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MUTUAL FUND APPRAISAL: REVIEW OF LITERATURE

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Abstract

One would do well to understand the term mutual fund in terms of its functions and the role it performs. It is a non-depository financial intermediary. Mutual funds are mobilizing savings, particularly from the small and household investors, for investments in stock and money market. Basically, these institutions have professional fund managers, capable of managing funds very prudently and profitably of individuals and institutions that may not have such high degree of expertise or may not have adequate time to cope with the complexities of different investment avenues, legal provisions associated therewith and vagaries and vicissitudes of capital markets. The objective of the present study is to highlight the various researches undertaken by the researcher. These researches are the matter of criticism on the various grounds such as number of samples, time period of the research or the selection of a particular scheme. This study is an effort to open up avenues for further intensive research. Review of previous studies provides the need and justification for the research work to be undertaken, and research methodology explains the research process.

Key words: Mutual fund, Sharpe Ratio, Jenson Model, Systematic Risk, Alpha

Introduction

It is rather difficult to define the concept of mutual fund exhaustively & comprehensively. One would do well to understand the term mutual fund in terms of its functions and the role it performs. It is a non-depository financial intermediary. Mutual funds are mobilizing savings, particularly from the small and household investors, for investments in stock and money market. Basically, these institutions have professional fund managers, capable of managing funds very prudently and profitably of individuals and institutions that may not have such high degree of expertise or may not have adequate time to cope with the complexities of different investment avenues, legal provisions associated therewith and vagaries and vicissitudes of capital markets. Mutual funds, thus, provide an alternative to the investors, who instead of making direct investments in shares or bonds through public issues or through secondary market subscribe to the corpus of mutual funds. Investors can reap all the benefits of good investment through mutual funds like enjoying growth in those scrip in which he might not have otherwise invested, holding a balanced and well-diversified portfolio, better returns due to specialized and professional management of funds etc. Mutual funds raise funds by selling their own shares also known as units. When an investor owns shares in mutual funds he owns a proportional share of their securities portfolio. In other words, share of a mutual fund actually represents a part share in many securities that it has purchased. Mutual fund share certificate combines the convenience and satisfaction of owning shares in many industries. Thus, mutual funds are investment intermediaries, which pool investors' funds, acquiring individual investments, and pass on the returns thereof to the investors, Besides Investment business, mutual funds may also undertake, if permitted, underwriting and other merchant banking activities.

Objective of study

The objective of the present study is to highlight the various researches undertaken by the researcher. As many researches conducted to evaluate the performance of the mutual funds have proved that this is a matter of concern for the researcher, academicians, fund managers and financial analysts. These researches are the matter of criticism on the various grounds such as number of samples, time period of the research or the selection of a particular scheme. This study is an effort of its own kind to contribute to this field and may open up avenues for further intensive research on its different related aspects of portfolio management practices. Review of previous studies provides the need and justification for the research work to be undertaken, and research methodology explains the research process.

Methodology

The present study used secondary data for the study. Various research articles were collected and studied to find out the scope of research in mutual fund industry. A variety of technical and quantitative measures have been developed to assess and compare the financial performance of mutual fund schemes as well as the performance of funds managers. These measures provide the methods of comparing risk-adjusted returns of a portfolio with other portfolios or with benchmarks. The present study is an attempt to highlight the various studies done on mutual funds.

Review of Literature

Research of the mutual funds' performance evaluation contributed a lot to the wealth of knowledge. Many of the funds studies have briefly looked at the predictability of performance as a part of a large study of mutual funds performance. Some of them are discussed here.

Friend, et al., (1962), have done an extensive and systematic study of mutual funds. The study considered 152 mutual funds with annual data from 1953 to 1958. Using their own benchmark the authors found that mutual funds earned an (un weighted) average annual return of 12.4 per cent, while their composite benchmark earned a return of 12.6 per cent. Their alpha-of-sorts was a negative 20 basis points. On the whole, it was revealed that overall results did not suggest widespread inefficiency in the industry. The study also compared returns of the funds across turnover categories and expense categories. The analysis did not reveal a strong relationship between turnover rates and performance. The same was found true in respect of expenses.

Treynor and Mazuy (1966) found no statistical evidence that investment managers of any of the 57 funds had successfully outguessed market. The results suggested that an investor in mutual funds was completely dependent on fluctuations in the general market. This is not to

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say that a skilful fund management cannot provide investors with a rate of return that is higher in both bad and good times than the one provided by market averages. But it did suggest that improvement in the rate of return was due to the fund manager's ability to identify under priced industries and companies, and not because of their ability to outguess turns in the level of market as a whole. These findings were based on the earlier developed methodology for reviewing the performance of fund management (Treynor, 1955)

Jayadev (1996) has made an attempt to evaluate performance of two growth-oriented mutual funds on the basis of monthly return. The study covered a period of 21 months from January 1992 to March 1994. The Economic Times Ordinary Share Price Index was considered market index as the benchmark. It found that Master Gain has performed better according to Jensen and Treynor measures and on the basis of Sharpe ratio its performance was not up to the mark. The performance of Magnum Express is poor on the basis of all the three measures. Researcher concluded that the growth funds have not performed better in terms of total risk and these funds were not offering advantage of diversification and professionalism to their investors.

Elton, Gruber and Blake (1996), this study has examined predictability for stock mutual fund using risk adjusted returns and it was found that past performance is not predictive of future risk adjusted performance. Applying modern-portfolio theory techniques to past data improves selection and allows this to construct a portfolio of funds that significantly outperforms a rule based on the past rank alone. The portfolio selected has small but statistically significant positive risk adjusted return, during a period where mutual fund in general had negative risk adjusted returns.

Khurana (1996) found inverse relationship between probability of managerial replacement and fund performance by taking growth rate in funds' assets base and its portfolio returns as two separate measures of performance.

Carhart (1997) conducted study on persistence in mutual funds performance. His database covers diversified equity funds monthly return from January 1962 to December 1993. He claims that the database is free of survivor bias, since they include all known equity fund over this period. He demonstrated that expenses have at least a one-for-one negative impact on funds' performance and that turnover has also negatively affected performance.

Sadhak (1997) conducted a study on mutual funds to examine the recent growth and performance of mutual funds in India, by identifying the constraints in their development. This study outlined the conceptual framework and established operational practices of mutual funds in developed capital markets much USA UK. and Japan.

Gupts & Sehgal (1998) evaluated investment performance of 90 mutal funds' schemes of the Indian market over a four-year period 1992 to 1996. They have examined performance of fund relating to fund diversification performance, parameter performance consistency, and objective in addition examining risk-return relationship in general. The study indicated that there has been lack of adequate portfolio diversification. The study supported the consistency of performance.

Kshama Fernandes (2003) evaluated index fund implementation in India. In this paper, tracking error of index funds in India is measured The consistency and level of tracking errors obtained by some well-run index find suggest that it is possible to attain low levels of tracking error under Indian conditions. At the same time, there do seem to be periods when certain index funds appear to depart from the discipline of indexation.

Wayne E. Ferson (2010) provides a review of the rapidly developing literature on mutual fund performance evaluation. The goals are to summarize the significant forces and contributions that have brought this field of research to its current state of knowledge and to suggest directions for future research. This review is written for readers who are familiar with financial economics, but not the specific literature, and who wish to become familiar with the current state of the art Suggestions for future research include refinements to portfolio holdings-based performance measures, a more balanced treatment of costs, and clientele-specific measures of mutual fund performance.

The literature on mutual fund performance evaluation is enormous Sharpe, William F. (1966) suggested a measure for the evaluation of portfolio performance Drawing on results obtained in the field of portfolio analysis, economist Jack L Treynor has suggested a new predictor of mutual fund performance, one that differs from virtually all those used previously by incorporating the volatility of a fund's return in a simple yet meaningful manner.

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