Risk v/s Reward while Investing in MFs

At the cornerstone of investing is the basic principal that the greater the risk you take, the greater the potential reward. Or stated in another way, you get what you pay for and you get paid a higher return only when you're willing to accept more volatility.

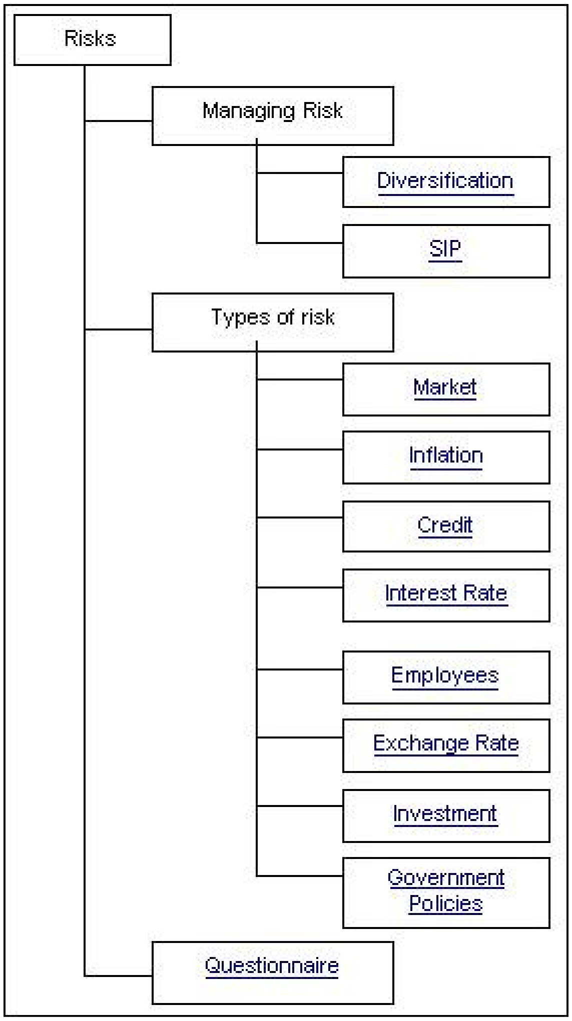
Risk then, refers to the volatility – the up and down activity in the markets and individual issues that occurs constantly over time. This volatility can be caused by a number of factors – interest rate changes, inflation or general economic conditions. It is this variability, uncertainty and potential for loss, that causes investors to worry. We all fear the possibility that a stock we invest in will fall substantially. But it is this very volatility that is the exact reason that you can expect to earn a higher long-term return from these investments than from savings account.

Different types of mutual funds have different levels of volatility or potential price change, and those with the greater chance of losing value are also the funds that can produce the greater returns for you over time. So risk has two sides: it causes the value of your investments to fluctuate, but it is precisely the reason you can expect to earn higher returns.

You might find it helpful to remember that all financial investments will fluctuate. There are very few perfectly safe havens and those simply don't pay enough to beat inflation over the long run.

Types of Risks

All investments involve some form of risk. Consider these common types of risk and evaluate them against potential rewards when you select an investment.



1. Market Risk – At times the prices or yields of all the securities in a particular market rise or fall due to broad outside influences. When this happens, the stock prices of both an outstanding, highly profitable company and a fledgling corporation may be affected. This change in price is due to "market risk". It is also known as systematic risk.

2. Inflation Risk – It is sometimes referred to as "loss of purchasing power." Whenever inflation rises forward faster than the earnings on your investment, you run the risk that you'll actually be able to buy less, not more. Inflation risk also occurs when prices rise faster than your returns.

3. Credit Risk – In short, credit risk evaluates the following – how stable is the company or entity to which you lend your money when you invest? How certain are you that it will be able to pay the interest you are promised, or repay your principal when the investment matures.

4. Interest Rate Risk – Changing interest rates affect both equities and bonds in many ways. Investors are reminded that "predicting" which way rates will go is rarely successful. A diversified portfolio can help in offsetting these changes.

5. Exchange Risk – A number of companies generate revenues in foreign currencies and may have investments or expenses also denominated in foreign currencies. Changes in exchange rates may, therefore, have a positive or negative impact on companies which in turn would have an effect on the investment of the fund.

6. Investment Risks– The sectoral fund schemes, investments will be predominantly in equities of select companies in the particular sectors. Accordingly, the NAV of the schemes are linked to the equity performance of such companies and may be more volatile than a more diversified portfolio of equities.

7. Changes in the Government Policy Changes in Government policy especially in regard to the tax benefits may impact the business prospects of the companies leading to an impact on the investments made by the fund.

8. Effect of loss of key professionals and inability to adapt business to the rapid technological change – An industries' key asset is often the personnel who run the business i.e. intellectual properties of the key employees of the respective companies. Given the ever-changing complexion of few industries and the high obsolescence levels, availability of qualified, trained and motivated personnel is very critical for the success of industries in few sectors. It is, therefore, necessary to attract key personnel and also to retain them to meet the changing environment and challenges the sector offers. Failure or inability to attract/retain such qualified key personnel may impact the prospects of the companies in the particular sector in which the fund invests.