Decision Function and the Decisional Matrix for Mutual Fund Investments

*Faisal Ahmed and **Maneesh Kumar Ahuja

Abstract

Managing one's investments, especially when one has a financial surplus of even a few hundred dollars, is not a strenuous deed in the contemporary business climate. In furtherance to the same notion, the paper investigates the affluence and the actionable benefits associated with the mutual fund investments. Along with reviewing various literatures of topical interest, the paper initiates a serious discussion on the vitality of the key factors affecting an individual's choice for a particular mutual fund. A Mutual Fund Investment Decision (ID_{mf}) Function is also being duly proposed to provide a framework to the investors to strategize their decisions in making a particular mutual fund investment. The function incorporates the essentially inevitable factors that drive an investor's decision choices for mutual funds. Moreover, a two-factor decision matrix based on Fund Size and NAV Returns, which culminates primarily from the ID_{mf} Function, is also constructed with the one-amongst-many intention of helping the investors assess and reassess their mutual funds investment inertia.

Introduction

Mutual Fund in itself is deemed to be an institutional entity that encompasses the commonly derived and/ or schematically accumulated financial goals of the community of investors. The money collected from a plethora of sources is invested by the Fund manager in various types of securities depending on their duly specified objectives. A mutual fund, therefore, in its rudimentary conceptualization, is a collection of stocks and/ or bonds, wherein an investor holds a share, which represents a part of the fund holding thereof. A proportionate sharing of income earned through such investments and capital appreciation witnessed by the schemes is duly carried out. It must however be mentioned that this proportional sharing by the unit holders is governed by the number of units owned by them. Mutual fund is therefore, the most suitable investment option available for a common man as it provides an opportunity to invest in a diversified, yet professionally managed portfolio at a competitive (relatively low) cost.

Mutual Funds Investment Decision (ID_{mf}) Function

The paper duly proposes the Mutual Fund Investment Decision (ID_{mf}) Function to establish the causal relationship inherently pertinent amongst the factors influencing one's decision to invest in a particular mutual fund.

Faisal Ahmed
Faculty Member & Head, School of Management Studies, ICAT, Universitas Nurtanio, Bandung, Indonesia. (Currently on leave from NDIM New Delhi)

**Maneesh Kumar Ahuja*
Project Consultant (Finance) IFS India Solutions Pvt. Ltd. Mumbai, India.

The Mutual Fund Investment Decision (ID_{mf}) Function can be expressed as:

$$\mathbf{ID_{mf} = f(F_f, F_s; T_f, T_s; R_{mf}, R_{fm}; P, L, C, v)}$$

Where,

ID_{mf} = Mutual Fund Investment Decision made by the investor
F_f = Fund Family
F_s = Fund Size
T_f = Type of Fund
T_s = Type of Portfolio & Schemes
R_{mf} = Risk involved in Mutual Fund
R_{fm} = Reputation of the Fund Manager
P = Past performance of the fund
L = Liquidity factors
C = Current Market Conditions
v = any other variable influencing the investors decision

a) $\mathbf{ID_{mf} = f(F_f)}$

Fund Families like UTI, SBI, etc. have high brand equity and such families are most likely to have greater investor's confidence in their funds.

b) $\mathbf{ID_{mf} = f(F_s)}$

Fund Size may be small, medium or large. It must be ascertained that a larger fund size would mean a higher amount of fund being invested and therefore a higher degree of involvement by the fund family. It would therefore mean one of the most profitable investment decisions that could be undertaken.

c) $\mathbf{ID_{mf} = f(T_f)}$

A mutual fund may be a growth fund, dividend fund, tax saving fund, etc., and therefore, their impact on the mutual funds investment decision is largely related to their respective functional intents.

d) $\mathbf{ID_{mf} = f(T_s)}$

Types of Portfolio could be mixed, equity, debt, etc. which also makes a sizeable impact on our decision to invest in a particular fund. It helps the investors to assess their utmost need to invest in either the mixed fund or equity fund or likewise.

e) $\mathbf{ID_{mf} = f(R_{mf})}$

A high risk involved in a particular mutual fund would generally mean a low investment in it. Though with some quick mathematical calculations, even the major and minor limits of the risk may be ascertained. The risk involved may be in the form of alpha, beta, sharp ratio, standard deviation, etc. A higher risk is normally considered a demotivator for a mutual fund investment decision.

f) $\mathbf{ID_{mf} = f(R_{fm})}$

A fund manager is a high authority in ascertaining an investor's financial roadmap. The reputation of the fund manager also plays a key role in determining the level and extent of profitable investment one could make in mutual funds. Fund managers with a high market reputation are the only ones who are apt to make a profitable investment decisions and whom an investor can rely upon for undertaking a high-risk investment initiative.

g) $\mathbf{ID_{mf} = f(P)}$

Good past performance of the fund is a reflection of its ingenuity and a high investor's confidence in it. Past performance is generally undertaken through ascertaining the annualized returns for the last 1, 2, 3 and 5 years and comparing it to benchmarks like NSE, BSE, etc.

h) $\mathbf{ID_{mf} = f(L)}$

Liquidity Factors have their own relevance especially when the investor wishes to rotate the profits for various investments for maintaining ones financial obligations. Liquidity factor simply denotes their pace of convertibility into cash which therefore serves as a major determinant of the mutual fund investment decision function.

i) $\mathbf{ID_{mf} = f(C)}$

An eagle's eye n the current market conditions also helps investors to make a better investment decision.

The knowledge as to how the share market, the real estate market, etc. are performing also helps investors in framing their relative decision choices.

c) $\mathbf{ID_{mf} = f(v)}$

Due impetus is also given to some of the other unavoidable or inevitable variables like loyalty, etc. which also, at times, helps the investor make a profitable, even if not a rational decision.

Actionable Relevance of ID_{mf}

1) A causal relationship can be ascertained to evaluate the ingenuity of an investment decision.
2) The factors can be arranged and rearranged as per their relevance and magnitude to enhance objectivity in one's decision.
3) The Function helps in outlining all such determinants which may have a direct or indirect influence on the investment decision, thereby reducing complexity in subsequent decisional analysis.
4) The Mutual Fund Investment Decision (ID_{mf}) Function establishes a key focs on various investment decision determinants, including past performance and fund size also, whose core elements have been used in designing the Size-Returns (SR) Matrix, which has also been proposed in this paper.

Decisional Matrix for Mutual Fund Investments

Size-Returns (SR) Matrix, a unique congregation of decisional alterations caused by traversing through the matrices, is also being duly proposed in this paper. The parameters of Fund Size on the x-axis

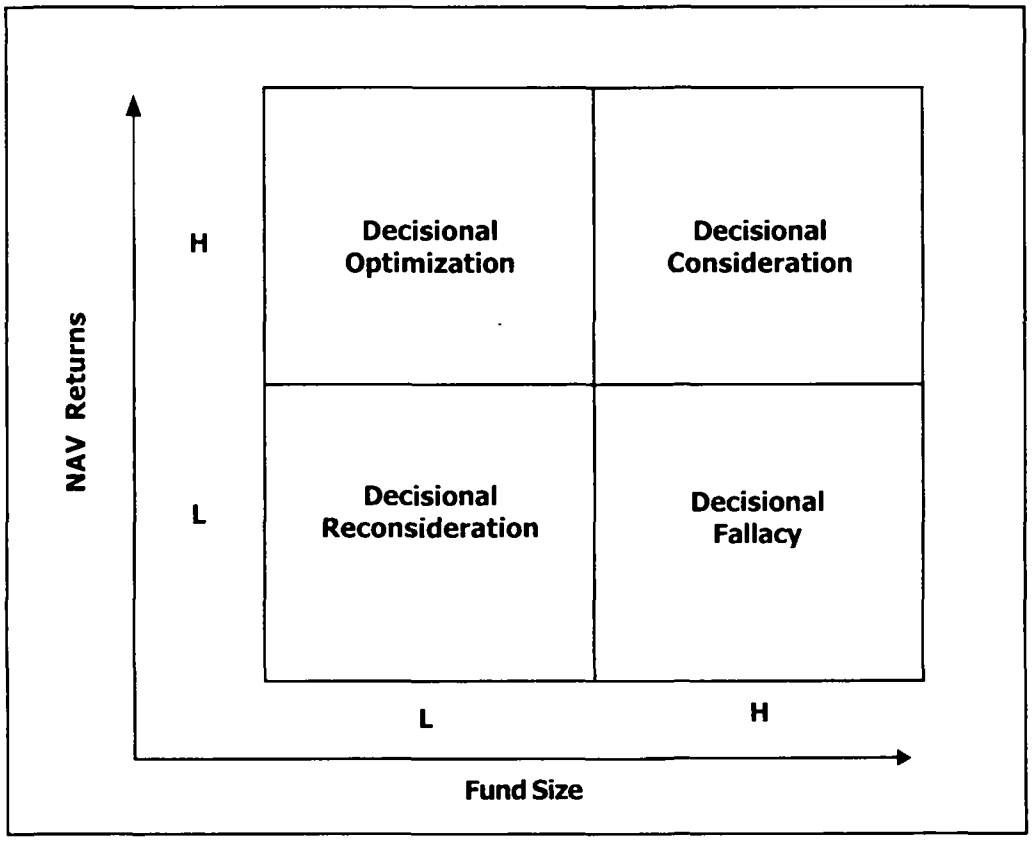

Figure I - The Size-Returns (SR) Matrix

and NAV Returns on the y-axis have been undertaken to enlist various rationally competent decision alternatives. The SR Matrix is a unique step to provide an auxiliary support to investors to ascertain the relevance and profitable intent in their investment decisions.

Decisional Fallacy

The Mutual Funds decisional fallacy exists when the fund witnesses a low or continuously declining NAV Returns, whereas the Fund Size remains on a higher side. Investments made in such mutual funds are a high risk choice and often results in wastage of the invested capital.

Decisional Consideration

A high NAV returns at the cost of a large (high) fund size, compels the investor to keep considering the existing investment option, but looking toward a more optimal solution. Such mutual funds ought to be under strict decisional consideration, if not necessarily complete acceptance by the investors.

Decisional Reconsideration

This is the highest level in the matrix which determines a strategic venturing into mutual fund investments. It is a stage where both the Fund Size and the NAV Returns witnesses a high, thereby culminating a conducive situation for investment in such mutual funds. Such mutual funds which are in the state of decisional optimization are the most sought after ones as they create a healthy investors climate boosting investors confidence.

Decisional Optimization

This is the highest level in the matrix which determines a strategically profitable venture into mutual fund investments. It is the stage where both the Fund Size and the NAV Returns witnesses a high, thereby culminating a conducive situation for investment in such mutual funds. Mutual Funds which are at the stage of decisional optimization are the most sought after ones as they create a healthy investment climate thereby boosting investors confidence.

Conclusion and Future Research

In today's complex financial scenario, where markets for equity shares, bonds and derivatives are traversing onto the path of unprecedented maturity, the option of mutual fund investment ultimately becomes a sought-after choice. The decision function and the decisional matrix for mutual funds investments, both of which have been duly proposed in their paper, are steps toward helping the investors enhance his confidence in mutual funds. The paper instigates wider research areas on the higher order relevance of mutual fund investment decision function and the modus operandi of the Size-Returns Matrix. A thorough revision of the SR Matrix can be carried out as a case study of its dynamic equilibrium on a particular mutual fund or the fund family.

References

1 Jayadev. M. And Mohinder N. Kaura (1998), Investment objectives and Mutual Funds – performance: An Empirical Analysis, Indian Journal of Finance and Research, Vol. VIII, No. 1 & 2 Pages 54-63.

2 Melt down Blues Impact industry Business India (2000), page, 120-137.

3 The resurgence of the Mutual fund, Business Today (2002), BT Xtra, January 12, Page 76-83.

4 The return of The Mutual Fund, Business today (2003) November 7-21, Page 116-121.

5 Thomas, Susan, Funds Management in India, Challenges and Opportunities (2002), Tata McGraw Hill.

6 URL: www.indiainfoline.com