Should you invest in unit trusts?

WOULD you invest in unit trusts if you thought you would lose money? Probably not! You may have heard of friends who lost money in unit trusts. And you swear you will not invest in them.

So have you ever wondered why some people have lost money in unit trusts?

One reason is probably their lack of understanding of the product. If you do not understand a product, you will not be able to maximise its benefits or be aware of its risks and take appropriate preventive action.

But why should you buy unit trusts if you can make money investing yourself? You can, only if you have the time and expertise to pick the right investments.

For instance, if you had bought City Development (CDL) shares and held them over a three-year period between the years of 1990 and 2004, you could have earned on average rolling return of 9.67 per cent per annum.

If, however, you had selected Neptune Orient Lines (NOL) shares, its average three-year rolling return would have been 2.51 per cent.

Contrast that with unit trusts that invest in the Singapore stock market. They have returned an average of 4.48 per cent during the same time periods. This is even better than the Singapore stock market, where the ST Index returned 1.86 per cent.

But remember that although unit trusts are pooled investments and managed by professional fund managers, they are not risk-free.

Notice from the table that when the ST Index, CDL and NOL posted their worst three-year performances, with average losses of 26.38 per cent to 39.9 per cent, unit trusts which were invested in the Singapore bourse also posted a corresponding loss.

However with these unit trusts, the average loss was lower at 19 per cent.

So in a bear market, unit trusts may not be left unscathed. This is partly because fund managers are often required to stay almost fully invested.

UNIT TRUSTS vs STI

PERIOD: JAN 1990 TO DEC 2004	3 YEARS ROLLING RETURN (% PER ANNUM)^		
	Average	High	Low
ST Index	1.86	28.10	-26.38
Average Singapore Unit Trust*	4.48	30.45	-19.02
City Developments	9.67	59.29	-27.88
Neptune Orient Lines	2.51	58.19	-39.90

* Unit trusts that invest in Singapore stocks
^ Annualised returns

SOURCE: S&P AIM, BLOOMBERG

But good fund managers can still help to mitigate downside risk by having prudent investment processes and good risk management systems.

While the examples we have cited so far were focused on the Singapore stock market, there are many other unit trusts which invest in other markets, sectors and asset classes such as bonds, money market instruments and property securities.

This, in essence, is the beauty of unit trust investing. It allows you to venture into overseas markets and a variety of investment opportunities.

What's more, with most unit trusts, you only need an initial investment of $1,000 with even smaller amounts for subsequent purchases.

And if you have limited time and know-how to pick the right investments yourself, unit trusts are something you should consider seriously.

No doubt, it would probably cost you more to invest in unit trusts compared with investing your funds on your own. But that is because with unit trusts, your money is in the hands of professional fund managers who have access to a lot more resources than average investors.

But to make money with unit trusts, you still need to buy the right ones.

How can you go about picking the right unit trusts? Find out next week.

Lure of emerging markets

EMERGING markets can offer attractive returns, but they also come with greater risk. Mr Devan Kaloo of Aberdeen Asset Management explains how to invest in these markets prudently.

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THE rewards for investing in emerging markets can be considerable, but they can also be both volatile and risky. Aberdeen Asset Management, known for its careful investing, adopts a stringent investment process based on careful stock selection.

Sharp pullbacks in markets often offer excellent opportunities to invest in quality companies with good long-term potential, said Mr Kaloo who leads Aberdeen's team of emerging market fund managers.

He said that emerging market stocks have fallen recently, due in part to higher US interest rates, which have caused investors to become more risk averse.

Concerns over the slowdown in global economic growth have also weighed on emerging markets. In addition, there has been increased volatility brought about by hedge fund losses.

When some of these hedge funds unwind, it can have an exaggerated effect on stock prices.

But Mr Kaloo is not perturbed by market swings. He said that Aberdeen's investment process aims to ensure that the fund management company picks only quality companies, with good management, backed by healthy balance sheets and stable business models.

Mr Kaloo said that while emerging markets are often seen as a warrant on global growth, Aberdeen prefers to invest in companies with a stronger domestic orientation. This is one factor that distinguishes it from many of its peers.

"In emerging markets, there is significant potential for growth fuelled by young people coming into the workplace, earning and consuming more," he said.

"We believe that quality domestic companies in these markets can capitalise on the promising long-term growth story and offer investors good returns."

But Mr Kaloo warned that anyone investing in emerging markets must take a long-term view. To mitigate risk, he said that Aberdeen runs a fairly conservative portfolio with a beta of less than one. In other words, its portfolio is less volatile than the market.

Emerging markets comprise three regions: Asia, Latin America and Emea (Eastern Europe, Middle East and Africa).

While Aberdeen is well regarded for its Asian investments, its expertise in non-Asian emerging markets is less well-known.

Nevertheless, Mr Kaloo said that his emerging markets team applies the same stringent criteria with its non-Asian investments, as it does for its Asian portfolios.

"We never invest in any company without first visiting it. Companies must first pass our quality screens, regardless of whether they are in Asia or any other part of the world," Mr Kaloo said.

"We need to meet the management, make our assessments, compare what they say to the financials they present. In addition, we factor in what competitors, suppliers or brokers are saying about them, in order to build up a profile of the management and thoroughly assess the quality of the companies," he added.

BLOOMBERG

Turkey is an emerging market with improving macroeconomic fundamentals.

Mr Kaloo said that while Aberdeen is positive about the outlook for Asia, the region has become "well-talked" about. Stock prices are, therefore, not as cheap as they were a few years ago.

On the other hand, Latin America is a lot cheaper than Asia and Aberdeen has been able to find good value in the region.

"With respect to Emea, we are looking at places such as Turkey and South Africa," said Mr Kaloo.

"These are big countries with young populations and improving macroeconomic fundamentals."

The bottom line is that global emerging markets provide a bigger universe of faster growing companies on relatively cheaper valuations to choose from, along with associated diversification benefits. But the flipside is that emerging markets also come with relatively higher risk.

*The writer is editor of finatiQ – Bank of Singapore.
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