

Mutual Funds: Determinants of Its Performance

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Abstract- *A mutual fund is always popularized as a tool for personal investments. It is the best of both worlds. People, hoi polloi, feel scared when exposed to securities due to their high risk. However, they always look for the highest possible returns within their risk-aversion range. Mutual funds aptly fit the bill. However, it is pertinent to ascertain the determinants of the mutual fund returns. This case provides an insight into this. The case provides additional information about different possible determinants of mutual funds and facilitates addressing the problem using multiple regression analysis.*

Indexed Terms- *Mutual Funds; Returns; Expense Ratio; Regression Analysis; NAV.*

I. INTRODUCTION

The performance of an MF (5-years returns) (yrret) depends upon its NAV and expense ratio (er). Mutual funds have a history in India. Mutual funds can be a safe avenue to invest the hard-earned money of small investors. Of late, it can be noticed that GOI is also promoting the investment of people in mutual funds. The obvious question is the rationale or benefits a government can derive from investing its people in a mutual fund.

The advocacy of investment in mutual funds comes from the fact that non-Participation in the stock market is a problem (Rastogi, 2014). People in India mostly want to invest in safer avenues for investment in financial assets (More than 90% of financial assets are in non-stock market investments). However, on average, companies have 50% financing through equity. It means there is a mismatch. Moreover, as long as people do not take risks, fixed income securities would remain a burden to the government and business organizations (BO). Fixed income securities demand fixed returns. However, returns should be congruous to the market. Fixed income

securities earn a fixed return even if there is no return for a firm to give back. This situation is not that BO is belly up or about to. This logic is the rationale behind support for investing in the stock market, and mutual funds are the safest bet for masses who want to go beyond fixed-income securities to invest.

The next obvious question is whether it leads to high returns in the long run. People say that the NAV of a mutual fund decides which firm will be able to provide high gains. The top-performing funds already sell at a premium and are not the best investment bet. Instead, a fund which has the potential to provide high returns can be a better choice.

Keeping the expectation mentioned above in mind, a group of investment advisors decided to use regression to decipher the mysterious and baffling world of mutual funds, especially equity-diversified mutual funds. They pulled out data for a few mutual fund schemes. They started with the logic that the 5-year average returns (annual returns) depend upon NAV and expense ratio (an inherent question is why and how this logic holds water?).

II. LITERATURE REVIEW

Regression analysis is an excellent tool to estimate the determinants of anything. The same can be applied to determine the determinants of mutual fund returns. The regression analysis has quite wide usage in terms of its utility to establish association among the variables/factors related to valuation [2], bank performance [1], shareholder activism [36]-[27]-[28], dividends [22]-[15]-[16]-[27]-[27]-[23]-[24] and behavioural aspects of the loaning [29]-[30]-[25]-[26]-[31]-[33]-[34].

The same can be said about the regression analysis regarding different data types. Even in the time series data, an advanced application is made to explore

conditional volatility using regression analysis [4]-[18]-[19]-[20]. It is undoubtedly equally relevant for cross-sectional [8]-[9]-[10]-[11]-[12]-[13]-[14] and panel data [1]-[3]-[5]-[17]-[21]-[32]-[34]-[35]-[37].

III. ISSUES TO BE SOLVED

- a) Build a model for a 5-Year annual average return based on NAV and Expense ratio.
- b) Predict the return for a fund showing NAV at \$30 and ER at 1.01%. (Provide the range as well of the prediction).
- c) Among NAV and ER, which makes more sense for its higher effect on mutual fund returns?

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