INVESTMENT BANKING, OPEN, CLOSED Ended FUNDS & UTI ①

Investment Banking Companies are financial intermediaries that sell shares to the public and invest the proceeds in a diversified portfolio of securities. Each share sold represents a proportional interest in the portfolio of securities managed by the company on behalf of its shareholders. The type of securities purchased depends on company's investment objective.

Types of investment companies

1) open-end funds (mutual funds)
2) closed end funds
3) Unit Trusts

Open-end funds (mutual funds) — These are portfolios of securities, mainly stocks, bonds and money market instruments.

Important aspects

1) investors own a pro-rata share of overall portfolio.
2) Investment manager of fund manages the portfolio actively i.e. buys some, sells some securities)
3) Value or price of each share of portfolio called

$$\text{NAV (net asset value)} = \frac{\text{Market Value of portfolio} - \text{liabilities}}{\text{No of shares (units) outstanding}}$$

4) NAV is determined once every day i.e. at close of day
5) All new investment into or withdrawals from fund during a day are priced at closing NAV.
6) Total No of shares in funds increases if there are more investments than withdrawals during the day and vice versa.
7) If prices of securities in portfolio changes, both total size of portfolio and ∴ NAV changes.
8) NAV will increase with inc in price of securities in portfolio & vice versa

Closed end funds. (like stocks of corporations)

New shares of closed end funds are initially issued by an underwriter for the fund. After new issue No of shares remains constant. After initial issue no sale ~~of~~ or purchase of fund shares by fund company.

Shares are traded on secondary market, either on exchange or OTC market.

Prices of shares are determined by demand & supply in secondary market.

Shares selling below NAV — trading at discount
" " above NAV — at premium

diff from open end funds
↓
No of shares varies
NAV = price of shares.

Initial investors have to pay substantial cost of underwriting.

The proceeds the managers of funds have to invest equals total paid by initial buyers of shares + costs of issuance (abt 7.5% of total amt) includes selling fees and ~~commissions~~ commissions paid to retail brokerage firms that distribute them to public

less popular.

(ETFs — hybrid closed end vehicles, which trade on exchanges, very close to their NAV.)

Cost to investor is lower cost of stock of corporation but there is stock brokers commission, Bid/offer spread is also a cost.

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Sale Price of Unit = (Market value of asset − liabilities) + brokerage + Comm. + taxes, + stamp duties and management expenses

No. of units outstanding

RePurchase Price = ________ − (brokerage charges, Comm. etc)

No. of units issued or outstanding

Rt of Return
RRU.

$$= \frac{(NAV_t - NAV_{t-1}) + \text{Dividends} + \text{Capital gain}}{NAV_{t-1}}$$

Advantages — economies of scale
to investor
spread of risk
diversification
liquidity, flexibility
tax benefits
wide choice of schemes
freedom for choosing

to financial system — inc. dividend for stock.
long term hedging
take into consideration capital gain along with inc. in dividends

Unit Trust
No. of Unit Certificates is fixed.
Unit trusts invest in bonds.
There is no active trading of bonds in the portfolio of Unit Trust.
Trustee holds all the bonds till redeemed by issuer.
But it may sell an issue in the portfolio if there is dramatic downfall in issuer's credit quality.
∴ Cost of operating trust is considerably less.
Unit trusts have a fixed termination date.
All unit trusts charge sales commission (3.5% to 5.5%)

<u>Costs Borne by Investors</u>
~~Fund~~ Sales Charges and Annual operating expenses

Shareholders fee
or Sales charge
one time cost

operating expense
Called expense ratio (mostly investment management)
imposed annually

<u>Sales charges</u>
two types of sales charges dependent on methods of distribution

Sales force or wholesale
ie to broker, ins. agent etc.
Sales charge in such cases is called a load.
front end load – at time of purchase
back end loads – " " sale
level loads – imposed uniformly each year

Direct (to investor)
No load
fund is bought at NAV

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Annual Operating Expense (Expense Ratio)

Management fee, Dist-fee (-ribution), other expenses → Costs of
1) Custody
2) Transfer Agent
3) Independent public Accountants fee
4) directors fee

Dist-fee: Continuing Agent Compensation
Marketing and Advertising expenses

in US {Not more than
Service fee = 0.25% of assets
total Dist fee - Not > 1%.

Sum of management fee + Dist. fee + Other Annual exp / to total assets
= Expense Ratio

Types of funds

By investment objective
eg stock funds, bond funds, money market funds

Passive and Active funds — Fund of Funds (Invest in funds)

Passive ↓ (Indexed) designed to replicate an index

Active funds ↓ try to outperform index.

Family of funds or (gp or complex of funds) management offers choice of numerous funds with different investment objectives

Stock funds

- On basis of M-Cap
  - Small: upto \$2 billion
  - Mid: \$2 to \$12 billion
  - Large: > \$12 billion
- ~~Stock~~ Style
  1) growth — high price to earning and price to book ratio
  2) value — low "
  3) Blend
- Sector: specialize in any one sector

Market capitalization is equal to share of a company at a pt. of time multiplied by outstanding no. of shares.