

## **While the Bull Sleeps**

The horns of the bull lay broken. I imagine that the matador is exhausted from the Carnival celebrations and is savouring the sea and sun somewhere in Maracas. The bear has robustly entered the parade, clawing down at stock prices. But while the bear growls in its glory what are investors to do? Now that the Carnival jubilation is over, it is an optimal time for investors perturbed by the falling prices to re-think their investment strategy given the current bear run of the market.

Savings accounts are currently only earning the investor approximately 2 per cent while fixed deposits start from as little as 2.4 per cent depending on the amount of the investment. A money market mutual fund however, is a prudent alternative since at this point in time, it has the potential to earn more than a savings account and fixed deposits and also preserve capital. In fact, one can take some of the money out of the stock market, put it into a money market mutual fund and re-invest it when the market has reached its floor. In this way, the investor would earn some interest on his money, and would be able to purchase more shares of the same Company when the price has bottomed.

## **What is a Mutual Fund**

A mutual fund is really a portfolio housing a group of equity and/or debt instruments. It can be made up of stocks, property, deposits, corporate bonds, government bonds to name a few. The weighting of the portfolio of the fund is decided by a fund manager and is constructed at his discretion in order to ensure that the fund produces the desired outcome.

One of the greatest purposes and advantages of a mutual fund is diversification. We all know that one of the cardinal rules of financial theory is that diversification minimizes risk. Because a large sum of money is invested in a pool of instruments, the extent of the diversification of the fund is one that is not easily executed by a normal investor. One of the reasons for this is that most funds are not only diversified over local instruments, but also over foreign instruments. In addition, due to the fact that a mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than what an individual investor would pay. Investors also have the luxury of having the portfolio constantly managed by a professional. The investor does not have the hassle of continuously monitoring the performance of each of the instruments.

Other advantages include liquidity and simplicity. Most funds give you the option to cash in your investment at any time. Investing in a mutual fund is also easy, all that is required is a visit to a bank or broker in order to invest. Some funds however understandably have a minimum on the amount of money to be invested.

The price of some mutual funds is based on the Net Asset Value (NAV) of the fund while others are priced on a Bid/Offer spread. The 'Offer' price would be the price that the institution is selling one unit of the fund (that is, the price at which the investor would buy) while the 'Bid' price is that which the institution will purchase one unit from you

(that is, the price at which the investor would sell). For example, if a fund lists its Bid price at \$5.00 and its Offer price at \$5.25, it means that if you are buying into the fund on that day you would pay \$5.25 per unit. Similarly, one selling the fund on that day would receive \$5.00 per unit.

Money is made from distributions that are re-invested into the fund. The distributions are generated from capital appreciation, dividends on stocks and interest on bonds or deposits. The frequency of the distributions would depend on the fund. If there is no distribution, the Net Asset Value of the fund would increase providing capital appreciation to the investor much like a stock.

### **Types of Mutual Funds**

Just as when one is considering investing in the stock market there are a host of choices, this is also the case with mutual funds. Fundamentally, there are three different categories from which all variations of mutual funds are derived. The three basic categories are:

1. Equity Funds (stocks)
2. Fixed Income Funds (bonds)
3. Money Market Funds

Equity funds represent the largest category of mutual funds and include Specialty Funds, Global/ International Funds and Property. The investment objective of a fund based in equity is long term capital growth. This fund would invest in companies for either the company's growth potential, value or a blend of both.

Specialty Funds are equity funds that invest in the same type of companies or region while an International Fund would comprise of investments outside of the home country. A Global Fund would include foreign and domestic investments and a Property Fund would consist of investments in real estate and different types of property.

A Fixed Income Fund would comprise primarily of government and corporate debt. Fixed Income Funds are also known as Bond Funds or Income Funds. The primary objective of these funds is to provide a steady cash flow to investors. A Balanced Fund would be made up of both Income (Bond) and Growth (Equity) instruments.

Of the three basic categories, a Money Market Fund is perhaps the safest place to park your money and appeals most to the conservative investor. The money market consists of short-term debt instruments, mostly treasury bills.

### **The Trinidad & Tobago Mutual Fund Market**

There is a wide range of Mutual Funds available in T&T market. They include Income and Growth (TT and US), Money Market (TT and US), Caribbean Equities and Global Equities to name a few. Some are priced using the Net Asset Value method and others by the Bid/Offer spread. The funds are differentiated based on their objectives, requirements of the investor and benefits.

One of the most important aspects of a fund is its ingredients. For example, an equity fund that comprises largely of stocks in our domestic market would be under some pressure at this point in time as our domestic market is facing downward forces. Those heavily tied to international equities of certain countries would no doubt be subject to the forces of that market though in both cases it would be to a lesser degree than if the investments were directly in the respective stock market.

When deciding which fund to invest in it is important therefore to request all the necessary information to aid you in making an informed decision. The fund's prospectus is one of the most important documents that one should read. The prospectus would include the fund's objectives, goals and the measurement put in place to achieve them. The investor's objective is also significant. If you are looking for long term growth, funds based in equities may suit your needs better, while if you are searching for income, a money market fund may be a better choice. One should also explore the fund's return over at least a five year period and the risks associated with the fund. See Table 1.

Given the current investment climate, we recommend placing your money in a money market fund until the market rebounds. Mutual funds heavily weighted in equity will not make sense as this switch in investment is for a short period and an equity fund would be subject to the activities of the market. In addition, those funds really facilitate investors with a longer term horizon. In my opinion, an income & growth fund also does not seem prudent at this time for investors waiting to re-enter the market because the state of the market would also influence the fund depending on the weighting of the portfolio. If one is considering an income and growth fund, it is imperative that they consider the weighting of the portfolio, where the equities are based and their investment horizon.

The money market funds are the safest, easiest way to make a return on your dollar while the bull sleeps as it carries the least risk as it comprises mostly of short term debt instruments. As said before, this would enable you to gain some interest on your investment while the market is swinging downwards. To add to that, rising interest rates benefit money market funds as greater interest payments would be made. This way, one would gain some interest on his investment in the interim and would be able to come back into the market at the right time and purchase more of the same share that was sold.

In conclusion, I remind you that the bull will not sleep forever. The bear's reign must at some point in time come to an end. Instead of worrying about the falling prices which has to happen anyway, think of what best one can make of the situation. Call your investment advisor to seek advice on the best mutual fund that would suit your needs.

**Table 1**

| <b>Type of Mutual Fund</b>                  | <b>Risk</b>                     | <b>Comment</b>                                                                                                                                                                                                                                                        |
|---------------------------------------------|---------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Equity</b>                               |                                 |                                                                                                                                                                                                                                                                       |
| (a) Specialty Funds                         | Very Risky                      | Because these funds would be concentrated on a certain sector they are very volatile because whatever is happening in the sector would affect the entire portfolio. Of course, there is also the possibility of bigger gains.                                         |
| (b) Global/International Funds              | Risky                           | The extent of the risk associated with these funds would vary dependent on the portfolio. These funds are subject to unique country and political risks. However, if they are a part of a well balanced portfolio they can reduce risk by increasing diversification. |
| (c) Growth Funds                            | Less Risky than Specialty Funds | This is less risky than specialty funds because it would be spread across different sectors and would not be subject to the falls of any one sector.                                                                                                                  |
| <b>Balanced Funds (Income &amp; Growth)</b> | Less Risky than Growth Funds    | There is less risk because the fund is balance between debt and equity instruments                                                                                                                                                                                    |
| <b>Bond/Income Funds</b>                    | Less Risky than Balanced Funds  | Because these funds are invested in Government and Corporate debt it is less risky than those funds invested in equity. Of course, the returns are usually less.                                                                                                      |
| <b>Money Market Funds</b>                   | Least Risky                     | The fact that these funds are mostly invested in short term debt which is more or less guaranteed make these the least risky of all mutual funds. They naturally offer the lowest returns.                                                                            |