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YOUR INVESTMENT CONSULTANTS

INVESTMENT BASICS

FUNDS/ COLLECTIVE INVESTMENT SCHEMES

What are collective investment schemes?

Share or units in a collective investment scheme or a fund represent ownership in a pool of investments (shares, bonds or a combination of both) that is managed by a professional fund management company. Funds are generally not traded on a stock exchange but investors buy and sell units in funds to the manager at any time. Funds are normally structured as open-ended, meaning that, when the fund manager receives new monies, additional units are created. Likewise, when investors withdraw their money from the fund, the units are cancelled in exchange for their cash value.

Close ended funds have a finite amount of capital in issue. New shares or units cannot be created or cancelled on a day-to-day basis. Investors wishing to buy or sell shares or units in a closed-ended fund must do so from investors, often through a stock exchange. Closed-ended funds are usually listed and traded on the exchange. In Malta, the only closed-ended fund is Santumas Shareholdings plc. This is listed on the Official List and can be traded like any share or bond.

Return to investors in a fund can include distribution to investors of dividends, interest, capital gains or other income earned by the fund. The returns to unit holders will depend on the fund's investment objectives, which are normally explained in the prospectus.

The price of the shares is based on the value of the investments the company has invested in.

You usually pay an initial charge when you buy and sell units in a fund, but otherwise there is no difference between the buying and selling price of shares. Some funds have no initial charge (no-load funds). Sometimes there is an 'exit charge' instead when you withdraw your money. The company takes a yearly management fee direct from the investment fund.

You can buy funds through a stockbroker or direct from the fund manager.

You can either invest a lump sum or invest on a regular monthly basis.

What Returns does an investor get from investing in Collective Investment Schemes?

The investor earns a return on his investment from:

- any distribution to him/her of the interest and dividends earned by the fund – this is available usually to those investors who subscribe to the Distributor or Income Class of shares; and
- any net increase in the Net Asset Value Per Share of his/her fund shares/units.

What are the advantages of a collective investment scheme?

There are many advantages for investing in collective investment schemes, namely:

Spreading risk: Even if you have only a small amount to invest (from, say, €60 a month or €1175 as a lump sum), you can spread your money across a wide range of investments. This is a lower risk strategy than putting all your money into just one or two investments. This is referred to as diversification.

Reduced dealing costs: If you yourself were to buy a large number of different investments, you would probably only be able to invest a small sum in each. This means dealing costs would take a

large chunk out of your profits. Pooling your money with that of other investors means you have the advantages of buying in bulk.

Cost averaging: Investing regularly smoothes out the effect of falls and rises in prices over the period of investment. If an investor regularly invests a fixed amount, this buys more shares or units when the price is lower, and fewer when the price is higher. This has the effect of making the average price paid lower than the average price over the same period. By comparison with investing the same amount in a lump sum at the beginning of the period, the regular contributions gains greater value when the price recovers.

Reinvestment of income: Many funds enable income to be automatically reinvested, either by purchasing additional shares or units, or by the use of an alternative share or unit type. It is normally possible to change to and from automatic reinvestment by advising the fund manager.

Professional Fund Management: The money invested in a fund is managed by professional managers and investment advisors, who have access to a wide range of resources and research data.

Reduced administration: If you hold investments direct, there is often a lot of paperwork involved in buying, selling, collecting dividends, and so on. Also dealing with foreign stock exchanges and brokers can be tricky and time consuming. With a collective investment, the fund manager deals with all of that.

What are the disadvantages of a collective investment scheme?
The disadvantages include:

Paying for a fund manager: The professional manager running the investment fund on behalf of all the investors takes a fee direct from the investment fund. This is a cost you'd avoid if you managed your own investments.

Lack of choice: Although you can choose the type of fund you invest in, you have no control over the choice of individual shares, bonds and so on which go into the fund.

Loss of owner's rights: If you hold a company's shares direct, you are sometimes entitled to shareholders' perks (for example, discounts on the company's products) and you have the right to attend the company's annual general meeting and vote on important matters. Investors in a collective investment have none of the rights connected with the individual investments in the fund.

Fund Classification
Funds are normally split in the following categories:

Money Market: these funds invest in deposit and short-term securities. These are low risk but cannot be expected to give high returns over the long-run. Examples of money market funds: La Valette Sterling Money Fund; La Valette Euro Money Fund; La Valette US Dollar Money Fund.

Bond Funds: Bond funds are pooled amounts of money invested in bonds. Example: La Valette Malta Bond Fund; Vilhena Malta Government Bond Fund; HSBC Malta Bond Fund; HSBC Malta Government Bond Fund; La Valette Sterling Income Fund; La Valette Euro Income Fund; La Valette Monthly Income Fund.

Balanced Funds: Balanced funds mix some stocks and some bonds. A typical balanced fund might contain about 50-65% stocks and hold the rest of shareholder's money in bonds. It is important to know the distribution of stocks to bonds in a specific balanced fund to understand the risks and rewards inherent in that fund. Example: La Valette Malta Fund; La Valette Mediterranean Rim Fund; Vilhena Malta Fund; Wignacourt Malta Fund; HSBC Maltese Assets Fund.

Equity Funds: Equity funds mainly invest in shares. Many equity funds invest primarily in the larger companies. Example: Malta Privatisation & Equity Fund; Amalgamated Growth & Income Fund; HSBC Equity Growth Fund.

International/Global Funds: International funds invest in overseas companies. Global funds invest in both U.S. and international-based companies. Example: La Valette European Opportunities Fund; La Valette Capital Growth Fund; La Valette International Equity Fund; Vilhena Top 100 Fund.

Sector Funds: Sector funds invest in one particular sector of the economy: technology; financial, computers, the Internet. Example: La Valette Multi-Manager Property Fund.