Picking the right unit trust

Dig below the sales pitch, do your research and you may unearth a gem

OUT of the 400 to 500 unit trusts available in Singapore, choosing the perfect one for your needs may seem a daunting task.

Navigating this maze requires some research and diligence on your part: Never buy a unit trust just because it sounds good.

Know what you're buying into.

It's never "just a unit trust" — this collective pool of funds is invested in underlying assets (stocks, bonds, etc) in a certain part of the world (Europe, Asia, North America, etc), perhaps in a certain industry (technology, retail, etc) for a period of time (say, 10-year bonds).

Knowing these details would help you assess the risks involved and whether they are suitable for your investment objectives.

"Many people think that unit trusts behave in the same way. But a fund that is globally invested in equities versus a single-country fund has very different risks," as the latter is more volatile, said Mr Wyson Lim, vice-president for wealth management at OCBC Bank.

Next, know which institution or fund manager is managing the unit trust.

"The reputation of the fund house is very important for the investor's comfort level," said Mr Lim. "Is it large enough? Is it capable enough? What is its track record?"

You also need to suss out the fund manager — has he consistently outperformed his peers or is he a star who has had flashes of brilliance, but mostly turns out average performances?

"Don't look at only the absolute returns of the fund manager. Look for one who consistently does well, not one who shines for a while only," Mr Lim added.

Next, acquaint yourself with the industry jargon.

For instance, the expense ratio of a unit trust tells you how expensive it is to maintain the fund. The higher it is, the more likely your gains would be watered down by the costs.

A rule of thumb is to avoid those with an expense ratio of over 3 per cent, quite common in smaller-sized funds that may face the danger of consolidation at a later stage. That was the case with some 18 funds closures in recent weeks, as they were considered too small to be viable.

Some fund managers may absorb the charges of small funds in the beginning, hoping that their track records would gradually improve and attract more investors, said Mr Lim. But this may not work out in the long run, so investors need to be aware of what they're getting into.

"Investors ought to be careful and do more research when investing in funds, especially those which are smaller than $10 million in size," he said.

Next, look out for the Sharpe ratio — a measure of the risk-and-return profile of the funds. It is a measure of the returns over the risk-free rate divided by the standard deviation of those returns.

"The higher the ratio, the better it is," said Mr Lim.

You should also ask about the investing strategy of the fund manager.

For instance, a growth strategy means the fund manager goes for stocks with good growth potential, even though they may be expensive. This aggressive approach will result in higher returns when the market does well, but will also backfire when markets take a plunge.

The opposite is value strategy, in which undervalued securities are picked, the criteria being valuation measures like price/earnings multiple, price/book ratio, etc.

"Which is better? There are no hard and fast rules. During the dot-com boom, growth style was very hot because the underlying stocks did very well, but once the cycle turned, they fell harder," said Mr Lim.

To get a feel of the fund manager's investment approach, look at his tracking error. A high tracking error suggests that he is more likely to adopt an aggressive investment strategy.

Some of these qualitative and quantitative elements of choosing the right unit trust are provided by independent parties such as Mercer Investment Consulting (*www.mercerfundwatch.com.sg*) and *www.fundsingapore.com*.

Mercer rates funds ranging from five-star to one-star, and offers analyses to help investors decide which funds they want to invest in. Investors can also find data about the funds and their managers such as the track records, expense ratios, investment styles, etc, on both websites.

"Ten years ago, it was very hard to find such information, but now it is much easier," said Mr Lim.

OCBC adopts Mercer's star ratings to ensure that the unit trusts it offers are being screened and rated by an independent party.

This is incorporated into OCBC's WealthMap™ — the bank's in-house financial planning system which helps customers ascertain their risk profiles and choose suitable funds that match their risk appetite.

Said Mr Lim: "OCBC's WealthMap™ helps clients to build a sound investment portfolio instead of just buying into the flavour of the month or the hottest unit trust in town."

Next week: Investing in uncertain times

Kuala Lumpur skyline at dusk. Unit trusts take on many forms and invest in individual countries, such as Malaysia; geographical regions, such as Greater China; industry sectors, such as biotechnology; different asset types, such as stocks or bonds; and have different investment time frames.

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Ask OCBC.

Q I am looking to invest my savings of $50,000, which I have accumulated over my working years. I have no immediate goals in mind, although I am looking at buying my own place in the medium term. I consider myself a moderate risk taker.

I have little experience in investing and the only investment I currently have is a global technology fund that I bought a few years back. The $10,000 investment is now worth only about $5,000.

Given my personal financial circumstances, what type of funds should I consider? Should I hold on to my global technology fund, or should I switch to some other funds?

A Before investing any of your savings, you should set aside an amount equivalent to about six months of your expenses. This amount is to tide you over in the event of an emergency.

A simple way to construct your investment portfolio is to start with a core portfolio. This core portfolio — one which is based on your longer term investment objectives and risk profile — should contain a mix of global bonds and equities.

A good way to start your core portfolio would be to consider OCBC MAP, which allows you to simply choose from four portfolios — conservative, balanced, growth or aggressive.

In addition to the core portfolio, you may also want to hold a tactical portfolio — one which is more opportunistic and serves to "spice up" the returns on your overall investments. A global technology fund would fall under this category.

A tactical portfolio should not form more than 10 to 20 per cent of your overall portfolio. Given that your global technology fund now makes up only a small portion of your investible portfolio, you can consider holding on to the fund, provided you have the risk appetite.

Do you have a question on your financial situation? Send it to us at Wealth_Mgmt@ocbc.com.sg.

TRUE OR FALSE ?

Send your answers together with your name, I/C number and telephone number to us at Wealth_Mgmt@ocbc.com.sg by Wednesday. Please remember to indicate "TODAY Quiz" in the subject line. A lucky winner will win $30 worth of Takashimaya shopping vouchers.

The answers to last week's quiz are: True, True, False
The lucky winner is Goh Shu Ting Candy (I/C: S8113395F)
Here are the questions for this week's quiz:

1. Before you buy a unit trust, you should assess factors like the reputation of the fund house, its track record and the consistency of its performance. (True/False)
2. You should buy funds with high expense ratios because they can offer higher returns. (True/False)
3. Independent parties like Mercer Investment Consulting offer analyses that can help you pick the right unit trusts. (True/False)