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FINANCE for DENTISTS – Part XII

The Current Scenario

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November – December 2019 Issue – Second Part

DISCLAIMER: Although every effort has been taken to make sure that there are no mistakes, there might be still, some mistakes inadvertently crept in the article. Please notify the same @ author's email: **drbhavdeep@gmail.com** or Call/Whatsapp: **98761-93039** and they will be corrected ASAP.

As mentioned in the last part of this series, I had started with an in-depth detail about a few terms and concepts used very commonly in the arena of Mutual Funds – Net Asset Value (NAV), Association of Mutual Funds of India (AMFI), Asset Management Company (AMC), Folio Number, Application Reference Number (ARN) Code, Common Account Number (CAN), Securities Exchange Board of India (SEBI) and some concepts associated with all of them. I hope the above terms and concepts don't seem alien to you as I move further.

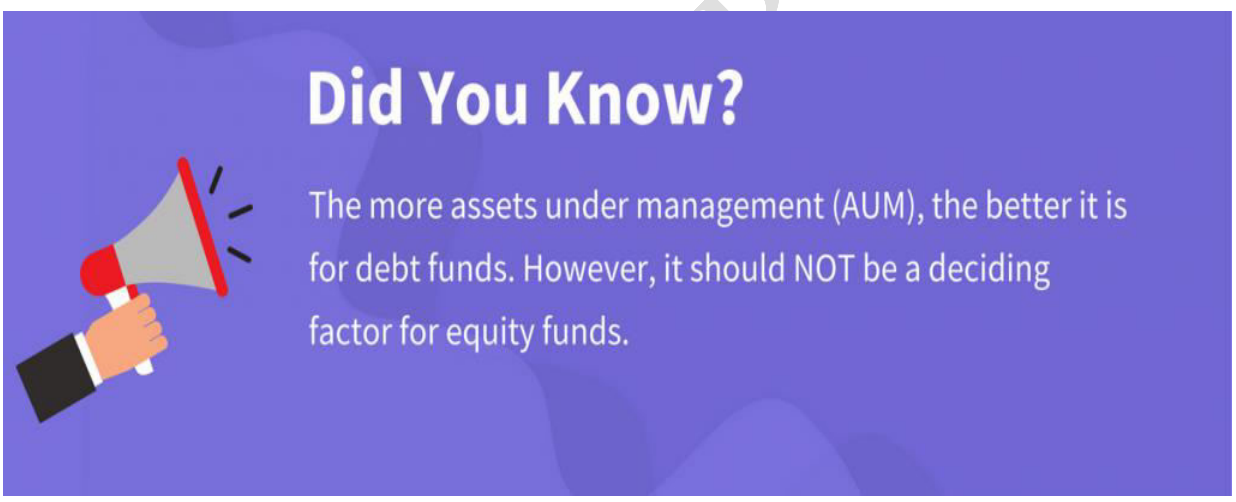
Let us continue ahead of that:

AUM (Assets Under Management)

Assets under management are the overall market value of assets / capital that a mutual fund holds. The fund manager manages these assets and makes all investment-related decisions on behalf of the investors. AUM is an indicator of the size and success of a given fund house. You can easily compare a fund's assets under management in various timelines and performance with other similar schemes. The AUM value also includes the returns that a mutual fund earns. The asset manager can invest this in securities, distribute to investors as dividends or hold as per the investment mandate. Let us suppose, we invest in a mutual fund scheme and there will be several investors like us investing in the same fund scheme. When we add up the investments made by all investors (both individual and institutional), the value we arrive at is the Assets Under Management (AUM).

Need to consider AUM before investing?

Mutual fund investors often look at the fund's AUM and get impressed if it is on the higher side. People think that if so many investors have already invested in the fund, then, it must be a good one. However, there are many reasons why this number should not be a significant factor while choosing a fund. The expense ratio, reputation of the fund manager and compliance with investment mandate are some of the most important factors to consider other than this alone. Let us dissect the importance of AUM concerning different fund types.



(Image Courtesy: Google)

1. **Equity funds**: Here, consistency in returns and compliance of the fund house with the investment mandate matters more than AUM. By consistency, we mean beating the benchmark throughout the market highs and lows. Hence, an equity fund runs on the asset manager's skill to generate good returns consistently rather than popularity or size.

2. **Debt funds:** AUM is a crucial factor to consider if you are planning to invest in debt funds. A debt fund with more capital under it can spread the fixed fund expenses across the number of investors. This can reduce the expense ratio per person and hence, increase the fund returns. More assets under the fund also help the fund company to negotiate reasonable rates with debt issuers.

3. **Small-cap funds**: Small-cap funds tend to restrict cash influx after a certain point. DSP BlackRock Micro Cap Fund is a widely known example

for this. This usually occurs when the assets under mutual fund grow beyond a point. If the fund becomes a significant shareholder in a company, it may not be able to trade its shares easily when the market fluctuates. This is why a small-cap fund often avoids lump sum investments and stick to SIPs.

4. **Large-cap funds:** Let us dissect how AUM impacts large-cap mutual funds through an example. Mirae Asset India Opportunities and HDFC Top 200 are two large-cap equity funds. The former has an AUM of just Rs. 4,738 crore, while the latter's AUM is Rs. 14,655 crore. Most investors may choose to invest in HDFC Top 200 for this reason. However, the Mirae has historically earned higher returns over various periods as the table below shows.

Fund name	1-year returns	3-year returns	5-year returns
Mirae Asset India Opportunities	21.35%	16.54%	20.81%
HDFC Top 200	15.90%	10.55%	15.13%

(Table Courtesy: Cleartax)

Impact of high AUM on mutual funds

Sometimes, an equity fund's bloating AUM can affect its performance negatively. Nevertheless, there is practically no evidence to indicate that a higher AUM affects the fund performance adversely or aids it. It is the fund manager who should grasp the market opportunities i.e. enter or exit a stock at the 'right' time. In many cases, a larger asset under management has hindered the manager in taking quick investment related decisions. So, always consider the performance of the fund you invested in against the benchmark and its competitors before investing.

Ways to calculate AUM

Fund houses employ different methods to calculate assets under management. The overall investment in a fund will rise when it gives consistently positive returns. A positive performance can attract new assets and more investors, leading to an increased AUM. Similarly, if there is a dip in the market value or the investment performance, it can decrease the assets. Same goes for unexpected closure of the fund or every time an investor redeems his / her share. Assets under management entail capital invested throughout the company's products and this includes the shares of the company executives as well.

Effect of AUM on expense ratio or fee

Every fund house levies a fee proportional to the fund size which is also called as the management fee. It is a flat rate to the whole fund; they charge investors based on the number of units they hold. The fund performance has no direct impact on the fees. It merely covers the administration charges and determines the asset manager's compensation for his efforts. Total Expense Ratio (TER) is the annual costs to operate a mutual fund (detailed below). SEBI mandates the AUM to be always higher than TER.

AUM and market movements

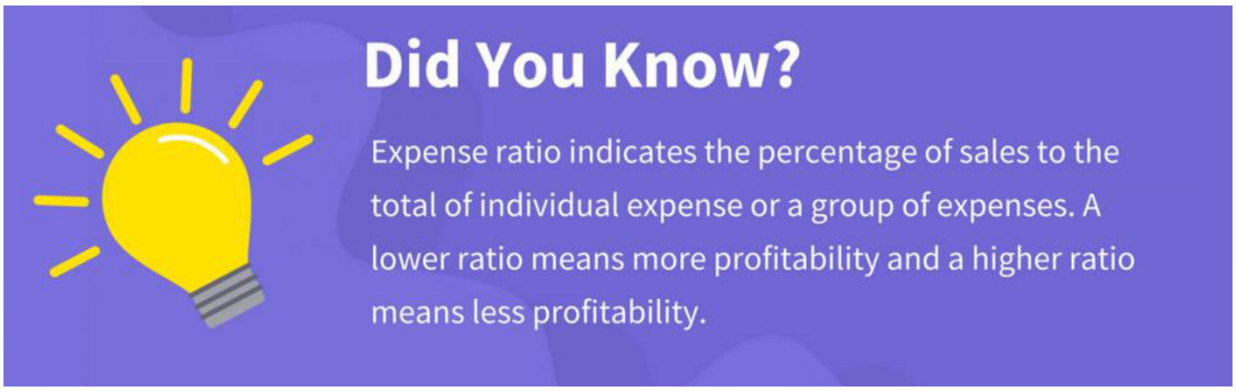
Market fluctuations impact the assets under management considerably. The fund's assets will rise when it earns returns and falls when it incurs losses. This also determines the mutual fund fee. Lesser value generally means lower costs. For example, let us presume that 100 investors have cumulatively invested Rs. 10,000 in a mutual fund that has earned 10% returns. Then the fund's AUM would be Rs. 11,000. This said and done and companies use different methods to calculate the value of assets they manage.

In a nutshell, AUM is an excellent way to assess a fund's popularity and performance but it shouldn't affect your decision to invest or not. If comparing these metrics seems complicated, you can always invest with the help of an able fund advisor who can select the best performing portfolios to cater to your individual diverse investment needs.

Total Expense Ratio (TER): Importance and Analysis

What is an Expense Ratio?

The expense ratio is defined as the annual fee that an investor is charged for the management of funds. These are also known as the Annual Fund Operating Expenses or mostly known as the expense ratio and is the percentage of assets payable to the fund manager (i.e. AMC). The asset manager, with the help of a team of analysts and other experts, allocate, manage (including the auditor and advisor fees) and advertise the fund to maximize returns and manage risks. If the funds' assets are small, then the expense ratio can be high. This is because the fund has to meet its expenses from a restricted or a smaller asset base. Similarly, if the net assets of the fund are significant, then the expense percentage should ideally come down. On 18th September 2018, SEBI brought about significant modifications by reducing TER of the mutual funds and changing the method of providing a commission to the distributors. Let us understand this aspect of mutual fund investment in detail through the following topics:



(Image Courtesy: Google)

Components of Expense Ratio

The expense ratio includes numerous charges for smoothly running the mutual fund scheme. They recover this cost from the mutual fund investors on a day to day basis. However, they disclose it to the investors once in every six months. Also, this will have a substantial impact on your take-home returns.

Types of Expense ratio

There are three major types of expenses as a part of the Expense Ratio:

1. **Management Fees**: Mutual funds require the formulation of investment strategies before actually investing money in the underlying assets. Fund managers need to possess a high level of educational, relevant fund management experience, and professional credentials. The management fee or investment advisory fee is compensation for these managers' expertise. On average, this annual fee is about 0.50% to 1% of the funds' assets.
2. **Administrative Costs**: The administrative costs are the expenses of running the fund. This would include keeping records, customer support, and service, information emails and communications. They can vary greatly and are expressed as a percentage of fund assets.
3. **12-1b Distribution Fees**: Many mutual funds collect the 12-1b distribution fee for advertising and promotional purposes. A 12b-1 fee is an annual marketing or distribution fee on a mutual fund. The 12b-1 fee is considered to be an operational expense and as such, it is included in a fund's expense ratio. It is generally between 0.25% and 0.75% (the

maximum allowed) of a fund's net assets. Usually, they charge their shareholders to market and promote the fund to the investors. These three fees combined are equal to the percentage of assets deducted from the fund.

Impact of Expense Ratio on Mutual Fund Returns

Expense ratios indicate how much the fund charges in terms of percentage annually to manage your investment portfolio. If you invest Rs. 20,000 in a fund which has an expense ratio of 2%, then it means that you need to pay Rs. 400 to the fund house to manage your money. In simple words, if a fund earns returns equal to 15% and has TER of 2%, then you will make a return equal to 13%. The Net Asset Value (NAV) of a fund is reported after deducting all fees and expenses. Hence, it becomes essential to know how much are you paying to the fund house.

Expense Ratio Implications

Expense ratio indicates the percentage of sales to the total of individual expense or a group of costs. A lower rate means more profitability and a higher rate means lesser profitability. It becomes critical for schemes with comparatively more moderate yields. Apart from that, you may use expense ratio to differentiate between actively managed and passively managed funds. In case of actively managed equity funds, the alpha (explained ahead in a separate section) generated by the fund manager is a compelling justification for the fee they charge. If you find a wide divergence between the returns of your fund and index funds, then you may think of making a switch.

Expense Ratio Limit by SEBI

All expenses of an AMC must be managed within limits specified under Regulation 52 of SEBI Mutual Fund Regulations. As per these regulations, the total expense ratio (TER) allowed is 2.5% for the first Rs. 100 crore of average weekly total net assets, 2.25% for the next Rs. 300 crore, 2% for the next Rs. 300 crore and 1.75% for the rest of the AUM. The limit for debt fund is 2.25%. On top of this, the Securities and Exchange Board of India allows all the mutual funds to charge 30 basis points more as an incentive to penetrate in smaller towns (B15 Cities). These cities also enjoy an additional 20 basis points as exit load charges. B15 cities are those which are beyond these mentioned top 15 cities – New Delhi (including NCR), Mumbai (including Thane & Navi Mumbai), Kolkata, Chennai, Bangalore, Ahmedabad, Baroda (Vadodara), Chandigarh, Hyderabad, Jaipur, Kanpur, Lucknow, Panjim, Pune and Surat.

How to calculate TER

For example, if you invest Rs. 50,000 in a fund with an expense ratio of 2%, then you are paying the fund house Rs. 1,000 to manage your money. It can be said that if a fund earns 10% and has a 2% TER, it would mean an 8% return for an investor. The mutual fund's NAVs are reported after netting off the fees and expenses and hence, it is necessary to know how much the fund is deducting or charging as expenses. Mutual fund expense ratios range from 0.1% to 3.5% for tax saving funds in India.

Example:

1. If the fund handles Rs. 10 lac in assets and collects Rs. 15,000 in fees and other charges from the fund holders, then the expense ratio is 1.5%.
2. Total assets of mutual funds X = Rs. 1 crore
3. Administrative expenses = Rs. 1 lac
4. Other expenses = Rs. 50,000

Expense ratio = Total Expenses/Total Assets

= Rs.1.5 lac/1 crore

= 1.5% of your Investment Value

Though the expense ratio is important, it is not the only criteria while selecting a mutual fund scheme. A scheme with a consistently decent track record may tell you differently about the TER. Sometimes, the higher expense ratio can overshadow the decent returns. If tracking markets aren't your thing and you are finding it too difficult to understand, then invest through an intelligent tax advisor who can invest in the best of hand-picked funds in a hassle-free and paperless manner.

Fund Manager – Role in Mutual Funds

One of the most important aspects of investing in mutual funds is the management of the portfolio of the stocks and bonds and any other asset class. The fund is managed, either actively or passively (will be detailed in coming sections) by a fund manager. This has a huge impact on the performance of the fund and your portfolio over time. It will be fair to say that the role of a fund manager is pivotal in either making or breaking your investment.

a. **Role of a Fund Manager**: As an investor, when you choose to invest in a mutual fund, it involves building a portfolio of securities. It is the fund managers who, based on research and analysis, make the decisions pertaining to buying and selling. Your portfolio can be active or passive. If your portfolio is passively managed, it is based on an established index and the components are chosen by keeping in mind the underlying index. In case of an actively managed portfolio, the fund manager picks the components of the portfolio. These fund managers play a decisive role in the performance of active mutual funds.

b. **Duties of a Fund Manager**:

1. **Meeting the reporting requirements**: Mutual fund managers have to design funds keeping in mind the reporting standards as per the regulatory guidelines. The building of a fund takes into account the objectives of the investors, the strategies, risks, expenses and various policies. Fund managers are responsible for ensuring that the investors are aware and abide by these details and rules. It is also the responsibility of the fund manager to make sure that all the documents are furnished on time and in accordance with the laws and regulations.

2. **Complying with Regulatory Authorities**: The operations of the funds must happen in line with the rules set out by the governing body like the SEBI (Securities and Exchange Board of India) and other relevant authorities. These regulations cover all aspects starting from signing clients to handling the redemptions. Fund managers are answerable to legislators and investors in case of non-compliance.

3. **The Protection of Wealth**: It is the duty of the fund managers to protect the wealth and money of the investors. It is a given that funds are subject to some risks to generate returns and to grow, but they must not be subjected to reckless risk-taking. The decision of the fund manager with regards to the buying or selling of assets must be done post extensive research and due diligence. To protect the wealth of the investors, the manager must, if need be, employ investigations into the company in question, use risk management techniques to evaluate the investments, etc. To address risk, fund managers have to ensure that there is adequate diversification in the asset portfolios.

4. **Monitor the growth and performance of the fund**: The all important decision of 'where to invest' is the fund manager's call and this decision is governed by regulations and the expectations and objectives of the investors. The fund managers are judged based on how well their funds perform and how they deliver growth well above the prevailing interest rates and inflation rate. This justifies the risk they take for investing.

5. **Oversight and Hiring**: With the responsibility of managing funds being

extensive, fund managers have to get assistance from various professionals and even firms, in order to deliver with aplomb. Certain duties like issuing annual reports, getting capital, negotiating with brokers etc. is outsourced. This way, the fund managers are able to transfer some of the regulation related responsibilities to a third party but, ultimately, it is still the fund manager alone who is responsible for the how the funds fare.

(Image Courtesy: Google)

Evaluating a Good Fund Manager

Fund managers are critical for the selection and performance of the mutual funds and so, it is important that we take certain things into consideration when picking the funds (and its manager). Most experienced investors pay attention to the manager and their fund management team. One can discern between a good fund manager and an average one by looking at such factors as:

1. Has the fund manager succeeded in outperforming the benchmark (explained in further sections) in perpetuity?
2. Does the manager keep track of the other institutional investors' (DII or FII – Domestic / Foreign Institutional Investors) buying and selling of stocks?
3. Are they adequately experienced with a high compensation?
4. Are they able to identify scripts way ahead of their peers?

Role of Fund Managers in deciding where to invest

Apart from the comprehensive knowledge on the subject and far-reaching insights, fund managers gather invaluable insights from their own research team. Some other considerations include:

1. They check for the shifts in the stock market to analyze the volume of the shifts.
2. An analysis of the competition in the industry plays an equally important role to gauge the macro-economic outlook.

3. A thorough analysis of the annual results of the companies that the fund manager intends to invest in.
4. Finally, all the above-mentioned information is weighed along with the experience of the top managers and directors before making investing decisions.

Investing in mutual funds is subject to market risk. Not having the insights to pick the right fund or fund manager can be a costly affair. Do take the help of your financial advisor who can help you select funds that meet your investment objectives and goals. Change of fund manager of a particular fund should not be the sole reason to switch or redeem from one fund or fund house to another. The expense ratio of a fund and composition of the portfolio a fund holds are other significant factors that may impact your returns. All the above information is provided in the Scheme Information Document (SID) and Key Information Memorandum (KIM) provided by fund houses, which undergo relevant revisions from time to time. If there is any change in portfolio, an investor has to read & understand before investing which is available in the SID and KIM. At last, a mutual fund is a tool for wealth creation & should not be judged in short run as it usually reaps benefit only in the long run. So keep investing keeping that aspect in mind.

Mutual Fund Fees, Charges and Expenses

Mutual funds are managed by Asset Management Companies that employ fund managers to handle each scheme. Fund managers are assisted by a team of market experts and financial analysts. Managing the expenses of these professionals whilst working towards overcoming market risks is no mean feat (can be a difficult task). It requires subject expertise, industry experience and a fair amount of passion. The main benefit of investing in mutual funds is that you get professional and expert money management by the fund house. It is for this reason that mutual fund houses charge fees to investors that takes care of their compensation as well as other investment related expenses. Asset Management Companies and fund managers grow in terms of reputation based on the fees or expense ratios charged by fund houses to investors. The better the performance of schemes managed by Asset Management Companies and fund managers, the better their reputation. The ultimate goal of Asset Management Companies and fund managers is to maximize returns and satisfy investors as doing so will help them acquire steady investments in the future. At the same time, their performance can attract new investors, thus increasing the company's Assets Under Management. However, to achieve these feats, operational costs are incurred by fund houses, and to cover these costs, fees and charges are levied to investors (SEBI approved). Sometimes, the Expense ratio is synonymous with mutual fund charges along with a few other investment charges payable by investors. Expense ratio or the fee to the fund house from individual investors is what motivates an asset manager to deliver stellar returns. The more they deliver to their investors, the reputation of AMC and fund manager increases. Hence, investors' satisfaction is their ultimate goal. One happy customer means not only steady investments but also more investors. This is capable of increasing the AUM (assets under management) but all of this comes at some operational cost to the investors. The following are the different mutual fund fees and charges in India and their relevance to the investors:

1. **One Time Charge**: One time charges are those that incur during the initial period for the investment. It is basically buy-in tariff, taking poker table as an example. It is also referred to as a transaction charge.

2. **Load**: A load is basically a commission or a fee. AMCs or intermediaries usually collect it before you invest it or after. Sometimes redemption charges or early withdrawal charges are also levied on investors. An investor ought to be familiar with the entry load and the exit load of a mutual fund.

3. **Entry Load**: An entry load is basically the fee charged by a fund house to an investor when he/she buys units of a mutual fund. In August 2009, however, entry load was deferred by the Securities and Exchange Board of India (SEBI).

4. **Exit Load**: An exit load is charged to an investor by a fund house when he/she redeems the units of a mutual fund. Exit loads are not fixed and can vary from scheme to scheme. Generally speaking, exit loads range from 0.25% to 4% based on the kind of scheme in which you invest. The fee is determined by the fund house and the main reason for the levy of an exit load is to ensure that investors remain invested in the scheme for a certain period of time also called in as the 'lock-in' period. No exit charges apply if you redeem your units after the lock-in period. Just as an example, if a fund is priced at Rs. 1000 and the investor wishes to withdraw in the lock-in period, then he has to pay an exit load of Rs. 10 per unit, if the exit load is 1%.

5. **Management Fees**: These fees are collected from investors to pay off fund managers for the services they render to manage the scheme.

6. **Account Fees**: Account fees are sometimes charged by Asset Management Companies when investors fail to meet the minimum balance requirement. These fees are subtracted from the investor's portfolio.

7. **Service Fees and Distribution Fees**: These fees are collected by Asset Management Companies for the printing, mailing, and marketing expenses incurred by them.

8. **Switch Fee**: A number of mutual fund schemes allow investors to switch their investments from one scheme to another. The fee charged for this service is called the switch fee.

Exit Load in Mutual Funds

An exit load refers to the fee that the Asset Management Companies (AMCs) charge investors at the time of exiting or redeeming their fund units. A mutual fund is a pool of investments drawn from various individual and institutional investors. Mutual funds require a team of financial experts to manage and generate returns. So, it is but evident that the service comes at a fee. This fee also goes by the name 'load'. Some AMCs charge exit load on exiting or redeeming units of a fund. It is also referred to as the commission to fund houses or exit penalty if an investor exits the fund in the lock-in period. However, not all funds levy an exit charge. Hence, while choosing a plan, do consider the exit load too, along with its expense ratio. You need to note that the exit load is not part of the expense ratio. In case of open-ended funds, the investors have the choice to exit the scheme as and when they want. Sometimes, investors fail to stay invested for the specified period for which they had agreed to invest in a fund. Hence, an exit load discourages investors from prematurely exiting the fund. This fee may also reduce the number of withdrawals from the mutual fund schemes. The exit fee is usually a percentage of the Net Asset Value (NAV) of the mutual fund units held by investors. Once the AMC deducts the exit load from the total NAV, the remaining amount gets credited to the investor's account. For example, if the exit charge for a one year scheme is 2% and you redeem within six months, then, this would be much before the agreed investment period. If the NAV of the fund is Rs. 50 during the time of redemption, then the exit fee would be 2% of Rs. 50, which amounts to Rs. 1. The remaining amount, Rs. 49 gets credited to the investor. If the investor completes the agreed fund tenure, then he/she will not be charged the exit load at the time of redemption.

How to Calculate Exit Load in Mutual Funds?

The exit load is, most often, at the discretion of the fund manager. Suppose, an investor invested Rs. 10,000 in a mutual fund scheme in January 2018 and the NAV of the scheme is Rs. 100 and the exit fee for redeeming before one year is 1%. In March 2018, the investor would opt to invest Rs. 6,000 at NAV of Rs. 100 in the same fund.

How will you calculate the exit fee, if he redeems the fund in November 2018, when the NAV is Rs. 110?

How can you know the exit fee, if the redemption happens in February 2019, when the NAV is Rs. 115?

It is quite simple, and as shown below:

Number of Units bought in January 2018	Rs. 10,000 / 100 = 100 (Total NAV / Number of Units bought)
Number of units bought in March 2018	Rs. 6000 / 100 = 60

For redemption in November 2018, the exit load would be charged for both investments in January 2018 and March 2018 as per the prevailing NAV of Rs. 110 in November.

Exit Load	1% of [(100 x 110) + (60 x 110)] = Rs 176.
The amount credited to the investor	17600 – 176 = 17424 (Total NAV – Exit fee)
For the second investment of March 2018	1% of (60 X 115) = Rs. 69

In case of redemption in February 2019, the first investment of January 2018 passes the one-year term. Hence, there is no exit load for its redemption. However, the second investment of March 2018 will attract payment of exit charge at 1% as specified in the above table.

Thus, being aware of exit fees is essential for investors. It helps in gauging returns after all expenses are met.

Costs involved in Equity/ Stock Investing

Equity Investing is the investment made towards the purchase of shares of any company is referred to as equity investment. In simple words, this is the money spent on buying shares of a company traded on the stock exchange where the investors purchase the shares in anticipation of appreciated value through capital gains or dividends from the company.

Benefits of Equity Investments

The primary source of profit in equity investments is the possible increase in the value of the principal invested amount; which comes either in the form of dividends or capital gains. With a minimum initial investment, you can get diverse investment options, and your fund can further increase with this investment by investing in the right shares to raise more capital.

Cost involved with investing in equity

There are several charges that an investor has to bear when buying or selling shares. When you make profits in the stock markets, they may be taxable. Some of the most common forms of cost include brokerage charges, stamp duty, securities transaction tax and other charges.

Brokerage Charges

As is suggestive of the name, the broker charges this fee as his commission for the services rendered. For instance, if your transaction amounted to Rs. 1,00,000, then your broker may charge a commission of 0.3% on that transaction which will amount to Rs. 300.

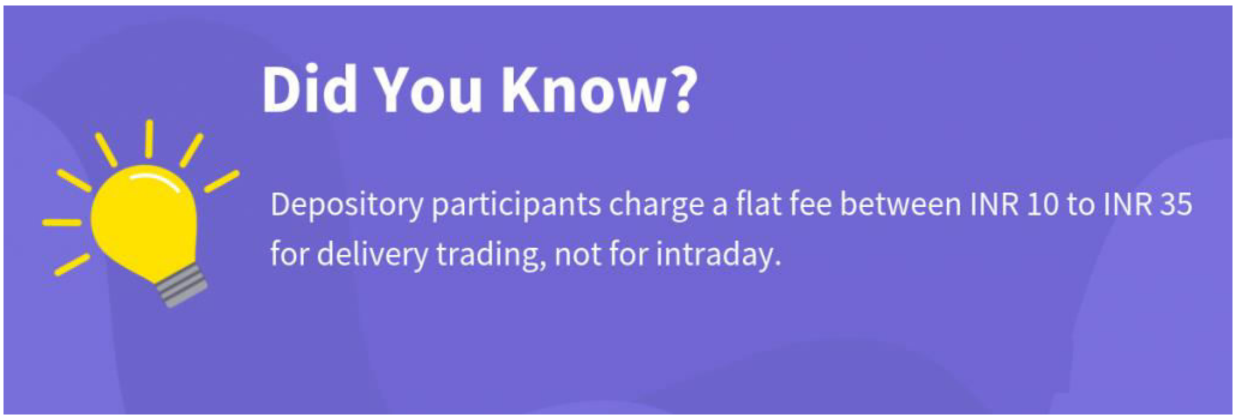
1. **Full-Service Brokers**: These are brokers who provide an all-inclusive trading service that includes trading stocks, currency, and commodities as well as related service of research advisory, management of sales and assets, investment banking, and so on. The charges of a full-service broker could range from anywhere between 0.01% to 0.5% brokerage charges on the delivery and Intraday trading.

2. **Discount Brokers**: Discount brokers provide investors with an execution platform for trading and charge a commission for their service. They, however, do not offer any investment advisory services. Their charges range between a flat fee of Rs. 10 and Rs. 20 per trade on intraday trading and delivery. But, you may also come across some discount brokers who do not charge any fee on delivery trading. Investors need to pay brokerage on both sides of the trade when buying and selling shares. But again, it is not entirely uncommon to come across some brokers who charge a brokerage fee only on one end of the transaction that is either on selling or

buying.

Charges on Share Trading

1. **Securities Transaction tax**: This is charged on both sides of the buy and sale transaction. In the case of intraday trading, the STT is only charged when the stock is sold. STT is levied at 0.1% of the total transaction, on each side of trading, for delivery in general. The charges for intraday STT are around 0.025% of the complete transaction on the selling party.
2. **Stamp Duty:** This fee is levied on the value of shares that are transferred, and this rate differs across states. This is because the states are in charge to levy and collect stamp duty. It is charged on both the buying and selling sides, charged on the total turnover amount.
3. **Service Tax**: Service charge is levied at 15% of the brokerage charge paid by investors and is the same for delivery as well as intraday trading.
4. **Transaction Charges**: Transaction charges are charged on both sides of trading by the stock exchanges. A transaction fee of 0.00325% of the total amount is charged by the National Stock Exchange, while a transaction fee charged by the Bombay Stock Exchange amounts to 0.00275% of the total amount.
5. **Securities and Exchange Board of India (SEBI) Turnover Charges**: The apex market regulator of the securities markets in India charges a fee on both sides of a trading transaction with a turnover charge of about 0.0002% of the total amount. The charges are the same for both intraday and delivery trading.
6. **Depository Participant Charges**: The two stock depositories in India, the Central Depository Services Limited and the National Securities Depository Limited charge a fixed sum for keeping your transactions in an electronic form. The depository participants, who happen to be your Demat account company or your broker company, are charged while the depositories don't cost the investors directly. The depository participants form the bridge between the investors and the repository as investors can't directly approach the depository. Therefore, the depository charges the depository participant who in turn, charges the investors.



(Image Courtesy: Google)

Another point traders must be aware of is the impact of the capital gains tax. There are two types of Capital gain Tax:

1. **Short term capital gain tax**: Short-term capital gains tax is levied if your holding period does not exceed one year.

(Image Courtesy: Google)

2. **Long-term capital gain tax**: As the name suggests, if you sell your stock after a holding period of one year, then it is considered as a long-term investment and the gains are known as a long-term capital gain (LTCG). LTCG above Rs. 1 lac is taxable at the rate of 10% without the benefit of indexation. These are some of the charges that an investor or trader must keep in mind when seeking to trade on the stock markets. Besides this, an essential aspect to keep in mind is with regards to the risks involved in these tradings. Do your research before participating in the stock market and get expert financial advice as well. No amount of saving on the trading fee will render results if you lose out on your investments due to careless investing.

LIQUIDITY

What is liquidity and why does it matter?

The term liquidity in finance refers to the time and the cost it takes to convert an investment into cash. Many times, investors focus only on the long-term objective of securing their retirement and don't take into account the provisions for unpredictable events. It is important to give some consideration to liquidity and not have all your capital tied up as you may encounter the need for urgent cash anytime. In simple terms, liquidity is the accessibility to your investment. This takes into account how much time it would take for you to access your investment when you are in need. The process of such a conversion differs from asset to asset. In the case of your retirement fund, you will not be able to liquidate the funds without the necessary paperwork that may be time-consuming. On the other hand, a fund in the money market is very liquid and can be accessed through a linked checkbook or can be easily transferred to your designated bank account. Thus, liquidity is the degree to which a security can be, easily and quickly, bought or sold without having its price affected. Your liquidity is determined by how quickly your investment can be converted into cash. The commonest example I can give citing the money invested in stocks and we are suddenly in need of cash; we have the option of selling our stocks quickly for a fee, through a broker and get liquid cash. In the same light, if you consider a less liquid investment like that of real estate, it is not so easy to convert the sale. This is accompanied by the legal paperwork, the market valuation of the property, seeking out potential buyers etc. Liquidity is thus, an important part of financial planning. When planning your investments, it is imperative to factor in liquidity in your plans to ensure that you are secured not only for your future needs but that your current needs do not eat into your long-term investment.

1. **Provision for cash reserves**: Regardless of how much you invest in illiquid assets; have a small portion of your money kept aside for you to access instantly in times of need. This will help in keeping the value of your funds intact rather than shifting the value due to any conversions. The cash you have must be used in times of emergencies only and even then, it must be re-stocked right away. There is often a debate about how much is the right amount for such provisions, but it is a personal parameter that differs from individuals to individuals based on their needs. A rough estimate would suggest having at least three months worth of your take-home SALARY or INCOME in cash or near cash reserve.

2. **A balance of liquid and illiquid assets**: It is advised to have at least 60 percent of your invested assets in liquid assets like stocks, bonds, mutual funds and other alternative investment funds. These are funds that you can encash monthly.

Role of Liquidity in Investments

Liquidity plays a crucial role in balancing your portfolio with tradeoffs between risk and return. If you invest in emergency funds, you will have high liquidity but the returns would be low, as will be the risk. Real estate investment again is low risk and a higher return (doubtful in today's times though) but the liquidity aspects are compromised. Opting for stocks and equity mutual fund, in the long run, garners higher returns with liquidity, but this is accompanied with higher risks as well, but despite these scenarios, it is a significant component in portfolio investment.

1. **Liquidity helps accelerate transactions**: Having liquid funds significantly reduces the time lapse from the moment you put the asset for sale to the time you find a buyer. Stocks are a good example of liquid assets which can be traded on the stock exchange on any working day.
2. **Liquidity eases the selling process**: It is easier to find a buyer for a liquid asset than for an illiquid one. This does not mean that one must not have illiquid funds at all, but rather, one must not depend on illiquid funds for emergency situations.
3. **Liquidity is a greatly overlooked attribute**: The value of liquidity in the investment realm is grossly underrated. In the race to secure the future, many investors miss out on making provisions for the unforeseen events that can come uninvited anytime. Not having this security can force you to dig into your long-term investment plans, defeating their very purpose.
4. **Liquid assets maintain their value**: To a huge extent, liquid funds manage to retain their value when they exchange hands, unlike many illiquid funds. When you break into your long-term investments to meet your emergency needs, chances are you will undergo a fine or penalty. When you sell your real estate or property, you may or may not get the price depending on the market conditions but when you access your savings account there is no such loss of value of your funds. When you are investing in various asset classes, ensure that you are equipped with ample liquid funds to avail in times of need.

(Series to be Continued)

(We shall continue this Article on Finance in the Part 13 of this Series in Volume 3 Issue 1 – January–February 2020 Issue – First Part with Mutual Funds)

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