Philequity Corner (11/27/2006)
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Basics of mutual fund investing

This article on mutual funds is a continuation of our investor education series which we started last week. Here you will learn what the advantages and disadvantages mutual funds offer, how to choose the right fund for you and how mutual funds can enhance your investment portfolio.

What is a mutual fund?

A mutual fund is a company that pools funds from investors to form an asset base. Investors may be individual or institutional (e.g. corporate and other funds like pension and trust). The collected assets are then invested by a professional fund manager in a diversified portfolio of security investments: stocks, bonds, short-term money market investments, other securities or assets, or a combination of these investments.

The investors in the fund are legally the owners of the mutual fund company. The shares that they purchased represent their proportionate ownership of the fund's holdings and the income those holdings generate.

What are the different types of mutual funds?

In the Philippines, there are currently four types of mutual funds to choose from:

1) Stock or equity funds which invest primarily in the shares of stock of Philippine corporations listed in the Philippine Stock Exchange. In terms of risk, equity funds exhibit the most volatility in the short-term. Over the long-term, however, equity funds have historically performed better than other types of investments.
2) Bond funds which invest in fixed income securities such as government bonds, treasury securities and corporate bonds issued by Philippine companies. In terms of risk, bond funds are more conservative than equity funds. The major consideration is capital preservation while generating interest income.
3) Money market funds which are similar to bond funds but invest only in money market securities or those that have maturities of one year or less (e.g. Treasury bills).
4) Balanced funds which invest in a combination of equities and bonds. They benefit from the advantages of both types of investment – the growth potential of equities and the regular interest income from bonds.

How do investors earn from a mutual fund?

Mutual fund investors earn money in two ways:

1) Dividend payments – A fund may earn income from the dividend or interest of a security in its portfolio.
2) Capital gains – The price or market value of the securities the fund holds may increase. If the market value of the entire portfolio increases after deduction of expenses and liabilities, then the Net Asset Value (NAV) of the fund and its shares increases.

What's in it for mutual fund investors?

Stocks and bonds generally offer significantly higher returns than the savings and time deposit accounts that an investor normally gets from the bank. But putting money in mutual funds (which hold a portfolio of stocks or bonds or a combination of both) is more attractive to individually investing in a stock or a bond because of the following features:

1) Professional management – backed by experience, training and analytical research
2) Diversified portfolio – variety spreads out the risk

3) Cost advantages / economies of scale – given larger investment size, a fund can take advantage of lower broker commission/fees and higher yielding assets
4) Low investment or capital requirement – Philequity fund, for example, requires only an initial investment of P5,000 and additional investment of P1,000
5) Liquidity – readily convertible to cash, mutual funds can be redeemed on any business day and payments are made within seven business days
6) Safety – mutual funds are regulated by the Securities and Exchange Commission

How to choose the fund that is right for you?

Each mutual fund type has its advantages and disadvantages. A particular feature may be important to one investor but not to another. Therefore the investor should choose the type that is compatible with his risk profile, earning potential and time horizon.

A risk-averse investor will typically choose the bond and money market funds over equity funds. Or he may put more weighting say 80 percent of his money in bond funds, and 20 percent in equity funds. Meanwhile, a more aggressive investor may do the opposite, 80 percent in equity funds and 20 percent in bond funds.

Another factor to consider is the investor's earning potential. The young professional (which still has a high earning potential), for example, can be more aggressive in his investments so he can put more weighting in equities. On the other hand, a retiree will put more emphasis on capital preservation, so he is geared more towards the bond funds and money market funds.

Lastly, an investor should take into account the time horizon he intends to put on his investments. If he is investing for the long-term, then an equity fund is advisable since historically equities have outperformed fixed income instruments. Meanwhile, if he intends to get back his investments funds much earlier, he may opt to put it in a money market fund since it normally requires a shorter holding period. Note that most mutual funds charge a redemption fee for investments redeemed before the holding period expires.

What other factors to consider?

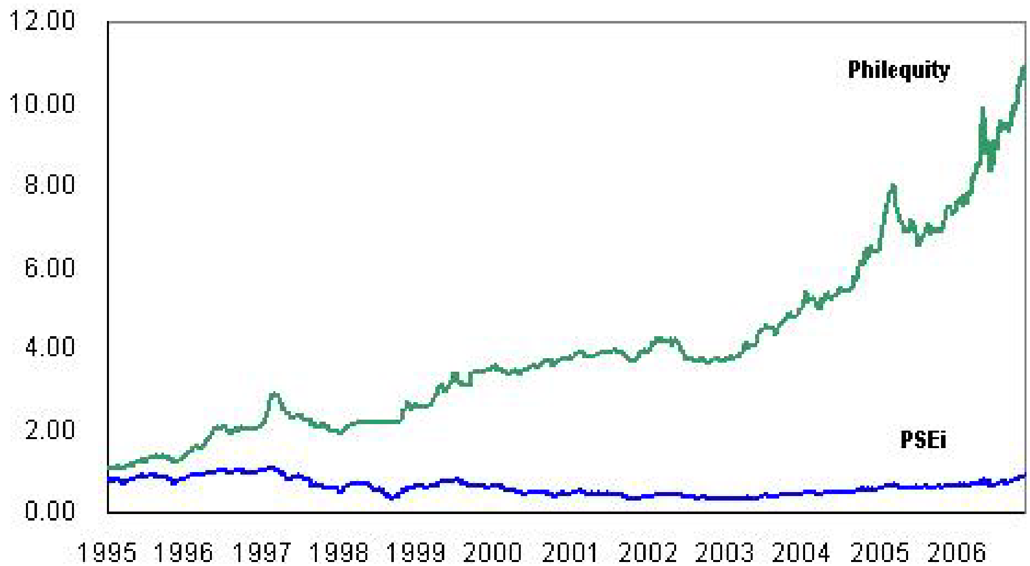
Currently there are close to forty mutual funds to choose from. Apart from knowing the type of fund that is right for an investor, there are other important factors to consider.

1) Qualifications of the fund manager – An investor can assess the qualifications of the fund manager by checking the fund prospectus. It is essential to note the training, education and experience of the fund management team. More important is the track record and the consistency of the fund manager's performance.
2) Investment strategy – It is also essential that the fund's investment strategy fits with an investor's financial goals and risk tolerance. For example, not all equity funds employ the same strategy. There are growth funds which focus on stocks that may not pay regular dividends but have the potential for large capital gains. There are income funds which look for stocks with high dividend yields. There are sector funds which specialize in a particular industry, e.g. a commodities fund. And lastly, there are index funds (featured in last week's article) which tracks a particular stock market index.
3) Fees – As with any business, running a mutual fund involves costs, which includes: transaction costs, investment advisory fees, and marketing and administrative expenses. Different funds may have different fee structures, so again check the fund prospectus where all the fees and costs are disclosed.

What do we have to offer?
Philequity Management, Inc. currently manages four mutual funds: Philequity Fund, Philequity Money Market Fund, Philequity Dollar Income Fund and Philequity PSE Index Fund. Our company boasts of a top-notch management team graced by three Finance Secretaries, four former chairmen of the Philippine Stock Exchange & the old Manila Stock Exchange, directors from various companies in different sectors, members of the academe, and a research team with more than 25 years of combined research experience.

Our flagship fund, Philequity Fund, is the biggest equity mutual fund in the Philippines with more than P1 billion in assets. It is the best-performing fund since inception returning 980 percent since 1994 (see chart below).

Philequity Fund vs. PSEi



Source: Technistock, Philequity Research

A peso invested in Philequity Fund back in 1994 is now worth P10.80, while a peso invested in the benchmark PSEi is now worth only P0.89. Philequity Fund is currently up 45.3 percent year-to-date vs. the 27.8 percent average return of other equity funds.

For investors wanting to get additional information on the mutual fund industry including the comparative performance of all the funds, you can check the website of Investment Company Association of the Philippines (ICAP) at www.icap.com.ph.

For inquiries and comments regarding Philequity, you can email us at gime10000@yahoo.com or research@philequity.net. Or call Jerome Gonzalez or Ricardo Puig at 634-5038.