

FUNDamentals



Understanding investment funds

This factsheet will give you a basic understanding of investment funds. However, your financial adviser will be able to tell you which investment solutions will suit your specific needs.

1. What are investment funds?

The majority of investors lack the time or experience to give a portfolio of shares the attention it needs. For these investors, investment funds combined with the know-how of a financial adviser can be a sound, individually tailored investment solution.

Investment funds offer the capability to achieve diversification across a range of investments by simply investing into one fund. This fund under supervision of a fund or asset manager, pools together money from many investors to collectively invest in a selection of stocks, bonds, properties or other financial instruments – ultimately providing a diversified investment.

Each investment fund has an objective of what it aims to achieve for its investors. This gives investors the ability to choose funds that are appropriate to the level of risk they are prepared to take. The objectives can be found on the fund fact sheet or prospectus.

It is the fund or asset manager's job to create a portfolio that blends different types of shares, bonds, and other financial instruments to achieve the objective of the fund.

As with all investments of this nature, the most important thing to remember is that investment funds should be viewed as long-term investments, meaning at least five years but preferably longer.

2. Types of investment funds

Equity funds

Equity funds invest in a diversified portfolio of shares of different companies and industries.

Depending on the investment strategy, some may only invest in large companies and some only in medium to small companies. There are also funds that will only invest in particular sectors, such as health and telecommunications – offering the investor a diversified investment into a particular industry.

Bond funds

In general terms bond funds invest in a diversified portfolio of fixed interest securities, for example government bonds and corporate bonds. The securities within the fund will give the investor an income from the coupons, or interest, that is paid out.

Funds that invest in government bonds are generally considered to be less risky than funds investing in corporate bonds. However, rates are not guaranteed.

Balanced funds

Balanced funds have the advantage of investing in a mixture of both equities and bonds. It would be common for a balanced fund to have the majority of the portfolio invested in a mixture of these assets, with the remainder held in other asset classes such as property and cash. However, this varies depending on the objective of the fund.

It is important to be aware of the split between stocks and bonds to fully understand the risks and rewards inherent within a particular fund.

Specialist funds

Specialist funds invest in a specific sector of the economy. No matter which sector you are interested in investing in, chances are there is a fund that invests in it. Examples of sectors include: health, telecommunications, IT and technology, property, natural resources, etc.

Global funds

A truly diverse portfolio should take advantage of global diversification opportunities. Global funds offer a convenient solution to achieve a geographically diverse portfolio.

If you do not have any specific preference of country, global funds are the easiest way to “go global”.

Emerging market funds

An emerging market fund invests in less developed countries that might, potentially, have a very high economic growth. Examples are Brazil, Russia, India and China (BRIC countries) as well as Malaysia and Taiwan.

This high growth potential may be due to a number of factors, such as political and structural changes in a country, for example privatisation; liberalisation of trade or better access to capital. The main risks on the other hand are political instability and higher reliance on external capital. The financial markets in these countries can fluctuate quite dramatically.

3. Risk and return

As with all investment, there is a degree of risk. Of course, investment funds can go down as well as up in value. It is important that the investor is comfortable with an investment fund’s risk profile and susceptibility for short-term volatility.

4. Measuring performance

You can find performance figures in the financial press and on the internet. These figures show you cumulative performance for one year or even up to 10 years.

The performance of a fund is often compared to a benchmark index or the sector average performance. The sector average indicates the average performance of all funds within that particular sector.

The performance and subsequent sector rank of a fund is an indicator of how good a fund is in comparison to funds with similar investment objectives. However, past performance is not a guide to future performance. Investing in funds is a long-term investment and it is therefore more important to look for funds and fund managers that consistently out perform the sector average over a sustained period of time. Remember, a fund may out perform its sector, but if the sector average is negative, the actual return on the fund could also be negative.

5. Charges

An investor typically pays a management fee for these services of between 0.5% and 2% a year. On top of this they may also pay the fund’s additional expenses such as performance fees, distribution fees and servicing costs. These charges combine to represent the total expense ratio (TER) which is taken from your funds performance.

There is no doubt that investment funds offer a potential for growth and a convenient way to diversify risk. However, with such a wide choice available – all with varying objectives – performance and risk profiles – it’s important to choose wisely.

Your financial adviser will be able to recommend investment funds that are suitable for your needs and that best fit your specific risk profile.

For more information on Discovery Invest, contact your financial adviser.

This material is provided for educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell investment funds.