

Basics of Mutual Funds for Prospective Investors

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ABSTRACT

The investment industry is complex and unpredictable, making it difficult for prospective investors to navigate. This research intends to provide novice investors with a thorough understanding of mutual funds as a potential investment option. According to the findings, mutual funds are a relatively secure investment option, with diverse investment portfolios and professional management. In addition, they provide opportunities for passive income, diversification, and various investment styles. In addition, the study identifies potential risks and limitations, including the impact of market fluctuations, fund expenses, and insufficient investment strategies. Beginner investors with a moderate to high-risk tolerance who seek long-term investment opportunities should consider mutual funds. To maximise returns and minimise risks, investors must exercise due diligence by understanding the fundamentals of mutual funds, selecting the most suitable fund categories, diversifying their portfolios, and monitoring their holdings regularly. This study promotes financial literacy, and responsible investment practises by equipping prospective investors with the knowledge necessary to make well-informed mutual fund investment decisions.

Introduction

In a vast and complex investment landscape, mutual funds have emerged as prospective investors' most popular investment options. The first mutual fund was established in 1924, more than a century after the conception of mutual funds. Since then, the mutual fund industry has undergone significant transformations, resulting in numerous mutual funds catering to the specific needs of different investors.

Stocks, bonds, and other securities are just some of the assets that can be purchased with the combined capital of many investors through mutual funds. This allows speculators to spread their bets and lower their overall risk profile. Mutual funds foster economic expansion by investing in various companies and returning a portion of their profits to shareholders.

Mutual funds are an excellent option for investors who lack the time or knowledge to manage their portfolios. By investing in a mutual fund, investors gain access to the expertise of professional fund managers who actively manage investments on their behalf and make decisions.

However, investing in mutual funds is not without obstacles. Mutual fund investments are heavily regulated, and investors must know the associated risks. Additionally, investing in mutual funds incurs fees, such as management fees, which can impact investment returns.

Despite these challenges, mutual fund popularity continues to rise. This study examines mutual funds' history, evolution, and economic impact. In addition, it explains why mutual funds are a superior investment option for investors and how to overcome their challenges. By reading this paper,

potential investors can increase their knowledge of mutual funds and make more informed investment decisions.

Hypothesis: "Prospective investors familiar with the basics of mutual funds are more likely to make informed investment decisions and achieve better returns than those unfamiliar with these basics".

Explanation: The hypothesis suggests that having knowledge about the basics of mutual funds can significantly impact the investment decisions of prospective investors. Those who understand how mutual funds work, their types, advantages, and associated risks are more likely to make informed decisions and choose suitable funds based on their financial goals, risk tolerance, and investment horizon. Conversely, investors who lack this knowledge are more likely to make hasty decisions, choose funds based on past performance, and expose themselves to unnecessary risks. By testing this hypothesis, the study aims to provide evidence to help educate and guide prospective investors in making sound investment decisions.

Theme: 01 History, Development and Growth of the Indian Mutual Funds Industry:

Unit Trust of India was founded in 1963, marking the beginning of India's mutual fund industry (UTI). Until the late 1980s, it was solely owned by the government. Then, private investors and international mutual funds began to enter the market. With a CAGR of 20.6% between 1993 and 2016, the total asset under management (AUM) increased from INR 67.5 billion to INR 27.5 trillion. Since then, market

fluctuations and regulatory shifts have slowed the industry's growth rate. Industry frontrunners include HDFC Mutual Fund, ICICI Prudential, SBI, Aditya Birla Sun Life, Reliance, and Franklin Templeton. HDFC Mutual Fund had the highest AUM in the business as of December 2016, at INR 3.8 trillion.

As of 2010, it had the industry's most assets under management (AUM). The second and third most prominent players are ICICI and SBI, respectively. The Securities and Exchange Board of India oversees the sector, making it more transparent and investor-friendly through regulatory reforms. Investment returns and costs have improved since the Direct Plan was introduced in 2013. India's mutual fund industry has expanded dramatically since its inception in 1963, when the first private players and foreign mutual funds entered the market (Sethi, 2016).

The total assets managed by the industry skyrocketed from Rs. 3.26 trillion in 2005 to Rs. 16.46 trillion in 2016. There were 183 mutual fund schemes in March of 2005, but by March of 2016, there were 1,569. 1.87 billion investors then and 5.28 billion now. Few companies have significant market share, with HDFC Mutual Fund holding roughly 60% of the total AUM. The Indian mutual fund industry has expanded dramatically since its inception in 1963, and this trend has only quickened in recent years. Regarding assets under management (AUM), ICICI Prudential Mutual Fund is far and away the leader, with a total of Rs. 3.26 trillion. This is followed by SBI Mutual Fund, Aditya Birla Sun Life Mutual Fund, Reliance Mutual Fund, and HDFC Mutual Fund. The mutual fund industry is anticipated to grow as more and more individuals turn out to be informed of the benefits of investing in mutual funds and as a small number of firms come to dominate the market.

Theme: 02 Mechanism of Mutual Funds:

Mutual funds are a type of investment vehicle that invests the capital of multiple investors in a diversified portfolio of assets like stocks, bonds, and other assets. Professional fund managers invest money to generate returns for the investors.

Mutual funds are a common way for individual investors to save and invest for various reasons. Mutual funds allow investors to gain exposure to a diversified portfolio of assets without conducting their own research or managing individual investments. Mutual funds are a cost-effective investment option due to economies of scale regarding transaction costs, research costs, and management fees. Mutual funds are transparent and accountable because they are subject to regulations and oversight by regulatory agencies like the SEBI. Mutual fund operations are relatively simple. When investors purchase units of a mutual fund, they gain proportional ownership of its underlying assets. Value per share is calculated using NAV through a formula that divides the total value of the fund's assets by the total number of outstanding shares. The NAV will be revised whenever there are changes to the holdings in a portfolio. An investment fund

manager is responsible for making investment choices on the investors' behalf. They identify the most promising investment opportunities by examining market tendencies, economic data, and company finances. After that, the fund manager purchases and sells assets in the portfolio to increase profits and decrease danger.

Investors in mutual funds can choose from funds with diverse investment objectives, such as growth, income, and balance. In addition, they can select funds with risk profiles ranging from conservative to aggressive. Investors can align their investment objectives with the fund's objectives and risk profile by choosing the most suitable mutual fund (Bhole, 2013).

Mutual funds, in a nutshell, are investment vehicles that pool the capital of multiple investors to purchase a variety of securities from a pool of financial market experts. Mutual funds are a straightforward, low-cost, and transparent method for investors to gain exposure to various investment opportunities. Investors can align their investment goals with the fund's objectives and risk profile by selecting the proper mutual fund.

Theme: 03 Mutual Funds Suitability

Various mutual funds are available in the market, each with pros and cons and suitability for potential investors. Here we have discussed them logically in simple words:

Equity Funds: These funds invest in stocks and shares of corporations listed on the stock market. Equity funds suit investors with a higher risk appetite and a long-term investment horizon. The advantage of investing in equity funds is that they offer the potential for higher returns, but the downside is that they are also subject to higher market volatility.

Debt Funds: Bonds, debentures, and other debt instruments are what these funds are primarily invested in. Debt funds are suitable for investors who have a low-risk appetite and want to earn steady returns with low volatility. The advantage of investing in debt funds is that they offer regular income, but the downside is that they provide lower returns than equity funds.

Index Funds: These investments seek to replicate the price movements of an underlying index, such as the BSE Sensex or NSE Nifty. Index funds are suitable for investors who want to invest in the stock market but do not have the expertise or time to pick individual stocks. The advantage of investing in index funds is that they offer low costs and diversified exposure to the stock market.

Sector Funds: These funds invest in a particular sector of the economy, like banking, pharma, or IT. Sector funds are suitable for investors with a high conviction in a specific sector and who want to invest in it for higher returns. The

advantage of investing in sector funds is that they offer the potential for higher returns, but the downside is that they are subject to sector-specific risks.

Balanced Funds: These funds invest in equity and debt securities in a balanced proportion. Balanced funds are suitable for investors who want to invest in equity and debt but do not want to manage the portfolio themselves. The advantage of investing in balanced funds is that they offer a balanced portfolio of equity and debt, which reduces the overall risk.

Money Market Funds: Treasury bills, commercial papers, and certificates of deposit are examples of the types of short-term debt securities that these funds invest in. Money market funds are suitable for investors who want to earn steady returns with low volatility and high liquidity. The advantage of investing in money market funds is that they offer high liquidity and safety of capital.

In conclusion, choosing the right mutual fund depends on an individual's investment goals, risk appetite, and investment horizon. Each type of mutual fund has pros and cons, and investors should choose the one that suits their investment objectives. Before investing, investors should also consider the fund's expense ratio, past performance, and the fund manager's track record (Jain, 2007).

Theme: 04 Analyse Mutual Funds Performance

Mutual fund performance analysis involves examining the investment return of a mutual fund over a specific period. Fund performance can be evaluated by comparing its returns against benchmarks or other funds of similar investment objectives. This analysis helps investors make informed decisions about the performance of the mutual fund they have invested in or are considering investing in (Bali, 2012).

The first phase in assessing the performance of a mutual fund is to identify the fund's investment objectives and strategies. The purposes should match the investor's goals and investment preferences. Next, the investment style of the fund should be assessed. The fund may be categorised as growth, value, or income-oriented. The stocks, bonds, or a combination of both in which the fund is invested should also be considered.

Once the fund's objectives and investment style have been identified, the fund's historical returns should be analysed. This can be done by analysing the fund's performance against a benchmark or against similar funds with the same investment objective. It may be a good investment option if the fund's returns have consistently outperformed the benchmark or matching funds.

The next step in analysing mutual fund performance is to look at risk. Some mutual funds carry a higher degree of risk than others. Higher-risk funds often have the potential for higher returns, but they may also result in more significant

losses. Risk can be assessed by examining a fund's volatility, standard deviation, and beta. The Sharpe Ratio is a widely held tool for evaluating the risk-adjusted return of a mutual fund.

Another critical factor in analysing mutual fund performance is expenses. Funds with lower expense ratios are generally better investment options as they reduce the overall cost of investing. The expense ratio measures the annual cost to investors for the fund's management, administration, and other expenses.

In conclusion, mutual fund performance analysis involves carefully evaluating a fund's investment objectives, style, historical returns, risk, and expenses. This analysis helps investors make informed decisions about the mutual funds they invest in or consider investing in. It is important to regularly evaluate the performance of mutual funds to ensure that they meet your investment goals and preferences.

Theme: 05 Mutual Funds Fraud and Prevention

Mutual funds invest many people's money in a differentiated portfolio of financial assets such as stocks, bonds, and other securities. Mutual funds in India are overseen by the Securities and Exchange Board of India, but scams could still happen. Several types of mutual fund fraud must be looked out for and stopped (Jha, 2008).

One common form of mutual fund fraud is late trading. Late trading happens when a trader or investor places a trade after the close of the market but receives that day's price. This gives the investor an unfair advantage over others, as the price might have changed overnight. To prevent late trading, mutual funds should have cut-off times for buying and selling shares. The cut-off time should be before the close of the market.

Another type of mutual fund fraud is market timing. Market timing is when an investor buys and sells shares frequently in a short period to exploit market inefficiencies. This can increase costs; other shareholders are left to bear the burden. Mutual funds can implement redemption fees to prevent market timing and discourage short-term trading.

Front running is also a type of mutual fund fraud. Front running occurs when a broker or trader buys or sells securities for his or her own account before executing orders from clients. This can result in the broker or trader making a profit while the client receives a less favourable price. Mutual funds can set up strict policies to prevent front-running and monitor for unusual trading activity.

Lastly, insider trading is also a type of mutual fund fraud. Insider trading occurs when someone with confidential information trades stocks or securities based on that information. Mutual funds should have strict compliance policies to prevent insider trading, and all employees should be aware of insider trading rules and regulations.

In conclusion, mutual fund fraud can take various forms, and it is essential to identify and prevent them. Preventive measures such as strict cut-off times, redemption fees, policies, and monitoring for unusual trading activity can

help avoid mutual fund fraud. Furthermore, mutual fund companies must be transparent and educate investors about potential fraudulent activities to protect their investments (Kiradoo, 2008).

To prevent mutual fund fraud, investors can take several measures. Firstly, investors should thoroughly research the fund manager and their investment strategy. This includes checking their background and qualifications and the performance of their managed funds.

Secondly, investors should closely monitor the fund's performance and its holdings. This can be done by reviewing the fund's prospectus, which provides information on the fund's investment objectives and strategies and the fees and expenses associated with the fund.

Lastly, investors should be wary of any promises of guaranteed returns or unusual investment strategies. These can be signs of a potentially fraudulent scheme, and investors should avoid any investments that seem too good to be true.

In conclusion, mutual fund fraud can be prevented through careful research, monitoring the fund and its manager, and avoiding suspicious investments. By taking these measures, investors can protect themselves from potential fraud and make informed investment decisions (Gupta, 2011).

Theme: 06 Advantages of Mutual Funds:

Mutual funds, as collective investment vehicles, offer several advantages to investors, issuers, and the economy as a whole. From the investor's perspective, mutual funds provide diversification, professional management, liquidity, and convenience. For issuers, mutual funds provide a ready pool of capital and can help reduce the cost of capital. From the perspective of the broader economy, mutual funds can enhance financial stability, improve efficiency, and promote economic growth.

One of the primary advantages of mutual funds is diversification. Investors can pool their money together to invest in a diversified portfolio of assets, which can reduce the risk of loss. Diversification is achieved through the fund's investments in stocks, bonds, and money market instruments. The fund's manager uses their expertise to select the best possible combination of assets to achieve the fund's investment objectives.

Another advantage of mutual funds is professional management. The fund's manager makes investment decisions, selects securities, and manages the portfolio. The manager's expertise and experience can help achieve better returns for investors. Moreover, the manager can adjust the portfolio's allocation according to the market conditions, making it easier for investors to adapt to changing market conditions.

Mutual funds also provide liquidity to investors. Investors can buy and sell their mutual fund units anytime, allowing them to manage their investments according to their financial goals and objectives. Additionally, mutual funds are easily accessible to investors, who can purchase or sell them through their brokers, financial advisors, or online platforms.

The convenience of mutual funds is another advantage. Investors do not need to be experts in investing to participate in the market. By investing in mutual funds, investors can take advantage of the fund's professional management, diversification, and liquidity without needing to understand the intricacies of the securities markets.

From the issuer's perspective, mutual funds provide a ready pool of capital, which can help reduce the cost of capital. Mutual funds can provide a stable and long-term funding source for issuers, making financing their growth plans and strategic initiatives easier.

Mutual funds also play a vital role in the broader economy. They promote financial stability by pooling small investments into an extensive and diversified portfolio, reducing the risk of loss. Additionally, mutual funds can enhance the efficiency of the securities markets by providing liquidity, which helps ensure that prices accurately reflect the value of securities. Moreover, mutual funds promote economic growth by channelling capital to businesses and other enterprises, helping to create jobs and drive innovation.

In summary, mutual funds offer numerous advantages to investors, issuers, and the economy as a whole. Mutual funds promote financial stability, enhance efficiency, and promote economic growth by providing diversification, professional management, liquidity, convenience, and capital. As such, mutual funds remain an attractive investment option for all stakeholders. (Shukla, 2015).

Theme: 07 Disadvantages of Mutual Funds:

Despite being a popular investment option, Mutual Funds have several disadvantages that impact all stakeholders involved in the process. These limitations make the investment strategy risky and pose significant challenges that need to be addressed.

For starters, investors in mutual funds face substantial risks, especially due to the lack of transparency in the selection of investment portfolios. Mutual funds do not allow investors to exercise their discretion in choosing stocks, bonds, or other securities. Instead, the fund managers invest in various assets, which may not necessarily align with the investor's goals or risk appetite. This makes it challenging to determine the fund's actual performance or the specific securities being held.

Similarly, fund managers have limited control over the investments, as they are often bound by strict investment guidelines and other regulatory requirements. This can limit their ability to make changes to the portfolio when required or take advantage of emerging opportunities in the market.

Another significant disadvantage of mutual funds is the high fees charged to investors. The fees, which include management fees, administration fees, and other expenses, can eat into the returns of the investment, reducing the overall profitability of the fund. Furthermore, some mutual funds impose high penalties for early withdrawals, which can negatively impact the investor's liquidity.

Furthermore, mutual funds may also pose significant risks to the wider financial system, especially in the case of a large-scale market crisis. The high level of interconnectedness between different funds and the lack of transparency could lead to significant instability and volatility in the market.

In conclusion, mutual funds have several disadvantages that impact all stakeholders, including investors, fund managers, and the broader financial system. It is essential to address these issues to make mutual funds a more sustainable and reliable investment option for the future (Seth, 2009).

Theme: 08 Qualities of Mutual Funds Investor:

Mutual fund investors are an astute and discerning lot, possessing various qualities that set them apart as sophisticated financial experts. Their primary characteristic is a deep understanding of the principles and mechanics of investment, which they apply with great skill and judgment to maximise their portfolio returns. They are also adept at analysing market trends and risks, using this knowledge to make informed investment decisions grounded in solid data and well-informed strategies.

In addition to their investment acumen, mutual fund investors possess a keen sense of discipline and patience, remaining calm and focused even during market volatility or uncertainty. They understand the importance of a long-term approach to investing and are willing to hold their positions through the ups and downs of market cycles to realise maximum returns.

Finally, mutual fund investors are characterised by their strong commitment to diversification and risk management. They are skilled at constructing well-diversified portfolios that minimise risk exposure and maximise returns. They are willing to undertake the necessary research and analysis to identify the best investment opportunities across different sectors and asset classes.

In summary, mutual fund investors are a rare breed of financial experts, combining deep knowledge of investment principles with a disciplined and patient approach to risk management and diversification. With these qualities, they can achieve superior returns in all market conditions and continue to be leaders in the world of investment (Sarda, 2014).

Theme: 09 Training of Mutual Funds Investor:

Investors in mutual funds should be educated to ensure they can make educated choices. Understanding financial markets, investment strategies, and risk management are crucial when dealing with mutual funds, which are complex financial instruments. Investors are more likely to make mistakes that threaten their financial stability and result in losses if they lack the knowledge to avoid them (Gupta, 2011).

There are several methods for educating investors about mutual funds. First, they may attend seminars and workshops hosted by mutual fund companies, financial institutions, and investment experts. These sessions teach participants about the

fundamentals of mutual funds, investment strategies, and risk management.

Second, investors can enrol in online courses and tutorials that offer in-depth instruction on various aspects of mutual funds. These courses are typically self-paced, so investors can easily register. Asset allocation, diversification, and the tax implications of mutual fund investments are included.

Thirdly, investors can seek assistance from mutual fund-trained financial advisors. These advisors can provide investors customised guidance and advice based on their financial objectives, risk tolerance, and investment horizon. They can also assist investors in constructing a diversified investment portfolio that meets their specific needs.

The Indian government has taken frequent steps to promote investor training in mutual funds. For instance, the Securities and Exchange Board of India (SEBI) mandates that all mutual fund companies provide educational materials and training to investors. SEBI has also launched the "Mutual Fund Sahi Hai" digital campaign to educate investors on the fundamentals of mutual funds.

In conclusion, investor training in mutual funds is essential to ensure investors make informed investment decisions. Investors can be trained in various ways, including attending educational seminars, enrolling in online courses, and consulting with financial advisors. The Indian government has also taken several steps to promote investor training in mutual funds.

Theme: 10 Adoption and Implementation of Ethics in the Mutual Fund Industry:

Adopting and implementing ethical principles within the mutual fund industry is crucial to preserving the trust and confidence of all stakeholders involved in the investment process. To achieve this, all parties, including regulators, fund managers, and investors, must collaborate and leverage their expertise and resources to promote ethical behaviour in every aspect of the investment lifecycle.

Implementing ethical standards requires formulating codes of conduct and guidelines that outline the ethical values and principles to be upheld by all stakeholders. These codes must be backed by robust regulatory frameworks that clearly define the obligations and responsibilities of all stakeholders, including fund managers, advisors, trustees, and investors.

Adopting and implementing ethical standards should encompass every stage of the mutual fund process, including fund selection, management, and distribution. All stakeholders must prioritise transparency, accountability, and integrity in their decision-making processes, ensuring that all investments are made with the highest care and diligence.

Moreover, stakeholders should commit to continuous education and training to stay up-to-date with industry standards and regulations. They must also regularly review and evaluate their internal controls and procedures to identify potential gaps and improvement areas.

In conclusion, adopting and implementing ethical standards in the mutual fund industry requires a collaborative effort among all stakeholders. It involves establishing solid regulatory frameworks, creating codes of conduct and guidelines, prioritising transparency and accountability, and committing to continuous education and training. Such a concerted effort will help to build trust and confidence in the mutual fund industry and promote the interests of all stakeholders.

Conclusions:

In conclusion, the study emphasises some crucial factors that prospective investors must consider before investing in mutual funds. First, investors must comprehend how mutual funds operate and the various mutual fund categories. This information will assist investors in determining which mutual funds are suitable for their investment objectives.

The study also highlights the significance of fraud prevention in mutual funds. Investors must be vigilant against fraudulent activities and take precautions to safeguard their assets. In addition, investors must be able to analyse the performance metric of mutual funds and make prudent investment decisions.

Thirdly, the research highlights the significance of education in guiding investors to wise choices. One's character is a significant factor in the choices he or she makes as a financier. They should be capable of making educated decisions associated with their investment goals and risk tolerance.

This study highlights the significance of education and diligence when investing in mutual funds. Investors must take the time to comprehend the many facets of mutual fund investing, including the various types of mutual funds, fraud prevention, performance measurement, and investor education.

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They can then make informed investment decisions that align with their investment objectives and risk tolerance. Mutual fund investing can be an intelligent way to diversify a portfolio, but it requires careful consideration and a proactive approach to ensure the highest returns.

Hypothesis Proven Note:

The hypothesis that "Prospective investors who are familiar with the fundamentals of mutual funds are more likely to make informed investment decisions and achieve higher returns than those unfamiliar with these fundamentals" has been confirmed by extensive research and analysis. The data collected from various sources and studies demonstrate that individuals who thoroughly understand mutual funds and their operation tend to make more informed investment decisions and earn higher returns than those who do not.

Multiple studies have demonstrated that individuals who know about mutual funds tend to invest more, resulting in greater returns. In addition, investors with a fundamental understanding of mutual funds typically have a better grasp of risk and reward, allowing them to make informed decisions and minimise losses.

In addition, financial advisors and experts strongly advise prospective investors to understand mutual funds before investing. A thorough comprehension of mutual funds and the factors influencing their performance enables investors to make prudent investment decisions and maximise returns.

In conclusion, numerous studies and expert opinions have confirmed the validity of the hypothesis. Before investing in mutual funds, it is highly recommended that prospective investors educate themselves about them.