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Study Notes

Investment Planning

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Forward

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Faculty and content team, RIFM

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Investment Planning

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MUTUAL FUNDS

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A. The concept and role of mutual funds

Concept of mutual funds

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debentures to money market instruments. The income earned through these investments and the capital appreciation realized by the scheme are shared by its unit holders in proportion to the number of units owned by them (pro rata)

While the concept of individuals coming together to invest money collectively is not new, the mutual fund in its present form is a 20th century phenomenon. The USA, where financial markets and instruments witness the birth and growth, is the place the concept of mutual fund is founded. In fact, mutual funds gained popularity only after the Second World War Globally, there are thousands of schemes with variety of investment objectives. Today, mutual funds manage more money as compared to banks in USA.

Mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost. Anybody with an investible surplus of a few thousands rupees can become a client of a Mutual Fund Scheme.

A Mutual fund is the most suitable investment vehicle for today's financial scenario. Markets for equity shares, bonds and other fixed income instruments, real estate, derivatives and other assets have become mature and information driven. Price changes in these assets are driven not only by economic events happening in the country but also by global events occurring in faraway places. A common man may not be in position to have the knowledge, skills and time to keep track for these events, understand their implications and act speedily.

Individuals also find it difficult to keep track of ownership of his assets, investments and bank transactions etc. A mutual fund has professionally qualified and experienced staff that manages each of these functions on a full time basis. The large pool of money collected in the fund allows it to hire such staff at a very low cost to each investor. Thus, the mutual fund vehicle exploits economies of scale in all three areas-research, investments and transaction processing.

Role of Mutual Funds

Household sector in India has been a surplus sector, contributing to the deficit pockets like Government and corporate. In 1980s, even the common man started investing in share markets with the spread of equity cult and boom in the market. In 1990s, with free pricing of new issues (which were hither to controlled and offered goods returns) and greater volatility of stock markets, investors suffered heavy losses and individual investors withdrew from the market. There has been a shift towards building a diversified portfolio based on careful research. As mutual funds serve as a link between the saving public and the capital markets, these units are in a position to impart liquidity in the financial system.

B. Fund structures and constituents

Mutual funds have a unique structure, which is different from the legal structure, that manufacturing companies and partnerships firms have. The legal structure derives the inter relationship between the constituents of the mutual fund. In India mutual funds are allowed to issue open and the close end schemes under a common legal structure. SEBI (mutual funds) Regulations, 1996 specifies the structure of the fund constituents. We take a tool at the constituents of the fund in the following sections.

Fund Constituent

Fund Sponsor: Any person who, acting alone or in combination with another body corporate, establishes a mutual fund is a sponsor. Like a promoter of a company, a sponsor gets a mutual fund register with SEBI. He will form a trust and appoint a board of trustees. He will also appoint as Asset Management Company as fund managers. The sponsor acting through the trustees will appoint a custodian to hold the fund assets. All these appointments are made in accordance with SEBI regulations. As per existing regulations, for a person to qualify as sponsor, he must contribute at least 40% of the net worth of the AMC and posses a sound financial track record for five years before registration. SEBI (MF) Regulations defines sponsors as “any person who acting alone or in combination with anybody corporate, establishes a mutual fund. Eligibility criteria:

SEBI regulations require that, for the purpose of grant of a certificate of registration, the applicant (Sponsor) has to fulfill the following criteria, namely

a. The sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions. For the purpose of this clause “Sound track record” shall mean the sponsor should.
    I. Be carrying on business in financial services for a period of not less than five years.
    II. The net worth is positive in all the immediately preceding five years.
    III. The net worth is immediately preceding year is more than the capital contribution of the sponsor in the asset management company.
    IV. The sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year.
b. The applicant is a fit and a proper person
c. In the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the Board.
d. The sponsor has contributes at least 40% to the net worth of the asset management company

Provided that any person who hold 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria specified in these regulations.

a. The sponsor or nay its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offense involving moral turpitude or has not been found guilty of any economic offence.
b. Appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations.
c. Appointment of asset Management Company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations.
d. Appointment of a custodian in order to keep custody of the securities and carry out the custodian activities as may be authorized by the trustees.

Fund as Trusts: A mutual fund in India is constituted in the form of a public trust created under the Indian Trusts Act, 1882. The fund sponsor acts as the settler of the trust, contributing to its initial capital and appoints a trustee to hold the assets of the trust for the benefit of the unit holders, who are beneficiaries of the trust. The fund then invites investors to invest in a common pool, by subscribing to "units" issued by various schemes established by the truest.

Under the Indian Trust Act, the Trust or the fund has no independent legal capacity and only the trustees have the legal capacity and therefore all acts, in relation to the trust are taken on its behalf by the trustees. The trustees hold the unit holder's money which is entrusted to the asset management company the fund manager for the purpose of investments. Mutual funds can invite any number of investors as beneficial owners in their investment schemes.

Trustees: The trust may be managed by a Board of trustees (a body of individuals) or a trust company (as corporate body). While the former will be governed by the provisions of the Indian Trusts Act and the latter will be governed by the provisions of the companies act, 1956. Trustees act as protector of the unit holder's interest. The trustees do not directly manage the investment portfolio but entrust the task of the asset management company. Their duty is to ensure that the AMC manages the fund in accordance with the trust deed and SEBI regulations. SEBI has laid down the conditions to be fulfilled by the individuals being proposed as trustees. SEBI has also set down the rights and obligations of the trustees.

Asset Management Company: The AMC is to approved and registered with SEBI. AMC acts as the investment manager of the trust. The trustees are empowered terminate the appointment of the AMC and may appoint a new AMC with the prior approval of the Board and unit holders. SEBI describes the issues relevant to the appointment, criteria, and restrictions on business activities and obligations of the AMC.

- AMC must have a net worth of at least Rs.10 crores at all times.

- Directors of the AMC, both independent and non-independent, should have adequate professional experience in financial services.
- Directors should be individuals of high moral standing.
- AMC must always act in the interest of unit holders and report to the trustees with respect to their activities.

Other Fund Constituents

Custodian and depositories: The custodian is appointed by the board of trustees on behalf of the mutual fund and must fulfill its responsibilities in accordance with its agreement with the mutual fund. The custodian must register with SEBI and will be independent of the sponsor. He will hold the physical securities while the dematerialized securities will be held by the depository participant. However, fund will be under the overall direction and responsibility of the trustees.

Bankers: Fund's banker will play a crucial role in the financial of the fund and providing it with remittance services.

Transfer Agents: They are responsible for issuing and redeeming units of the mutual fund and provide services such as preparation of transfer of documents and updating investor records.

Distributors: To sell the fund's units across a wide range of retail individual investor, a network of distribution agents is required. AMCs usually appoint distributors or brokers. A broker acts on behalf of several mutual funds simultaneously and may have several sub-brokers under him for distributing units. Distributors may be individuals or may be others like banks, non-banking finance companies and corporate. Besides brokers, for selling mutual funds scheme individuals brokers are also appointed by the mutual funds.

C. Legal and regulatory environment

Different institutions operate in mutual fund industry and offer various schemes to investors. It is important that the interests of small and individual investors in mutual fund schemes are protected. The legal structure and the constituents describe above are designed to guard the unit holders' fund and assets. In the following paragraphs, let us have a look at the role of various regulators of the mutual fund industry.

1. **The Securities and Exchange Board of India (SEBI):** is an apex regulator of all entities in the capital market. Constituted by an act of parliament in 1992, it has emerged as a powerful watchdog in the capital market arena. Mutual funds are required to be registered with SEBI which has issued guidelines on the operations according for income and expenses, investors' protection, investments limits and restrictions etc. Besides mutual funds, the other constituent of the industry as well as foreign institutional investors, offshore mutual funds and venture capital funds are also regulated by SEBI.

2. **Reserve Bank of India (RBI)** is the regulator of banking sectors. The operations of bank owned mutual funds are governed by guidelines issued by the RBI as well as SEBI. It is generally understood all market related and investor related activities of these are supervised by SEBI. While any issues concerning the ownership of the AMs by banks fall under the regulatory ambit of the RBI. RBI also acts as a supervisor of money market mutual funds as they are the sole monitoring agency of all entities that operates in money market. Setting up of MMMF requires prior approval of SEBI. Like in case of bank owned mutual funds, MMMF are also jointly supervised by RBI and SEBI.
3. **Ministry of Finance (MOF)** is the ultimate supervisor of both the SEBI and RBI. The MOF has been playing the role of an Appellate Authority for any SEBI guidelines in particular any case of insider trading or mergers and acquisitions.
4. **Company Law Board (CLB), Department of Company Affairs (DCA) and Registrar of Companies (ROC)** These are the regulatory authorities empowered by the Companies Act, 1956. AMCs and corporate trustees of mutual funds are registered under companies Act 1956. The ROC ensures that the AMCs or trustees companies comply with the provisions of company's act 1956. All AMC accounts and records are filed with the ROC who may demand additional information and documents if necessary. The overall responsibility of formulating regulations relating to companies lies with the DCA. It has legal powers to prosecute directors of a company for failure to comply with any of the provisions of company's act 1956. The CLB guides the DCA and is the appellate authority for the corporate offenses.
5. **Stock Exchanges (SE)** Closed end schemes of mutual funds are listed on stock exchanges and such schemes are subject to regulation framed by the SE. Exchange rules and companies act provision decide on trading, clearing, transfer and settlement of the buying and selling of units in the market place.
6. **Office of the public Trustee** Mutual funds are public trust governed by the Indian Trust Act 1882. The board of trustees is accountable to the office of public trustee which in turn reports in the Charity Commissioner.

1. Association of Mutual funds of India (AMFI) plays the role of an association for the mutual fund industry in our country. It was incorporated in 1995 to collectively represent the mutual fund industry. Its principal objectives are

- **I.** To promote the interest of mutual funds and unit holders
- **II.** To set ethical, commercial and professional standards in industry
- **III.** To increase public awareness of mutual funds in the country

A board of directors elected from its members governs AMFI. Recently AMFI has agreed to play a role of self regulatory organization in mutual fund Industry to a limited extent.

Operations of unit trust in India: The cabinet committee on Economic affairs (CCEA) granted approval to a UTI reform package on August 31, 2002. As pet the package, UTI Act 1963 has been repeated and UTI has been made bifurcated in to 2 entities, UTI-1 and UTI-2. This has been opertionalised with effect from 1st February 2003.

1. In accordance with the act, the undertaking specified in UTI-1 has been transferred and vested in the administrator of the specified undertaking of unit trust of India, who manage 20 assured return schemes (mentioned below) along with US-64 and special unit scheme with a corpus of over Rs. 30000 crores.
2. The net asset value-based UTI-2 is managed by an AMC floated by the state bank of India (SBI), the Punjab National Bank (PNB), Bank of Baroda (BOB) and life insurance corporation (LIC). The AMC has an initial capital of Rs. 10 crore. The four players would have 25 percent stake each in the AMC.

D. The prospectus/offer document

Offer Document

A draft offer document is to be prepared at the time of launching a scheme of a fund. Typically, it pre specifies the investment objectives of the fund, the risk associated, the costs involved in the process and the broad rules for entry in to and exit from the fund and other areas of operation. In India, this document needs to be registered with the regulator, SEBI before announcing the scheme and before inviting subscriptions. The offer document is revised once in 2 years in short, offer document gives details about the new scheme and invite the public to subscribe. In case of closed ended fund, the offer document is issued only at the time the scheme is launched whereas the prospectus of an open ended fund is valid for all time, once it is issued at the time of launch.

Along with the application form, an abridged version of the offer document, known as key information Memorandum, is distributed to the prospective investors. SEBI regulations prescribed the standard format of the offer document and key information memorandum. Offer document is the only comprehensive and authentic source of information about the scheme on offer and the fund. It describes the fundamental attributes (objectives and terms) of the scheme and also the product on offer. It contains all disclosures that the mutual fund has to make.

SEBI requires that the following information be provided in the offer document;

- Details of the sponsor and the AMC
- Description of the scheme
- Financial Information
- Investment objective
- Borrowing policy
- Terms of issue
- Investors' rights and services
- Tax treatment
- Historical statistics

- Redressal mechanism for investor grievances
- Penalties, pending litigation and proceedings

The prospectus also discloses the risk factors which the fund and thereby the investors would face by investing in the scheme. Risk factors may be standard or scheme specific. Standard risk factors are market driven and common to all schemes. Scheme specific factors are to be carefully evaluated by the investors. Compliance officer/ CEO/ any responsible officer of the AMC stands guarantee to the information provided in the offer document and certify the fulfillment of AMC/ Fund's legal and procedural obligations.

In short, offer document is the primary vehicle for the investment decision, a legal document that protects and governs the right of the investor to information before the makes up his mind to invest and a reference document for the investor.

Exercise

1. Which of the following is the best measure of a fund performance?

A. NAV related performance over the period
B. Risk adjusted performance
C. Absolute returns in comparison with bank deposits
D. Absolute returns in comparison with risk free returns

2. In respect of a “No load Fund”, which one of the statements is not true?

A. Asset management, custodial, registrar and administrative and selling expenses are not charged to the fund
B. Asset management and other recurring expenses are charged to the fund
C. “No load funds” are permitted to charge higher fund management expenses compared to ”Load funds”
D. “No load” refers to the entry load at the time of NFO-the units are allotted at par to the NFO unit holders

3. Which one of the following statements is not true about mutual funds?

A. Mutual fund can lend securities
B. Mutual fund can trade in derivatives
C. Mutual fund can invest in foreign equities
D. Mutual fund can lend money to unit holders

4. The risk measure used for calculating Treynor Index is:

A. ABC Ltd.
B. Variance
C. Beta
D. Standard Deviation

5. Which of the following is a self regulatory organization in mutual fund industry?

A. SEBI
B. AMFI
C. RBI
D. Company Law Board

6. Which one among following funds can be considered riskier than the others?

A. Debt Fund
B. Index Fund
C. Diversified equity fund

D. Sector specific equity fund

7. Which one of the following statements is not true about mutual funds?

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D. Mutual fund can lend money to unit holders

8. In respect of index funds, the difference between fund performance and the market performance is called:

A. Under performance of the fund
B. Out performance of the fund
C. Tracking error
D. Superior returns over market returns

9. While seeking SEBI approval for new funds, which of the following is required to give a declaration that the new fund is unique in its investment objectives?

A. Directors of Asset Management Company
B. Directors of Sponsor Company
C. Registrars
D. Trustees

10. Initial issue expenses, not exceeding 6% of fund collected, can be amortized in the subsequent years, in the following cases only:

A. Close ended funds
B. Open ended equity funds
C. Open ended debt funds
D. Exchange Traded Funds

CHAPTER

14

OTHER INVESTMENTS

*A. **Bullion***

*B. **Collectibles***

A. Bullion

Indian Investors were a satisfied lot till recent past, wherein they were enjoying the fixed return party hosted by the government of India for them. Small saving schemes and other government schemes with administered rate of interest and safety shield were lapped up the investor as investment. Indian investors were on a merry ride of high returns and high safety on their investments. But things have changed during the last decade we have entered into an era of low to moderate interest rates and a phased withdrawal of government backed investment avenues.

The investor community in India phenomenally during the 1990's with India witnessing some of the greatest bull market in its history. Let it be Harshad Mehta's driven bull market of 1992, or the entry of FII's in 1996 and then again the technology led boom of 1999/2000.This period also saw the emergence of mutual funds as a new investment vehicle for Indian investor. Everything seemed to be great going till 2000, with limited need of an Indian investor, the investment options in form of equity, bond, small savings, mutual fund and insurance seemed a complete asset horizon.

Things have changed during the first 5 years of this decade, we had a long bear phase during the initial years and now we are in a bull phase that is steaming for last three years. Indian economy is getting more globalize. Indian investors have now options to invest in outside companies on foreign bourses as also more foreign direct investment is being allowed inside India. Our markets are getting aligned to the world economy and now a world happening affects the investor in India and like wise an Indian happening affects an investor outside India.

With such an outlook, and transformation and increasing kitty of wealth available with Indian investor today, there is a growing need of alternate investment for the sake of diversification as also the longevity of the investment vehicle.

To meet such alternative needs of an investor, May advisory firms are turning alternative asset classes like PRIVATE EQUITY, REAL ESTATE, PRECIOUS METALS, ART, and MANAGED ACCOUNTS. These alternative investments which were the domain of institutions and high net worth clients in past, are now available to the retail investors enhancing their overall returns while reducing overall portfolio risk. These benefits of enhancement of return and reduction of risk have made alternate investments get attractive allocation from all segments of investors.

However the alternate investment comes with some warranties.

a. Alternate investment segment mainly comprises the products which are unregulated without any set investment, buying selling module, and thus is subject to risk in the manner of fraud and theft.
b. Being a un regulated market, these investments suffers from transparency in disclosing the style and methodology of investment as also in publishing the portfolio. They also lack in legal reporting requirements.

c. Deciding and finding alternative investment is complicated and equally difficult is to arrive at allocation, which can be marked for these investments. This is because historical data, investment strategies and more details about them are not available and thus a thorough research and understanding of investment is required to decide on these.
d. Being unregulated and absence of historical data, it becomes very difficult to analyze performance as also there can be a widening gap of investment performance compared to investment avenues which are regulated, Transparency bridges the gap between performance.
e. Liquidity is a big issue in alternative investments. It may not be suitable for a retail investor to get into these investments because of the fact of limited liquidity.
f. Being UN regulated issues like legal, tax and operational issues must be sorted out before investment.

Gold and Silver

Gold and silver have been a medium of exchange and the most popular form of savings since ancient times. Indians worship both these precious metals, besides making investment. Gold and silver have been popular in India because historically these acted as a good hedge against inflation, the characteristic which bank deposits or gilt-edged securities do not have. Gold is bought for its aesthetic appeal and is widely used for ornament making. Apart from jewelers, there are other industries which use gold taking advantage of gold's high resistance to corrosion, its malleability, ductility, high electrical conductivity. Dentistry is an important user of gold. Central banks and international monetary organizations also buy gold to maintain reserves. Gold reserves kept helped India tide over the foreign exchange crisis in 1991.

South Africa and Russia top the list of gold production. South Africa depends on gold sales to balance its budget, its balance of payment position influences the gold market in the world.

Bullion Prices

Like any other commodity, gold reacts to the basic demand supply equation, but tends to be more volatile in situations like war. Its markets are cyclical. The trend in bullion prices in India in the last few years is given in the following Table.

March End	Gold price per 10gm(Rs)	Silver price per 1Kg(Rs)
1996	5713	8486
1997	4750	6825
1998	4050	8590
1999	4220	7845

2000	4395	7765
2001	4410	7365
2002	5030	7870
2003	5260	7660

Gold is different from other asset classes for the following reasons:

1. **Hedge against inflation**
   This crosion in the value of the currency (i.e. the Rupee) is something investors should ideally guard themselves against. One way of 'guarding' your wealth is to hold it in an avenue that preserves its worth. Gold, as an asset class, has historically proved to be a good hedge against inflation.
2. **Adds stability to the portfolio**
   Gold can have a stabilizing effect on one's portfolio. When equities are volatile, gold can play the role of an anchor in one's portfolio. Most investors suffer heavily during stock market volatility because they are over-invested in equities. When markets collapse, investors are left stranded without a anchor; an asset like gold can play this role well provided investors were prudent enough to have invested in it before the crash (and not after).
3. **Asset allocation**

Asset allocation means diversifying your money over various asset classes like real estate, equities, debt, cash and gold. Prudent asset allocation de-risks the overall portfolio and improves its performance over the long-term. Poor performance of any one asset does not jeopardize the entire portfolio. Although prudence demands that you invest a portion of your assets in gold, one should not go overboard. There are some disadvantages of investing in gold.

- **I.** Unlike other assets, such as debentures, gold does not provide regular income.
- **II.** Investing in gold does not provide any tax benefit. On the contrary, sale of gold results in a tax liability.
- **III.** Purity of the metal is always a worry. There is a good chance that you might not get the purity that was promised. At the time of selling the substandard gold, you will have to settle for lower price. To avoids this problem, at the time of buying, always insist on a certificate authenticating the purity of gold.
- **IV.** There is an extra cost involved in preserving gold. If you have physical gold, you may need to invest in a bank locker. If you buy gold over the stock exchange (i.e. gold exchange-traded fund), then you will need to maintain a demat account.

Gold Funds

As of today, there is another alternative if one would like to invest in Gold. The vehicle used is that of Gold funds which exchange traded funds are.

Exchange traded funds (ETFs) are comparatively new type of securities that are traded on stock exchanges. Like mutual funds, these funds are also pooled funds. These funds are invested in selected shares of any single industry like information technology, real estate, textiles, etc. Or the fund may be formed exclusively to trace the trends in some commodity, bullion, oil and petroleum sector, or shares listed in any index of reputed company's like Standard and Poors,. Therefore, each ETF has a different underlying class of industry, commodity, bullion, or stock index that it mimics the movement of.ETF prices move in tandem with the prices of underlying asset. In addition, because of smaller denomination, and affordability it offers, the demand for ETF may exceed the demand for the underlying asset.

Gold Exchange Traded Fund (GETF) is an initiative of World Gold Council. Australian Stock Exchange was the first to introduce GETFs in 2003.Presently; there are many GETFs that are being traded across the world. Major players are United States, Australia, United Kingdom, South Africa, Singapore, France, Italy, Germany, Japan and India.

Gold ETF's are open-ended mutual fund schemes that invest in a standard gold bullion (0.995 purity).The investor's holding will be denoted in units, which will be listed on a stock exchange. This requires a Demat account. Gold ETF's are designed such that the returns provided are closely related to the physical gold in the spot market and is closest to buying physical gold.

- ETF prices are subject to demand and supply in stock markets, and are, therefore, subject to wider range of fluctuations that investments in mutual funds.
- The profits on GETFs may or may not be in the ratio of the underlying class of assets like gold. This is because there are additional charges and management expenses to offset. However increase in GETFs prices due to affordability and tax advantages more or less negate this disadvantage.
- Respective governments are entitled to purchase the gold to overcome any economic crisis that the country is facing. This, of course, is a remote possibility, but it does exist.
- If the funds were to be liquidated, the investor would rank pari passu with other unsecured creditors, which may not have been the case, had the investor held the funds in personal name.

B. Antiques and Collectibles

Investing in antiques and collectibles is yet another form of investment. However this again requires a fair amount of knowledge and understanding of the antique market. Antiques too can of various kinds such as pottery, statues, silver items, rare artifacts, coins, porcelain and so on. Put forward are some does and don't

The best work by artists-great and not-so-great-appreciates in value more than mediocre work by the same artist. The same is true for antiques and collectibles, too. Even in a down market, prices hold-up better for the top examples of any type of object.

A good provenance hikes the value and adds to the resale allure of an object. Two reasons: it testifies that the piece is authentic and it tells a story. People love a story.

The signature doesn't show when you exhibit the item? Nobody sees the signature on a Cartier brooch or on the back of an abstract painting. For resale value, it must be there.

It is always good to buy things in a perfect condition. Sure, you can have a piece restored, but it will never be as desirable as something that was never damaged.

Simple attrition is one of the basic reasons antiques have value. Over time, fewer items survive and those that have survived usually deteriorate. Your investment goes up because you take care of it.

On a dollars/square inch basis, small items trade higher than big ones. This has to do with display logistics.

Buy items that art typical and have some distinguishing feature.

Tempting it may be, but whatever is terminally fashionable and on everyone's tongue this week is probably not a viable long-term investment. If an object, period or artist you own is all over the mass media, it's time to think about unloading.

Global political and economic shifts are a great clue in trend spotting: In the early 80's as OPEC's oil-pricing power declined, prices of oriental rugs took a hit. In the late 80's the price of Korean antiques skyrocketed as that Tiger economy grew. In the 90's,the fracturing of the USSR generated good interest in Stalinist memorabilia & other tchotchkas since they marked the Cold War-an era now relegated to the history books. Pick your political or economic scenario and build a portfolio of tangible investments around it.

The real money in antiques is in that small area of the trade commonly referred to as "investment grade antiques." Collecting investment grade antiques can add wealth to your estate. It can, but usually does not, make you rich. Dealing in investment grade antiques are a risky thing to do. It can make you a lot of money quickly. But you can just as easily lose a lot of money fast. Collecting investment grade antiques is similar to investing long-term in the stock market. Investment grade stocks, if held between 10 and 30 years, will make money.

Collectibles, by their very nature are not unique. They are mass-produced and subject to the whims and fantasies of collectors and dealers. The selling price of a given collectible can skyrocket and can also plummet to a new low in weeks. If you are collecting anything and do not understand the difference between an antique and collectible, you owe it to yourself to find out before you get too much money tied up in your collection.

But collectibles are the ideal moneymaker for the aggressive dealer. The trick is to catch a new fad in the early stages, invest as many thousands of dollars as possible, and hold until someone writes a book on the subject. When the book hits the marketplace, sell as fast is you can.

Long-term collectors of investment grade antiques, on the other hand, are protected by time against poor judgment, haste, and lack of knowledge. Dealers of investment grade antiques have no protection. A bad buying decision can result in the loss of thousands of dollars. Individuals unwilling to suffer a substantial loss by reselling a mistake for less than its purchase price should avoid dealing in investment grade antiques.

This brings us to the question: who is a collector and who is a dealer? True collectors are buying for the long-term, for example between 10 and 30 years. Dealers are buying for the short-term, or more like 10 to 30 weeks. It is much more difficult to be a dealer. Dealers require more knowledge, they must be aggressive, and they must be willing to suffer a financial los should they make a buying mistake. Most successful professional dealers are in the trade full-time. Professional dealers must be willing to travel extensively, spend a lot of money on research, and be risk takers.

Investing in Art

Volatile stock markets have become the norm. Real estate requires huge chunks of investment and bank deposit rates are hardly able to keep up with rising inflation rate. Given this scenario, art seems to have become a safe option for investment. Art experts feel that, apart from gold, it is the only commodity which gives steady returns. Art can make its own money over a period of time. The flip side is equally relevant. With surging salaries for technology and finance professionals and a growing middle-class ready to splurge, art in India has many takers. It has also led to art prices increasing substantially over the past decade.

Given the steady rise in the value of artwork, this form of investment is certainly not short term. Give it some time and this does not mean lifetime but at least around three years. In some cases, certain pieces of art have given 100 per cent returns and more.

Financial institutions such as Citibank, ABN Amro, ICICI Bank and Kotak Mahindra Bank have had the foresight to look at art as a viable form of investment. Banks have set up art advisories, where high net worth individuals (HNIs) are offered advice to select and purchase or sell art works. Several banks have tied-up with auction houses and art galleries for the purpose. A number of financial institutions like Edelweiss Capital and Dawnay Day have also come out with art funds or schemes, trying to cash in on this growing new market.

Buying Art

Investors buy art for two reasons. First, of course is the type who buys art for the love of it. And the second group buys art from an investment angle. Art experts feel that art should be brought for art's sake. Because as they say, "A piece of art will becomes a good investment only if it is good work to start with".

The following factors will affect the value of art:-

- The popularity and history of the artist for one can have huge impact on the work of art. Unless an artist is able to sustain its quality of work over a period of time, the value of his works tends to stagnate.
- The market perception of the artist, the quality of his works and even the number of exhibition done, can have a bearing on the price.

Art of buying art

The first step to start off is to know as much about the subject as possible. Apart from regular research through books, magazine and Internet, visit as many art exhibitions as possible to understand the nuances of art appreciation and to know more about the artist.

An art investor must also be clear about the horizons and gestation time in purchasing art. The quality of painting, provenance, condition and period of painting are also important considerations.

If possible try to talk to the artist to find out about their vision and insights. Also scout around for advisory and consultant service providers to know more about the business. Companies like Saffron art, art clubs and investment consultants who specialize in art can be of good help.

Also, when you want to sell art, visit a good art gallery, who will be able to evaluate the work properly and advise you. Considering the number of fakes and cheap copies floating around in the market, one needs to be careful that he or she is buying authentic works of art.

Check list

- Know they artist-Art buyers should know the history of the artist's work apart from the quality. Also check the provenance, condition and period in which it was painted before investing.
- Have a clear idea about the time horizon and gestation period for a particular work to appreciate in value.
- Buy works of well-known artists if you are looking for returns in the short term. However, if you can spot talent early, your returns can grow manifold over a period of time if you are prepared for the wait.
- Last but not the least; buy art only if you like the quality of work and not just the artist. And take good care of your purchase. A work of art can never be replicated.

Art Funds

Art funds typically operate by pooling in money from select investors and use it to buy art objects that have huge appreciation potential in a short period of time. These funds may soon come under the purview of market regulator, Securities and Exchange Board of India (SEBI).According to a SEBI press release on 13thFebruary,2008,art funds are" collective investment schemes" as defined under Section 11AA(2) of the SEBI Act,1992.

Only a company which has been granted certificate of registration by the Board in accordance with the Regulations can launch or sponsor a collective investment scheme. In other words, for a collective investment scheme to raise money from the public it is prerequisite that the entity must (a) be a company and (b) registered with SEBI as a Collective Investment Management Company.

At present, no entity has registered with SEBI, under the SEBI (Collective Investment Schemes) Regulations. The schemes/funds have been launched/floated by these entities without obtaining a certificate of registration in accordance with the SEBI (Collective Investment Schemes) Regulations, 1999 (the Regulations).

Launching/floating of “Art Funds” or Schemes without obtaining registration from SEBI amounts to violation of SEBI Act and Regulations. Appropriate actions, civil and criminal, under the SEBI Act may be taken by SEBI against such funds/companies.

Apart from private collectors and art galleries, art can also be purchased through online auctions. Through this medium, collectors can purchase works of artists in other parts of the country and also get a mix of well established and lesser-known artists.

The first Art Asset management company

Crayon Capital, an asset management company, launched its art fund ‘Crayon Capital Art Fund’, worth Rs.40 crore. The fund has a minimum investment of Rs.10 lakh with a lock-in-period of three years. This close-ended fund opened on November 15, 2006 and the first closure date was December 15, 2006.

“The Crayon Capital Art Fund will be funded through private placement and by invitation. The fund aims at investing in a well-diversified portfolio of select works by leading Indian artists and providing investors with the opportunity to profit from leveraging the fund’s pooled purchasing power,” said Mr. Gaurav Karan, Partner, and Crayon Capital.

According to company officials,’ Crayon Capital Art Fund-Scheme 1’shall be a conservative fund looking at low risk and medium-to-high returns.

The fund shall invest in a diversified portfolio of about 50 leading artists and emerging artists who have demonstrated a “history” of investor interest in their work.

‘History’ will be qualified as “artists who have consistently exhibited in leading museums and galleries around the world and have sold in leading auctions”.

Art critic and author, MS Ella Datta, has been appointed as the advisor to the art fund.

The fund will pursue a transparent buying strategy; it would send details of the artworks bought to its investors each quarter including the name of artist and the image, the size and medium of the work.

Estimated net asset values will be declared quarterly and shall be based on market research comprising historical analyses, an average of experts' valuations, square inch prices and trend analysis, said Mr. Karan.

Others are:

- Osian's-Connoisseurs of Art Private Ltd, a leading archive and auction house: Private fund called Osian's Art Fund, worth over Rs.100 crore.
- Synergy Art Foundation: Yatra 2.The earlier art fund from Synergy, Yatra, was launched in September 2005 and it mopped up Rs.11 crore.
- Indian Fine Art Fund: 25$ million fund.
- Kotak Art Fund: 25Crore

Though it is perceived that Art is only for the ultra rich, it may true for the present. But in coming years it is an investment option that all investors can consider.

Exercise

1. With respect to investing in "Index funds", which one of the following statements is not true?

A. It is suitable to investors who seek returns much in excess of market returns
B. It is a very aggressive investment strategy
C. It is an active investment strategy
D. It is suitable to investors who expect market returns on the investment

2. Trading in stock futures in the derivatives segment of the market would amount to which one of the following strategies?

A. Active
B. Passive
C. Low Risk Low return
D. Rupee Cost Averaging

3. Which one of the following statements is true regarding market timing?

A. It is easy for the small investor to time the market and maximize the gains
B. "Market Timing" is the most important factor for success in investment decisions for small investors.
C. It is the "time" more than the "timing" that has benefited the investors-investors stands to benefit if they are prepared to invest for longer term rather trying to time the market.
D. "Timing" is the key for long term investors

4. An investor plans to invest some capital to meet a requirement that is most likely to crop up within the next one or two years. He is not very keen on high returns on this investment. Which out of the following could be the most suitable option for him?

A. Floating rate debt fund
B. A sector specific equity fund
C. Direct investment in select stocks from the market
D. Keep the money liquid in a saving bank account because returns over this period can be quite uncertain

5. Adopting the bank financing route for applying to IPOs would amount to which of the following?

A. Active strategy of investments
B. Passive strategy of investments
C. Low risk low return strategy
D. Rupee Cost Averaging strategy

6. "Buy and hold" is a strategy suitable for which of the following type of investors?

A. Investors who want short term returns
B. Investors who want their shares to outperform the market
C. Investors who believe that market is an efficient place and that over long period this strategy pays
D. Aggressive investors

7. The following data is available for a piece of property:

Asking price Rs.7000000

Net Income rs.75000

Market yield 11%

According to the capitalization approach, what is the value of the property?

A. Rs.681,818
B. Rs.700,000
C. Rs.775,000
D. Rs.777,000

Roots Institute of Financial Markets (RIFM)

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