

CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Capital Market was created to be a facilitator of the securities market and was indeed the main driving force for the establishment of the same. Due to the limited financial resources economy can be develop only after mobilizing limited resources. For this, small saving of individuals can be place in capital market. Capital market is the mechanism which facilitates the exchange of financial instrument by bringing buyers & sellers together. It is the intermediary link in facilitating the flow of funds from savers to investors. Capital market plays a role of a bridge to mobilize the inactive saving of individuals (savers) into productive sectors.

Capital Market of Nepal has not long history. It is just standing like a child. Capital market plays a fundamental role to develop nation. It is the vehicle that drives the economy to the prosperity. Economic development & developed capital market is the moving wheel of the same vehicle. So to develop the nation, it is necessary to improve the activities of capital market. By these facts, an attempt to analyze the performance and problem of mutual fund operating in Nepal has been made.

The definition of Mutual Fund is simply a financial intermediary that allows a group of investors to pool their money (saving) together with a predetermined investment objective. The Mutual fund will have a professional fund manager who is responsible for investing the pooled money into specific securities (Usually stock or bonds). In another word a Mutual Fund is a corporation that pools large sums of money from individual investors who wish to make (save) money and professional money manager run Mutual funds by investing pooled money into stocks, bonds or other securities. By

investing in mutual fund investors' money is spread out and diversified among a wide range of stocks, bond and other securities minimizing risk. Main objective of investing money on mutual fund is to minimize the overall risk through diversification by experts of investment companies. Mutual fund is the best investment alternative. An investor doesn't have to figure out which stock or bond to buy, so investment in Mutual Funds is very easy.

Mutual fund is a form of collective investment that pools money from many investors and invest their money in stocks, bonds, debenture and short-term money market instrument and other securities [US SEC answers on Mutual Funds. U.S. Sen. Securities & Exchange Commission (SEC)].

An investment company whose capitalization is not fixed at a given number of shares but that issue shares in accordance with customer demand. Mutual fund sells their own new share to investors; stands ready to buy back their old shares, and are not listed on organized exchanges. Mutual funds often are classified on the basis of the kinds of investment they specialize in (Dictionary of business and Economics).

Invest money (Saving) in mutual fund, investor need not to buy bonds and stocks directly. Furthermore investors are not limited to the volatile of performance of merely one or two stocks, securities are professionally managed and investors hold a prorate share of portfolio. Individuals who owns share in a mutual funds does not have to worry about the investment portfolio. Beside this, investor pays minimal fees of their investment (per annum) while earning money with the expertise of the mutual fund manager. A mutual fund is an attractive transparency option to suit every class of investors with leading better returns and lower cost.

'Massachusetts Investors Trust' is the first official mutual fund was born on 21st march 1924. However, the idea of pooling money together for investment purposes originated from Europe in mid- 1800s.

In Nepal NIDC Capital Market Ltd. and Citizen Investment Trust are the financial intermediary companies that work for the development of mutual fund. NIDC Capital Market Ltd. Collects from investors through NCM Mutual Fund and Citizen Investment Trust collect it through Citizen Unit Scheme.

NCM Mutual Fund of NIDC Capital Markets Ltd

NIDC Capital Markets Ltd. was established under the Finance Company Act, 2042. It is functioning as intermediary and facilitator for the mutual fund. It provides professional management services in the area of mutual fund in order to expand investment opportunity by encouraging general public to save the capital and to bring dynamism of capital market in the country by introducing the first mutual fund called "NCM Mutual Fund" in Nepal. The First mutual fund was created after the starting of the first stock exchange in this country end 1993. The main reason for the establishment of the first mutual fund was that no stock market in the world can flourish without institutional players. Institutional players are necessary to bring securities investment to a broad segment of society. NCM, the First Mutual Fund 2050, established by NIDC Capital market floated units of Rs.10 par value in the beginning. The fund was open-end type which performed well when there was boom in the stock market. In 1995, its performance deteriorated and trading had to be suspended due to excessive selling pressure. In August 2002, the fund was restructured into closed-end and brings it back into operation as 'NCM Mutual Fund 2059' with two options to the previous unit holders either to return or to participate in this new scheme. The fund has 10 Million units of Rs.10 each (Source: Website).

Citizen Unit Scheme of Citizen Investment Trust

Citizen Investment Trust (Nagarik Lagani Kosh) was incorporated under the Citizen Investment Trust Act, 1991, Sec.19. CIT introduced Citizen Unit Scheme in 1994/95 in the capital market as a second collective investment scheme to help small and medium level of savers providing opportunities to them with the benefit of capital market by mobilizing of their saving towards capital market. The fund was established as an open-ended scheme with Rs.100 each. The seed capital of this scheme was 5 million. CIT develop a base

for institutional investors in the securities market by creating long-term investible funds in the form of mutual fund (Source: Website).

The market for mutual fund is very limited and mutual fund as an instrument for investment has not been popular among the investors in Nepal. Even though mutual funds are becoming one of the most popular investment avenues for small and risk-shy investors globally, their presence is negligible in Nepalese capital market due to the absence of laws. The government had announced in the budget proposal a string of plans including establishment of regulatory and supervisory body in order to encourage mutual fund but this has been limited to paper so far.

1.2 Focus of the Study

The major focus of the study will be on performance and problem of mutual fund. The concept of mutual fund is new and it is nascent stage. Most savers of Nepal don't know about mutual fund and they are risk averter so most of them keep their saving with them, without investing bond, shares or other securities due to thinking to invest in securities is risky and no habit of the bank. There are so many alternatives for the investment of the saving i.e. investment on gold, investment on securities of the other companies, investment on real state, investment in durable and luxurious goods and so forth. However, the study will focus on Mutual Fund out of many investment alternatives.

1.3 Statement of the Problem

Most people do not have the expertise and time to manage portfolio due to limited funds. No body wants to lose the money by investing in risky venture. Therefore the study is directed to identify the better sources of investment alternatives. Mutual fund is accepted as risk reduction alternative in the world. Thus this study deals with the following issues.

1. Why to invest in mutual fund?
2. What is the problem of mutual funds in Nepalese capital market?
3. Which of the collective investment schemes generated higher return?
4. Is the performance of mutual fund satisfactory to the Nepalese investor?
5. How mutual fund makes investment less risky?
6. What will be solutions to improve portfolio performance of mutual fund in Nepal?
7. What are the advantages & disadvantages of mutual fund?

1.4 Significance of the Study

This study deals with the performance, problem and prospects of mutual fund in Nepal. Mutual fund helps to mobilize the individual saving to the productive sector to earn extra income and to develop economy. This study is significant in the following way:

1. This study will be helpful to those individual investors who are willing to invest in mutual fund and issuer of mutual fund as well.
2. This study will help to the institutional investors to overcome the problem.
3. This study will be effective guide to other researcher on mutual fund.
4. This study will also be benefited to Nepal Stock Exchange, Security Board of Nepal as well as to those who take interest about capital market because it will represent the true picture of the current situation of mutual fund operating in Nepal.

1.5 Objectives of the Study

The prime objective of the study is to evaluate the NCM Mutual Fund and Citizen Unit Scheme and their necessity in Nepalese context. Study will cover almost all area of mutual fund operating in Nepal. To make the research work more precise the specific objective are pointed below:

1. To examine the performance of NIDC's NCM Mutual Fund and CIT's Citizen Unit Scheme.
2. To analyze problems faced by mutual funds in Nepal.
3. To examine the importance and necessity of mutual fund for the development of Nepalese capital market.
4. To recommend NIDC Capital Market Ltd. and Citizen Investment Trust for further research work.

1.6 Limitation of the Study

The study is conducted focusing to the two investment companies in Nepal i.e. NCM Mutual Fund of NIDC Capital Market and Citizen Unit Scheme 2052 of Citizen Investment Trust under certain assumptions because world of uncertainty and different factors that affect the financial performance of the investment companies. The study will be conducted on the basis of the following limitations:

1. The research report depends upon collected and provided data.
2. The relevant data collected from questionnaire, interview, and observation may not represent the actual population so the calculation and conclusion of the study are completely dependent on the accuracy of the data provided by the organization.
3. The study on the performance of mutual fund operating in Nepal depends upon the published and secondary data.
4. Major constraint of the study is time constraint because it must be submitted within stipulated time period.
5. Analysis tools are based on academic courses because the study is conducted to fulfill the partial requirement of Master Degree of MBS.
6. The study is based on researcher's financial resources.

1.7 Organization of the Study

The study is classified into five chapters which are as follows.

Chapter I: Introduction

This chapter consists background of the study, focus of the study, statement of problem, significance of the study, objective of the study and limitation of the study.

Chapter II: Review of Literature

This chapter is belongs to review of related different studies and theoretical analysis. It also explains the conceptual review of subject matter.

Chapter III: Research Methodology

This chapter describes the research methodology and consists research design, sources of data, method of data collection, population & sample and method of analysis & presentation

Chapter IV: Presentation and analysis of Data

This chapter describes the presentation and analysis of primary & secondary data with main findings by analysis and interpretation of result.

Chapter V: Summary, Conclusions and Recommendations

This chapter consists of Summary, Conclusion and Recommendation of the whole study.

Finally, Bibliography & appendices will be included to support the study.

CHAPTER - II

REVIEW OF LITERATURE

Review of literature is basically a stock taking of available literature in the field of research. Review of literature helps to avoid the chances of unnecessary duplication in the study. It also helps to learn what research has been done in the study and what remains to be done. This chapter presents the related literature about the existing research that has been reviewed by the researcher. The study deals with the performance and problem of mutual fund in the context of Nepal. In order to have understanding of all the variables involved within concerned topic the review of literature have been classified in the following two parts:

2.1 Conceptual Review

2.2 Review of Past Studies

2.1 Conceptual Review

This part of literature review focuses on proving a general concept and understanding about mutual fund regarding the variables selected for inclusion in the research.

2.1.1 Meaning and Importance

Mutual fund is a type of Investment Company. Investment companies are specialized financial intermediaries that collect funds from individual investors by selling units to the investors and invest those funds in portfolio of securities in such a way that the return of the individual will be higher with low level of risk. Each investor has a claim to the portfolio established by the investment company in proportion to the amount invested. Thus, these companies provide a mechanism for small investors to obtain the benefits of

large scale investing. Thus, mutual funds play a crucial role in boosting national economy by mobilizing the saving of the individuals towards the security market.

Mutual funds is an investment company that buys a portfolio of securities selected by a professional investment advisor to meet a specified financial goal, Investors buy shares in a fund, which represent ownership in all the fund's securities. A mutual fund stands ready to buy back its shares at their current net asset value, which is the total market value of the fund's investment portfolio, minus its liabilities, divided by the number of shares outstanding. Most mutual funds continuously offer new shares to investors (Glossary of Mutual Fund Terms).

A mutual fund raises money from investors to invest in stocks, bonds and other securities. It is a package made up of several individual investments. When those investments gain or lose value, one gains or loses as well. When they pay dividends, one gets share of them. Mutual funds also offer professional management and diversification. They do much of ones investing work for oneself ([www. ameritrade.com](http://www.ameritrade.com)).

In a developed nation such as U.S., one group saves while another invests. Bridging the gap between these two groups are the financial intermediaries: commercial Banks, Savings and Loan Associations, Mutual Savings Banks, Credit Unions, Life Insurance companies, Pension Funds, Mutual Funds and property and Casualty Insurance Companies (Roy, Marvin E & Scott, David L. Scott, 1968).

Among the financial intermediaries, mutual funds have come up as such an investment fund that pools the invested funds of others specially individual investors and invest those funds on their behalf, usually in a specific

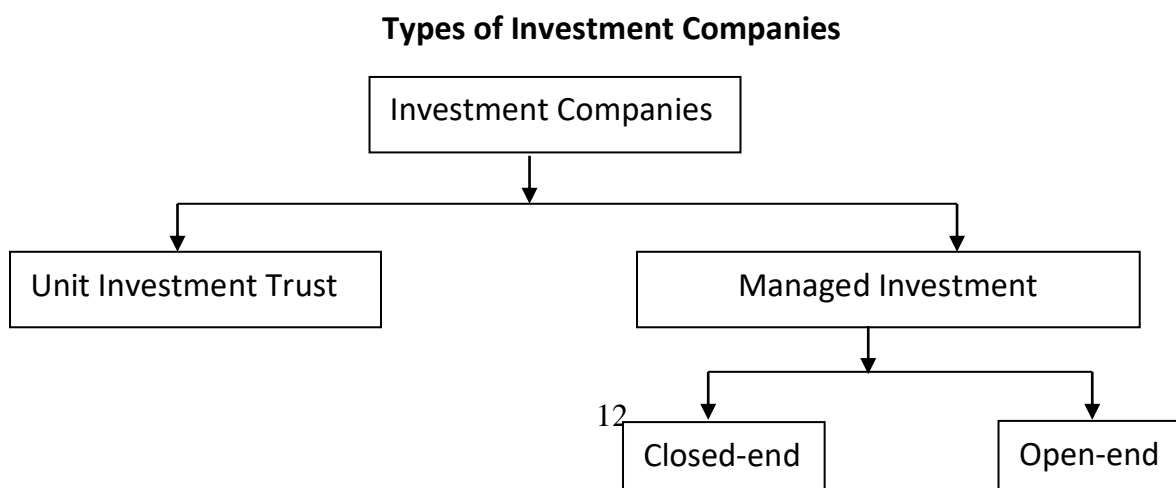
kind of investment, such as money market institutions, municipal bonds, or common stock (Brownstone, David M. and Irene M. Franck, 1981).

Mutual funds are the investment companies that issue and sell redeemable securities that represent an undivided interest in the assets held by the fund. Mutual fund assets usually include stocks, bonds, government securities, and real estate. Primary advantages to investors are portfolio diversification and professional money management. Mutual funds are typically classified as income funds, growth funds or combination of both income and growth (Woelfel, Charles J., 1994).

On the basis of the above definition mutual fund is a type of financial intermediaries company which pooled money (saving) from individual investors to invest in a potentially wide range of securities or other assets. They provide professional services to the investors and take management fee for the service provided. Investors obtain the benefits of large scale investment created through portfolio investment each investor has a claim to the portfolio made by the investment company in proportion to the amount invested.

Investment Company is a corporation, trust, or partnership that invests pooled shareholder dollars in securities appropriate to the organization's objective. Mutual funds, closed-end funds, and unit investment trusts are the three main types of investment companies. (Glossary of Mutual Fund Terms)

Fig 2.1



As in Fig 2.1, in the United States, investment companies are classified by the Investment Company Act of 1940 as either unit investment trusts or managed investment companies. The portfolios of unit investment trusts are essentially fixed for the life of the company and thus are called unmanaged. In contrast, managed companies are so named because securities in their investment portfolios continually are bought and sold. The portfolios are managed. Whereas a unit investment trust has no board of directors and no portfolio manager, managed investment companies have both. Managed companies are further classified as either closed-end or open end. Open-end companies are commonly called mutual funds. Unlike closed-end funds, open-end mutual funds do not trade on organized exchanges; instead, investors simply buy shares from and liquidate through the investment company at net asset value. Thus the number of outstanding shares of these funds changes daily (Zvi Bodie, Alex Kane, Alan J. Marcus, 2002).

According to U.S. Securities and Investment Commission, Investment Company is a company (corporation, business trust, partnership, or Limited Liability Company) that issues securities and is primarily engaged in the business of investing in securities. The three basic types of investment companies are mutual funds, closed-end funds, and unit investment trusts.

Prof. V.K Bhalla has classified investment companies into open-end and closed end companies.

- i) **Open-end Investment Companies:** - These investment companies raises fund through issue of new share. The fund company continues to offer new shares of the fund to new investors and the portfolio manager continuous to invest new cash from investors in the securities of other companies. The shares of open-end company do not trade on stock exchange. It is handled by specific dealer in over – the – counter transaction based on NAV.
- ii) **Closed-end Investment Companies:** - Closed-end investment companies are specialized investment companies which raise funds by issuing a fixed number of shares and invest funds to other company's securities. Share of closed-end companies may be listed on a stock exchange and can sell and buy like other company's share. So closed-end funds behave like a stock and the market value is driven by supply and demand for the shares.

2.1.2 Types of Mutual Fund

In addition to above, mutual funds can be classified into many ways. On the basis of objectives and portfolio, mutual funds are classified as follows:

- i) **Growth Funds:** A growth fund is a fund that buys stock in companies that are increasing rapidly in value. The risk with growth funds is much higher than other fund. These funds are more aggressive and as a result the growth is the greatest over long period of time.
- ii) **Value Funds:** A value fund is a fund that buys stocks when they are undervalued and holds into them as they grow. These funds are considered to be a conservative estimate. The risks associated with this fund are much lower.
- iii) **Income Funds:** - Those funds which invest in securities which will earn high income.

iv) Leveraged funds: - Those funds which increase the size cum value of the portfolio and benefit the shareholders by exceeding gains to the cost of the borrowed funds.

v) Special Funds: - Those funds which are invested only in specialized channels like a) gold and silver, b) a specific country (Japan Fund, India Fund, etc.) a specific category of companies (Technology Fund).

vi) Liquid Funds: -Those funds which specialize in investing in short-term money market instruments with emphasis on liquidity with a low rate of return.

vii) Real State Funds: -Such funds are meant for the real estate ventures.

viii) Balanced Funds: - Those which divide their investments between equity shares and bonds in order to meet the objectives of safety, growth and regularity of income.

ix) Hedge Funds: - Funds that buy shares whose prices are likely to go up and sell short, shares whose prices are expected to go down.

x) Index fund: An index fund is a fund that tries to match the growth of the various indexes, such as the S&P 500. These funds work in two different ways. Some of the mutual funds hold stocks from all of the companies listed over the index, while others pick and choose a few stocks over the wide spectrum.

xi) Offshore Funds: - They specialize in investing in foreign companies.

xii) Equity Funds: -Those funds which invest in equity shares and undertake associate risk. These funds are most volatile.

xiii) Blend Funds: A Blend fund is a fund that combines its holding with portions of the other types of funds. They may additionally have other means of investing as well.

According to Dustin Woodard, a mutual fund is simply a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the pooled money into specific securities (usually stocks or bonds). When one invests in a mutual fund, one is buying shares (or portions) of the mutual fund and become a shareholder of the fund. (www.mutualfunds.about.com)

He classifies mutual funds in following categories:

- i) Money Market Funds:** - These funds invest in short-term debt instruments and typically produce interest rates that double what a bank can offer in a checking account or savings account and rival the returns of a CD (Certificate of Deposit). The beauty of money market funds is that one can often write checks out of ones account and they provide a high amount of liquidity (ability to cash out quickly) not found in CD.

- ii) Bond Funds** -Bond funds carry more risk than money market funds are often used to produce income (useful in retirement) or to stabilize a portfolio (diversification). The primary types of bond funds are:
 - **Municipal Bond Funds** -uses tax-exempt bonds issued by state and local governments (these funds are non-taxable).
 - **Corporate Bond Funds** -uses the debt obligations of U.S. corporations.
 - **Mortgage-Backed Securities Funds** - uses securities representing residential mortgages.

- **U.S. Government Bond Funds**- uses U.S. Government Bond Funds -uses U.S. treasury or government securities another way bond funds are often classified by maturity or the date the borrower (whether it be the bank, the government, a corporation or an individual) must pay back the money borrowed. Using this classification bonds are often called short-term bonds, intermediate-term bonds, or long-term bonds.
- iii) **Stock Funds:** - Stock funds also called equity funds, which are more volatile. Stocks are fluctuate because of investors assessment of economic conditions and their likely impact on corporate earning but stocks have performed better over the long term than other types of investments. All stock funds are not the same. Some of the common types of stock funds are:

a) Strategy Types

- **Growth Funds:** A growth fund is a fund that buys stock in companies that are increasing rapidly in value. The risk with growth funds is much higher than other fund. These funds are more aggressive and as a result the growth is the greatest over long period of time.
- **Value Funds** - These funds invest in large and mid-sized companies that appear to be overlooked or out of favor. These undervalued stocks tend to pay dividends.
- **Blend Funds** - These funds are a “blend” of both growth and value stocks. It combines its holding with portions of the other types of funds. They may additionally have other means of investing as well.

b) By Size:

- **Small-Cap Funds** - These funds invest in emerging companies whose market value is less than \$1 billion. These companies tend to use profits to grow rather than pay dividends.

- **Mid-Cap Funds** - These funds invest in mid-sized companies whose market value is more in the range of \$1 billion to \$9 billion.
 - **Large-Cap Funds** - These funds invest in companies whose market value (# shares outstanding X current market price) is large. By large, I mean greater than \$9 billion. These “blue-chip” funds tend to be well-established corporations and tend to pay dividends.
- iv) Index Funds:** -These funds try to mimic a chosen index. Examples of indices include the S&P 500, NASDAQ, and the Russell 2000. An index is simply a group of stocks chosen to represent a particular segment of the market. Usually this is accomplished by purchasing small amounts of each stock in market. Index funds are a hands-off approach to investing. The manager is not trying to find the hot stocks or great deals. Instead, the manager is simply trying to match a chosen index. The results are funds that are very cost efficient, meaning the operating costs are very low, and often beat most actively managed funds.
- v) Sector Funds:** -Sector funds choose to invest in a particular industry or segment of the market. Examples of sectors include automotive, technology, banking, air transportation, biotechnology, health care and utilities. Sector funds are considered less diversified than most mutual funds, but they do offer diversification within a particular industry.
- vi) International Funds:**
- Global Funds** - These funds invest in both U.S. and International stocks.
- Foreign Funds** - These funds invest primarily outside the U.S.
- Country Specific Funds** - These funds focus on one country of the world.
- Emerging Markets Funds** - These funds focus on small developing country and are considered very risky.

2.1.3 Legislation Regarding Mutual Funds in Nepal

In Nepal, NCM Mutual Fund, 2050 was floated for the first time to taste a case of mutual fund which was managed by NIDC Capital Markets Ltd. The fund was a closed ended fund with an amount of 100 million. The SEBO/N accommodated the floatation after making the issue prospectus more transparent. SEBO/N had also prescribed an investor friendly provision. This provision includes the autonomy of the fund, the manager and the custodian with their clearly defined roles and transparency in the valuation of assets. Beside this, the fund should have an earning cum growth scheme and that sponsor should bring at least 15% corpus to the fund. However, SEBON had no clear mandate to regulate such fund. The existing legal framework also was not sufficient. When the fund could not cope with the liquidity pressure generated by the fund holders, the SEBO/N got involved in restructuring of the fund. It cooperated to the effort to rescue the fund and approved amended prospectus that restructured the fund. The fund size was turned to Rs.52.3 million that was to be retired on July 15, 2001.

The experience encouraged the enactment of Securities Investment Trust Act, 1997 and SEBON got involved in drafting the Act. SEBON observed the necessity of drafting an Investment Trust Act to enable the establishment and operation of trust funds. With a view to give a sound legal footing and to protect the interest of the investors, the legislation has provisions regarding the fund management companies and the trustee. The act enhances transparency and brings the trust fund within the regulatory domain of SEBON. [SEBO Nepal - A Five Year Performance (1993-1998)].

The Citizen Unit Scheme is administered with reference to citizen investment Act, 2047, its bylaws and “Nagarik Akanka Yojana Sanchalan Karyabidhi Niyamharu, 2052.” The rule book or prospectus of this scheme does not mention either it is open-ended or closed-ended fund but looking

the operation it is an open-ended fund. However rule number 15 of Citizen Scheme mention that its units will be listed in NEPSE in accordance to Securities Exchange Act, 2040.

NCM Mutual Fund is a closed-end fund which is administered in accordance to the rules and guidelines of its prospectus.

Citizen Unit Scheme is a perpetual scheme. When there is a repurchase of more than 75% of the outstanding units, it shall come to an end. If this situation occurs the remaining units shall be purchased back at the determined price. The life-time of the NCM Mutual Fund is 10 years from its date of issue. The management Company can terminate its activities incase of critical situation leading to its end with the consent of the concerned authorities. Such information will be published at least in 3 daily newspapers. The funds of the investor will be returned as cash certificate of new issue or distributing its security in case of liquidation within 3 months of its termination.

Due to no separate rules and regulation of mutual fund in Nepal, the management of mutual fund guided by the following act, laws, and regulation.

1. Securities Exchange Act, 1983.
2. Securities Allotment Guidelines, 1994.
3. Securities Exchange Regulation, 1993.
4. Securities Listing Bye-laws, 1996.
5. Issue Management Guidelines, 1997.
6. Company Act, 1997.
7. Government Securities Trading Management 2005.
8. Securities and issue Regulation, 2006.
9. Securities Board of Nepal Regulation, 2006.
10. Broker and Dealer Regulation, 2006.

11. Company Ordinance, 2006.

2.1.4 Net Asset Value

Net Asset Value (NAV) is the value of mutual fund. It is the market value after subtracting liabilities. The share price of mutual fund is based on Net Asset value per share. NAV is found by subtracting from market value of fund and then dividing by the number of mutual fund shares outstanding. The equation of NAV is as follows.

$$\text{Net Asset Value} = \frac{\text{Market Value of Portfolio} - \text{Liabilities}}{\text{Number of Mutual fund Shares Issued}}$$

An investor who wants to invest in mutual fund should pay NAV with front-end load and if investor wants to sell the fund will pay him NAV subtracting back-end load. NAV per share fluctuation is depends on holding of fund and changes of outstanding share. The movement of mutual funds indicates by NAV.

2.1.5 Strategy for Mutual Funds

Before investment in mutual fund, an investor has become necessary to understand and adopt appropriate investment strategy. An investor should flow one of the following strategies while investing in mutual fund.

i) Active Strategy

Active strategy is known as an effective management strategy which assumes a certain exceptional return by selling and buying securities in efficient market. Since, the market cannot be perfectly efficient. It emphasis selection and timing. In case of selection, investment of funds made on specific industries by selecting properly with the aim of earning certain exceptional return. In case of timing, they can pursue market timing strategy

by switching between money market, common stock, bond and specialized funds within a family of funds.

ii) Passive Strategy

This strategy deals with a segment of the market with no interference from a manager. Passive strategy emphasizes buying and holding securities among the available investment alternatives. The alternatives buying and holding such mutual fund exposes to risk however holding on mutual fund is not always superior strategy. If there is lack of professional knowledge for security analysis, this strategy helps to take advantage of professional investment management.

Index mutual fund is also alternative of passive strategy. Index in which index made a portfolio that tries to match the portfolio of market. The advantages of index fund are broad diversification and the fees on these are generally the lowest.

2.1.6 Advantage and Disadvantages of Mutual Funds

No thing is the best in the world. Mutual funds have become more popular in recent years. Investment may or may not be better to the investors. There are advantages and disadvantages of investing in each and every investment vehicle. Advantage and disadvantage are the head and tail of the same coin. An investor should have the knowledge of appropriateness of mutual funds.

Advantages of Mutual Funds:

1. Professionally managed: Many investors don't have the resources or the time to manage individual stocks. Investing in individual securities, such as stocks not only takes resources, but a considerable amount of time. By contrast, mutual fund managers and analysts wake up each morning

dedicating their professional lives to researching and analyzing current and potential holdings for their mutual fund.

2. Diversification: The beauty of a mutual fund is that you can buy a mutual fund and obtain instant access to a hundreds of individual stocks **or bonds**. Otherwise, in order to diversify your portfolio, you might have to buy individual securities, which exposes you to more potential volatility.

3. Low Cost: mutual Companies allow investors to get started in a mutual fund with little money. If you tried to create your own portfolio absolutely you need more money.

4. Systematic Investing and Withdrawals: It is simple to invest regularly in a mutual fund. You can easily redeem your shares anytime you need cash by letter, telephone, bank wire or check, depending on the fund. Your proceeds are usually available within a day or two. Money can be pulled directly from a bank account and invested directly in the mutual fund. On the other hand, money can be regularly withdrawn from a mutual fund and be deposited into a bank account. There are generally no fees for this service.

5. Recordkeeping Service: With your own portfolio of stocks and bonds, you would have to do your own recordkeeping of purchases, sales, dividends, interest, short-term and long-term gains and losses. Mutual funds provide confirmation of your transactions and necessary tax forms to help you keep track of your investments and tax reporting.

6. Automatic Reinvestment: An Investor can easily and automatically have capital gains and dividends reinvested into their mutual fund without a sales load or extra fees.

7. Safety of Investing: If a mutual fund company goes out of business, mutual fund shareholders receive an amount of cash that equals their portion of

ownership in the mutual fund. Alternatively, the mutual fund's Board of Directors might elect a new investment advisor to manage the mutual fund.

8. Investor Information: Shareholders receive regular reports from the funds, including details of transactions on a year-to-date basis. The current net asset value of your shares (the price at which you may purchase or redeem them) appears in the mutual fund price listings of daily newspapers. You can also obtain pricing and performance results for the all mutual funds at this site, or it can be obtained by phone from the fund.

9. Liquidity: If you want to sell your mutual fund, the proceeds from the sale are available the day after you sell the mutual fund.

10. Flexibility: A mutual fund comes in many types and styles. There are stock funds, bond funds, sector funds, target-date funds, money market mutual funds and balanced funds. Mutual funds allow you to invest in the market whether you believe in active portfolio management (actively managed funds) or you prefer to buy a segment of the market with no interference from a manager (passive funds and index mutual funds). The availability of different types of mutual funds allows you to build a diversified portfolio at low cost and without much difficulty.

11. Dividend Options: You can receive all dividend payments in cash. Or you can have them reinvested in the fund free of charge, in which case the dividends are automatically compounded. This can make a significant contribution to your long-term investment results. With some funds you can elect to have your dividends from income paid in cash and your capital gains distributions reinvested.

12. Sweep Accounts: With many funds, if you choose not to reinvest your stock or bond fund dividends, you can arrange to have them swept into your

money market fund automatically. You get all the advantages of both accounts with no extra effort.

13. Transparency: Mutual fund holding are publicly available (with some delays in reporting), which ensures that investors are getting what they pay for.

14. Online Services: The internet provides a fast, convenient way for investors to access financial information. A host of services are available to the online investor including direct access to no-load companies.

15. Life Cycle Planning: With no-load mutual funds, you can link your investment plans to future individual and family needs -- and make changes as your life cycles change. You can invest in growth funds for future college tuition needs, then move to income funds for retirement, and adjust your investments as your needs change throughout your life. With no-load funds, there are no commissions to pay when you change your investments.

Disadvantage of Mutual Funds:

1. Lack of Control: The manager of mutual funds makes all the decision regarding the funds. He/She decides about the securities' buying and selling and the time to do so. This decision makes you in difficulties when you are trying to manage your portfolio. For example, the tax consequences of a decision by the manager to buy or sell assets at a certain time might not be optimal for you.

2. Over Diversification: Diversification is the key to reduce the risk which makes the investment successful reducing the risks associated with holding a single security but you get over diversification when you acquire many funds that are highly related and you don't get the risk reducing benefits of diversification, because the funds that invest only in particular industry or region are irrelatively risky.

3. Poor Performance: The performance of fund manager is not the best. The return of on mutual funds is not guaranteed. Most of the mutual funds fail to beat the market index, like NEPSE Index, S & P 500, that's why a question arises that whether or not professional fund managers have better portfolio making capabilities than the average investor.

4. Fluctuation of Returns: The return of the mutual fund is not guaranteed. It is because the return is depends upon the portfolio of funds. A portfolio made by the fund manager fluctuate the return. There is always the possibility that the value of your mutual fund will depreciate. So if you are looking to buy a particular fund you need to take the risk involved in hand.

5. Hidden Charges, Fees and Expenses: An investor of mutual fund should bear different hidden fees, charges and expenses. Most mutual funds charge operating and management fees, which are the management expenses to the investors. Some mutual funds charge redemption fees, high sales commission and 12b-1 fees. In some mutual funds, transaction cost of trading share also adds up significantly.

6. Poor Trade Execution: If you buy or sell a mutual fund, the transaction will take place at the close of the market regardless of the time you entered the order to buy or sell the mutual fund. Because of the calculation of the current value of their holding, it can not bought or sold in the middle of the trading day.

7. Lack of Insurance: Mutual funds provide benefit of risk-reducing diversification. It will be losses; however there are no facilities of insurance against losses. The Federal Deposit Insurance Corporation (FDIC) only insures against certain losses at banks, loan, savings and credit union, but not mutual funds.

8. No Assurance: Risk can be minimized making the portfolio but all risk cannot be avoided. The level of risk depends upon the nature of investment but no investment is risk-free. If the value of the entire stock market declines, the value of mutual fund shares also will go down. Investors encounter fewer risks if they invest in mutual funds instead of investing in stock on their own but mutual funds have no assurance of losing money.

9. Inefficiency of Cash Reserves: To give the protection against a large number of simultaneous withdrawals, mutual funds usually maintain large cash reserves. This reserve is not invested in assets, which tends to lower the return to the investors.

10. Difficulties in Selection: There are different types of mutual funds in operation. These funds vary according to investment strategy, objective, size, and style. Mutual funds are available for every sector (e.g. biotech, internet etc.) every investment strategy (index, growth). So selection of an appropriate mutual fund to invest is not easy, it can be tedious.

11. Management Risk: Investing in mutual funds involves management risk. Every decision regarding the fund's portfolio is made by the manager. You should depend on the fund manager's decision. If the fund manager does not perform well, you might not make as much money on your investment as you expected.

2.1.7 History of Mutual Funds

The history of mutual funds began when three Boston securities executives pooled their money together in 1924 to create the first mutual fund, they had no idea how popular mutual funds would become. The idea of pooling money together for investing purposes started in Europe in the mid-1800s. The first pooled fund in the U.S. was created in 1893 for the faculty and staff of Harvard University. On March 21st, 1924 the first official mutual fund

was born. It was called the Massachusetts Investors Trust. After one year, the Massachusetts Investors Trust grew from \$50,000 in assets in 1924 to \$392,000 in assets (with around 200 shareholders). In contrast, there are over 10,000 mutual funds in the US. today totaling around \$7 trillion (with approximately 83 million individual investors) according to the Investment Company institute. (www.invesiopedia.com)

The origin of the Indian mutual fund industry can be traced back to 1964 when the Indian government, with a view to augment small savings within the country and to mobilize these savings to the capital markets, set up the Unit Trust of India (“UTI”). The UTI was set-up under a specific statute, the Unit Trust of India Act, 1963. The Unit Trust of India launched its first open-ended equity scheme called Unit 64 in the year 1964, which turned out to be one of the most popular mutual fund schemes in the country. In 1987, the government permitted other public sector banks and insurance companies to promote mutual fund schemes. Subsequently, in 1993, the Securities and Exchange Board of India (“SEBI”) introduced The Securities and Exchange Board of India (Mutual Funds) Regulations, 1993, which paved way for the entry of private sector players in the mutual fund industry. (www.nishithdesai.com) Mutual Fund industry today, with about 34 players and more than five hundred schemes, is one of the most preferred investment avenues in India. (www.mutualfundsindia.com)

The history of mutual fund in Nepal is quite new. The NCM First Mutual Fund, 2050 was brought by NIDC Capital Markets Ltd. into operation in 1993. The objective of this fund was to provide the expert services in investment sector but it was not able to meet its objective successfully so the scheme was terminated by the end of fiscal year 2000/2001. Under Citizen Investment Trust Act, 1990, with the view to expand investment opportunities, by encouraging small and medium savers to bring the dynamism in the

development of capital market, Citizen Investment Trust was established in 1990. Citizen Investment Trust (CIT) launched Citizen Unit Scheme in 1994/95. The scheme was Open-ended with the face value of Rs.100 per unit. Again NIDC Capital Markets Ltd. launched another mutual scheme in 2002. The scheme was 'NCM Mutual Fund, 2059'. Thus, NCM Mutual Fund, 2059 and Citizen Unit Scheme are currently in operation.

2.1.8 Mutual Fund in Nepal

Out of three mutual funds in Nepal, the NCM First Mutual Fund, 2050 has already been terminated so there are only two mutual funds The NCM Mutual Fund, 2059 and the Citizen Unit Scheme are in existence.

i) NCM First Mutual Fund, 2050

NIDC Capital Markets Ltd floated NCM First Mutual Fund, 2050 in the year 1993. The fund was an open-ended type with a par value Rs.10 per unit. The fund was issued in multiple of 100 units. The main objective of this fund was to provide expert management service of investment. The fund was performed well in the beginning when there was boom in stock market. However, its performance deteriorated in 1995 and its trading had to be suspended due to excessive selling pressure. Again after some times, it was restructured into closed end fund to bring it back into operation. In the year 1995, Nepal Rastra Bank and Nepal Industrial Development Corporation injected an amount of Rs.45 million and Rs.15 million respectively to revive the fund and provide liquidity. After restructuring, NCML was the custodian and the trustee of the scheme and NIDC Capital Markets Ltd. was the fund manager of the scheme. The scheme was terminated by the end of fiscal year 2000/2001. The main features of this fund were:-

- The management company of the scheme was NIDC Capital Market Ltd.
- The custodian and the banker of the scheme was Nepal Arab Bank Ltd.

- The sale of this scheme was started from 17th Ashad 2050 to 11th Bhadra 2050.
- The allotment of this scheme was made in 11th Ashwin 2050.
- This scheme was listed according to Security Exchange Act 2040.
- After the distribution of Unit Certificate, the buy and sale were made on the NAV of the First Mutual Fund.
- The unit price of this fund was Rs. 10/- and the investors are required to hold a minimum of 100 units. Investors for wishing to subscribe in addition to above can hold any without limit.
- The expected return of this scheme was 19% annually.
- The target collection of capital was 100 millions.

ii) NCM Mutual Fund, 2059

All the assets and liabilities of NCM First Mutual Fund, 2050 was valued in Ashoj 29, 2058 and was transferred to NCM Mutual Fund, 2059. SEBO approved this new fund on 9, August 2002. The main features of NCM Mutual fund, 2059 are as follows:-

- The scheme is a closed- end type and limited to 1 crore (10 million) units.
- The par value of each unit is Rs.10.
- The term of the scheme is 10 years.
- The fund has guaranteed at least 5% return on the face value of subscribed units.
- The scheme is managed by NCML and the trustee is NIDC Capital Markets Ltd.
- The units have been listed in NEPSE in accordance to Securities Exchange Act, 2040.
- The price of the units is determinate in the exchange through the interaction of market forces based on demand and supply.

Out of this fund, 7.17 million units were issued to the public, 1.33 million units distributed to the previous fund holder, 1.5 million units distributed to its management trustee.

The fund manager has constituted a committee of fund management and investment sub-committee to manage the fund properly. The committee should follow the policy of investment.

iii) Citizen Unit Scheme, 2052

Citizen Unit Scheme, 2052 came into operation in 1995 with par value of Rs.100. This scheme has managed by CIT. The scheme is an open-ended scheme which provide dividend as regular income to its unit holder. CIT put Rs.5 million as seed capital in the beginning. The main feature of this scheme is as follows:

- It is an open-ended scheme. The provision of repurchase has been maintained by CIT in order to maintain liquidity. Therefore, the number of outstanding units varies from time to time.
- Maximum of 30% of the investment shall be on organized institutions.
- It is regular income and growth oriented scheme.
- This scheme has guaranteed a minimum return to its investors.
- Most of the income earned from the scheme shall be distributed as dividends.
- CIT invests the fund in government securities, share & debenture of corporate organization, bridge financing, fixed deposit account of commercial bank and term loan.
- For the calculation of income, the increase in the value of securities has been converted into income either by handing over or selling it.

2.1.9 Performance Measures of Mutual Funds

Performance of mutual fund is the actual situation of portfolio made by the funds manager by mobilizing and operating the funds. Performance may be either satisfactory or not can be determined. Performance depends upon the ability of funds manager. Mixing the collection or saving to make portfolio does not take important place, right selection of underlying securities to make portfolio is one of the key of a good performance of mutual fund. Selection of securities is depends upon the ability of fund manager. Fund manager should also consider the right time to invest because experienced investors know that it is easier to select companies out of the underlying companies to invest than to determine the right time to invest so investment in a right time is difficulty and complex. Every investor wants to maximize profit with their limited funds. To maximize profit right purchase and sell of securities should do in right time.

Performance of mutual fund also related to risk associated to the investing fund. Fund manager should face the different level of risk while making investment or portfolio. Risk and return are the two sides of the same coin. In generally, if there is more risk, there will be more return so the decision made by fund manager to the appropriate portfolio should minimize the overall risk and maximize the benefit of the fund.

Risk is the fluctuation of return made by the market guiding forces. Systematic risk and unsystematic risk is not from same reason. If general fluctuation of market that affects all the securities in the market, we can not minimized it so it is called systematic risk or market risk. It is measured in terms of Beta. If the fluctuation made by specific securities in the fund portfolio, can be minimize or diversify by revising the portfolio so it is called unsystematic risk. The total risk of a given fund is sum of these two risks and it is measured in term of standard deviation. Strength of the mutual funds can be finding using risk return relationship.

It is very difficult to determine the future fluctuation of security price. Different tools and technique can be used to analyze problem related to selectivity. The Sharpe, Treynor and Jensen evaluation tools are well suited to analyze problem related to selectivity. However, these evaluation tools cannot be analyzed timing related problem within the framework, unless underlying theoretical framework is extended. Following measures can be used to evaluate performance of portfolio.

- i) Sharpe Measure
- ii) Treynor Measure
- iii) Jensen Alpha
- iv) Appraisal Ratio
- v) Fama Model
- vi) Fama-French three-factor model alpha
- vii) Carhart 4-factor model
- viii) CAPM market-timing alpha and gamma
- ix) Morning Star Ratings
- x) Modigliani Measure

The relevant measures for this study are as follows:

i) Sharpe Measure

The Sharpe index of desirability can be used for comparing portfolios in different risk classes. In this model performance is evaluated on the basis of Sharpe ratio. Sharpe ratio is a ratio of returns that is generated by the fund over risk free rate of return and total risk associated with it. The Sharpe index is written in equation as:

$$S_i = \frac{\text{Risk Premium}}{\text{Total Risk}} = \frac{\bar{r}_i - R_f}{\sigma_i}$$

Where, S_i = Sharpe Index

\bar{r}_i = Average Return from Portfolio i

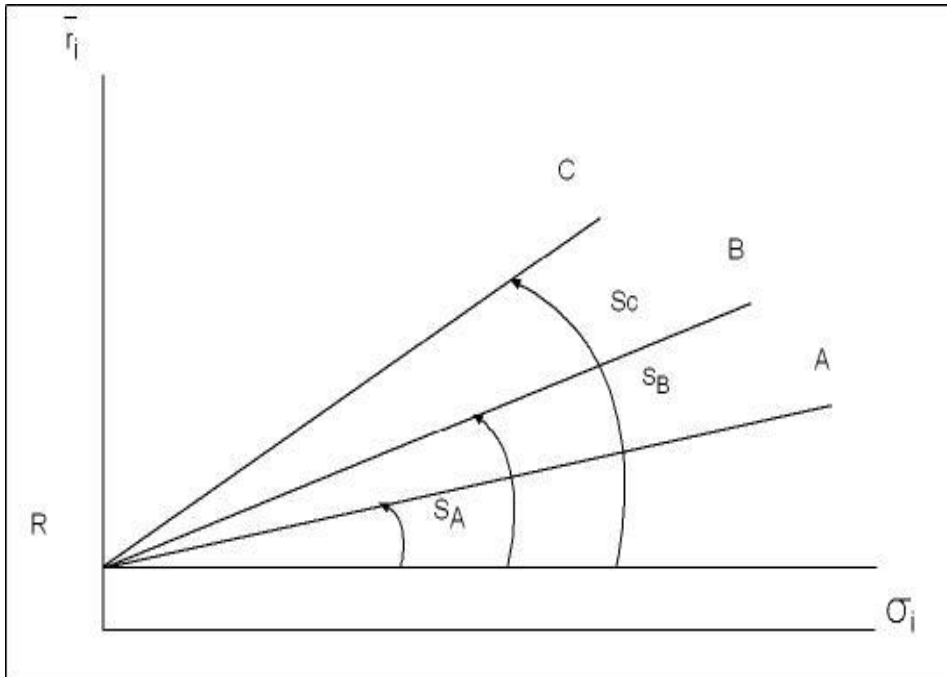
σ_i = Standard Deviation of Returns for Portfolio i

R_f = Risk free rate of return at period t.

If the Sharpe ratio shows low and negative, it indicates an unfavorable performance but if the Sharpe ratio shows high and positive, it indicates a superior risk adjusted performance.

Figure 2.2

Graphical Representation of the Sharpe Index



(Source: Jack Clark, Francis, 1992)

In the fig. 2.2, the index, S_i measures the slope of the line emanating from the risk less rate (R) outward to the portfolio in question. Thus, $S_A < S_B < S_C$ indicates that asset A is weaker performance than asset B and B is weaker performance than asset C.

ii) Treynor Measure

This measure is developed by Jack Treynor. This performance measures evaluates funds on the basis of Treynor's index. The Treynor measure is similar to Sharpe's Measure except that, it defines the reward as a ratio of CAPM beta risk. Treynor suggests measuring a portfolio's return relative to its systematic risk rather than relative to its total risk, as does the Sharpe's measure. This index is given by the following equation:

$$T_i = \frac{\text{Risk Premium}}{\text{Systematic Risk Index}} = \frac{\bar{r}_i - R_f}{\beta_i}$$

Where,

T_i = Treynor Index

r_i = Average Return on Portfolio i

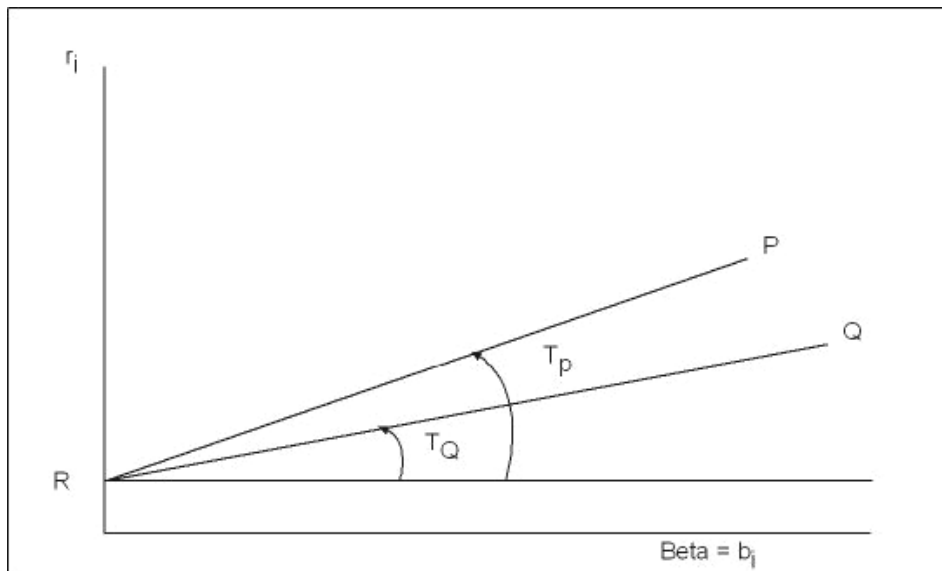
R_f = Risk-free Rate of Interest

β_i = Beta Coefficient of Portfolio i

A characteristic line in Treynor's is the key to this model. The slope of the characteristic line is the beta coefficient, a measure of the portfolio's systematic risk. Some people view systematic risk as a type of volatility measure. Thus, by comparing the slopes of characteristic lines, the investor gets an indication of the fund's volatility. The steeper the line, the more systematic risk or volatility the fund possesses. Treynor has proposed incorporating these various concepts into a single index to measure portfolio performance more accurately.

Figure 2.3

Graphical Representation of the Treynor's Index



(Source: Jack Clark, Francis, 1992)

In the fig.2.3, the index measures the slope of the line emanating outward from the risk less rate to the portfolio under consideration. As shown in the fig., Portfolio P is more desirable than portfolio Q because P earned more risk premium per unit of systematic risk: That is $T_p > T_q$.

iii) Jensen Alpha

This measure for portfolio is developed by Michael Jensen. The Treynor and Sharpe indexes provide measures on a risk adjusted basis for ranking the relative performance of various portfolios. Jensen attempts to construct a measure of absolute performance on a risk-adjusted basis that is, a definite standard against which performances of various funds can be measured. This standard is based on measuring the “portfolio manager’s predictive ability—that is, his ability to earn returns through successful prediction of security prices which are higher than those which we would expect given the level of friskiness of his portfolio.” Or Michael C. Jenson has modified the characteristic regression line to make it useful as a one parameter investment performance measure (M.C. Jensen, 1968).

His model is given by:

$$\bar{R}_{it} - R_{Ft} = \alpha_i + \beta_i(\bar{R}_{Mt} - R_{Ft})$$

Where,

R_{it} = Average Return on Portfolio i

R_{Ft} = Risk Free Rate of return for Period i

α_i = Intercept that Measures the Forecasting Ability of the Portfolio Manager

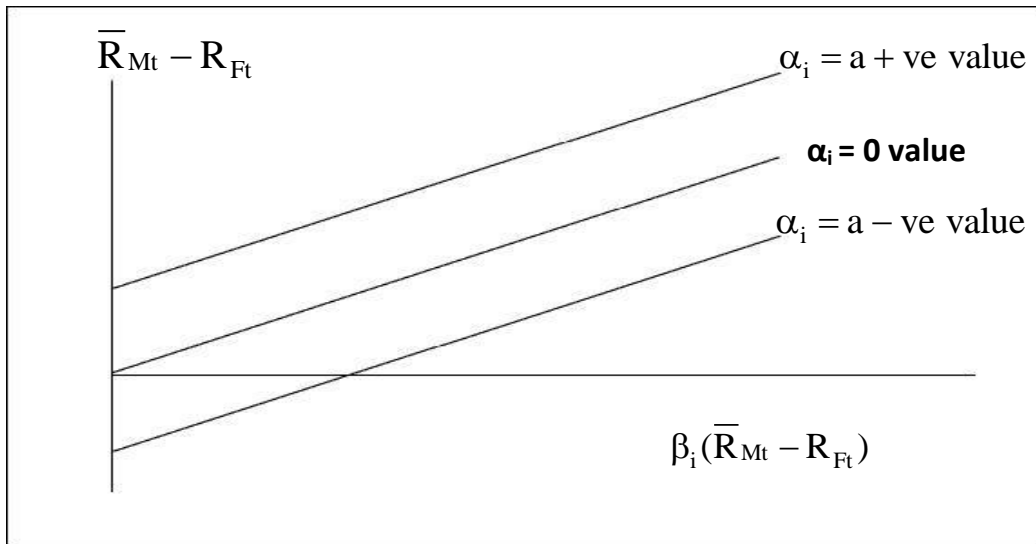
β_i = A Measure of Systematic Risk

R_{Mt} = Average Return of a Market Portfolio for period t.

The reader should note the similarity between the Jensen's model and the basic Sharpe and Treynor models. An implication of forms of the Sharpe and Treynor models is that the intercept of the line is at the origin. In the Jensen model, the intercept can be at any point, including the origin.

Figure 2.4

Graphical Representation of the Jensen's Index



Source: Fischer, Donald E., and Ronald J. Jordan, 1997.

In the fig.2.4, $\alpha_i = a$ positive value represents the average superior extra return accruing to that particular portfolio because of superior management talent. The $\alpha_i = 0$ indicates neutral performance by management; that is management has done as well as an unmanaged market portfolio or a large, randomly selected portfolio managed with a naive buy-and-hold strategy. The lower $\alpha_i = a$ negative value, indicates inferior management performance, because management did not do as well as an unmanaged portfolio of equal systematic risk. This situation could arise in part because portfolio returns were not sufficient to offset the expenses incurred in the selection and managing process.

Higher alpha represents superior performance of the fund and vice versa. Limitation of this model is that it considers only systematic risk not the entire risk associated with the fund and an ordinary investor can not mitigate unsystematic risk, as his knowledge of market is primitive.

Among the above performance measures, Treynor measure and Jensen model use systematic risk based on the premise that the unsystematic risk is diversifiable. These models are suitable for large investors like institutional investors with high risk taking capacities as they do not face paucity of funds and can invest in a number of options to dilute some risks. For them, a portfolio can be spread across a number of stocks and sectors. However, Sharpe's measure considers the entire risk associated with fund is suitable for small investors, as the ordinary investor lacks the necessary skill and resources to diversify. Moreover, the selection of the fund on the basis of superior stock selection ability of the fund manager will also help in safeguarding the money invested to a great extent. The investment in funds that have generated big returns at higher levels of risks leaves the money all the more prone to risks of all kinds that may exceed the individual investors risk appetite. (www.mutualfundsindia/researchteam)

The finance professionals have used the Sharpe measure, Jensen alpha, Treynor measure and appraisal ratio performance measures for many years. The Jensen alpha, the Treynor measure and the appraisal ratio are all rooted in the Sharpe-Linter CAPM, whereas the Fama-French three-factor alpha is the equivalent of the CAPM-based Jensen alpha in a multi-factor setting that includes size and book-to-market factors along with the market factor. To evaluate market timing, CAPM-based market-timing alpha and gamma and Fama-Fench three-factor model- based timing alpha and gamma are used (Kothari and Warner, 2001).

2.2 Review of Past Studies

This part present and discusses the literature on the field of the study of different unpublished research papers, Books, Journals and articles etc. It helps to research the gap and uncovered study in the study area and fulfilling

the gap of uncovered area. Following are the some literature that contributes in the selected field of the study.

2.2.1 Review of Related Studies and Articles

Friend, Irwin; Marshall Illume and Jean Crockett (1970) in their book, "Mutual Funds and Other Institutional Investors: A new perspective" has deal with the preference of money mangers for equities and its impact on the investing public, on the stock market and on the entire economy. The study attempts to provide some answers to the questions based on new and deeper look at the operations of the equity-minded institutions, especially mutual funds, which are as follows:

- i. How well do the institutional investors fulfill their obligations to the people they represent?
- ii. Do their trading activities- moving them in and out of specific stocks in massive transactions- contribute to the efficiency of capital markets?
- iii. How do their investment policies- especially their demand for common stock - affect the growth of the economy?

The book is based on the studies made by the Wharton School "Study of Mutual funds" and two subsequent SEC studies, "Special Study of Securities Markets" and "Public Policy Implications of Investment Company Growth." Regarding the conflicts of interest between mutual fund shareholders and management, the Wharton study reported that the main problems caused by the growth of mutual funds stemmed from the size of the industry as a whole and not from the size of individual firms. The firm size may be a future problem, because of the potentially great power over the market portfolio performance analysis of mutual funds suggests that many investors who own or are considering buying mutual fund shares could expect higher rates of return and less risk if they invest their own funds by selecting securities randomly and then simply holding them. This statement does not mean that

all mutual fund shares represent poor investment decisions. Mutual funds can perform some valuable investment services. He opines that mutual fund helps to minimize the portfolio's unsystematic portion of total risk. The majority of mutual funds earn long-run average rates of return that exceed the returns paid by insured savings accounts. Thus, investors receive some added return for assuming risk unless some misfortune forces them to liquidate their holdings in a period of depressed price. By examining mutual funds' quantitative risk coefficients, an investor can find a fund that will fairly consistently maintain a given level of risk. Thus, it can help an investor stay in some preferred risk class.

Regarding the portfolio performance measures, he mentions that ranking portfolios' yearly rates of return reveals whether any of them are consistently able to outperform their competitors. However, such rankings may make an efficient low-risk portfolio appear to be doing poorly. To evaluate a portfolio adequately, the level of risk it assumes must be considered simultaneously with its rate of return. Unfortunately, the statements of a few portfolio managers about the degree of risk they are seeking are misleading. In contrast, portfolios' empirically measured risk coefficients furnish more stationary indexes of the level of risk the portfolios undertake. If the standard deviation is used, portfolios' standard deviations and average rates or return may be plotted in $[\sigma, E(r)]$ space and compared with the efficient frontier. Sharpe's index of portfolio performance measures the risk premium per unit of risk borne by individual portfolios. This index considers both risk and return and yields one index number for each portfolio; these index numbers may be used to rank the performances of a group of portfolios or individual assets. Some analysts prefer Treynor's portfolio performance measure because systematic risk is more relevant than total risk in certain applications and because Treynor's performance measure can be used to compare both individual assets and portfolios. But Treynor's

performance measure has the disadvantage that it is sensitive to the market index used, and it is not clear which market index is most appropriate. The Treynor index uses portfolio's beta systematic risk coefficients and average returns to compare portfolios' performance in $[b_i E(r_j)]$ space. The Treynor, Jensen and Sharpe investment performance measures all tend to rank mutual funds similarly.

Fisher, K Donald and **Jordan J. Ronald (1996)** in their book, "Security Analysis and Portfolio Management", have examined a number of alternative types of managed portfolios available to the investor. These have included closed-end investment companies, open-end investment companies or mutual funds, dual funds, money market funds, municipal bond unit trusts and fund, index funds, pension funds, trust agreements, common trusts, and professional investment counsel. 'The characteristics of these alternative investment opportunities as well as the alleged advantage of such professionally managed portfolios have been discussed. Analysis of a number of alternative measures of performance evaluation, including the Sharpe, Treynor, and Jensen approaches has been done. Then, they have reported the results in the summary fashion of a number of key empirical studies of mutual-fund performance. Finally they have concluded with a survey of key source so information on investment companies.

They have tried to examine the result of number of key empirical tests that have been conducted to answer questions such as, "Can mutual funds do better for me than I can do by myself?" "Are the management and selling fees that mutual funds charge worth the price?" and "Do managed funds adhere to their stated investment objectives?"

Considering the returns on a sample of thirty nine mutual funds during 1951-60, they have concluded that the answer to the first question is negative; that is, mutual funds contained in the considered sample has not, on

the average, outperform the returns that can be earned by following a naïve strategy cover the sample period.

Regarding the second question, they have referred to the study conducted by Wharton School of Finance and Commerce engaged by SEC. The investigation found no relationship between the performance of the mutual funds studied and the management fees and sales charges that these funds levied. The fact that the analysis does not reveal a significant relation between management fees and performance indicates, in other words, that investors cannot assume the existence of higher management fees implies that superior management ability is thereby being purchased by the funds. They have also referred to the conclusion drawn by Jensen in his study, "Performance of Mutual funds," and Sharpe in his study, "Mutual Fund Performance."

With reference to the third question, taking into account the results of the empirical investigations, they have found that fund managers are able to assess properly the risks and potential returns associated with alternative investment opportunities and have thus been able to meet their investment objectives fairly well.

They have also recommended the sources of investment-company information, which are Wiesenberger's Investment Companies, issued annually, Morningstar's Mutual fund Source Book, Forbes, an investment magazine published twice a month, and Money magazine.

Katerina Simons (1998) in her article, "Risk-Adjusted Performance of Mutual Funds" in *New England Economic Review* evaluates the performance of mutual funds. Business Week, *Baron's*, Forbes, Money, and many other business publications rank mutual funds according to their performance. Information services, such as Morningstar and Lipper Analytical Services, exist specifically for this purpose. There is no general agreement, however, about

how best to measure and compare fund performance and on what information funds should disclose to investors.

The two major issues that need to be addressed in any performance ranking are how to choose an appropriate benchmark for comparison and how to adjust a fund's return for risk. In March 1995, the Securities and Exchange Commission (SEC) issued a Request for Comments on "Improving Descriptions of Risk by Mutual Funds and Other Investment Companies." The request generated a lot of interest, with 3,600 comment letters from investors. However, no consensus has emerged and the SEC has declined for now to mandate a specific risk measure.

Risk and performance measurement is an active area for academic research and continues to be of vital interest to investors who need to make informed decisions and to mutual fund managers whose compensation is tied to fund performance. This article describes a number of performance measures. Their common feature is that they all measure funds' returns relative to risk. However, they differ in how they define and measure risk and, consequently, in how they define measure risk-adjusted performance. The article also compares rankings of a large sample of funds using two popular measures. It finds a surprisingly good agreement between the two measures for both stock and bond funds during the three-year period between 1995 and 1997.

Section I of the article describes simple measures of fund return, and Section II concentrates on several measures of risk, Section III describes a number of measures of risk-adjusted performance and their agreement with each other in ranking the three-year performance of a sample of bond, domestic stock, and international stock funds. Section IV describes measures of risk and return based on modern portfolio theory. Section V suggests some additional information that fund managers could provide to help investors

choose funds appropriate to their needs. In particular, investors would benefit from better estimates of future asset returns, risks, and correlations. Fund managers could help investors make more informed decisions by providing estimates of expected future asset allocations for their funds

In the article, "Liquidity, Investment Ability, and Mutual Fund Structure," **Vikram, Nanda; Narayanan M. P. and Warther Vincent A, (2000)** has developed a model of the mutual fund industry in which the management fees and loads charged by actively managed open-end funds and average fund returns are determined endogenously in a competitive market setting. It is shown that heterogeneity in managerial skills at investing and minimizing costs, and the existence of investor clienteles with differing liquidity and marketing needs, gives rise to a variety of open-end fund structures that differ in the average return delivered to investors. Managers choose a fund's structure to maximize the rents they capture from their ability, taking into account the effect on investor flows. In equilibrium, funds that constrain liquidity withdrawals may have to charge lower fees and share some profits in the form of higher investor returns, when there is relative scarcity of investors with low liquidity needs.

Kothari, S. P., and J. Warner (2001), in their article, "Evaluating mutual Fund Performance," have studied standard mutual fund performance measures, using simulation procedures combined with random and random-stratified samples of NYSE and AMEX securities. They have tracked simulated fund portfolios over times. These portfolios' performance is ordinary and well-specified performance measures should not indicate abnormal performance. The main result is that the performance measures are badly, mis-specified. Regardless of the performance measure, there are indications of abnormal fund performance, including market timing ability, when none exists.

They have constructed a 50-stock mutual fund portfolio each month from January 1964 through December 1991 and have tracked these 336 simulated mutual fund portfolios' performance over three-year periods (months 1 through 36) using a number of performance measures, namely, Sharpe Measure, Jensen Alpha, Treynor Measure, and the Appraisal Ratio, and Fama-French Three Factor Model Alpha.

From the simulations, the main message that has been derived is that standard mutual fund performances are unreliable and can result in false inferences. In particular, it is easy to detect abnormal performance and market-timing ability when none exists. The results show that the range of measured performance is quite large even when true performance is ordinary. It provides a benchmark to gauge mutual fund performance. Comparisons of the numerical results with those reported in actual mutual fund studies raises the possibility that reported results are due to misspecification, rather than abnormal performance.

Finally, the results have indicated that procedures based on the Fama-French 3-factor model are some what better than CAPM based measures This is not surprising, and indicates that "style:" analysis is useful in benchmarking fund returns. The misspecification even for Fama-French suggests at least two possibilities. One is that size and book-to market do not community describe the characteristics relevant for expected return. The second is related to the estimation process, and that sampling distributions of the performance measures differ from those assumed under null hypothesis, for example because expected returns change overtime. Further investigation of the latter possibility could be particularly fruitful in explaining why the tests using simulated portfolios often show market timing when none is present.

In the book, " Investments," **Bodie Zvi; Kane Alex and Mareus Alan J. (2002)** opine that the mutual funds free the individual from many of the

administrative burdens of owning individual securities and offer professional management of the portfolio. They also offer advantages that are available only to large-scale investors, such as discounted trading costs. On the other hand, funds are assessed management fees and incur other expenses, which reduce the investor's rate of return. Funds also eliminate some of the individual's control over the timing of capital gains realizations.

The average rate of return of the average equity mutual fund in the last twenty five years has been below that of a passive index fund holding a portfolio to replicate a broad-based index like the S&P 500 or Wilshire 5000. Some of the reasons for this disappointing record are the costs incurred by actively managed funds, such as the expense of conducting the research to guide stock-picking activities. And trading costs due to higher portfolio turnover. The record on the consistency of fund performance is mixed. In some sample period, the better- performing funds continue to perform well in the following periods; in other sample periods they do not.

The research paper, "International Evidence on Ethical Mutual Fund Performance and Investment Style" written by **Baucr, Rob; Koedijk, Kees and Often, Roger** is the winner of the 2002 Moskowitz Prize for Outstanding Research in Socially Responsible Investing, awarded by the Social Investment Forum in the US.

Using an international database containing 103 German, UK and US ethical mutual funds we review and extend previous research on ethical mutual fund performance. By applying a multi-factor Carhart (1997) model they have solve the benchmark problem most prior ethical studies suffered from. After controlling for investment style, they have found little evidence of significant differences in risk-adjusted returns between ethical and conventional funds for the 1990-2001 periods. Introducing time-variation in betas however had led to a significant under-performance of domestic US

funds and a significant out: performance of UK ethical funds, relative to their conventional peers. Finally, they have differentiated previous results by documenting a learning/effect. After a period of strong under-performance, older ethical funds finally are catching up, while younger funds continue to under-perform both the index and conventional peers.

Bollen, Nicolas P.B. and Busse, Jeffrey A. (2003) in their paper, “Short-term Persistence in Mutual Fund Performance,” have revisited the issue of persistence in mutual fund performance, emphasizing short measurement periods. They have ranked funds every quarter by their risk-adjusted return measured over a three-month period using stock selection, market timing, and mixed strategy models. Then, they have measured the risk-adjusted return of deciles of funds over the following three-month period. They have found that the top decile of funds generates a statistically significant abnormal return in the post-ranking quarter of 25 to 39 basis points across the performance models.

They have conducted a number of tests to ensure that their results are not spurious. First, their analysis generates results that are robust across stock selection, market timing, and mixed strategy models, which suggests that misspecification of the performance model is not driving the results. Second, they have created a set of synthetic fund returns by simulating a momentum strategy. The after-expenses abnormal returns of these funds are in almost all cases negative. Third, they have created a variety of momentum factors to reflect different momentum frequencies. Their results are robust across these momentum factors they have also ensured that the abnormal returns are not a spurious microstructure effect by reproducing our main result using monthly returns instead of daily returns.

As their results conflict with those of Carhart (1997), who finds no evidence of superior ability after controlling for the momentum anomaly, they

have re-run the analysis several times, each time varying the methodology so that it more closely follows Carhart's. They have found that when funds are 30 sorted by return rather than abnormal return, the post- ranking performance spread between the top and bottom deciles disappears. They also increased the length of time over which they measure risk-adjusted returns, both in the sorting procedure and in the post-ranking procedure. They have found that the abnormal return of the top decile disappears in both cases.

Regarding the risk involved in mutual funds, **Bhalla, V.K. (2004)** mentions in his book, "Investment Management- Security Analysis and Portfolio Management," that because most mutual funds are so diversified, their investors are largely immune to the business and financial risks normally present with individual securities. Even with extensive diversification, however, the investment behavior of most funds is still exposed to a considerable amount of market risk. In fact, because mutual fund portfolios are so well diversified, they often tend to perform very much like the market- or some segment of the market that's being targeted by the fund. Although a few funds, tend to be defensive, market risk is an important behavioral ingredient in a large number of mutual funds, both open-and closed- end. Investors should be aware of the effect the general market has on the investment performance of a mutual fund. For example, if the market is trending downward and they anticipate the trend to continue, it might be best to place any new investment capital into something like a money fund until the market reverse itself At the time, they can make a more long-term commitment.

Another important risk consideration revolves around the management practices of the fund itself. If the portfolio is managed conservatively, the risk of a loss in capital is likely to be much less than for aggressively managed funds. Obviously, the more speculative investment goal of the fund, the

greater the risk of instability in the asset value. But, conservatively managed portfolio does not necessarily eliminate all price volatility. The securities in the portfolio are still subject to inflation, interest rate, and general market risks. However, these risks are generally reduced or minimized as the investment objectives and portfolio management practices of the funds become more conservative.

The **Monthly Mutual Fund Report** published by Federal Reserve Bank of Boston is a summary of financial market, economic and mutual fund industry internal conditions. This document is published the first Friday of the month. Most of the analysis results from the month-end Investment Company Institute (ICI) release, which describes one-month prior flows, returns, liquidity, and short term performance among the 51 ICI categories of 8,151 mutual funds. Trim Tabs Financial Services provides more recent data tracking biweekly flows and returns from a sample of funds. Other data are synthesized to describe current capital market conditions. These include investor returns, valuations, and earnings for the Standard and Poor's 500 Composite Stock Index and Citigroup Broad Investment Grade Bond Index, profits from the National Income Accounts, earnings forecasts from Thomson Financial First Call, and the value of assets from the Flow of Funds Accounts.

Kuriau, A.P. (2004) provides an insight on Indian Mutual Fund Industry through his article entitled, "On a Growth Trajectory", in the magazine, Analyst, Vol. X, Issue-7 July. Mutual funds industry is undoubtedly one of the fastest growing industries particularly in the financial sector. Looking at the last ten years, the compounded annual growth rate is around 10% and similarly in the last 11 years it is about 11-12% per annum. This reflects how consistently they are growing and this will be further accelerated as they go ahead.

The major factor that is pushing the industry's growth today is the awareness level on mutual funds among the investors. In addition, in terms of products they have almost all that is available anywhere in the world-traditional, sophisticated and second generation products. So, product-wise they have a large menu and service-wise their quality is world-class and return wise, they are again at par with market-related and service returns. Their regulatory framework is again one of the best in the world. So in all respects, the industry is on a strong growth path. Association of Mutual Funds in India (AMFI) is committed to develop the industry on professional and ethical lines following the highest professional standards at a time when their disclosure and transparency match with the best in the world. AMFI's job is to promote this industry on these lines. With this backdrop, the industry's future is very good. It has great potential to grow and is already on that path.

Tamar Frankel & Lawrence A. Cunningham presented the paper, "The mysterious ways of Mutual Funds: Market timing, Annual Review of Banking & Financial Law (2007)", in the paper they have opined the issue of Mutual funds on social science research network (tomorrow's research today) as follows:

The term market timing was little known outside the arcane world of mutual funds until state attorneys general from across the country popularized it. The term's innocuous-sounding ring assumed a more pernicious note when the mysterious ways of mutual funds became more transparent. In its pernicious sense, market timing denominates mutual fund insiders using the inscrutable structures of mutual funds to provide benefits selectively to favored participants at the expense of less favored participants.

Mutual fund shares are not like common stocks; investments made using these vehicles are unlike those made through traditional securities markets. While the peculiar features of mutual funds were manifested in the contemporary environment, these peculiarities are inherent in the very

structure of mutual funds. Regulatory efforts dating to the 1940s recognize these realities and regulatory reforms of the early 2000s struggle to respond in much the way earlier reforms did.

The wide range of reforms that have been adopted and proposed may overlook this reality, however. By correcting this oversight, and unveiling the historical and contemporary landscape, this Article provides more realistic appraisals for increasing the integrity of the mutual fund investment vehicle. Chief among these is a deeper point: critical to sustaining the mutual fund as an important institution in the financial system is a renewed appreciation of concepts of trust and professionalism.

2.2.2 Review of Previous Thesis

The contributions regarding the mutual funds of the previous academic researcher are as follows:

Neupane, Suman (2001), conducted a study on “A Study of Mutual Funds Performance in Nepal,” and laid the following objectives.

- To find out the performance of the mutual funds currently operating in the country in terms of risk-adjusted returns.
- To figure out whether the funds have been able to out perform the market portfolio in terms of risk-adjusted returns.
- To find out as to which of the two funds performed better during the period studied in terms of risk-adjusted returns.

He set the above objective indicating the following problem:

- Why are the investors shying away from investing in mutual funds?
- What is the performance of the mutual funds in the country in terms of risk adjusted return?
- Are the mutual funds generating returns in excess of market returns?

- Is there a need of a mutual fund (or investment company) in country like ours?
- Which of the funds generated higher returns?

His study concluded that, CIT is better performing fund than NCM Mutual Fund on the basis of the annual rates of return. The NCM Mutual Fund is not efficient as the market portfolio. He also pointed out several deficiencies in the practice of mutual funds in Nepal. The deficiencies range from passive investment strategy adopted by funds managers to the repurchase of units at par value rather than at NAV.

Mahato, Srijana (2002), in her study entitled, “Risk and Return Analysis of Investing in Mutual Fund” has been set the following objectives:

- General idea and practice of mutual fund in Nepal.
- Performance of the mutual fund in current status.
- To find out whether investing in share is better or in fund.
- To know why people are not showing interest towards Mutual funds.
- The main purpose of her study was to know the risk and return of mutual fund in Nepal and its performance so she provide the answer to the following research question on her study.
- Why investors are shying away from Mutual Fund?
- Why it has not been as successful as its counterparts in India or in developed country.

Her study concluded that NCM mutual fund is riskier than the market and it is not as efficient as the market portfolio. Investors are hesitating to invest their money in mutual fund due to less return and high risk in comparison to the market. Thus, investors prefer investing in share is better than the mutual fund. She point out that, one of the major reasons for the failure of mutual fund might be the investors do not have adequate knowledge about mutual fund.

Hada, Rabin (2004) conducted a study on “Mutual’ Fund: An Emerging Trend in Nepalese Financial Market” with the following objectives:

- To examine the need and significance of mutual fund for Nepalese economy.
- To examine the steps taken by government to introduce mutual funds it in Nepalese stock market.
- To explore the current problems being faced by of the mutual fund and its performance in Nepalese market.
- In his study, he has examined the trading trend of NCM mutual fund in NEPSE index. He has been also set of the following problems:
 - Why is mutual fund needed especially in Nepalese market?
 - What are the advantages and disadvantages of mutual fund?
 - How mutual fund makes investment less risky?
 - What are the current problems of mutual fund?
 - Does mutual fund help to increase the habit of investment of people?
 - How far it is relevant in the Nepalese financial market?

He concluded after his analysis that mutual fund could not perform efficiently and has led to poor popularity among investors due to lack of proper government policy, efficient management and financial knowledge.

Sthapit, Anubrata (2004) in his study entitled, "Mutual Funds And Securities Market in Nepal" has laid the following objective:

- To examine the role of mutual funds in the securities market of Nepal.
- To evaluate the performance of mutual funds.
- To find out the reasons affecting the performance of mutual funds in the securities market.
- The above objective has been set in terms of the following problem:

- Why there is not a satisfactory level of participation of mutual funds in security market?
- What are the reasons for the lack of liquidity in the shares of NCM mutual fund 2059 and citizen unit scheme?
- How to achieve prominence that mutual funds have in a developed nation?
- What are the reasons behind the Luke-warm response of public towards collective investment schemes?
- What are the steps initiated by the NCM mutual fund, 2059 and citizen unit scheme to educate the general public?
- He concluded after his analysis that investment portfolio of mutual fund is dominated by investment in securities and existence and market capitalization of mutual fund is very low.

Rai, Rajkumar (2005) in his study entitled, "A study on problems and prospects of mutual fund in Nepal" has set the following objectives:

- To study the existing situation of mutual fund in Nepal.
- To find out the problems of mutual funds in Nepal
- To trace out the prospects of mutual fund in Nepal.
- To provide suggestion & recommendations.
- The above objective has been set in terms of the following problems:
- Why are people shying to invest in such funds?
- Are these funds making portfolio of assets?
- Does Nepalese capital market have professional mutual fund experts?
- Are the existing securities market laws sufficient for the growth & development of mutual funds in Nepal?
- Is Nepalese capital market enough developed for mutual funds?

His study revealed that the gap between average rate of return and market rate of return. He also concludes that investors don't invest their

money in mutual funds due to lack of adequate knowledge and the existing mutual fund schemes are not sufficient for investors.

Katuwal, Bholan Man (2007) in his dissertation, "Performance and Prospects of Mutual Fund" has the following objectives:

- To examine the performance of NCM mutual fund and Citizen Unit Scheme.
- To examine the need and significance of mutual fund for the development of capital market.
- To identify the problems and prospects of mutual fund launched by NIDC & CIT.
- To suggest and recommend NIDC and CIT for further research work.
- The objectives were set with respect to the following problem:
- Why to invest in mutual fund?
- What is the trend of return obtained from the investment in mutual fund?
- What are the problems and prospects of mutual fund in Nepalese capital market?
- What are the advantages & disadvantage of mutual fund?
- Is the performance of mutual fund satisfactory to the Nepalese investor?

His study has revealed that the condition of mutual fund is closer to satisfactory level. However it has not become marketing tool for investors. Due to the lack of proper information, investors are in favor of common stock rather than mutual fund and they are also suffering for liquidity in secondary market. If the government support mutual fund by giving tax incentive on its earning, the mutual fund would be more popular. He also concluded that CUS is better than NCM in term of risk correlation and performance models.

Thapa, Indra (2009) in his dissertation, "Performance of Mutual Fund in Nepal" has the following objectives:

- To examine the financial performance of mutual fund during the period studied.
- To examine the consistency in performance of mutual fund companies.
- To make recommendations to overcome the obstacles in NCM and CUS to improve portfolio performance.
- To analyze the problems faced by mutual funds in Nepal.

The above objective has been set in terms of the following problem:

- What are the major problems faced by mutual funds companies in Nepal?
- Which of the collective investment schemes generated higher return?
- Why the investors are not interested to invest in mutual funds companies in Nepal?
- What will be solution or ways to improve portfolio performance of mutual funds in Nepal?
- Whether collective investment schemes are consistence in their performance or not?
- What is the current scenario of mutual fund in Nepalese market?

His study concluded that investment portfolio is dominated by investment in securities. NCM mutual fund is better than CUS in terms of liquidity, management team and investment strategy. However NCM is more risky than CUS. To improve condition of mutual fund, fund management should adopt dynamic investment strategy and efficient portfolio management.

2.3 Research Gap

The review of above relevant literature has contributed to enhance the fundamental understanding and knowledge, which is required to make study meaningful and purposive. There are various article publish related to mutual fund, a few research also conducted on mutual funds. All of the research

made in this topic is mainly concentrated in presenting the financial status of the funds by using limited data. Thus seem gloomy in the context of funds mobilization, performance, measures of return and risk and explanation of problem. Still there are lots of things to be done in mutual fund.

The purpose of this research is to develop some expertise in one's area to see what contribution can be made by using financial and statistical tools with 11 years data. Further, the study measures the performance and problem of funds as well. So this study will be fruitful to the funds operators, regulatory body, government, investors, interested person, parties, students, scholars, professor, and businessman to know the actual condition & improvement of fund, for the properly regulation, policy perspective, choices of investment, to get knowledge as well as matter for the further research.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Background

Research methodology is a systematic way of solving the research problem. It refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view. In other words research methodology described the methods and process applied in the entire subject of the study.

“Research methodology is a way to solve the research problem systematically. The research methodology considers the logic behind the methods used in the context of research study and explains why particular method or technique is used. It also highlights about how the research problem has been defined, what data have been collected, what particular method has been adopted, why the hypothesis has been formulated etc.”
(Joshi; 2002:19)

Research methodology depends on various aspects of the research. The variable that determine the research methodology of that particular project are the size of the project, importance of the project, the objective of the study, time frame of the project, impact of the project in the aspects of the human life etc.

3.2 Research Design

A research design is the arrangement of conditions for collection and analysis of data that aims to combine relevance to the research purpose with economy in procedure so a research design is purely and simply the framework or plan for a study that guides the collection and analysis of data. Research design is the definite procedure and techniques which guides the

study and the way to do the study. A research design is basically concerned with various steps to collect the data for analysis and draw a relevant conclusion.

To achieve the objective of this study, descriptive and analytical research design has been used. The design is confined to the peripheries of mutual fund operation in Nepal. Some financial and statistical tools have been applied to examine the facts.

3.3 Population and Sample

There are only two collective investment of mutual fund (ie. The NCM mutual fund and Citizen Investment trust) currently operating in Nepal. Both the schemes have been undertaken for the study so the schemes consider as population. It means, all the schemes of mutual fund have been taken rather than a specific sample for the purpose of this study. All the available information is gather from different sources.

3.4 Sources of Data

The study is conducted on the basis of primary as well as secondary data. The data required for the analysis are obtained from different sources. All the data are compiled, processed and tabulated in the time series as per the need and objectives.

Primary Sources of Data

The primary data are taken from questionnaires and also collected through direct interview with experts. The questionnaires are distributed to different categories of respondents who are participated in the capital market and collected back after five days. Preparing the questionnaire regarding the performance and problem of mutual fund in Nepal, was distributed to the respondents which showed by the following table.

Table 3.1

Respondents Category

Category	Questionnaire Distributed	Response Collected	Percentage of Response
Regulating Bodies (SEBON & NEPSE)	25	21	38.89
Issue manager (NCML & CIT)	15	13	24.07
Stockbrokers	13	11	20.37
Investors	15	9	16.67
Total	68	54	100

(Source: Personal Survey 2010)

The above table shows that out of 68 distributed sets, only 54 sets of questionnaire have been collected through different sources.

Secondary Sources of Data

The secondary data are collection from the following sources:

- Annual Report of CIT
- Prospectus, Bulletins of CIT
- Annual Report of NIDC Capital Markets Ltd
- Unit purchase application form of NIDC Capital Markets Ltd
- Annual Report of SEBON
- Bulletins of SEBON
- Prospectus, Bulletins of NEPSE
- Business and Finance Journals
- Text book and materials

- Previous study Research Reports
- Websites
- Encyclopedia Wikipedia

3.5 Tools and Techniques of Data Analysis

To achieve the desired objectives of the research, both financial and statistical tools are used. To know the existing situation of mutual fund and its performance in Nepalese capital market, Secondary data plays vital role. However primary data and information helps to make the study more meaningful. All the primary and secondary data has been presented in the tabular form after editing, coding and classification in order to make the study more precise. The summary of the tabulated data has been presented in the body and the detail is attached in the appendix. The study is used descriptive and analytical method to analysis the data in order to draw meaningful result. Following analytical tools have been used in the study.

- Statistical Tools
- Financial Tools

3.5.1 Financial Tools

To evaluate the performance of mutual fund, different financial tools are developed by the financial experts. Out of these tools following tools are more related to measure the performance and efficiency of the mutual fund of this study.

i) Net Asset Value: Mutual fund's Net Asset Value is equal to the total market value of the mutual fund's holding minus liabilities by dividing the total number of outstanding share on a particular time. It is given by:

$$\text{Net Asset Values (NAV)} = \frac{\text{Assets} - \text{Liabilities}}{\text{No of Units Outstanding}}$$

If mutual fund is of open-end type and that has front-end load at certain percent, then Net asset value of the fund calculated using the following equation.

Net Asset Value = Offering price (1- front-end load)

ii) Portfolio Yield: This is one of the financial tools that evaluate the performance of portfolio. This tool will be used to determine the portfolio yield of mutual fund and portfolio yield of whole market for this study. This model is given by

$$\text{Portfolio yield} = \frac{\text{NAV}_{t+1} + D_{t+1}}{\text{NAV}_t} - 1$$

Where;

NAV_{t+1} = net asset value per share at the end of period t+1.

D_{t+1} = Total of dividends & capital gains per share during period t+1.

NAV_t = Net asset value per share of the end of previous period.

iii) Market price of the Fund: It is one of the important financial tools to measure the funds performance and the efficiency of the management. Market price is the price of a stock that purchase and sales in the market. It is determined by the laws of demand and supply. Different factors such as; net income, expected dividend, firm's goodwill etc affect the market price of the stock. Closing market price of the fund is used for the analysis.

iv) Total Risk: Forces that contribute to variation in return is known as risk. Those influences, which affect internal to the firm or particular industry and can be eliminated to some extent are known as unsystematic risk. Those forces that are basically beyond the control and affect large number of securities which are external to the firms and can not be eliminated are

known as systematic risk. Total risk is the sum of systematic risk and unsystematic risk. Total risk measure the performance of fund. Total risk measurement is given by

Total Risk = Systematic Risk + Unsystematic Risk

$$\sigma^2 = \beta_i^2 \sigma_m^2 + \sigma_e^2$$

Where,

σ^2 = Total Risk or variance

β_i^2 = Portfolio bata square

σ_m^2 = Market Variance

σ_e^2 = Unsystematic risk variance of error term.

v) Sharpe's Index: It was developed by William sharpe. It is the risk premium return earned per unit of total risk. In another word, Sharpe's measures the risk premium of the portfolio relative to total number of risk in the portfolio. A higher value of S_i means a better performing portfolio. The Sharpe index is given by

$$S_i = \frac{\bar{r}_i - \bar{R}_f}{\sigma_i}$$

Where,

S_i = Sharpe's index of portfolio performance

\bar{r}_i = Average returns on portfolio 'i' during a specified period

\bar{R}_f = Average risk free rate during the same time period

σ_i = Standard deviation of portfolio i.

vi) Treynor's Index: It was developed by Jack Treynor. It measures the risk premium of the portfolio. This measures the risk premium of the portfolio, where risk premium is equal to the difference between the return of the portfolio and risk free rate. The risk premium is related to the amount of systematic risk assumed in the portfolio. Treynor's measure the sum up the risk and return of a portfolio in a single way, which categorizing the performance of the portfolio. A higher value of T_i indicates a better portfolio for all investors. The Treynor's index is given by

$$T_i = \frac{\bar{r}_i - \bar{R}_f}{\beta_i}$$

Where,

T_i = Treynor's index

\bar{r}_i = The average rate of return for portfolio 'i' during a Specified time period.

\bar{R}_f = The average return on a risk free investment during the same Period.

β_i = The slope of fund's characteristic line during that time Period.

vii) Jensen's Alpha: This method is developed by Michael Jensen, which is based on CAPM to evaluate portfolio performance. Jensen's measure is the average return on the portfolio over and above the predicted CAPM, given the portfolio's beta and the average market return, Jensen's measure is the portfolio's Alpha value.

If αp is +ve, portfolio is undervalued

If αp is -ve, portfolio is overvalued

Jensen's measure is given by

$$\alpha p = \bar{r}_p - [R_f + \beta_p (\bar{R}_m - R_f)]$$

Where,

αp = Jensen's measure

\bar{r}_p = Average return on portfolio p

R_f = Risk free rate of return for the period

β_p = A measure of systematic risk

\bar{R}_m = Average return on market portfolio

viii) Bar Diagram

For the analysis of primary data bar diagram have been used. All respondent are tabulated and calculated to find out the percentage. All respondents are assume to be hundred percent. On the basis of percentage; the result has analyzed.

3.5.2 Statistical Tools

The statistical tools are indispensable measure for evaluating the performance of the fund. For the purpose of the study, various statistical tools have been used which are as follows:

i) Average Rate of Return: The average rate of return is the sum of value of all observations divided by number of elements in the observations. It is given by:

$$E(R_i) = \frac{R_i}{n}$$

Where,

$E(R_i)$ = Average rate of return or mean.

R_i = Return of Security i .

n = Number of observation in the sample.

ii) Standard Deviation: It is statistical tools that measure the variability of distribution of return from its average return or mean. Standard deviation is the square root of the average of the squared distances of the observations from the average return or mean. It is used to find out the total risk of the fund. It is given by

$$\sigma = \sqrt{\frac{[R_j - E(R_j)]^2}{n}}$$

Where,

R_j = observation

$E(R_j)$ = expected mean of observation

n = no. of observation

σ = standard deviation of the observation

Σ = sum of all value $[R_j - E(R_j)]^2$

iii) Variance: Variance means deviation between the average return and a value. Sum of squared deviation between average return and each item in the observation is divided by total number of items in the observation is variance. It is given by

$$\sigma^2 = \frac{\Sigma[R_j - E(R_j)]^2}{n}$$

Where,

σ^2 = variance of observations

Σ = sum of all the values $[R_j - E(R_j)]^2$

R_j = items or observation

$E(R_j)$ = Arithmetic mean values or expected mean value

n = total number of items in the observation

iv) Co-efficient of Variation: The relative measure of risk based on the standard deviation is known as the coefficient of variation. We use Co-efficient of variation to compare the amount of variation on the data groups that have different expected return. It is given by

$$C.V. = \frac{\sigma}{E(R_j)} \times 100$$

Where,

C.V. = Coefficient of Variation

σ = standard deviation

$E(R_j)$ = average of the variable/ expected return

v) Co- variance: Co-variance measures the change in each variable with respect to another variable. It is given by

$$COV(R_i, R_m) = \frac{\sum [R_i - E(R_i)][R_m - E(R_m)]}{n}$$

Where,

$COV(R_i, R_m)$ = covariance of returns between individual portfolio i and market portfolio m .

R_i = Return on individual portfolio i .

R_m = Return on market portfolio m .

$E(R_i)$ = Average return of observation for portfolio i .

$E(R_m)$ = Average return of observation for portfolio

n = Total number of observation

vi) Correlation Coefficient: Correlation Coefficient is used to measure the degree of association between the variables. Correlation coefficient indicates the direction of the relationship between two variables. It is given by

$$\rho_{im} = \frac{COV(r_i, r_m)}{\sigma_i \times \sigma_m}$$

Where,

ρ_{im} = correlation between the mutual fund's return and market return

$COV(r_i, r_m)$ = covariance between fund's return and market return

σ_i = standard deviation of mutual fund

σ_m = standard deviation of the market

vii) Beta Co-efficient: Beta is used to measure the systematic risk associated with the fund. Beta of market return is always equal to 1. If a particular asset has a beta less than 1, it means that the returns of the assets are less volatile than market return. If a particular asset has beta greater than 1, it means that the return of the assets are more volatile than return of the market. It is given by

$$\beta_i = \frac{COV(R_i, R_m)}{\sigma_m^2} = \frac{\rho_{jm} \times \sigma_i \times \sigma_m}{\sigma_m^2}$$

Where,

β_i = Beta coefficient of fund i or stock i

$COV(R_i, R_m)$ = covariance between the returns of individual portfolio i and market portfolio m

σ_m^2 = variance of market portfolio

$$\rho_{im} = \frac{COV(r_i, r_m)}{\sigma_i \times \sigma_m}$$

ρ_{im} = correlation between the mutual fund's return and market return

viii) Trend Analysis: Trend analysis is used in order to identify the variation of trend of the repurchased and outstanding units of citizen unit scheme. To analyze the trend, following trend line equation has been used. Trend Line Equation:

$$y = a + bx$$

$$a = \frac{\sum y}{n} \quad \text{and} \quad b = \frac{\sum xy}{\sum x^2}$$

Where,

y = underlying trend value

x = Points of time i.e. (Year-average of the eyars)

a = intercept terms

b = change in xy with respect to change in units

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

This chapter is concerned with the presentation, analysis and interpretation of data. The raw data obtained from primary and secondary sources have been organized, arranged and tabulated for the purpose of analysis. Using various tools and techniques, the data relating to performance and problem of mutual fund in Nepal have been presented and interpreted systematically in order to fulfill the objectives of the study. For the presentation, analysis and interpretation of data, the chapter has been divided into three sections as follows.

4.1 Presentation and Analysis of secondary data

4.2 Presentation and Analysis of primary data

4.3 Major findings

4.1 Presentation and Analysis of Secondary Data

With the help of secondary data, this part has been made in order to examine the performance of mutual fund in Nepal. The performance of mutual fund has been analyzed in term of portfolio yield, Systematic Risk, Unsystematic Risk of fund, Correlation of funds with market, Co-efficient of determination and so on.

4.1.1 Performance in Terms of Portfolio Yield

The return of the managed portfolio and market portfolio is calculated with reference to the market index (NEPSE index), NAV and dividends of NCM Mutual Fund including CUS-052. The performance of NCM Mutual Fund, Citizen Unit Scheme and NEPSE is measured by comparing the yields of respective portfolio.

Table 4.1**Portfolio Yield**

Fiscal Year	Market Portfolio (NEPSE)	NCM Mutual Fund	Citizen Unit Scheme
2056/57	66.28	46.72	30.69
2057/58	-3.40	8.86	10.39
2058/59	-34.70	-43.96	8.34
2059/60	-9.97	-17.94	8.36
2060/61	8.39	16.37	0.30
2061/62	15.08	27.03	18.52
2062/63	27.07	33.95	16.77
2063/64	110.65	68.69	-19.30
2064/65	40.85	60.48	7.07
2065/66	-22.24	12.89	21.69
Total	198.01	213.09	102.83
Average yield [E(R _j)]	19.80	21.31	10.28
σ_i	41.50	32.66	12.84
$C.V. = \frac{\sigma_i}{E(R_j)}$	2.10	1.53	1.25

(Source: Appendix-2)

In table 4.1, it can be seen that the average yield of NCM mutual fund is higher than the average yield of market and the average yield of Citizen Unit Scheme is less than market. It means, the NCM mutual fund is performing

better than the market in terms of average yield and the performance of Citizen Unit Scheme is not satisfactory in comparison to market in terms of average yield but higher average return not always be taken as better performer. Hence in order to resolve this, average C.V. should be consider. Considering the C.V., yearly return from Citizen Unit Scheme seems more consistent than NCM mutual funds and Market. However, yearly return from NCM is also consistent than market.

The table also depicts that the yearly return of market is ranged from -34.70 to 110.65 in the F/Y 2058/59 and 2063/64 respectively. The yearly return of market seems -34.70 because the index of NEPSE decreased in F/Y 2058/59 in comparison of the Previous year and yearly return of market seems 110.65 in F/Y 2063/64 due to increase the NEPE index in comparison to the previous year which is clearly shown in the Appendix-2. Similarly, yearly return of NCM mutual fund is ranged from -43.96 to 68.69 in the F/Y 2058/59 & 2063/64 respectively and CUS is ranged from -19.30 to 30.69 in the F/Y 2063/64 & 2056/57 respectively due to decreased and increased the NAV of the fund in comparison with previous year.

4.1.2 Investment Portfolio Analysis

Good investment portfolio plays a crucial role in mutual fund schemes. Better portfolio of investment makes the scheme's performance better. Investment portfolio refers to the choice of investment in different types of securities e.g. shares, bond, debenture, fixed income securities etc. Fixed income securities are those securities which provide the fixed return during the investment period. The investment in shares is more risky with high return. On the other hand, fixed deposit and investment in government bond is secure but provides low yield. There is no rule to make the portfolio better however, portfolio should be optimum that maximize the return and minimize the risk.

Table 4.2**Investment Portfolio of NCM**

(Rs. In Million)

Fiscal Year	Value	Share/ Debenture	Government Bond	Bank Deposit	Total	Percentage Change
2060/61	Rs.	95.88	10.00	8.83	114.71	-
	%	83.58	8.72	7.70	100	
2061/62	Rs.	126.21	10.00	16.54	152.75	33.16%
	%	82.63	6.55	10.83	100	
2062/63	Rs.	183.53	10.00	13.68	207.21	35.65%
	%	88.57	4.83	6.60	100	
2063/64	Rs.	86.00	10.00	93.30	189.30	-8.64%
	%	45.43	5.28	49.29	100	
2064/65	Rs.	88.95	10.00	81.93	180.88	-4.45%
	%	49.18	5.53	45.30	100	
2065/66	Rs.	90.80	10.00	16.34	117.14	-35.24%
	%	77.51	8.54	13.95	100	
Average %		71.15	6.57	22.28	100	

(Source: Appendix-3)

Table 4.2 depicts the fact that total investment of NCM was increased in the fiscal year 2061/62 and 2062/63. From the year 2063/64, it was decreased. In compare with the previous year, total investment of fiscal year was decreased by 35.24%. The average percentage of investment by NCM in share & debenture is 71.15% which is more with compare other sector i.e. Government Bond (6.57%) and Bank Deposit (22.28%). In the fiscal year

2065/66, investment in Share & Debenture (77.51%) and Government Bond (8.54%) are more than average. However, Bank Deposit (13.95%) seems less than average.

Table 4.3

Investment Portfolio of Citizen Unit Scheme

(Rs. In Million)

Fiscal Year	Value In	Government Bond	Bank Deposit	Share/ Debenture	Loan & Advance	Total	Change
2060/61	Rs.	182.00	92.00	26.50	116.50	417.00	-
	%	43.65	22.06	6.35	27.94	100	
2061/62	Rs.	184.60	100.00	22.80	260.20	567.60	36.12%
	%	32.52	17.62	4.02	45.84	100	
2062/63	Rs.	173.90	317.50	26.50	139.60	657.50	15.84%
	%	26.45	48.29	4.03	21.23	100	
2063/64	Rs.	93.20	490.60	28.90	139.50	752.20	14.40%
	%	12.39	65.22	3.84	18.55	100	
2064/65	Rs.	93.20	529.50	42.59	139.56	804.85	7%
	%	11.58	65.79	5.29	17.34	100	
2065/66	Rs.	70.00	392.84	67.60	139.56	670.00	-
	%	10.45	58.63	10.09	20.83	100	
Average %		22.84	46.27	5.60	25.29	100	

(Source: Appendix-4)

Above table shows that percentage change of total investment amount of CUS was in decreasing trend. In the year 2065/66, total amount of investment decreased by 16.75% with compare to previous year. The average percentage of investment on Loan & advance is the major portion of total investment that covers 25.29%. Other sector of investment by CUS on an average is Government Bond (22.84%) and Share/ Debenture (5.60%). Bank deposit seems 46.27% on an average. In the fiscal year 2065/66, Bank Deposit (58.63%) and investment in Share & Debenture (10.09%) are more than average. However, Government Bond (22.84%) and Loan & Advance (20.83%) seems less than average investment.

By evaluating the investment portfolio of NCM and CUS mutual fund, it is seen that NCM mutual fund emphasize the share & debenture but CUS focuses Government securities. So, on the basis of investment portfolio NCM mutual fund is risk seeker and CUS mutual fund is risk averter. It can also conclude that the return of the NCM mutual fund may be more fluctuate than the return of the CUS mutual fund.

4.1.3 Performance in Terms of Sharpe's Index

The sharp index measures the risk premium of the portfolio relative to the total amount of risk in the portfolio i.e. both systematic as well as unsystematic. It is defines a single parameter portfolio performance index that is calculated from both the risk and return statistics. It measure the reward to variability treaded off.

Table 4.4

Sharpe's index

Particular	NCM Mutual Fund	Citizen Unit Scheme
Average return of the portfolio (\bar{r}_i)	21.31	10.28
Standard deviation of return (σ_i)	32.66	12.84
Average risk free rate of return (\bar{R}_f)	6.00	6.00
Sharpe's index (S_i)= ($\frac{\bar{r}_i - \bar{R}_f}{\sigma_i}$)	46.88	33.33

(Source: Appendix-5)

With reference to table 4.4, Sharpe index for NCM mutual fund is higher than Citizen Unit Scheme i.e. 46.88% > 33.33%. So NCM mutual fund seems

better performer. Hence, NCM mutual fund is providing higher return than Citizen Unit Scheme.

4.1.4 Performance in terms of Treynor's Index

Treynor index measures the risk premium of the portfolio relating to the amount of systematic risk assumed in the portfolio.

Table 4.5

Treynor's Index

Particular	NCM mutual fund	Citizen Unit Scheme
Average portfolio Return (\bar{r}_i)	21.31	10.28
Beta-Coefficient of portfolio (β_i)	0.69	-0.12
Average Risk free rate of Return (\bar{R}_f)	6.00	6.00
Treynor's index (T_i) = $\left(\frac{\bar{r}_i - \bar{R}_f}{\beta_i} \right)$	22.19	-35.67

(Source: Appendix-5)

As per table 4.5, NCM mutual fund seems better performer because index of NCM mutual fund is higher than that of Citizen Unit Scheme. Hence, NCM mutual fund is more desirable in terms of treynor's index.

4.1.5 Performance in Terms of Jensen's Index

Jensen's performance measure is absolute performance on a risk adjusted basis i.e. a definite standard against which performance of various funds can be measured. This standard is based on measuring the predictive ability of portfolio manager's to earn return through successful predication of security prices.

Table 4.6

Jensen's Index

Portfolio	Alpha Value $\alpha = \bar{r}_p - [R_F + \beta_p(\bar{R}_w - R_f)]$	Risk adjusted Alpha $= \frac{\alpha}{\beta}$
NCM mutual fund	=21.31-[6+0.69(19.80-6)] =5.79	8.39
Citizen Unit Scheme	=10.28-[6+(-0.12)(19.80-6)] = 5.94	-49.5

(Source: Appendix-5)

In table 4.6, the risk adjusted alpha of NCM mutual fund is greater than Citizen Unit Scheme (i.e.8.39>-49.5). So, NCM mutual fund is ranked as better performer than Citizen Unit Scheme. In other words, NCM mutual fund is of superior performance.

4.1.6 Analysis in Terms of Risk

Table 4.7

Total Risk, Systematic Risk and Unsystematic Risk of Funds

Particular	NCM mutual fund		Citizen Unit Scheme	
Total Risk (σ^2_i)	1066.84	100%	164.91	100%
Systematic Risk	820.06	76.87%	24.80	15.04%
Unsystematic Risk (σ^2_e)	246.78	23.13%	140.11	84.96%

(Source: Appendix-5)

Above table 4.7, shows that NCM mutual fund has higher level of undiversifiable risk or systematic risk (i.e.76.87%) which can not be minimized. In other words, due to low portion of unsystematic risk of NCM mutual funds can not be minimized to the desired level by efficient management. In contrast, Citizen Unit Scheme has higher level of unsystematic risk of diversifiable risk (i.e. 84.96%) and low portion of systematic risk (i.e. 15.04%). So risk of Citizen

Unit Scheme can be minimized by efficient management. Hence, NCM mutual fund seems to be riskier than Citizen Unit Scheme in comparison to the level of risk.

4.1.7 Performance in Terms of Co-efficient of Determination

Table 4.8

Co-efficient of Determination of Mutual

Particular	NCM Mutual Fund	Citizen Unit Scheme
Co-efficient of determination $\left(\frac{\beta_i^2 \times \sigma_m^2}{\sigma_i^2} \right)$	0.77	0.15

(Source: Appendix-5)

As per table 4.8, NCM mutual fund consists highest portion of systematic risk i.e. 0.77 and Citizen Unit Scheme consists lowest portion of systematic risk i.e. 0.15 in total risk. So Citizen Unit Scheme can diversify more its risk than NCM mutual fund. Hence, Citizen Unit Scheme seems better performer in term of Co-efficient of determination.

4.1.8 Performance in Terms of Correlation of Funds with Market

Table 4.9

Correlation Coefficient of Mutual Funds with Market

	NCM Mutual Fund	Citizen Unit Scheme
Correlation Coefficient $\left(\rho_{i,m} = \frac{COV(r_i, r_m)}{\sigma_i \cdot \sigma_m} \right)$	0.87	0.39

(Source: Appendix-5)

In table 4.9, both mutual funds are positively correlated with the market. Correlation of NCM mutual fund with market is 0.87 and correlation of Citizen Unit Scheme with the market is 0.39. Hence, any change in the market will influence less to Citizen Unit Scheme than that of NCM mutual fund.

4.1.9 Performance in Terms of Repurchase and Outstanding Units

Analysis on this part is focused to open-end type mutual fund operating in Nepal i.e. Citizen Unit Scheme. It is regularly undertaking the act of repurchase with no limits of maximum share outstanding. On the basis of available information two separate trends line has been fitted in order to know the growth rate of repurchase unit per fiscal year and growth rate of outstanding unit per fiscal year. The summary version of information available for analysis is as follows.

Table 4.10

Trend Analysis of CUS

	For Repurchase Units	For Outstanding Units
$\sum x$	0	0
$\sum x^2$	110	110
$\sum xy$	2049.95	17693.65
$\sum y$	769.01	4219.96
b	18.64 Lakh Units	160.85 Lakh Units

(Source: Appendix-6)

Using the trend equation, $y = a+bx$ two straight trend line has been fitted to obtain the growth rate (b) for repurchase units and outstanding units. Above table 4.10 shows the growth rate of repurchase units is 18.64 lakh units per year and outstanding units is 160.85 Lakh units per year. Both growth rates are in rising trend and the growth rate of outstanding units is higher than repurchase units.

4.2 Presentation and Analysis of Primary Data

To analyze the 2nd, 3rd and 4th objectives of the study, primary data are taken. This part is dedicated to the analysis of primary data. This primary data basically relates to the need, significance, problem and prospects of mutual fund in Nepal. This part deals with the study of options made by different groups of respondents to obtain knowledge on the various aspect of the mutual fund as how they regard the mutual fund in a capital market. So as to obtain primary data sum total of 68 questionnaire have been distributed to these, who are the capital market participants. Out of 68 participants, 54 questionnaires were collected within stipulated period. Hence this analysis part is based on the questionnaire survey of 54 respondents. The main purpose of distributing questionnaire is to find out the need and problem of mutual fund in Nepal. It is assumed that questionnaire survey covered the response of those group they have certain knowledge regarding mutual fund in Nepal. It is very important to identify and analyze the factors affecting the performance and its problem. For obtaining response effectively, structured of questionnaire have been prepared and distributed. Out of 54 respondents, 21 were from Regulating Bodies, 13 from issue managers, 11 from stockbrokers and 9 from investors. After collecting respondents opinions, they are arranged (Source: Appendix A₈), tabulated and shown in bar graphs. Percentage of Respondents category is presented in following table.

Table 4.11

Classification of Respondents

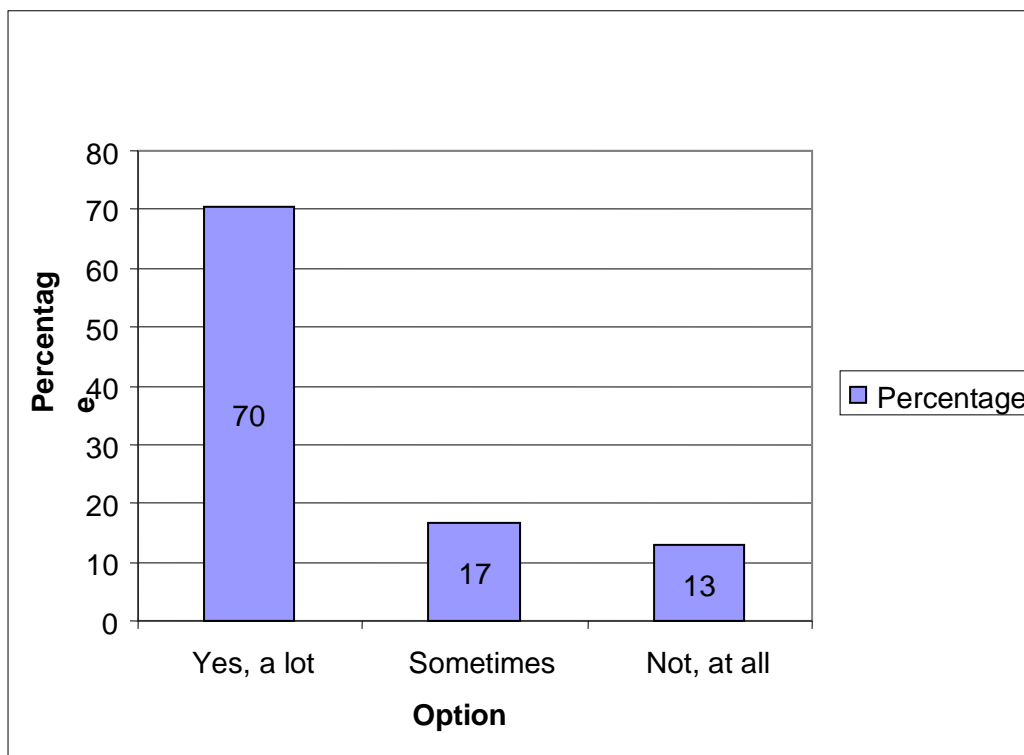
Respondents Category	No. of Respondents	Percentage
Regulating bodies	21	39%
Issue Manager	13	24%
Stock Brokers	11	20%
Investors	9	17%
Total	54	100%

Question-1: Analysis of Knowledge about Mutual Fund

The main purpose of this question is to get the level of knowledge regarding mutual fund to Nepalese capital market practioners. Each category of respondents are asked whether they are familiar with the mutual fund. The view points of the different respondents are presented in the following graph.

Figure 4.1

Level of Knowledge About Mutual Fund



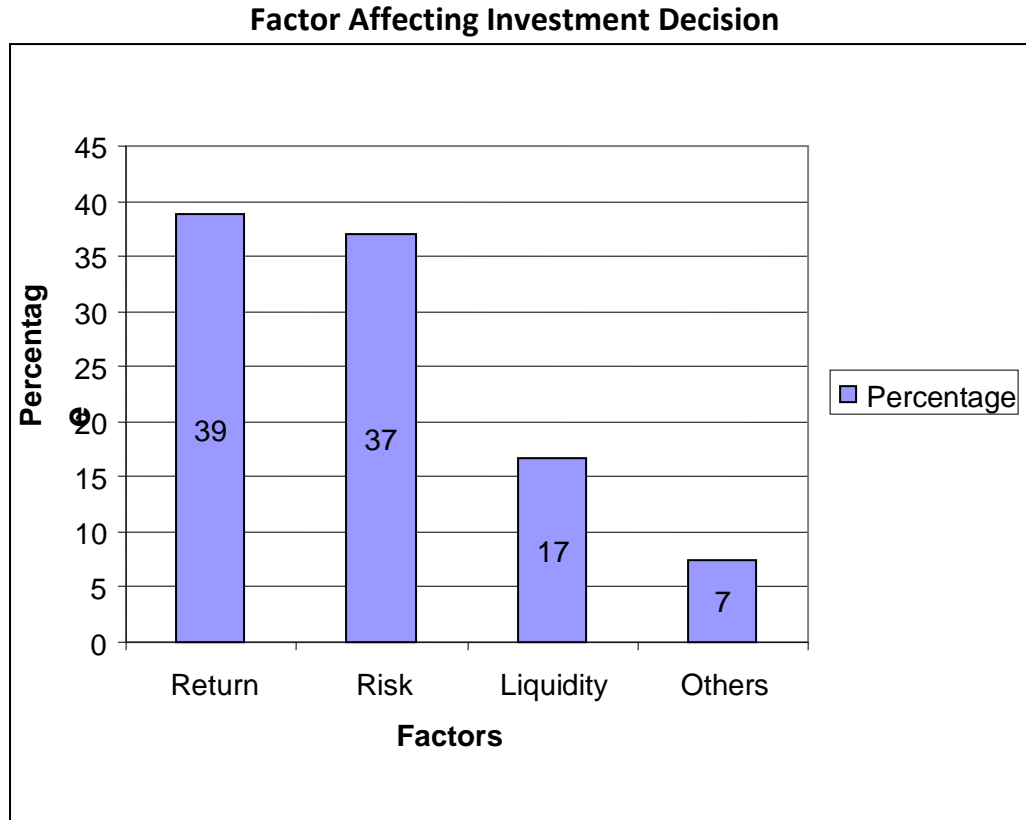
(Source: Appendix-7)

From the above figure we can say that the majority of respondent i.e. 70% know about mutual fund in great deal. However 17% of respondents too have little knowledge about mutual fund and 13% of respondents still do not familiar with the mutual fund. Hence it is seen that it is not completely new concept in the Nepalese capital market.

Question 2. Analysis of the Factor Affecting Investment Decision

There are many factors that play crucial role while choosing investment alternative. Regarding this fact, the respondents were asked to specify the factor affecting investing decision. The responses of the respondents are as follows:

Figure 4.2



(Source: Appendix-7)

Above figure shows that most of the respondents opined that return is the factor that affects their decision. 39% of respondent are in favor of return, 37% of respondents are in favor of risk. Similarly 17% of respondent are in favor of liquidity and rest 7% of respondents are in favor of others alternative. So, we can say that mutual fund have problem of liquidity on trading floor. However it would be attractive alternative due to less risky and providing minimum fix return.

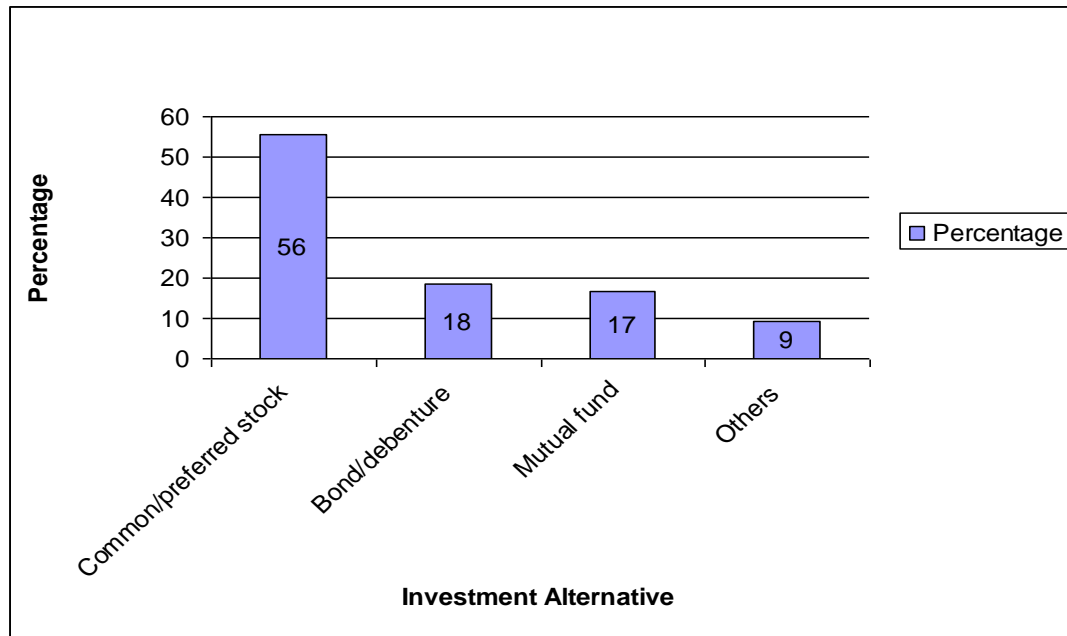
Question 3. Analysis of Investment Alternative

There are several investment alternatives in the capital market. Basically, financial assets and real assets are two types of assets to invest in. By focusing financial assets, it can also categorize into Short-term Securities, Long-term

Securities and Derivative Securities. By assuming mutual fund is one of the selective alternatives among the different alternatives, each respondent were asked regarding the investment alternatives and obtained the following result.

Figure 4.3

Choice of Investment Alternative



(Source: Appendix-7)

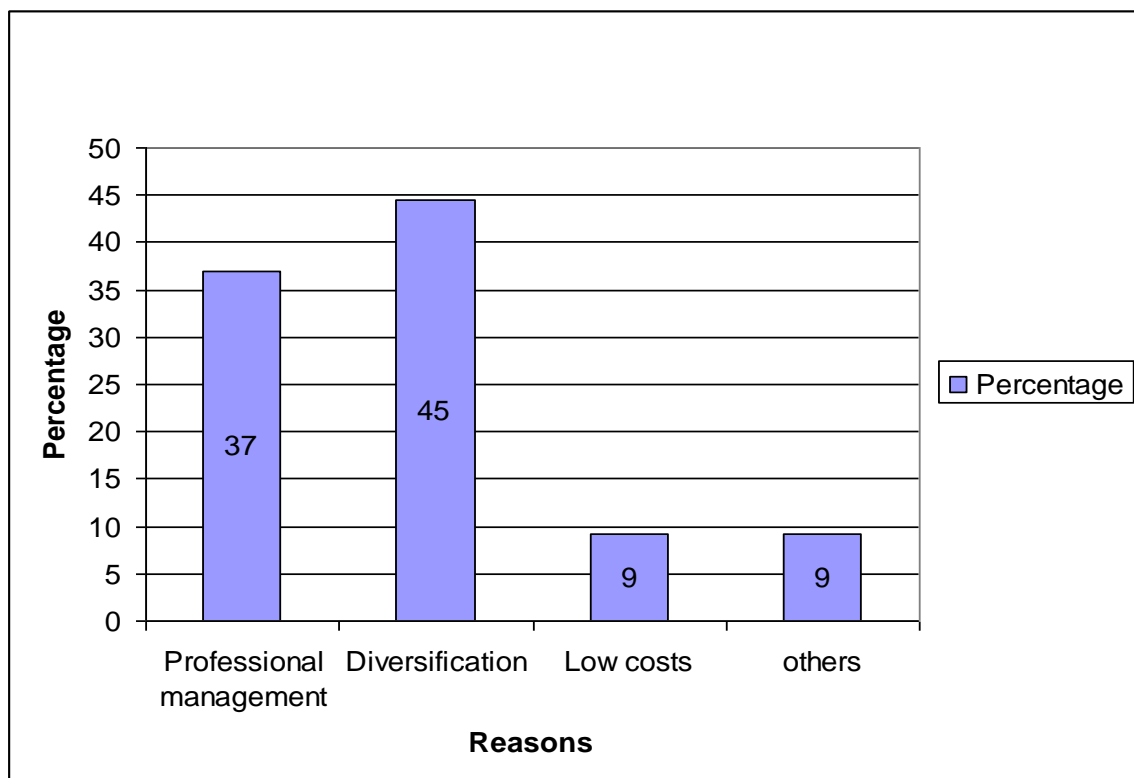
Above figure shown that most of the respondents, i.e. 56% are in favor of Common Stock, 18% of respondents like Bond and debenture. Only 17% of respondents are in favor of Mutual Fund which takes 3rd position among the alternatives. The percentage belongs to mutual fund is less due to the lack of proper information about mutual fund and capital market also is not enough developed for the operation of mutual fund. It means that mutual is less preferred investment alternative to the investors.

Question 4. Analysis of the Reason for the Selection of Mutual Fund

This question is related to the choice of mutual fund among the alternatives. Every alternative have its own operating characteristics. Comparing and assuming the role played by alternatives which makes the investment superior, investors decided to select alternative. In this context, respondents were asked about causes of selection of mutual fund.

Figure 4.4

Reasons for the Selection of Mutual Fund



(Source: Appendix-7)

Above figure shows that majority of respondents were in favor of diversification because 45% of respondents support diversification. Due to the advantages of mutual fund as diversification, they select mutual fund for investment. Similarly, 37% of respondents were support to professional

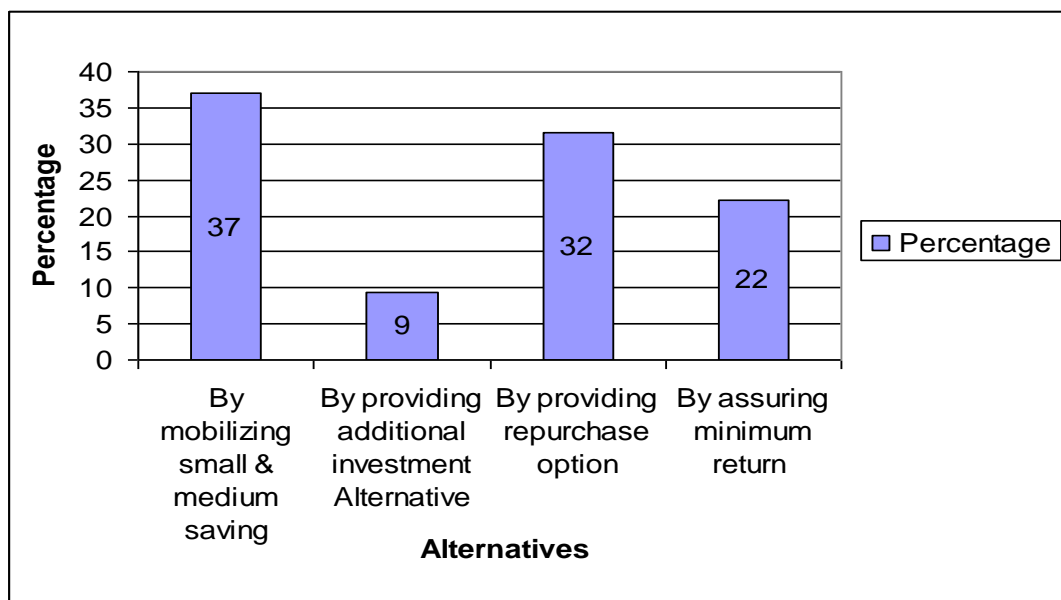
management of mutual fund. Remaining 9% respectively of respondents were in favor of low cost and other reasons such as liquidity, transparency, lifecycle planning, flexibility etc. Hence, advantage of diversification of mutual fund is the main ornament of mutual fund.

Question 5. Analysis of Contribution of Mutual Fund

Mutual Fund is the key to contributor to capital market. It collects and mobilizes small and medium saving. It provides alternative for investment to the investors who want to invest in capital market assuring minimum return with repurchase option. This question find out the importance and necessity of mutual fund for the development of Nepalese capital market. Respondents are asked how mutual fund can contribute the capital market. The following responses were obtained.

Figure 4.5

Contribution of Mutual Fund



(Source: Appendix-7)

From the above figure, it is seen that 37% of respondents were infavor of mobilization of small and medium saving. This means mutual fund is important to mobilize the saving to the capital market. Similarly 32% of respondents

opined that mutual fund is important due to providing repurchase option which makes liquidity in trading floor. Likewise, 22% of respondents expressed that. Mutual fund provide minimum fix return and 9% of respondents were in favour of additional investment alternative option.

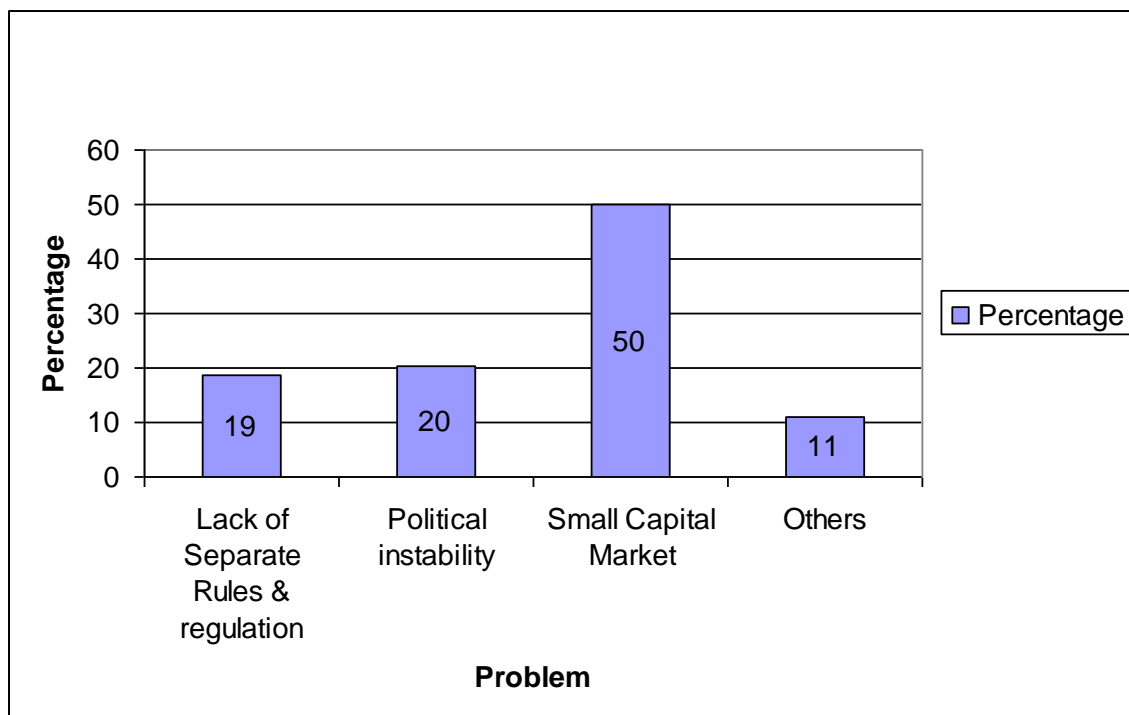
By analyzing response of respondents, mutual fund is much important in Nepalese capital market. It mobilizes the saving into productive sector of the capital market, so the necessity of mutual fund is growing up day by day.

Question 6. Analysis of Problem face by Mutual Fund Companies

Problem is the difficulties include in operation of the activities. There is always a reason for problem. Problem would be related to act, behavioral, economical or manual. Identification of proper problem is the key of success. Mutual fund companies that face the different problem from operating environment of surrounding atmosphere, plays crucial role. In this context, respondents have given questionnaires regarding the problem face by the mutual fund companies.

Figure 4.6

Problem Faced by the Mutual Fund Companies



(Source: Appendix-7)

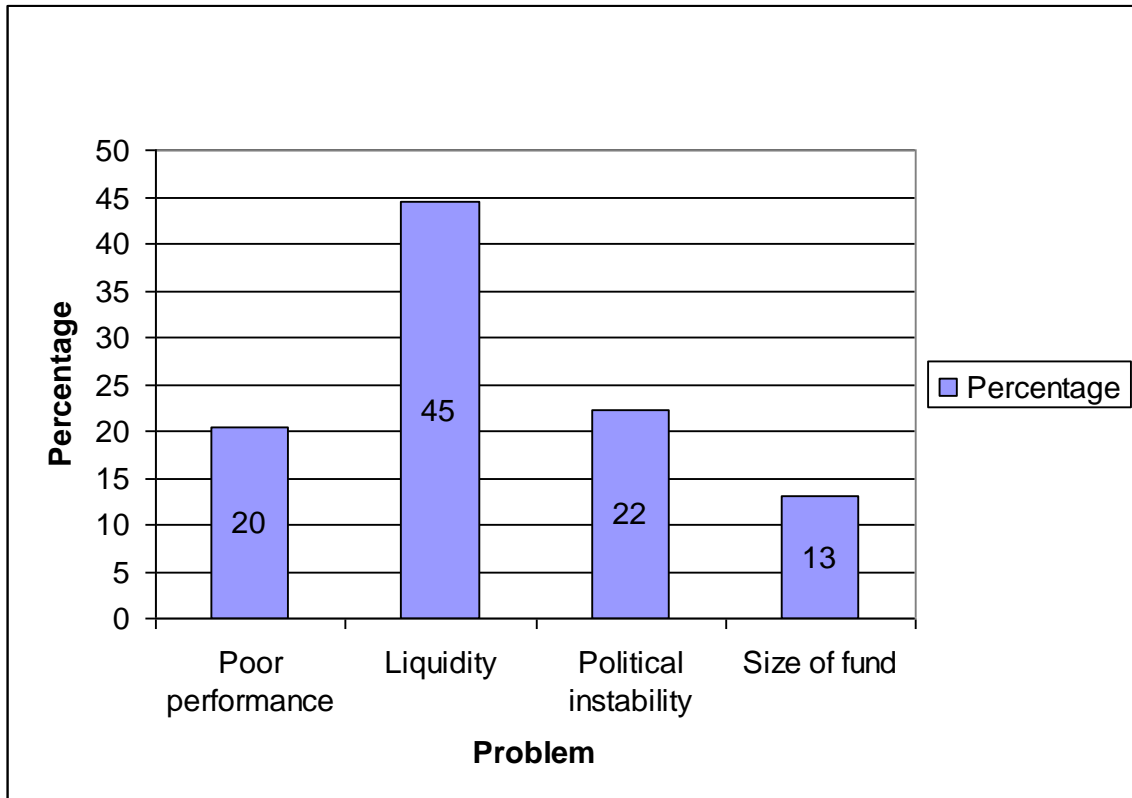
According to above figure, majority of respondents were in favor of of the problem due to small capital market which is 50% of respondents. It clears that mutual fund companies are facing the problem of small capital market. Similarly 20% of respondents pointed out political instability are the problem. 19% of respondents expressed no separate rules and regulation regarding mutual fund, as a problem. Remaining 11% of respondents were in favor of other problem.

Question 7. Analysis of Problem Faced by Investors

Investors are the indicator of the capital market that drives the capital market in any direction. This question is related to different problem which is faced by the investors of mutual fund. Each categories of respondent are asked about the problem faced by the investors to invest in mutual fund, the result were as follows.

Figure 4.7

Problem Faced by the Investors



(Source: Appendix-7)

From the figure, it is seen that 45% of respondents pointed out liquidity as a major problem to the investors. 22% of respondents pointed out political instability is the problem. Similarly, 20% of respondent thought poor performance of mutual fund is another problem and 13% of the respondents opine that size of fund is the reason.

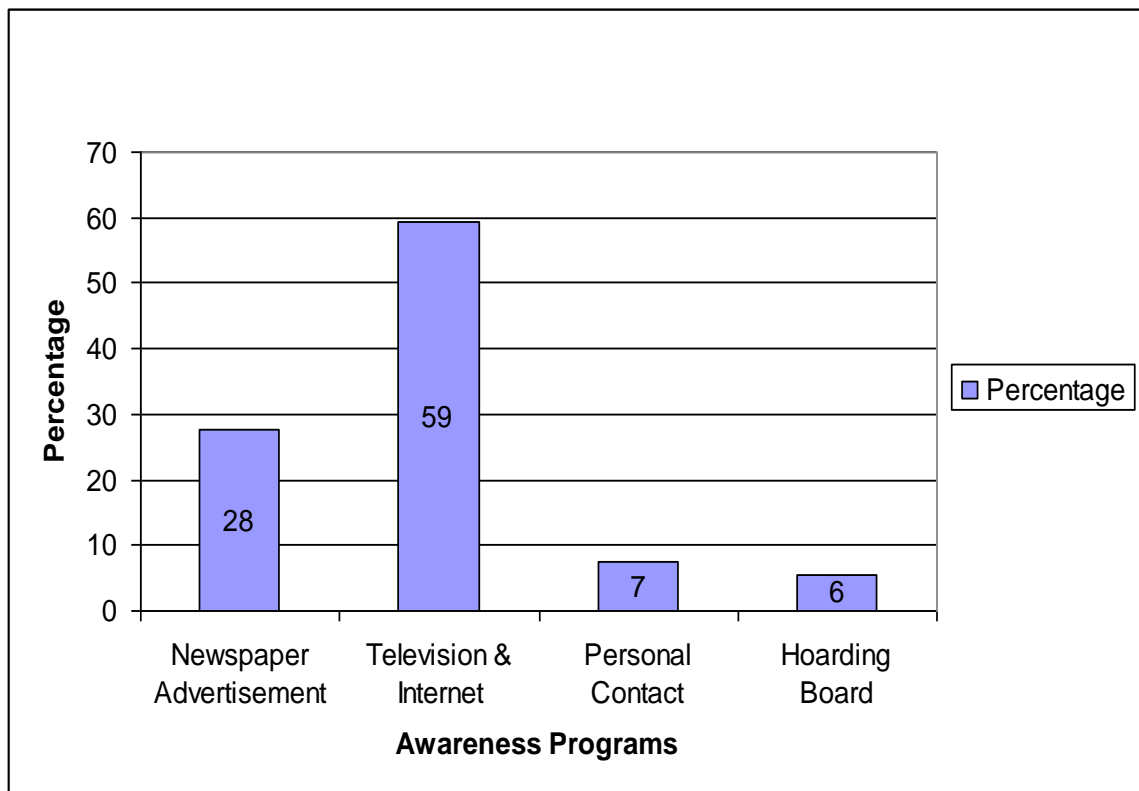
Question 8. Analysis of Awareness to the People

Most of the people do not have adequate knowledge of mutual fund. For the development of mutual fund, people should have proper knowledge. So this question tries to find out the better way to create awareness to the people about mutual fund. Questionnaires were given to the respondents asking them

what will be the most effective way of awareness to the people about mutual fund. Their response was shown in the following graph.

Figure 4.8

Awareness about Mutual Fund



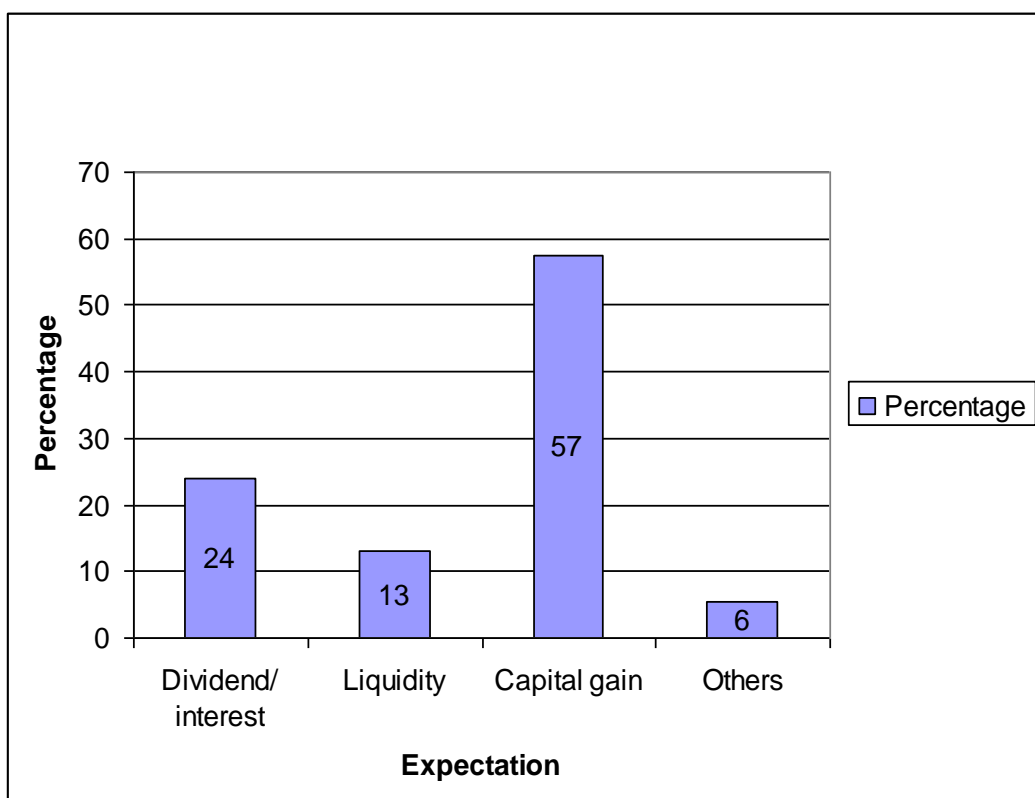
(Source: Appendix-7)

From the above figure, it is found that 59% of respondents were in favor of advertisement through television and internet. 28% of respondents were in favor of advertisement in newspaper. Rest 7% and 6% of respondents respectively were in favor of personal contact and hoarding board. Hence, advertisement through television and internet are more effective for the awareness to the people.

Question 9. Analysis of Expectation from Investment

Everything in the world goes by assumptions. Hence the respondents were asked what they have assumed or expected from their investment. There is always certain expectation through investment and expectation may be in terms of dividend, interest, capital gain, liquidity, right to control, goodwill of company and so on. The responses were as follows.

Figure 4.9
Expectation of Investors



(Source: Appendix-7)

Above figure shows that majority of respondents i.e. 57% selected the option of capital gain. Capital gain motivates them to invest because the price of the security may go up. 24% of them votes to the dividend and interest income which drives them to invest. Similarly, 13% of them opined that their expectation of investment is liquidity. This means that they want to buy and sell

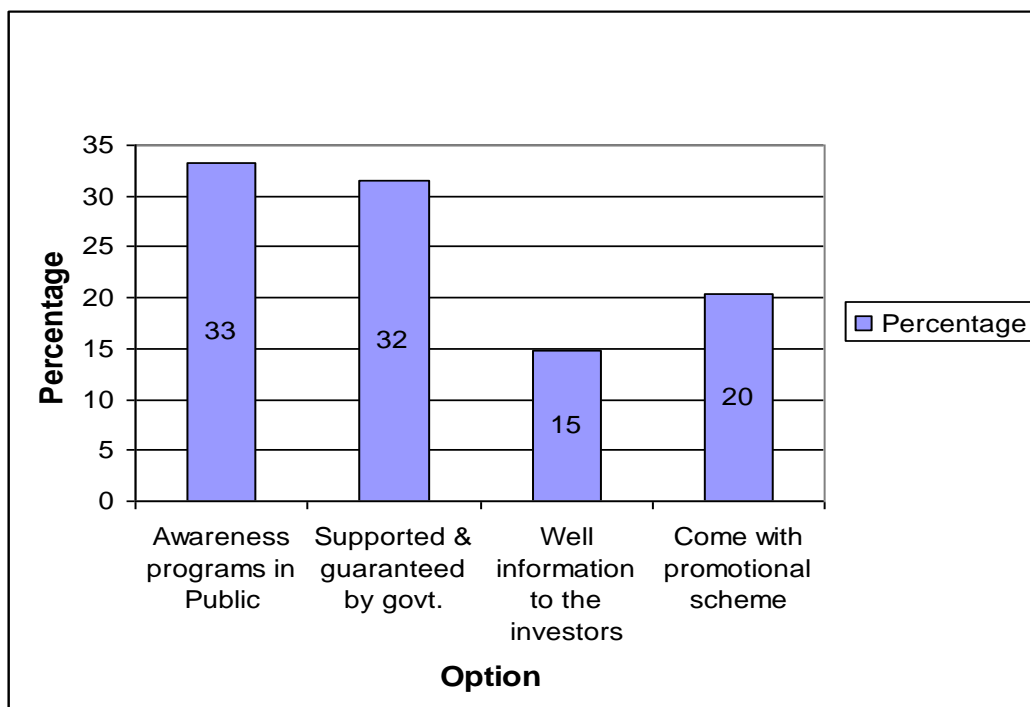
whenever they want. Remaining a few respondents i.e. 6% had expected others such as voting rights, elected as a board member of company.

Question 10. Analysis of View for the Development of Mutual Fund

Development is the adaptation of change and opportunity. The programs should be dynamic. No single policy may be useful and suitable forever. Hence, the major question for the study is to find out the activities which support and helps for the development of mutual fund. Regarding this, respondents were asked what steps should be taken for the development of mutual fund. The view points of the respondents are shown in the following graph.

Figure 4.10

Opinion for the Development



(Source: Appendix-7)

From the above figure, we can conclude that majority of respondents support the awareness programs in public which is more effective steps to be taken for the development of mutual fund in Nepal because 33% of respondents support it. Similarly, the great support of respondents was given to the option of supported and guaranteed by the government, which is 32% of respondents. 20% of respondents were in favor of promotional scheme and remaining 15% respondents agreed with well information to the investors.

4.3 Major Finding

On the basis of presentation and analysis of both primary and secondary data, using different useful financial and statistical tools, the finding have been presented as follows:

4.3.1 Major Findings of Secondary data.

4.3.2 Major Findings of primary data.

4.3.1 Major Findings of Secondary Data

Analyzing the eleven years data of NCM mutual fund, Citizen Unit Scheme and NEPSE following major findings has been obtained.

- In case of yearly return, the fluctuation range of yearly return of NEPSE is -34.70 to 110.69, NCM mutual fund is -43.96 to 68.69 and Citizen Unit Scheme is -19.30 to 30.69. The fluctuation of yearly return of both mutual funds seems to be less than market yearly return. However, fluctuation of NCM mutual fund is more than the Citizen Unit Scheme.
- NCM is offering 15% dividend in the fiscal year 2065/66. So far as the CUS case is concerned, it was providing only 6.25% dividend.

- Considering Average yield $[E(R_j)]$, portfolio yield of NCM mutual fund (21.31) is more than market portfolio (19.80) and CUS (10.28). Hence, NCM performance seems to be better than others.
- In case of investment portfolio of NCM mutual fund, total investment seems to be in decreasing trend and the portfolio consists of share & debenture, government bond and bank deposit and give priority on share & debenture i.e. 71.15% in an average of its total investment.
- So far as the Citizen Unit Scheme case, total investment increased every year except fiscal year 2065/66. Citizen Unit Scheme adds one more category of portfolio i.e. loan & advance than NCM mutual fund and it focus on bank deposit.
- As for as the analysis of Sharpe's index, NCM mutual fund and Citizen Unit Scheme both have positive index. However, NCM index is higher than CUS i.e. $46.88 > 33.33$. NCM mutual fund found as the better performer in terms of Sharpe's index with higher reward to variability trade off.
- Considering Treynor's index, NCM mutual fund has positive index but Citizen Unit Scheme has negative index. Due to negative index, Citizen Unit Scheme seems as negative performer and hence NCM seems to be better performer.
- By the analysis of Jensen's index, Risk adjusted alpha of NCM is greater than CUS. Hence NCM seems to be better performer than CUS.
- So far as the risk analysis, NCM seems to be more riskier portfolio than CUS due to greater variance i.e. $1066.84 > 164.91$
- With reference to standard deviation CUS is favorable than NCM due to its lower standard deviation i.e. $12.84 < 32.66$.
- So far as Beta Coefficient, NCM seems to be aggressive portfolio than CUS.

- In terms of risk minimization, CUS has higher degree of Unsystematic risk but NCM has lower degree of unsystematic risk. Hence CUS can minimize its risk by efficient management.
- With reference to Co-efficient of determination, NCM can diversify only 0.23 portion of risk. However CUS can diversify 0.85 portion of risk.
- In terms of Co-efficient of variation, both funds have less C.V. than market. However C.V of CUS (i.e. 1.25) is less than NCM (i.e. 1.53). Due to the less C.V., CUS is more consistency in the yearly return than NCM.
- Considering Correlation Coefficient NCM seems to be highly positively correlated with market. The level of impact to NCM would be higher than that of CUS due to any changes in market.
- As per trend analysis of CUS, the growth rate of outstanding units (160.85 lakh units) is higher than repurchase units (18.64 lakh units). Hence liquidity position is satisfactory and popularity is going up with its increasing trend.

4.3.2 Major Findings of Primary Data

For the study relating to performance and problem of mutual fund in Nepal, the data were collected through questionnaire to different respondents and response collected from them were processed, analyzed and interpreted. The analysis of primary data has been resulted in the following major findings.

- Different respondents expressed their different views regarding the familiarities or knowledge about mutual fund in Nepalese capital market. Majority of respondents agree with the fact that they were familiar with mutual fund. However, few respondents were even not heard about mutual fund.
- Majority of respondents favored that return is the factor on which their decision is based. Some of the respondent's decision was based on the risk associated with securities or portfolio. The analysis concluded that

mutual fund is less risky in terms of risk and provides minimum stable return to investors and those who doesn't want to lose their money by investing risky alternative. It is the best alternative in terms of both return and risk.

- 56% of respondents preferred common stock as the investment alternative and only 17% of respondents were preferring mutual fund. The analysis revealed the fact that majority of capital market practitioners are not in favor of mutual fund despite its numerous benefits and this is basically due to lack of proper information to the investors and other stake holders.
- Most of the respondents favored that diversification is the major benefit of mutual fund. 45% of respondents select the mutual fund for diversification 37% of respondent support the professional management of mutual fund for the benefited investment. Hence, mutual fund is the most benefited portfolio to medium and small savers.
- Main contribution of mutual fund is found that it mobilize small and medium saving to the capital market.
- On the basis of response collected, it is seen that small capital market is the major problem faced by the investment companies which is supported by 50% of respondents.
- Majority of respondents i.e. 45% indicate that liquidity is the major problem faced by the investor. They opined that there is no good market where there are enough buyer and seller at trading floor. 22% of respondents indicate the political instability in the country becoming problem the investors.
- Based on the option of respondents, 59% expressed advertisement through television & internet as the most effective to ware the people.
- Based on the option of respondents most i.e. 57% motivated by capital gain. Rest of the respondents opined that dividend/interest or liquidity

motivates to choose the fund. The analysis concluded that mutual fund does not belong to high capital gain high return for the investors.

- Majority of respondents i.e. 33% expressed that in developing countries like Nepal, awareness programs in public is essential to cover middle class people so as to mobilize their small scale saving to capital market. 32% respondent opines that government support and guarantee helps for the development of mutual fund.

The above findings have shown that the main reason of poor performance of mutual fund is lack of proper information and promotion. There are a number of difficulties for the growth of mutual fund in Nepal. Slow growth rate of capital market, lack of institutional investors, market imperfection and lack of marketability low level of return, lack of varieties scheme, lack of tax incentives and low level of public saving or per capita income are found to be the major problem for the growth of mutual fund in Nepal. Likewise, the Nepalese capital market is highly suffering due to the transition phase. Needless to state, political instability are also affecting crucially for its development. Whenever, there will be peace in nation leaving the political war of the political party to make good constitution for the people and nation, and then Nepalese capital market will be grown in full potential.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Mutual fund is a corporation having objective to pool large sums of money from small investors to make portfolio investment in a professional and efficient way to maximize the return & minimize the overall risk through diversification. The professional fund manager of mutual fund will be responsible for investing the pooled money. The pooled money from the small and medium savers mobilize in the capital market investing in shares, bond, debenture, government securities etc. by the portfolio manager of mutual fund constructing a good portfolio. Thus, mutual funds help small and medium level of Investors providing opportunities to them with the benefit of capital market by mobilizing of their saving towards capital market. In other hand mutual fund develop a base for institutional investors in the securities market by ensuring long-term investable funds in the form of mutual fund.

The idea of pooling money together for investing purpose started in Europe in the mid – 1800s. In Nepal, the concept of mutual fund has been introduced from last decade. NIDC Capital markets Ltd. and Citizen Investment Trust were established with the collective investment Scheme in the corporate sector. NIDC Capital markets Ltd. launched NCM mutual fund-2050, an open ended fund with a par value of Rs10 in multiple of 100 as a first mutual fund in Nepal in 1993/94. Later on, it was transferred to NCM mutual fund-2059 and turned into closed ended fund. Likewise, Citizen Investment Trust was established in order to expand investment opportunities by encouraging general public. It was functioning on the basis of the Citizen Investment trust management By-laws 1991 and launched an open ended fund with par value of Rs.100 in 1995.

Looking the operation of mutual funds in developed country it is one of the fastest growing financial instruments. Even in India mutual fund companies have been operating very well. However in Nepalese contest, even the term 'mutual fund' is new and operating the scheme with low performance. Various obstacle and problem are facing by mutual funds companies. In this contrast situation, this research study the performance and problem of mutual fund in Nepal with reference to NIDC Capital markets Ltd. and Citizen Investment Trust to obtained the specific objective of the research and its need and significance for the development of capital market.

During the study period various literature concerned with the topic have been reviewed for the inception of concept of mutual funds history, advantage & disadvantage, types, legislation and its scenario in Nepal taking the 11 years secondary data, the study examined and analyze the performance & problem, need & significance and prospects relating to the concerned topic. A descriptive and analytical research design was used.

The Study based on primary data seeks to assess the opinion, behaviors of the given population i.e. NCM mutual fund and Citizen Unit scheme. A scheduled and open-end questionnaire was distributed to possible respondents belonging to regulating bodies, stock brokers, issue managers and investors to collect primary data. The data obtained from primary sources were analyzed using bar graph after tabulating the data. Secondary data were analyzed using various statistical tools and financial tools such as average, variance, coefficient of variation, standard deviation, beta coefficient, correlation, covariance and coefficient of determination. Sharpe's index, Treynor's index, Jensen's Alpha was used as financial tools to measure performance of portfolio. Trend analysis was used to obtain the growth rate of repurchase units and outstanding units of open-ended fund i.e. Citizen Unit Scheme.

5.2 Conclusion

On the basis of finding of the study, the conclusion can be drawn that investment portfolio of both the mutual funds have not been better portfolio. NCM mutual fund has focused its investment in share while Citizen Unit Scheme focused in government securities. The overall finding in term of average yield, NCM mutual fund is better than Citizen Unit Scheme due to more average return. However, yearly return of NCM mutual fund is inconsistent in comparison to Citizen Unit Scheme. In terms of performance model, NCM is better performance than CUS but risk and correlation supported CUS than NCM. By using the trend analysis of CUS, it is appropriate condition due to higher growth rate of outstanding units than repurchase units.

The analysis of primary data showed that the mutual fund is new concept and introductory phase till this date in Nepal. Mutual fund seems to be attractive due to providing higher return than bank deposit and less risky than other investment alternatives such as common stock, preferred stock, bond etc. However investors are in favor of common stock because of the lack of proper information about mutual fund. To make the fund more popular, promotion scheme and government support by way of tax incentive of its earning is necessary. The mutual fund is facing the problem of liquidity at trading floor and proper regulation. Mutual fund was allowed to begin operation on a contractual basis with out any specific regulation. On these days, the SEBON has been working to create the mutual fund regulation but the regulation is not enough for the improvement its performance & increases its popularity. Certain norms & guidelines are needed for the proper regulation

Due to the centralize base of collecting money by the companies, small investors through different part of the country have been missing the good

investment opportunity. Small and medium savers will be canalized and mobilized for the development of capital market because mutual fund is the main contributor for the development mobilizing the fund in productive sectors. In Nepal there are only two mutual funds operators institution, which are not sufficient to the investors for the choice of mutual fund so, additional operators with new scheme of mutual fund is needed. In present, Due to the absence of law, mutual fund is facing different obstacle. However the prospects of mutual fund will be good in future because the Ministry of Finance has been able to bring out the regulation which is in the process of approval in the Nepal Rastra Bank. Similarly, Nepalese mutual funds are also facing struggle because of various challenges of external and internal factors but the problems and challenges of mutual fund can be managed through properly regulation. Incomplete of the peace process is becoming a problem to the improvement of performance so, after managing and overcoming from the above stated problems and challenges, it has obtained ways to expand & improvement of the fund.

Finally, from the overall analysis, the performance of mutual fund in Nepal is not satisfactory. People rarely understood it. Even though mutual funds are becoming one of the most popular investment avenues for small and risk – shy investors globally, their presence is negligible in the Nepali market.

5.3 Recommendations

Overall development of nation depends on the economic growth of nation. Economic growth depends on the development of capital market. Being a important part of capital market, mutual fund development is the must. On the basis of the study following recommendations have been conducted for the improvement and development of the mutual fund.

- Well inform to the prospective investors is the essential for the improvement of mutual fund. In order to provide proper information to the prospective investors the fund management company needs to maintain separate department for counseling and information so that their performance will go up.
- Mutual fund companies should collect a large sum of money of small savers through nation to mobilize in the productive sector therefore mutual fund operators should established the branches in the major city of Nepal with the trained and efficient manpower.
- Many companies are interested in operating mutual fund but they can not go into business because of the absence of relevant regulations. However, the regulation is in process of approval in Nepal Rastra Bank. The act should cover it and the government should permit to the interested companies in order to promote mutual fund scheme.
- Mutual fund is not properly regulated by the SEBON. Therefore, DEBON should set certain norms and guidelines to regulate properly.
- The capital gain tax on individual and institutional is 10 and 26 percent respectively at the moment. The government should be improved the tax laws. The capital gain tax on individual and institutional investments should be the same.
- The NIDC and CIT should offer the promotional scheme by analyzing and conducting research of the market. Proactive action need to be taken in order to survive in the long run.
- Mutual funds reduce risk by diversification and ensure return with the professional management. So it is safe investment than other investment alternatives therefore investors should invest in mutual fund to get the benefit of professional management.
- Both the Mutual funds companies investment is mainly focused on share & debenture and government securities that have not been

producing maximum return minimizing risk. Therefore, it is recommended that they should construct better portfolio so that they can produce maximum return with the same level of risk.

- It is estimated that mutual funds have a potential market worth Rs. 5 to 10 billion in Nepal. However, it had unable to expand because the government had not come out with investment friendly law. Therefore it is recommended that government should come with the necessary law.
- The government had announced in the budget proposal a string of plans including establishment of a regulatory and supervisory body in order to encourage mutual funds but this has been limited to paper only. Therefore the government should implement the announcement.
- Mutual fund companies should invest in the international market to seek better returns so the government should allow mutual funds to invest some of their collection money in the global financial market in order to encourage them.

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APPENDICES

Dear Sir/Madam

Under a partial fulfillment of the requirement of the degree of Master of Business Studies, I am carrying out research and data collection regarding the PERFORMANCE & PROBLEM OF MUTUAL FUND in Nepal with reference to NIDC & CIT. Therefore I hope that you will be able to help me in this research effort by completing this form.

Thank you for your co-operation with this research.

Mr. Yam Karna Basnet

Researcher

Shanker Dev Campus

Putalisadak, Kathmandu

QUESTIONNAIRE

Name (Optional):

Designation:

Organization/Occupation:

Address:

1. Are you Familiar with mutual fund?

- a. Yes, a lot b. Sometimes c. Not at all

2. What are the Factors that affect investment decision?

- a. Return b. Risk c. Liquidity d. Others

If others specify them

- i. Fees, service charges and taxes ii. Company's goodwill

iii.

3. Which alternative of investment do you like the most?

- a. Common/Preferred stock b. Bond/Debenture
c. Mutual fund d. Others

If others specify them

- i. Short term securities ii. Real assets

iii.

4. Why mutual fund is selected by the investors for the investment?

- a. professional management b. Diversification
c. Low costs d. Others

If others specify them

- i. Ease of investing ii. Market cycle planning

iii.

5. How mutual fund can contribute for the development of capital market in Nepal?

a. By mobilizing small & medium saving

b. By providing additional investment alternative

c. By providing repurchase option

d. By assuring minimum return

6. What problems are faced by the mutual fund companies in Nepal?

a. Lack of Separate Rules & regulation b. Political Instability

c. Small Capital Market d. Others

If others specify them

i)

ii)

7. What problems are faced by the investor to invest in mutual fund?

a. Poor Performance b. Liquidity

c. Political instability d. Size of fund

8. What will be the most effective way of awareness to the people about mutual fund?

a. Newspaper Advertisement b. Television & Internet

c. Personal Contact d. Hoarding Board

9. What do the investors expect from their investment?

a. Dividend/Interest

b. Liquidity

c. Capital gain

d. Others

If others specify them

i. Right to control

ii. Company's goodwill

iii.

10. What steps should be taken for the development of mutual fund in Nepal?

a. Awareness programs in public

b. Supported & guaranteed by govt.

c. Well information to the investors

d. Come with promotional scheme

Appendix -2

Calculation of Portfolio Yield of Market

Fiscal year	Market's Yield	
	Index	Yield $\frac{NEPSE_{t+1} - NEPSE_t}{NEPSE_t}$
2055/56	216.92	
2056/57	360.70	66.28
2057/58	348.43	-3.40
2058/59	227.54	-34.70
2059/60	204.86	-9.97
2060/61	222.04	8.39
2061/62	255.53	15.08
2062/63	324.69	27.07

2063/64	683.95	110.65
2064/65	963.36	40.85
2065/66	749.10	-22.24
		198.01

Source: NEPSE

$$E(R_M) = \frac{198.01}{10} = 19.80$$

Calculation of Portfolio Yield of NCM Mutual Fund

Fiscal year	NCM Mutual fund's yield		
	NAV	Dividend	Yield = $\frac{NAV_{t+1} - D_{t+1} - 1}{NAV_t}$
2055/56	15.07		
2056/57	22.11		46.72
2057/58	24.07		8.86
2058/59	13.49		-43.96
2059/60	10.57	0.5	-17.94
2060/61	11.8	0.5	16.37
2061/62	14.49	0.5	27.03
2062/63	18.91	0.5	33.95
2063/64	31.40	0.5	68.69
2064/65	48.89	1.5	60.48
2065/66	53.69	1.5	12.89
			213.09

Sources: NCML

$$E(R_{\text{NCM}}) = \frac{213.09}{10} = 21.31$$

Calculation of Portfolio Yield of CUS

Fiscal year	Citizen Unit Scheme's return		
	NAV	Dividend	Yield = $\frac{\text{NAV}_{t+1} + D_{t+1} - 1}{\text{NAV}_t}$
2055/56	85.27	11.00	
2056/57	100.44	11.00	30.69
2057/58	101.88	9.00	10.39
2058/59	101.88	8.50	8.34
2059/60	102.40	8.00	8.36
2060/61	95.71	7.00	0.30
2061/62	106.44	7.00	18.52
2062/63	117.29	7.00	16.77
2063/64	88.40	6.25	-19.30
2064/65	88.40	6.25	7.07
2065/66	101.32	6.25	21.69
			102.83

Sources: CIT

$$E(R_{\text{CIT}}) = \frac{102.83}{10} = 10.28$$

Appendix-3

Performance of NCM Mutual Fund

Rs. in million

S.N.	Particulars	Fiscal year					
		2060/61	2061/62	2062/63	2063/64	2064/65	2065/66
1	Investment	114.71	152.75	207.21	189.3	180.88	117.14
	a) Share/debenture	95.88	126.21	183.53	86	88.95	90.8
	b) Government bond	10	10	10	10	10	10
	c) Bank deposit	8.83	16.54	13.68	93.3	81.93	16.34
2	Net income	9.5	11.47	13.89	23.1	47.68	34.25
	a) Dividend in share	2.16	1.9	2.82	3.4	3.3	3.85
	b) Interest on govt. bond/debenture	0.77	0.81	0.81	0.8	0.8	3.49
	c) Bank interest	0.61	0.35	0.54	3.9	10.67	0.72
	d) Income from sale of shares	5.96	8.42	9.71	15	32.69	26.17
3	Net asset value	118.02	14493	189.14	314	488.88	536.85
4	Outstanding unit (in thousand)	10,000	10,000	10,000	10,000	10,000	10,000
5	Net asset value per price (Rs.)	11.8	14.49	18.91	31.4	48.89	53.69
6	Per unit market price (Rs.)	-	10	11	-	-	-
7	Number of unit holder	2882	2559	2481	2417	2950	29.51
	a) Institutional	19	20	20	20	20	20

	b) Individual	2,863	2,539	2,461	2,461	2,930	2,931
8	Dividend (%)	5	5	5	5	15	15

Appendix-4

Performance of Citizen Unit Scheme

(Rs. in million)

S.N.	Particulars	Fiscal year					
		2060/61	2061/62	2062/63	2063/64	2064/65	2065/66
1	Total amount of unit sold	100.39	121.56	148.63	170.23	1980	2262
2	Total amount of units repurchased	53.63	70.25	82.9	100.41	200.22	173.6
3	Investment	417	567.6	657.5	752.2	804.85	670
	a) Government bond	182	184.6	173.9	93.2	93.2	70
	b) Bank deposit (fixed)	92	100	317.5	490.6	529.5	392.84
	c) Share/debenture	26.54	22.8	26.5	28.9	42.59	67.6
	d) loan & advances	116.5	260.2	139.6	139.5	139.56	139.56
4	Net income	36.26	41.9	50.31	49	65	42.7
5	Dividends (%)	7	7	7	6.25	6.25	6.25
6	Number of unit holders	9871	2651	2840	2840	2426	2050
	a) individual		2579	2747	2747	2323	1947
	b) Institutional		72	93	93	103	103

Appendix 5

Calculation of Variance, Standard Deviation, Covariance,

Beta Co-efficient & Correlation

For NCM Mutual fund

Fiscal year	R_M	R_{NCM}	$[R_M - E(R_M)]^2$	$[R_{NCM} - E(R_{NCM})]^2$	$[R_{NCM} - E(R_{NCM})][R_M - E(R_M)]$
2056/57	66.28	46.72	2160.39	645.67	1181.06
2057/58	-3.4	8.86	538.24	155	288.84
2058/59	-34.7	-43.96	2970.25	4260.17	3557.22
2059/60	-9.97	-17.94	886.25	1540.56	1168.47
2060/61	8.39	16.37	130.19	24.4	56.37
2061/62	15.08	27.03	22.28	32.72	-27
2062/63	27.07	33.95	52.85	159.77	91.89
2063/64	110.65	68.69	8253.72	2244.86	4304.47
2064/65	40.85	60.48	443.1	1534.29	824.53
2065/66	-22.24	12.89	1767.36	70.9	353.98
Total			17224.64	10668.35	11799.82

For Citizen Unit Scheme

Fiscal year	R_M	R_{CUS}	$[R_M - E(R_M)]^2$	$[R_{CUS} - E(R_{CUS})]^2$	$[R_{CUS} - E(R_{CUS})][R_M - E(R_M)]$
2056/57	66.28	30.69	2160.39	416.57	948.66

2057/5 8	-3.4	10.39	538.24	0.01	-2.55
2058/5 9	-34.7	8.34	2970.25	3.76	105.73
2059/6 0	-9.97	8.36	886.25	3.69	57.16
2060/6 1	8.39	0.3	130.19	99.6	113.87
2061/6 2	15.08	18.52	22.28	67.9	-38.89
2062/6 3	27.07	16.77	52.85	42.12	47.18
2063/6 4	110.65	-19.3	8253.72	874.98	-2687.34
2064/6 5	40.85	7.07	443.1	10.3	-67.57
2065/6 6	-22.24	21.69	1767.36	130.19	-479.68
Total			17224.64	1649.12	-2003.44

$$\sigma^2_M = \frac{\sum [R_M - E(R_M)]^2}{n} = \frac{17224.64}{10} = 1722.46$$

$$\sigma_M = \sqrt{1722.46} = 41.50$$

$$\sigma^2_{NCM} = \frac{\sum [R_{NCM} - E(R_{NCM})]^2}{n} = \frac{10668.35}{10} = 1066.84$$

$$\sigma_{NCM} = \sqrt{1066.84} = 32.66$$

$$\sigma^2_{CUS} = \frac{\sum [R_{CUS} - E(R_{CUS})]^2}{n} = \frac{1649.12}{10} = 164.91$$

$$\sigma_{CUS} = \sqrt{164.91} = 12.84$$

$$\text{COV}(R_{\text{NCM}}, R_M) = \frac{\sum [R_{\text{NCM}} - E(R_{\text{NCM}})][R_M - E(R_M)]}{n} = \frac{11799.82}{10} = 1179.98$$

$$\text{COV}(R_{\text{CUS}}, R_M) = \frac{\sum [R_{\text{CUS}} - E(R_{\text{CUS}})][R_M - E(R_M)]}{n} = \frac{-2003.44}{10} = -200.34$$

$$\rho_{(\text{NCM}, M)} = \frac{\text{COV}(R_{\text{NCM}}, R_M)}{\sigma_{\text{NCM}} \times \sigma_M} = \frac{1179.98}{32.66 \times 41.50} = 0.87$$

$$\rho_{(\text{CUS}, M)} = \frac{\text{COV}(R_{\text{CUS}}, R_M)}{\sigma_{\text{CUS}} \times \sigma_M} = \frac{-200.34}{12.48 \times 41.50} = 0.39$$

$$\beta_{\text{NCM}} = \frac{\text{COV}(R_{\text{NCM}}, R_M)}{\sigma^2_M} = \frac{1179.98}{1722.46} = 0.69$$

$$\beta_{\text{CUS}} = \frac{\text{COV}(R_{\text{CUS}}, R_M)}{\sigma^2_M} = \frac{-200.34}{1722.46} = -0.12$$

Calculation of Systematic Risk

For NCM = $\beta_{\text{NCM}}^2 \cdot \sigma_M^2$ = $(0.69)^2 \times 1722.46$ = 820.06	For CUS = $\beta_{\text{CUS}}^2 \cdot \sigma_M^2$ = $(-0.12)^2 \times 1722.46$ = 24.80
--	--

Calculation of unsystematic risk (σ_e^2)

NCM Mutual Fund	Citizen Unit Scheme
Total Risk (σ_{NCM}^2) = 1066.84	Total Risk (σ_{CUS}^2) = 164.91
Systematic Risk = 820.06	Systematic Risk = 24.80
Unsystematic Risk = 246.78	Unsystematic Risk = 140.11

Calculation of co-efficient of determination

Particulars	NCM Mutual Fund	Citizen Unit Scheme
Beta co-efficient (β_i)	0.69	-0.12
Portfolio variance(σ^2_i)	1066.84	164.91
Market variance(σ^2_m)	1722.46	1722.46
Coefficient of determination $\left(\frac{\beta_i^2 \times \sigma_M^2}{\sigma_i^2} \right)$	0.77	0.15

Appendix-6

Trend Analysis of CIT's CUS

For Repurchase Unit

Year	$x = x - \bar{x}$	x^2	Repurchase Units (in Ten Thousand) (y)	xy
2055/5 6	-5	25	1.20	-6.00
2056/5 7	-4	16	4.41	-17.64
2057/5 8	-3	9	11.06	-33.18
2058/5 9	-2	4	28.06	-56.12
2059/6 0	-1	1	43.27	-43.27

2060/6 1	0	0	53.63	0.00
2061/6 2	1	1	70.25	70.25
2062/6 3	2	4	82.90	165.80
2063/6 4	3	9	100.41	301.23
2064/6 5	4	16	200.22	800.88
2065/6 6	5	25	173.60	868.00
Total	$\sum x = 0$	$\sum x^2 = 110$	$\sum y = 769.01$	$\sum xy = 2049.95$
<p>Growth rate (b) = $\frac{\sum xy}{\sum x^2}$</p> <p style="text-align: center;">$= \frac{2049.95}{110}$</p> <p style="text-align: center;">= 18.64 Lakh repurchase units per year</p>				

Trend Analysis of CIT's CUS

For Outstanding Unit

Year	$x = x - \bar{x}$	x^2	Outstanding units (in Ten Thousand) (y)	xy
2055/5 6	-5	25	4.25	-21.25
2056/5 7	-4	16	14.33	-57.32
2057/5 8	-3	9	22.62	-67.86
2058/5 9	-2	4	36.46	-72.92
2059/6 0	-1	1	40.47	-40.47
2060/6 1	0	0	46.76	0.00
2061/6 2	1	1	51.31	51.31

2062/6 3	2	4	65.73	131.46
2063/6 4	3	9	69.82	209.46
2064/6 5	4	16	1779.81	7119.24
2065/6 6	5	25	2088.40	10442.00
Total	$\sum x = 0$	$\sum x^2 = 110$	$\sum y = 4219.96$	$\sum xy = 17693.65$

$$\text{Growth rate (b)} = \frac{\sum xy}{\sum x^2}$$

$$= \frac{17693.65}{110}$$

$$= 160.85 \text{ Lakh Outstanding units per year}$$

Appendix-7

1. Are you familiar with the mutual fund?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Yes, a lot	18	10	9	1	38	70
Sometimes	3	1	3	2	9	17
No, at all	0	0	1	6	7	13
Total					54	100

2. What are the Factors that affect investment decision?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Return	7	7	2	5	21	39
Risk	9	2	7	2	20	37
Liquidity	3	2	3	1	9	17
Others	2	0	1	1	4	7
Total					54	100

3. Which alternative of investment do you like the most?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Common/Pref. stock	12	10	3	5	30	56
Bond/Debenture	4	0	4	2	10	18
Mutual fund	2	0	6	1	9	17
Others	3	1	0	1	5	9
Total					54	100

4. Why mutual fund is selected by the investors for the investment?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Professional management	7	3	6	4	20	37
Diversification	9	6	4	5	24	45
Low costs	3	1	1	0	5	9
others	2	1	2	0	5	9
Total					54	100

5. How mutual fund can contribute for the development of capital market in Nepal?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
By mobilizing small & medium saving	10	2	5	3	20	37
By providing additional inv. Alternative	4	1	0	0	5	9
By providing repurchase option	2	5	6	4	17	32
By assuring minimum return	5	3	2	2	12	22
Total					54	100

6. What problems are faced by the mutual fund companies in Nepal?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Lack of Separate Rules & regulation	5	2	2	1	10	19
Political instability	4	2	3	2	11	20
Small Capital Market	10	6	7	4	27	50
Others	2	1	1	2	6	11
Total					54	100

7. What problems are faced by the investor to invest in mutual fund?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Poor performance	4	6	0	1	11	20
Liquidity	9	4	6	5	24	45
Political instability	5	1	4	2	12	22
Size of fund	3	0	3	1	7	13
Total					54	100

8. What will be the most effective way of awareness to the people about mutual fund?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Newspaper Advertisement	5	4	4	2	15	28
Television & Internet	13	6	8	5	32	59
Personal Contact	1	0	1	2	4	7
Hoarding Board	2	1	0	0	3	6
Total					54	100

9. What do the investors expect from their investment?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Dividend/ interest	5	1	5	2	13	24

Liquidity	3	1	2	1	7	13
Capital gain	13	7	6	5	31	57
Others	0	2	0	1	3	6
Total					54	100

10. What steps should be taken for the development of mutual fund in Nepal?

Category Option	Regulating Bodies	Stock Brokers	Issue Managers	Investors	Grand Total	Percentage
Awareness programs in Public	8	5	3	2	18	33
Supported & guaranteed by govt.	6	3	4	4	17	32
Well information to the investors	4	1	2	1	8	15
Come with promotional scheme	3	2	4	2	11	20
Total					54	100

85660000	Tax Revenue
29651900	VAT
27087000	Income Tax
14073000	Excise Duty
3500000	Vehicle Tax

