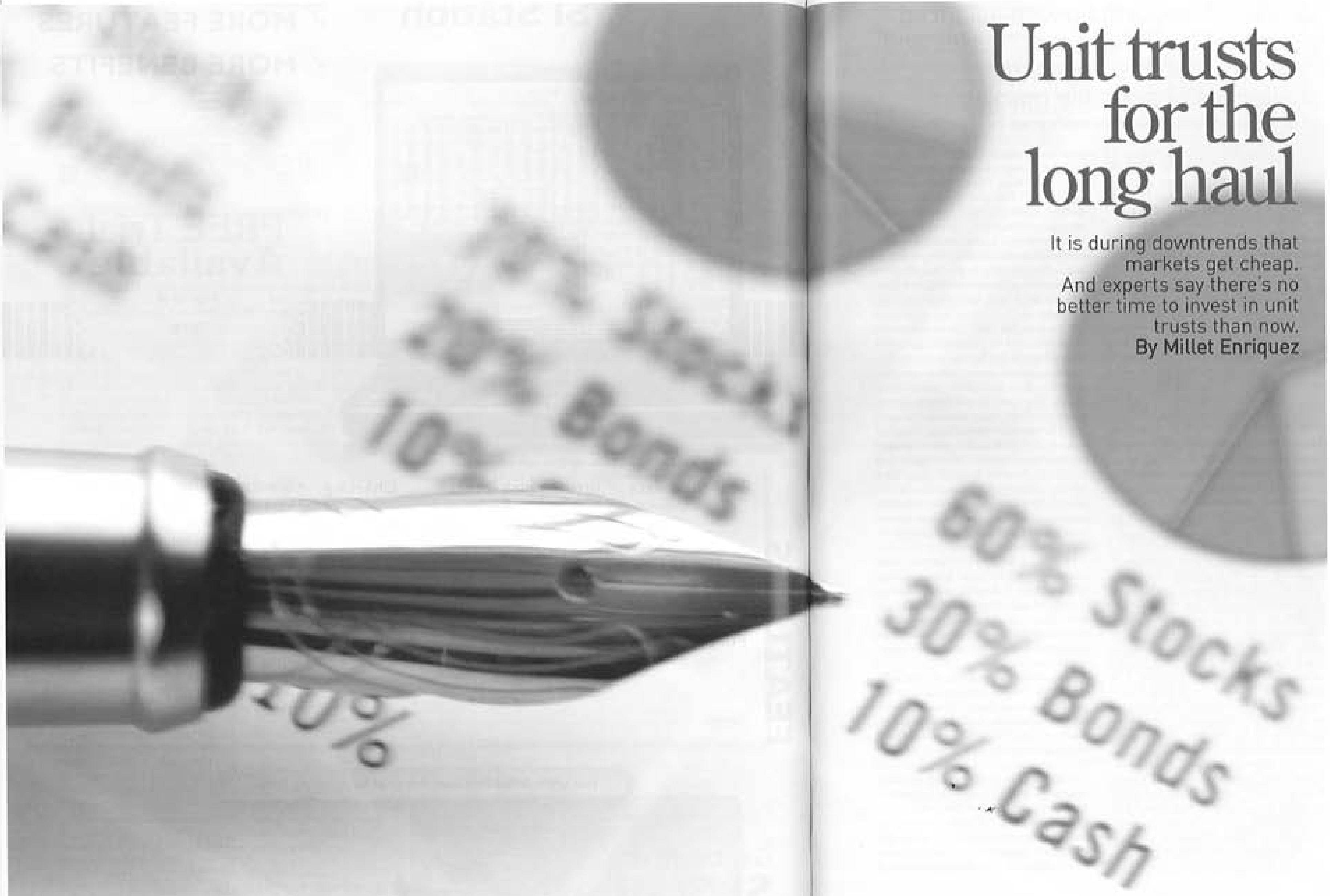

Unit trusts for the long haul

It is during downtrends that markets get cheap. And experts say there's no better time to invest in unit trusts than now.

By Millet Enriquez

Write downs, buy-outs and sub-prime have racked up the headlines of financial circles in recent months. At the rate that the US economic debacle is unfolding – the latest being the collapse of investment bank Bear Stearns and the subsequent takeover bid of JP Morgan Chase – it appears that the global community is yet to see the last.

As markets continue on a downward tumble, investors understandably panic and take cover. Opting to go for safe havens like commodities, which not surprisingly have reached historic heights – oil hit over $100 a barrel and gold made it to the $1,000 per ounce mark.

In a situation where a wait and see attitude seems to be the most apt reaction, the benefits of investment diversification has never been more apparent. And among the many investment vehicles that offer diversity, unit trusts have proven their resilience to changing market conditions.

Industry players are optimistic about the growth of unit trusts for 2008. They see Asia excluding Japan to have a major growth potential. Singapore, for one, is poised to be financial hub with many fund management companies and private banks establishing their presence here.

Why invest in unit trusts

The reduction of risks through diversification makes unit trusts a good investment choice. Because investments are spread over asset classes, geographic regions, by sectors and companies, investors do not have to suffer the same amount of risk losing their capital if they invested with one equity and it ends up in failure.

With unit trusts, investors also do not have to put up a large amount of money to buy stocks in order to construct a well-diversified portfolio, as they would only need a fraction of the cost to buy units. Investors also gain access to stock markets and asset classes that would not normally be possible due to steep costs.

Unit trusts have the added advantage of management by specialists and professionals in their fields.

"By using unit trusts, investors can leverage on the fund manager's expertise as an alternative to monitoring their own portfolio which can be both difficult and time consuming," says Mr Alex Henderson, managing director for Asia of Henderson Global Investors (Singapore) Limited.

Recent downturns in global equity markets have inevitably affected unit trusts, however. Mr Dexter Tan of Phillip Securities Pte. Ltd. (a member of Phillip Capital) says this is due to the underlying components of unit trusts, such as equity and fixed income.

Nevertheless, he says unit trusts remain a good investment option "as they are designed to spread your money across different securities, thereby reducing unfavorable impact of a single investment that may not be performing as expected."

Because unit trusts invest in listed companies, Mr Albert Lam, investment director at IPP Financial Advisers says, the continuing US credit crisis, which dragged down the equities market would also affect the performance of unit trusts. "When investors sell individual stocks, the selling pressure lowers prices and the performance of unit trusts would be dragged down together," he explains.

As such, many investors have scrambled to pursue other alternatives. Some prefer to sell out while others opt for cash investments while waiting for the market to bottom out – a strategy the Mr Alan Chua, portfolio manager at Franklin Templeton believes is a much riskier undertaking.

"With inflation in Singapore at six per cent and bank interest rates at less than one per cent, the investor is really better off buying unit trusts which provides an opportunity to invest and grow the money for the long term," Mr Chua says.

It is during volatile markets, in fact, that markets get cheap and therefore, a better time to invest in unit trusts.

Strategies against volatility

Staying on course and sticking to the long-term investment plan would be the better option for unit trust investing in such uncertain times. If the underlying asset of the investment remains sound, there is no need to panic and sell as this would only crystallize losses, believes Mr Donald Soo, practice manager and senior financial planner of licensed financial advisory firm Professional Investment Advisory Services Pte Ltd. (PIAS).

It is a common mistake to buy at the peak and sell at the worst possible time. As an investment should address the financial objectives, risk appetite and the financial capability of the individual, it would be wiser to not speculate on the market.

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> Managing director for Asia of Henderson Global Investors (Singapore) Limited, Mr Alex Henderson

"We do know that historically the market has always picked itself up and surpassed its previous high over time. In a bull market investing in a lump sum is okay. However, in volatile times like this drip, feeding the funds at regular intervals by using dollar cost averaging (DCA) is better," Mr Soo says.

The strategy requires an investor to regularly set aside a fixed amount at regular intervals into the unit trust investment. An example would be $1,000 per month. "You buy more units when prices are low and fewer units when prices are high and over time your average cost per unit may be less than the average NAV (net asset value or price at which you buy a unit trust)," explains Mr Soo.

Mr. Paul See, senior branch manager of Priority Wealth Group with PIAS, says it would be a good idea for investors to set up a back-up plan and compartmentalize their resources into four components: the emergency fund, core portfolio, tactical fund, and reserve fund. During volatile markets, investors can use the tactical fund to purchase more investment at cheaper levels.

For current volatile market conditions, it would be wise to implement a strategy called Value Cost Averaging (VCA). VCA is a method in which one could utilize his/her tactical funds to purchase more investments when the market dips. This allows more investments to be bought at much lower prices and as a result reduces average weighted cost of investment. It is good to use VCA on top of Dollar Cost Averaging (DCA) because they complement each other allowing for a portion of investment to be allocated to buy more units during market downturns.

"Our observations have shown that results using both VCA and DCA have been constantly outperforming just DCA methods. The diagrams show how VCA uses less money ($400 difference) to actually obtain a higher number of units. I would personally recommend complementing VCA with DCA for better returns," he says.

Investors may also consider to review and re-balance their portfolio. Mr Lam of IPP Financial Advisers says the strategy works in either weak or strong market conditions.

"If the investor has built up cash savings, he could consider entering the market in stages. For example, if you have $15,000 for investment, consider splitting into three tranches of $5000 each to invest," Mr Lam says.

He adds that the recent sell-down, which occurred on January 21 presented an opportunity for buying in stages. "For investors who are on a regular savings programme where they invest a sum every month, they can consider increasing the quantum of the investment amount provided his cash flow allows."

A diversified portfolio with balanced exposure to various asset classes and region is able to surpass the challenges of a volatile market. Mr Alex Henderson believes that those who have taken such approach can enjoy the potential returns from equities and the relative security of bonds and the yields they offer.

"Bonds are likely to perform best when investors expect economic growth to slow, inflation falls and when equities subsequently struggle. Equities usually outperform other asset classes when interest rates start to fall and investors expect the economy and company profits to grow or recover," he says.

To spread one's risk across different asset classes, he advises investors to consider global balanced funds. "Investors who have made healthy gains in their investments can also consider adopting a top-slicing approach, to lock in their profits," Mr Henderson adds.

Unit trusts are ideal especially for those looking for mid- to long-term investment. As such, it is always wise to stay the course of the investment. "As fund managers, we take a five-year horizon, and research has shown that investing long term gives you a higher probability of making money," says Franklin Templeton's Mr Chua.

The growth of unit trusts

Strong economic growth in countries like China and India translated into good performance for funds hinged on these emerging markets. HSBC's GIF Indian Equity Fund AD topped the 2007 fund performance report of Morning Star among over 700 registered funds in Singapore. While DWS's China and India Equity funds came in second and third.

"Indian and Chinese funds did well in 2007. This is primarily due to the growth expectations for these countries to continue growing in the long run," explains Mr Tan of Phillip Securities.

The increasing demand in commodities in China and other emerging markets also contributed to the funds' better performance, "as growth in these countries also translate to consumption of both hard and soft commodities," says Mr Lam of IPP Financial Advisers.

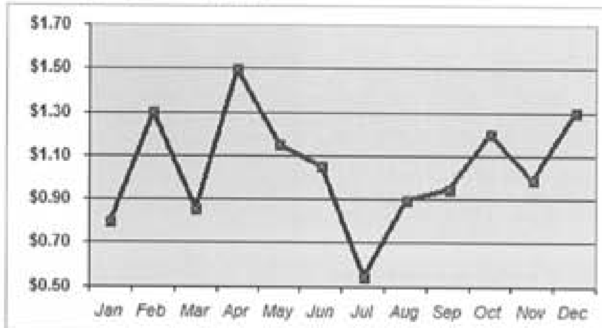
Among the emerging markets in Latin America, Brazil has become a preferred theme for investors. The least performing funds were on the Japan theme, financials and property equity. It would appear that investors are still wary about the outlook for Japanese equities, despite positive valuations on the country's economy.

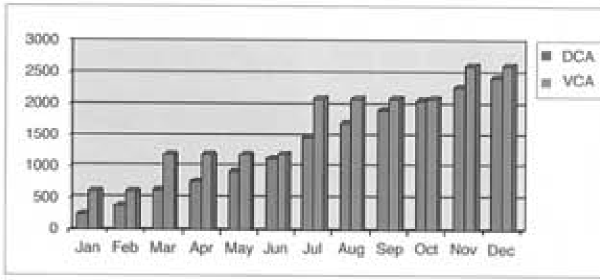
The record increase in oil prices and the continued deterioration of the US economy has made investors turn to alternative investment options, foremost of which are commodities. Not surprisingly, the first two months of 2008 showed strong performance from funds with the theme on gold and precious metals. From December 31, 2007 to February 29, 2008, both of DWS's Noor Precious Metals funds have landed on the top three of Morningstar's fund performance report. Bonds (European and global), currency and Thailand-themed funds have also shown early strong performance.

So far, Indian equity funds, which outperformed in the previous year, are currently at the bottom 20 for the first two months of 2008 – a completely different story, to say the least.

Singapore's unit trust industry registered total fund inflows amounting to $31.88 billion for 2007, based on the Singapore Fund Flows Insight Report of the Investment Management Association of Singapore (IMAS). Investments in Central Provident Fund Investment Scheme-approved unit trust provided bulk of the fund flows for 2007, the report added.

DCA = investing on regular intervals (all points)





VCA = investing at only the dips in the chart (green points)

Total cost for DCA: 12x200 = $2,400
Total cost for VCA: 4 x 500 = $2,000

Unit trusts have overtaken stocks as the preferred investment vehicle for Singaporeans looking to invest their CPF savings. As of end December 2007, about $5 billion of the CPFIS Ordinary Accounts went to unit trusts, while funds allocated to stocks and loan stocks amounted to $4.51 billion according to figures released by the Central Provident Fund Board.

This is a big turnaround from 2004, where unit trusts were only getting $2.5 billion of the CPFIS-OA compared to the $6.49 billion allocated for stocks and loan stocks.

"The growth in CPFIS last year was possibly due to two key reasons. First, the robust GDP (gross domestic product) growth led to higher disposable income, leading to portion of it being invested in unit trusts. Second, CPF Board revised the sales charge to be capped at three per cent from five per cent last year, providing the incentive to invest in unit trusts," says Mr Tan of Phillip Securities.

Mr Lam of IPP Financial Advisers believes, "The interest rates of savings deposits have been very low, thus investors have to look for alternatives to get higher returns. This could be the main driver of growth in unit trust investing."

The tides may turn the other way, however, as a new CPFIS policy kicked in on April 1. Beginning this month, CPF Ordinary and Special Accounts must have a minimum of $20,000 before any fund can be used to purchase unit trusts. Only certain funds are also allowed under the CPF Investment Scheme, so investors need to consult the fund manager for the fund's eligibility.

With an additional interest rate allocated for the CPF accounts beginning January 1, it also remains to be seen whether CPF members would still opt to invest their savings on unit trusts or just keep their cash with the CPF Board.

"The CPFIS reform will most probably affect the amount of investment coming from CPFIS, especially from new graduates and couples with newly purchased housing. Having said that, the incentive to invest is dependent on market conditions as well as the amount of liquidity in the market. Nevertheless, we might see a surge in volumes before April 1 as investors might take the opportunity to invest their CPF monies," added Mr Tan.

Mr Albert Lam agrees, "The new CPF ruling will put a dampener for unit trust investments using CPF money. However, investments using cash will continue."

Where to park your investments

Though inflationary concerns and the financial turbulence in the US economy continue to have an effect, outlook for the industry remains positive. Franklin Templeton's Mr Chua believes the current market volatility is in fact a necessary correction to fix the excesses in the financial system, which had existed over a period of time.

Mr Henderson agrees the recent fall in equities market is but part of the economic cycle. He says, "Reacting to market falls by withdrawing funds is not prudent investing (it locks in losses with no chance of recovery). Likewise, chasing markets whenever they have risen sharply is not sensible. Equity markets tend to have the strongest gains after a significant correction."

Mr Lam of IPP Financial Adviser sees, "The first half of the year will be extremely challenging. There is a chance that we will see better third and fourth quarters, provided that the sub-prime crisis does not worsen."

Global market woes aside, financial advisers and fund managers still see favor in certain asset classes and sectors worthy of investment.

Equities and bonds

Though equities have performed below expectations, Franklin Templeton's Mr Chua believes they should still be a good place for investors in the next three to five years. He says those who invest in distressed companies will be rewarded in the long run.

"At the dawn of 2008, global equities are trading at the cheapest valuations in 30 years, based on the earnings yield of equities relative to bond yields, making the current environment a meridian hour for opportunistic investors," Mr Chua says.

Mr Alex Henderson believes that the direction for equity markets will likely depend on how the US economy fares, the depth of its recession and how the global market will react to it.

"We believe that global equities will struggle to advance in the first half of 2008. What happens in the second half of the year will then depend on the severity of a US recession. If it turns out to be mild, equities might recover, perhaps quite strongly and continue to improve in 2009. Alternatively, if the recession turns out to be a deep one, then we may be on the brink of a serious equity bear market," Mr Henderson says.

Mr Tan of Phillip Securities says, "For equity funds, we favor the agriculture sector and related countries. This comes on the back of the demand for bio-fuel, supply shortage and high demand for foods."

Investors can also consider sovereign bonds in a volatile market condition, he says: "Monies usually flow from equities to bonds in a volatile equity environment, and from bonds to equities in good equity markets."

Sectors and themes

For long-term investments, Mr See of PIAS believes a thematic portfolio would be sensible. These would include upcoming economics giants, differentiation and comparative advantages, rising affluence of middle class families, globalization of financial services and green venture.

Mr Chua of Franklin Templeton picks telecommunications services, banks, pharmaceuticals, biotechnology, and the life sciences to be worthy of exploration.

But since the current volatility traces its roots in the financial sector, Mr Soo of PIAS sees it best to be under weight on financial, property, US and Greater Europe until the market becomes more stable.

"However, I think that certain hedge funds will do well in this period as volatility allows some of the funds to look for arbitrage opportunities," he adds.

Commodities

Gold and precious metals are hot markets and unit trust investment in these sectors are very much favoured in the current market condition.

Mr Lam of IPP Financial Advisers says demand for commodities in the emerging markets of China and India, where about a third of global population resides, would continue to be strong as they continue to develop infrastructure. "Increased standard of living leads to increased consumption of soft commodities. Rapid urbanization leads to greater demand for energy in the form of crude and gas," he explains.

Sector funds like gold and precious metal, commodities and materials continue to do well. But PIAS' Mr Soo advises, "Commodities are still looking good but I would take a cautious approach to this as commodity prices are relatively high."

Emerging markets

Like commodities, country funds such as Middle East, Africa, and Brazil have shown positive returns since the beginning of this year, despite negative average market performance of -10 per cent, says Phillip Securities' Mr Tan citing figures from Morning Star.

The case of Middle East, Mr Lam of IPP Financial Advisers says, is un-correlated to global mainstream markets as it's only recently that the region opened itself to foreign investors. "The region is also flushed with capital and fiscal surplus. Companies valuations are relatively attractive with earnings growth potential," Mr Lam says.

A region of growth that continues to grow rapidly, emerging markets are seen to be a place where investments would likely flow, given the existing negative climate in the US.

"The Middle East is a proxy to crude oil via the producers. It is undergoing financial and economic renaissance – economic diversification supported by state-owned wealth. A young population holds the key to future productivity. The possible revaluation of GCC (Gulf Cooperation Council) currencies provides some speculative upside," Mr Lam adds.

He says that for 2008, emerging markets, BRIC (Brazil, Russia, India and China), commodities and possibly infrastructure could do well. "Domestic consumption and companies operating on competitive margins will continue to drive the growth of emerging markets," says Mr Lam.

But funds invested in these themes will not be spared the volatility in the short term, however, and he says market-neutral hedge funds and money market funds to possibly weather the volatile market conditions. **SI**

Top 20 Funds for 2007

Singapore Registered Fund	% Chg 12/29/06 -12/31/07	Rank
HSBC GIF Indian Eq AD USD	77.92	1
DWS China Eq SGD	75.73	2
DWS India Eq SGD	72.39	3
Parvest India C	72.08	4
Prudential PRU Dragon Peacok	71.34	5
ABN AMRO India Eqty A USD	69.26	6
DWS Noor China Equity B Acc	68.9	7
Franklin India A acc $	67.5	8
Lion Capital India SGD	62.4	9
Templeton Asian Gth A Y-D $	62.12	10
ABN AMRO Brazil Eqty A USD	61.74	11
FF - China Focus A USD	60.96	12
First State Regional India SGD	60.47	13
Franklin Temp F-Asian Equity	59.98	14
ABN AMRO China Eq Fd A USD	58.59	15
Parvest BRIC C	57.93	16
Legg Mason SEA Spec Situations	57.22	17
FF - India Focus A USD	57.1	18
First State Global Resource SGD	56.95	19
DB PI Commodity Euro R1C	56.88	20

Source: Morningstar

Top 20 funds as of February 29, 2008

Singapore Registered Fund	% Chg 12/31/07-2/29/08	Rank
DWS Noor Precious Metals B Acc	19.25	1
DB PI IV Metal Drive Gtd Fds R1D	19.18	2
DWS Noor Precious Metals A Acc	19.1	3
DB PI Commodity Euro R1C	18.32	4
UOB United Gold & General	11.51	5
ABN AMRO Currency Fund EUR A	11.16	6
Templeton Gbl Bond A acc € H1	9.44	7
Schroder ISF StrBd €Hdg A Acc	9.32	8
Templeton Gbl TotlRn A acc € H1	9.31	9
DBS Sprint Capital Protected	8.85	10
First State Global Resource SGD	8.23	11
Schroder Strategic Bond	8.12	12
FF - Thailand A USD	7.73	13
Man AHL Diversified Futures	7.63	14
Allianz-dit Europazins A	7.24	15
Schroder ISF Gl Infl Lnked A	7.24	16
UOB Global Bond SGD	6.84	17
ABN AMRO Euro Govt Bd A EUR	6.83	18
Templeton Gbl Bd (EUR) A Y-D €	6.8	19
ABN AMRO US Opps A USD	6.61	20

Source: Morningstar

Setting up a portfolio

There are various things to consider when investing in unit trusts, but foremost of these would be the investor's objective, financial capacity and risk appetite. It would also be important to come up with a strategy for choosing which sectors, country or theme to invest in.

An investor should look at a fund's performance by checking its Sharpe ratios to assess its risks. "This measurement is very useful because although one portfolio or fund can reap higher returns than its peers, it would only be a good investment if those higher returns do not come with too much exposure to risks," explains Mr. Paul See, senior branch manager with Professional Investment Advisory Services.

Mr Dexter Tan of Phillip Securities says "investors can also look at the information ratio (a technique used to measure a fund manager's performance against a benchmark) of the fund. In choosing the sectors, one can consider the relative valuation of the index as one of the factors."

He says that comparatively, unit trusts still performed relatively better than equities. For example, year to date performance of Singapore funds was -13.61 per cent versus the Straits Times Index's -19.43 per cent.

Mr Albert Lam of IPP Financial adviser says, "The minimum amount of investment differs for different unit trusts, some accept an initial minimum investment from as low as $500."

The benefits of unit trust investments do come with a price, however. Professional fund management, administration services and payment for third party trustees in charge of the safekeeping of the investment are levied in the form of initial sales charge and annual management fees.

"There are other fees and expenses, which include trustees' fees, administration fees, so investors should seek advice on the total expense ratio (TER) of the unit trust before making an investment," explained Mr Alex Henderson, managing director for Asia of Henderson Global Investors (Singapore) Limited.

The TER refers to the expenses incurred by the fund and would largely be constituted by management fee. A unit trust investment would usually charge fees upfront with initial charges of about three to five per cent of the investment.

There are funds that allow switching – from one asset class to another, for example – and these would also involve fees and costs. The basic rule would be to not just base the investment on costs and discounts, but on one's investment objectives and needs.

Just as there are pros to unit trusts, there would also be the cons. "Unit trusts which are traded daily provide liquidity. However, there are limitations to investing in unit trusts as well. One of which would be the inability to short the market," says Mr See.