NFO or Existing Funds?

A new mutual fund product is offered for the first time to investors in a New fund Offer (NFO). An NFO is open for a limited period, say 30 days. Investors can buy an open-ended mutual fund product even after the NFO, when the scheme re-opens for on-going transactions. After the first set of investors has invested and the portfolio and investor records have been created, the fund opens for on-going transactions. While the NFO is made at face value, usually of Rs.10, on-going purchase price depends on the NAV of the fund. Investors therefore have the choice of investing in an NFO or an existing fund.

Several investors tend to believe that buying a mutual fund in a NFO is a better option. This comes from a wrong perception of price and value. When a new fund is launched, there is no portfolio in place. The portfolio is created only after the funds are mobilized by the investors. Therefore units are offered at a nominal price of Rs.10 per unit. Once the NFO closes, and the funds are invested, the value of the portfolio changes with the market. Mutual funds calculate the current value of a mutual fund unit and represent it as net asset value (NAV). Subsequent transactions in a fund happen at a price that is based on the NAV.

If the on-going purchase and redemptions after the NFO are also done at Rs.10, it would be wrong. If the NAV is Rs.20, then a new investor should buy units at that price, to enter the portfolio equitably. And an investor who quits should get the current value of Rs.20, not the NFO price of Rs.10, as the portfolio has grown in value when he stayed invested. NAV is the correct and current representation of the value of an investor's holding in a mutual fund.

Will the investor who buys a new scheme at a NFO price of Rs.10 be better off that the investor who buys an existing fund at the current NAV-based price of Rs.20? Not at all. Both investments represent a share in a portfolio at current market levels. Let us assume that the NFO mobilized Rs.10,000 and was invested at the market index level of 10,000 points. The investment in the existing scheme was also invested at the same market levels. If the market index were to move to 15,000 levels, say six months later, the NAV of the new fund would also move up by 50% to Rs.15 and the existing fund will move up by 50% to Rs.30. There is no way that a Rs.10 fund will move faster than a Rs.20 fund, if both invest in the same manner at the same time. Several investors fail to see this logic and look at the price per unit, rather than the rate of return.

An existing fund even at Rs.200 may be a good investment option, if the portfolio objectives meet the investor's needs. A long term conservative investor will be better off buying an existing diversified equity fund at Rs.200, than buying a risky sector fund at Rs.10 in an NFO.

An NFO is useful for its novelty value. If a particular strategy is new, or is a particular segment is attractive an NFO can enable participation in such opportunities through an NFO. If the investor is only looking to invest in a generic product, an existing fund with a track record of performance is always a better bet. There is more information about the portfolio and performance to make an informed choice.

Investors need to choose their mutual fund product based on their need, and not the price. Just as one would not rush into a monsoon sale to buy poor quality products at lower prices, investors should be wary of making investment decisions purely on the basis of price.

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Mutual fund investments are subject to market risks. Please read the scheme information document carefully before investing.