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MUTUAL FUNDS VS FIXED DEPOSITS: COMPARE WHICH IS BETTER

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Abstract:

A Mutual Fund is a trust that pools the savings of a number of investors who allocate a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures, government and other securities. Mutual fund industry has experienced a drastic growth in the past two decades. Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, Multidimensional professionally managed basket of securities at a relatively low cost. SO To fulfil the expectations of millions of investors, the mutual funds are required to function as successful institutional investors. Proper assessment of various fund performance and their comparison with other funds helps retail investors for making investment decisions.

The main aim of this paper is to evaluate the performance of mutual fund and compare these returns with domestic term deposit rates.

Keywords: Mutual Funds, Fixed Deposits, Rate Of Return, Market Investment, Investor Liquidity.

OBJECTIVES:

To analyze the returns of mutual fund schemes and To compare the average returns of selected Mutual fund schemes with bank deposits.

INTRODUCTION:

Investors always look for safer investment avenues and want to maximize their returns in accordance with their risk tolerance. Return is motivating force and the principal reward in the investment process so. Investor tries to invest money as early as possible so that the

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money will grow accordingly in his lifetime. Choosing a wise investing option is very crucial because a balance is required to be maintained between the risks and returns involved.

Comparison between mutual funds and fixed deposits is a long debate, especially when it comes to a comparison between fixed deposits and debt mutual funds. While talking about conservative and risk averse investor, would think investing in bank fixed deposits is better than mutual funds. But , the market scenario has changed a lot in the recent years, and many a mutual funds family has come up with interest debt mutual fund schemes with guaranteed returns with capital appreciation.

One of the important reasons that’s why one needs to invest wisely is to meet the cost of inflation. Inflation is the rate at which the cost of living increases at that time. The cost of living is simply what it cost to buy the goods and services one needs to live. Inflation causes money to lose value because it will not buy the same amount of a goods or services in the future as it does now or did in the past. Savings, when not invested will gradually lose its value due to inflation or rise price level. Hence if a person saves, investment becomes a compulsion and not an option. Usually investors in a country like India prefer bank deposits and insurances as their favorite instruments of investments.

So with the increasing awareness among the investors attention is requires to draw between mutual funds and traditional investment (particularly bank deposit).

Comparison of BANK DEPOSITS Vs DEBTFUNDS:

Fixed Deposits are the traditional investment choice for most Indian households. As per RBI research released in June 2020, 53% of average household financial assets are invested in Bank FDs (as on March 2020). Though mutual funds have a long history in India with setting up of Unit Trust of India in 1963, popularity of mutual funds among retail investors have grown only in the last 20 – 25 years. As per AMFI data, AUM of mutual funds in India has grown at CAGR of nearly 17% over the last 20 years. Despite the rapid growth, RBI research suggests that mutual funds comprise only 7% of household savings. We will compare FD vs mutual fund so that investors can make informed decision on whether to invest in FD or mutual funds.

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Mutual funds are financial instruments formed by pooling money from many investors and managed by Asset Management Companies. Mutual funds are portfolios of stocks or bonds of which unit-holders have ownership. .

Bank deposits cater to a segment of the investor class that looks for safety and accepts a relatively lower return. A bank deposit is guaranteed by the bank for repayment of principal and interest. Any risks associated with investment of the investors' funds have to be borne by the bank. The depositor has a contractual commitment from the bank to pay.

A mutual fund, on the other hand, invests at the risk of the investor. Hence, there is no contractual guarantee for repayment of principal or interest to the investor.

The bank depositor does not directly hold the bank portfolio of investments, as he does in case of a fund. The investor needs to assess the risk in terms of the credit rating of the bank, which provides an indication of the financial soundness of the bank.

In case of investments, in debt funds, however, only a few debt funds in India are rated by a Credit Rating Agency. Where a fund rating is available, it is a useful guide for the investor to know the risk level of the fund. In all other cases of unrated funds, the investor has to assess the risk on the portfolio held by the fund. The investor needs to know whether the fund invests in high quality assets or lower rated debt. Unlike in case of bank deposits, therefore, the investor needs to know his own investment objective and risk appetite before investing in debt fund. The expected returns will be commensurate with the level of risk assumed by the fund.

What influence investors to invest in Mutual Fund (MF)?

Type of Risk	**Percentage (%)**
Low Risk	14
High Return	52

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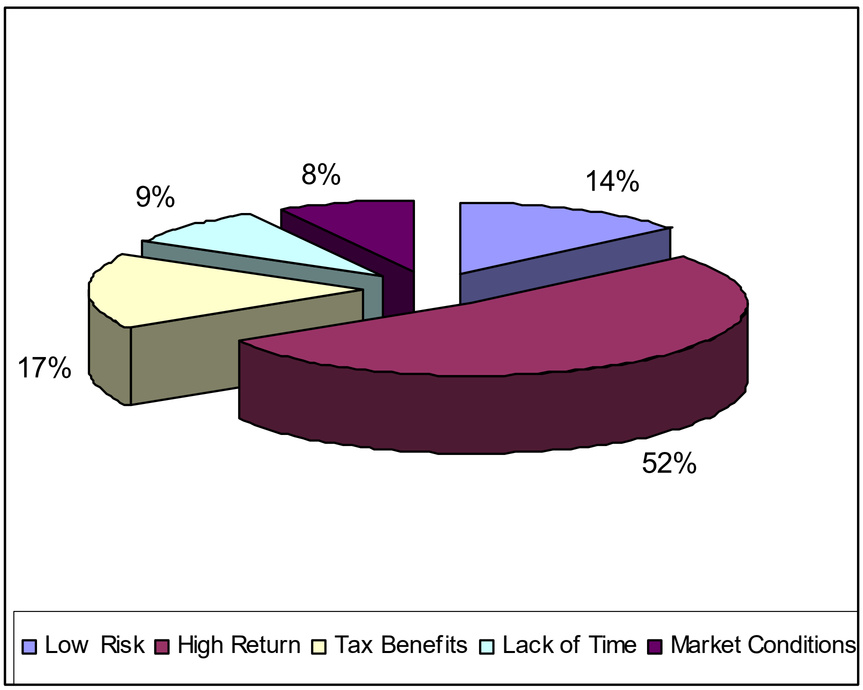

INTERPRETATION:

14% respondents invest in Mutual Fund due to Low Risk, 52% respondents invest due to High Returns, 17% respondents invest due to Tax Benefits, 9% respondents invest due to Lack of time, and 8% respondents invest due to Market conditions.

Return on investments vary for mutual funds, but not bank deposits:

Bank deposits offer you a fixed percentage of return, as would be agreed upon by the investor and the bank at the time of the investment on the other hand, debt mutual funds have

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no assured rate, and the return on investment for debt mutual funds depend completely on the market and the performance of the fund. Fluctuations in the money market impact the NAV of the fund, thereby altering returns. Thus, a great advantage of bank fixed deposits is that, you will continue to earn the same interest rates even if the market goes down.

Nevertheless, this very advantage of fixed deposits over mutual funds can actually turn out to be their great disadvantage. If the market goes up mutual funds will give more returns accordingly, but your FD will continue to yield in the same old rate. So, the actual question becomes, whether there is any chance of the Indian market going up in near future, especially following the recent recession? Yes, there is. At least, we think so. Market researches and predictions indicate that the Indian money market will go up in 2013, may get stagnant for a while in 2014, then taking another upward curve.

Risk factor of mutual funds and fixed deposits:

One of the reasons why most investors prefer fixed deposits to debt mutual funds is the assured return of the capital. On the other hands, returns from investments in mutual funds are subject to the volatility of the market, and may result in low or even negative returns. An investor should be wise enough to judge the quality of the investment instrument and thereby minimizing risk factors. Do take a look at the Beta Ratio of your mutual fund.

Mutual funds and fixed deposits: Capital appreciation:

The capital appreciation in, mutual funds are better than fixed deposits, because of the equity investment. In longer time periods, market changes result in increasing interest rates. And, the mutual funds manager is there with all the expertise and professionalism to ensure a better capital appreciation.

Which one are more liquid-Mutual funds or fixed deposits:

In terms of liquidity both fixed deposits and mutual funds are almost same. Mutual funds are equally liquid;. The return for premature withdrawal of mutual funds units is done on the prevalent NAVof the fund. Usually, there is an exit load of 1% for premature withdrawals before 1 year.

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Fixed deposits are actually meant for long lock in periods, but most banks allow premature withdrawals with a nominal penalty (usually 1%).

Fixed deposits interests are considered incomes and come under income taxes. Similarly, short term capital gains of debt funds are considered income and are accordingly taxable. For long term capital gains, tax is 10% without indexation or 20% with indexation. However, dividends received on debt mutual funds are tax free.

Cost of investments in mutual funds and bank fixed deposits:

Investing in bank fixed deposits costs nothing. On the other hand, there is a minimum charge for mutual funds investments management and fund distribution, borne by the investor irrespective of returns. In other words, no matter whether your return on mutual funds investments is positive or negative, investors have to bear an expense as the fees of fund management.

Mutual funds and bank fixed deposits- Reduction /Diversification of Risks:

When an investor invests directly all the risk of potential loss is his own. While investing in the pool of funds with other investors, the potential losses are also shared with other investors this risk reduction is one of the most important benefits of collective investment vehicle like mutual funds.

Mutual funds and fixed deposits- Flexibility:

Mutual funds offering multiple schemes follow investors to switch easily between various schemes. This flexibility gives the investor a convenient way to change the mix of his portfolios overtime

Conclusion

As we said, it is not FD vs MF but rather finding the perfect balance as per your requirements. Depending on your goals and risk appetite, you can find the right mix that suits you. Both the products can find a place in your portfolio owing to their specific advantages. Whether you choose to invest in a fixed deposit or mutual funds, it is important to be sure of

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the product features and all the fine print before investing. So what will choose fixed deposits or mutual funds or both?

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