Concept of Mutual Funds

A mutual fund is just the connecting bridge or a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the gathered money into specific securities (stocks or bonds). When you invest in a mutual fund, you are buying units or portions of the mutual fund and thus on investing becomes a shareholder or unit holder of the fund. Mutual funds are considered as one of the best available investments as compare to others they are very cost efficient and also easy to invest in, thus by pooling money together in a mutual fund, investors can purchase stocks or bonds with much lower trading costs than if they tried to do it on their own. But the biggest advantage to mutual funds is diversification, by minimizing risk & maximizing returns.

Genesis MFs emerged in the USA many years' back because of the inefficiency of the banking system there. Banks would take money at deposit rates and lend it out to various corporate investors. But there was a huge gap between the rates at which they were willing to take money from individual investors and the rates at which they would lend to huge corporate borrowers. In such a situation a lot of retail investors were willing to go out and lend directly to corporate borrowers. They figured the risk was acceptable. Lots of corporate borrowers also felt that rather than borrow from banks at preposterous rates, they would do much better to access individual investors directly. The catch was that the ticket size of individual investors was very small. For a corporate borrower to transact directly with individual investors would mean running up a towering transaction bill. This was when the concept of a mutual fund emerged, whereby an entity with very high levels of efficiency, no capital adequacy ratio's, extremely low costs and not maintaining any priority sector lendings or government bonds etc, could pool everybody's money together and lend it out to a AAA company. Of course, in such an eventuality the concept of getting a return guaranteed became endangered. Because individual investors in the mutual fund would then have to risk a portfolio that some anonymous mutual fund manager put together. This brought in a new requirement for diclosures. Investors who took such a risk wanted a very high level of transparency. They wanted disclosures at any given point in time. They wanted to know where their money was being invested.