani (2013) used the mean return beta, Sharpe, Treynor, Jensen, and Fama Ratio to evaluate the risk-adjusted performance of a few balance scheme options. In other words, the study found that most of the schemes outperformed the market, had low average beta, disproportionate unsystematic risk, and some schemes had a mismatch between risk and return. These are primarily caused by a lack of professional management skills, including inadequate diversification, stock selection, and security analysis.

A study on the risk-adjusted performance of mutual funds that invest in European investment-grade corporate bonds was conducted in 2009 by Dietze, Oliver, and Macro. For a five-year period, 19 investment grade corporate bond funds were assessed. Utilizing multi-index and asset class factor models, these funds were assessed. The findings showed that no fund had a positive return, and corporate funds generally underperformed the benchmark portfolio.

A study was carried out by Boudreaux and Suzanne (2007) to assess the risk-adjusted returns of global mutual funds from 2000 to 2006. Using Sharpe's performance index, ten international mutual fund portfolios were examined. Benchmark was established using the US mutual fund market. Nine out of ten funds, according to the findings, outperformed the market.

In their 2010 study, Yangbo et al. looked at the relationship between excess returns in the Hong Kong and Singapore stock markets between 1998 and 2007. Empirically, it was discovered that there was no such two-way relationship between fund flows and stock market returns in Singapore as there was in Hong Kong.

Mutual Funds can be categorized according to their nature as below:-

**a) Equity funds:**

Stocks of publicly traded companies are purchased by equity mutual funds with pooled money. When choosing stocks for their portfolios, equity fund managers use a variety of stock picking techniques. Some fund managers take a value approach to stock selection, looking for undervalued stocks compared to those of competing companies. Another strategy is to focus on growth, looking for stocks that are expanding more quickly than their rivals or the market as a whole. Some managers build a portfolio of both growth and value stocks by purchasing both varieties of stocks.

**b) Debt funds:**

Debt mutual funds are a particular kind of mutual fund that are created for low risk investors whose primary goal is capital appreciation along with respectable returns on investment. These are for investors who favor less volatile investments and seek a steady stream of income.

Debt funds can give:

- ✓ Capital Appreciation
- ✓ Regular Income

**Balanced funds:**

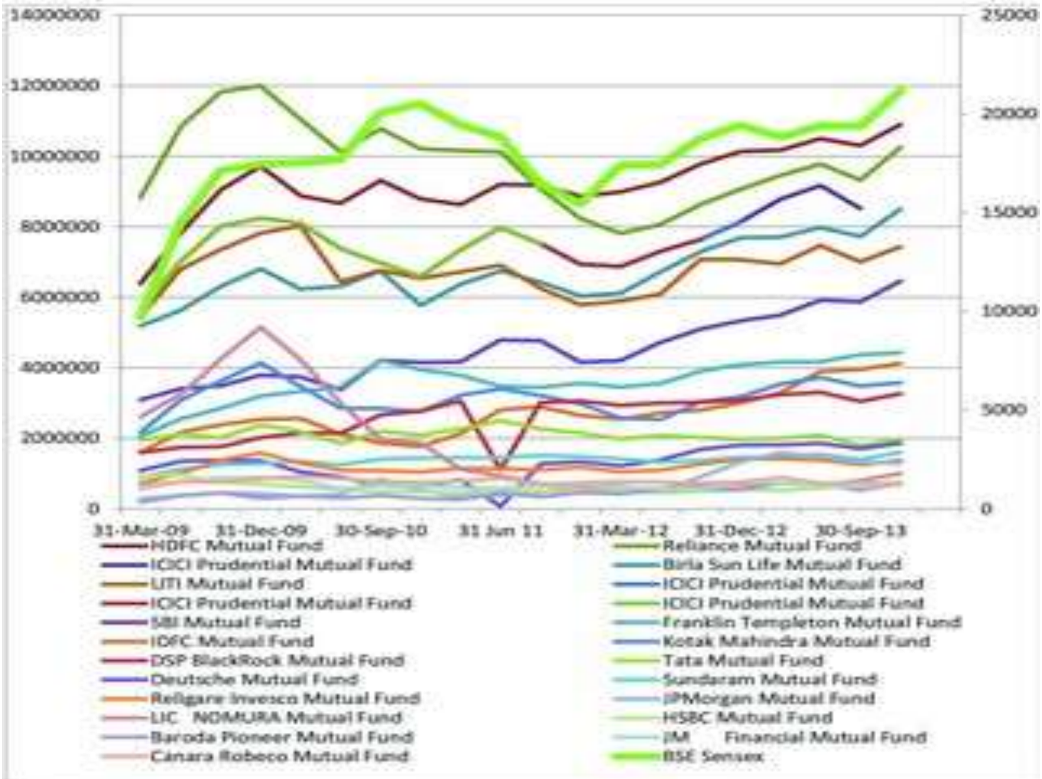
They are a combination of both equity and debt funds, as their name suggests. They follow the pre-established investment objective of the scheme by investing in both fixed income and equity securities. Growth is provided by equity, while return stability is provided by debt. These funds are designed to maintain reasonable returns while reducing some of the equity risk through exposure to debt. Even though this means less upside during a bull market, some investors prefer to stick with a single investment that offers a reasonable chance of a good return on their money and that is more likely to avoid major volatility when the economy slows down. The best chance of accomplishing that is through a well-managed balanced fund because bonds typically hold their value better during stock market downturns and have lower yields during stock market upturns. Parameters to choose Mutual Fund for investing:

A good track record is no guarantee for future performance. Investor should also look at some quantitative measures to evaluate which fund is good for them.

**Expense Ratio:** Indicates the funds' annual costs, which include management and administrative costs. Better is a low expense ratio. The percentage of total assets used to manage a mutual fund that is known as the expense ratio. Expenses play a significant role when comparing bond funds because bond fund returns frequently have similar characteristics. A fund's chargeable maximum has been set by SEBI. In terms of expense ratio, management and advisory fees make up the majority of the total. It's not always true that a fund with a lower expense ratio is one that is better managed. A good fund is one that generates a good return while incurring few costs.

**Standard Deviation (SD):** A mutual fund's overall risk (market risk, security-specific risk, and portfolio risk) is quantified by its "Standard Deviation" (SD). The standard deviation of mutual fund returns shows how far they deviate from expected returns based on past performance. In other words, it assesses the fund's volatility. The degree to which a fund fluctuates in relation to its average return over a period of time is how the standard deviation of a fund gauges this risk. A mutual fund with a higher SD number has a higher risk profile and more volatile net asset value (NAV) than one with a lower SD.

**Sharpe Ratio:** A telltale sign of whether excessive risk or wise investment choices are to blame for the return on an investment. Better is a higher Sharpe Ratio. Another crucial metric, the Sharpe ratio (SR), assesses how well a fund has performed in relation to the risk it has taken. An investor can use this ratio to determine whether it is safe to invest in this fund while assuming a certain level of risk.




**Above figure 1 showing AUM and Sensex**

**HISTORY OF MUTUAL FUNDS:**

In 1822, Belgium became the first country to offer the modern mutual fund. This type of investment quickly became popular in France and Great Britain. Since the 1930s, open-end mutual funds, in particular, have remained popular in the United States since the 1920s when they first gained traction. After World War II, mutual funds expanded significantly, particularly in the 1980s and 1990s. While GIC had established its mutual fund in December 1990, LIC had done so in June 1989. A new era in the Indian mutual fund industry began with the entry of private sector funds in 1993, giving Indian investors a wider selection of fund families. Additionally, the first Mutual Fund Regulations, which required all mutual funds, with the exception of UTI, to be registered and governed, were established in 1993. The first mutual fund in the private sector was registered in July 1993 under the name Kothari Pioneer, which has since merged with Franklin Templeton. With many foreign mutual funds opening funds in India, the number of mutual fund houses continued to rise. Additionally, the industry has seen a number of mergers and acquisitions. There were 33 mutual funds with a combined asset value of Rs. 1,21,805 crores as of the end of January 2003. With assets under management totaling Rs. 44,541 crores, the Unit Trust of India was far ahead of other mutual funds. After the Unit Trust of India Act of 1963 was repealed in February 2003, UTI was divided into two distinct organizations. One is the Specified Undertaking of the Unit Trust of India, which as of the end of January 2003 had assets under management totaling Rs. 29, 835 crores, roughly equivalent to the assets of the US 64 scheme, assured return, and a few other schemes. The Unit Trust of India's Specialized Undertaking, which is governed by an administrator and by laws set forth by the Indian government, is exempt from the Mutual Fund Regulations.

**MUTUAL FUND PROSPECTUS:**

A legal document called a prospectus contains details about the mutual fund. You can learn more about the offer's conditions, the issuer, and its goals in this document. The Securities Act of 1933, passed by the federal government in the wake of the 1929 stock market crash, mandated that security companies publish prospectuses. A prospectus might appear overwhelming at first. The prospectus typically contains a lot of information, is written in technical and legal language, and is lengthy and full of tables and graphs. Before you invest in a mutual fund, use the information in this document to make an educated investment decision. Pay close attention to the following crucial sections to obtain the information you require: Investment Purpose: a succinct description of the investment goals of the fund. While some funds may prioritize long-term stability, others may aim for short-term growth. Investment Strategy: The precise method by which the fund intends to achieve its goals. The types of assets that the fund purchases are described in this section. Fees and Expenses: While mutual funds aim to make money for their investors, their primary objective—as with any business—is to do so for their own financial benefit. The fees and costs that funds charge their shareholders in order to achieve this must all be disclosed in the prospectus. Each prospectus includes a table outlining the various fees and expenses, along with an estimation of how the fees would affect a $10,000 investment over a ten-year period. You can compare costs and fees among mutual funds as a result. Account Information: The very basic instructions for buying and selling shares, as well as other information pertaining to accounts, are provided in this section. The prospectus will explain how to withdraw your money from the fund in addition to how to put money into it. You can learn about your options for redemption in the prospectus. Risks: The prospectus's most crucial section deals with the fund's level of risk-taking and the risks connected to the particular investments the fund has made. Performance: Details regarding the fund's performance over the previous ten years are provided. Investors need to be aware that past performance does not guarantee future outcomes. The fund's historical performance in comparison to an index, like the S&P 500, is crucial. Performance of a fund is also influenced by turnover, dividend payments, and volatility of the fund. Management: The names of the managers are listed, along with some additional details about their backgrounds and credentials. To get a sense of their previous strategies and outcomes, it can be useful to know whether or not they have managed other funds in the past and whether or not they were successful. A company with speculative growth should eventually develop into a top-tier organization. Aggressive Growth: Businesses with aggressive growth exhibit a little more maturity than those with speculative growth: They record rapid growth in profits as well as sales, which indicates greater tenacity. It's time to start earning some money at this point. Classic Growth: These companies are in the prime of their careers and don't have much to prove. The top traditional growers have developed into money-making machines, producing consistent growth, high capital returns, positive free cash flows, and rising dividends. The problem is that they are growing much more slowly than the group with aggressive growth. Slow Growth and High Yield: These companies' growth is now just a distant memory. Due to a lack of lucrative investment opportunities, the majority of them pay out the majority of their profits in dividends (high payout ratios) as opposed to reinvesting the money in their companies.

***PROFESSIONAL MANAGEMENT & RANKING OF MUTUAL FUNDS***

***Professional management: Mutual*** funds use professional managers to make the decisions regarding which companies' securities should be bought and sold. The managers of the mutual fund decide how the pooled funds will be invested. Investment opportunities are abundant and complex. Fund managers are expected to know what is available, the risks and gains possible, the cost of acquiring and selling the investments, and the laws and regulations in the industry.

***Ranking: Funds*** are ranked based upon their performance as a whole and performance against their peers by such companies as Morningstar which has an industry recognized rating system for mutual funds. They have a one-to-five star system in which five stars is the best. Usually the higher the rank, the higher the quality of the fund. For example Morningstar rates mutual funds from 1 to 5 stars based on how well they've performed (after adjusting for risk and accounting for sales charges) in comparison to similar funds. Within each Morningstar Category, the top 10% of funds receive 5 stars and the bottoms 10% receive 1 star. Funds are rated for up to three time periods: three-, five- and 10- years and these ratings are combined to produce an overall rating. Funds with less than three years of history are not rated. Ratings are objective, based entirely on a mathematical evaluation of past performance. The ratings are a useful tool for identifying funds worthy of further research, but should not be considered signals to buy or sell.

**MUTUAL FUND ANNUAL REPORT**

Every year mutual funds send each investor an Annual Report. The Annual Report includes a list of the fund's financial statements, a list of the fund's securities, and explanations from the fund's management as to why the fund performed as it did for the previous year.

**CONCLUSION:**

Without a doubt, the Indian economy is likely to return to a high growth path in a few years with the structural liberalization policies. Therefore, it is necessary for mutual fund organizations to upgrade their knowledge and equipment. However, the success of the mutual fund would depend on how well the suggestions were put into practice. Regarding the mutual fund investor, we believe that the investor must simultaneously develop two critical skills for successful investing: a sense of timing and investment discipline.

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