Philequity Corner (November 12, 2012)

By Valentino Sy

All About Mutual Funds

In celebration of Mutual Fund Week, we would like to do our part in increasing investor education about mutual funds. In this light, we'd like to share with you the most common questions about mutual funds, as well as our answers to those questions.

1. How does mutual fund investing work?

A mutual fund pools or aggregates funds from many investors and invests it in different asset classes (such as stocks, bonds, money market instruments, etc.), depending on its mandate. This aggregation allows the mutual fund to move as one investment vehicle even if there are many investors who own it. This provides economies of scale and may result to lower transaction costs for the investors. This also gives smaller investors the access to professionally managed and diversified portfolios.

2. How do mutual funds compare with bank deposits?

Bank deposits, such as those deposited in savings and checking accounts, typically yield an interest of 0.25%. Time deposits, on the other hand, yield an average of 2.50%, depending on the amount and tenor of investment. In contrast, mutual funds which invest in Philippine stocks may provide higher returns. Note that the PSE Index, the most common benchmark of local equity mutual funds, has delivered a compounded annual return of 17.80% over the past 10 years. In contrast, over the last 10 years, the Philequity Fund delivered a compounded annual return of 21.89%, clearly beating the PSE Index by a wide margin.

3. What are the risks associated with investing in a mutual fund?

While bank deposits give fixed interest, investments in mutual funds do not offer guaranteed returns. Also, while bank deposits are insured by the Philippine Deposit Insurance Corporation (PDIC), return of investment is not guaranteed on investments in mutual funds. A mutual fund investor may therefore face the risk of capital loss if he redeems his investment after the mutual fund's Net Asset Value (NAV) has declined in value. This usually happens when the core holdings of the mutual fund, whether stocks or bonds or both, also decline in value.

4. What are the fees associated with mutual fund investing?

Mutual funds typically charge 3 types of fees. The first type of fee is the sales load. This is charged upon the placement of the investment and the rate is usually dependent on the amount of investment. The second fee is the management fee. This is usually charged on an annual basis and the reported Net Asset Value per share (NAVPS) is already net of management fee. The management fee is used to pay the fund management company for its expenses. The third is the exit fee, which is typically charged when an investor decides to redeem his investment before a pre-determined time.

5. Are the gains from mutual fund investing subject to tax?

According to National Internal Revenue Code of 1997, capital gains realized from mutual fund investing are not subject to tax. This adds to the attractiveness of investing in a mutual fund.

6. Why should one invest in mutual funds instead of investing in individual stocks or bonds?

Diversification and professional management are the two main reasons why one should invest in a mutual fund rather than make the investment decisions himself. A typical equity mutual fund in the Philippines maintains 30 or more stocks in its portfolio in order to achieve a certain level of diversification and manage the overall risk of the portfolio. Average investors will find it difficult to replicate this diversification strategy.

Aside from this, mutual funds are managed by professional fund managers who monitor the markets closely. These fund managers have years of experience under their belt and may be in a better position to make the right investment calls for their clients. In the case of the Philequity Fund, it has been professionally managed by the same fund managers since 1994.

7. What types of mutual funds can one invest in?

An investor may choose to invest in different types of mutual funds depending on his investment goals, investment horizon and risk tolerance. If an investor is rather conservative and prefers a steady stream of income, we would advise him to invest in a bond fund. If an investor wants more growth from his investments and can tolerate more risk, he can invest in an equity fund. If he wants a balance between growth and steady returns, he can explore investing in a balanced fund.

8. How does one search for mutual funds that he can invest in?

A prospective investor may visit the website of the Philippine Investment Funds Association (www.pifa.com.ph) so that he can compare the performance of local mutual funds for various time periods. The NAVPS of all mutual funds can also be compared by reading the major business dailies. One can also visit the websites of local mutual funds in order to learn more about them.

9. What should be the criteria for selecting a mutual fund to invest in?

There are four things that one should look at when evaluating a mutual fund: performance, risk, fund composition and the fund managers. These can be obtained from the Fund Fact Sheets that can be downloaded from the websites of the mutual fund companies.

One should prefer to invest his money in a mutual fund that has a long history of outperformance against its benchmark. Also, one should seek to understand the level of risk (measured by its standard deviation of returns; a lower standard deviation than the benchmark means lower risk) that the mutual fund takes.

Moreover, an investor should make an effort to check what the fund's top 10 holdings are. A prudently managed fund is one that only invests in reputable companies with solid business models and strong growth prospects. Lastly, it is important to know who the fund managers are. An investor should prefer investing with a fund manager that has been consistently outperforming and a fund that has been handled by the same fund manager for an extended period of time.

10. How did Philequity Fund perform this year and over the past years?

Philequity Fund has delivered a year-to-date return of 26.44%, outperforming the PSE Index which only returned 25.09%.

More importantly, Philequity Fund has a long history of outperformance. It has delivered a compounded annual return of **20%** for the past **18 years**. In addition, Philequity Fund has also outperformed the PSE Index, S&P500 and MSCI Asia Pacific which only returned 3.83%, 6.57% and 0.04%, respectively, over the same period. S&P500 is composed of the 500 biggest publicly-listed companies in the U.S. while MSCI Asia Pacific is composed of all the stock market indices of Asia. As such, **P1.00** invested in Philequity Fund in 1994 is now worth **P27.00**. In contrast, P1.00 invested in the PSE Index in 1994 would only be now worth P1.95.

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We hope that this article was helpful in outlining the basics about mutual fund investing. Considering how strong our economy is, we highly encourage people to invest their money in Philippine assets such as stocks, bonds and even the local currency. Investing in a mutual fund is an attractive alternative because it allows an investor to partake in a diversified portfolio of Philippine assets that will be expertly handled by a professional fund manager.

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