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THE CASE FOR INVESTING IN MANAGED FUNDS

The last 18 months have been challenging for investors. Investment returns have been disappointing in many sectors on the back of weak share markets, falling property values, a raft of finance company failures, the global credit crunch and now economic recession spreading across the developed world. What started off in late 2007 as a US sub-prime mortgage problem last year turned into broader global financial sector problem and then a global economic problem.

Understandably, this has left many investors shell-shocked and reluctant to take risks with their money. Investor confidence is close to the lowest it has been in 10 years and investors' focus is currently more on capital preservation and keeping their money "safe" rather than finding attractive investments.

The latest *ASB Investor Confidence Survey* tells the story.

New Zealanders currently rate term and bank deposits as the best places to put your money, followed by rental property and then managed funds and shares.

That investors favour bank and term deposits is not surprising given the turmoil in investment markets and the government's decision last October to launch the crown Deposit Guarantee Scheme. However, the Deposit Guarantee Scheme runs until only October 2010 next year and we are in a falling interest rate environment. At the beginning of last year the official cash rate was 8.25% whereas it is now 3.0% and could well fall further over coming months. That may not make money in the bank and term deposits the best option for all of your money if you have longer term goals such retirement planning or funding your children's tertiary education.

Investors looking at their savings and investment options should have a closer look at managed funds.

They are not so much investments in their own right like property and shares, but they're investment vehicles.

The principles behind them are straightforward enough. Investors' money is pooled and then invested on their behalf by investment professionals who use it to build a portfolio of investments.

Managed funds can invest in anything from bank deposits, bonds, property, shares, commodities or financial instruments both in New Zealand and internationally.

As well being straightforward, the principles behind managed funds are tried and true.

The modern managed funds industry dates back to the 1930s in the USA.

After the Crash of 1929 and the Great Depression of the early 1930s wiped out the life savings and hopes of middle America, the US Government asked an economic thinktank, the Cowles Commission, to look into how ordinary citizens could survive the inevitable (but thankfully rare) sharemarket crashes and banking failures which occur from time to time.

The Cowles Commission's brief was to see whether there was a prudent way of investing money to give ordinary investors the best chance of riding out market storms.

It concluded there were five steps prudent investors should take:

- Buy quality – and be prepared to pay for it;
- Diversify your investments – don't put all your eggs in one basket;
- Use investment professionals;
- Invest for the long term; and,
- Use dollar-cost averaging. (This is a strategy of easing in to an investment by investing small amounts over a period rather than taking a punt with all your funds at once and hoping you get the best price – and it's one of the core mechanisms of how KiwiSaver operates.)

Those five principles are just as valid now as they were 75 years ago.

The Commission's findings prompted a Boston company to create pooled investment vehicles (they called them "mutual funds") which made it easy to for ordinary investors to put the above five principles into practice. Before long, a thriving managed funds industry evolved which has served countless millions of investors well by providing vehicles through which they could achieve their savings and investment goals.

So why are some investors currently shy of managed funds?

Among the reasons would be the turmoil we've seen in the markets and the losses many funds have posted, and the bad press the financial services sector and some managed funds have been getting hasn't helped either.

Contrary to what some investors might think, the risk/return model hasn't broken down. Over time, the key to achieving better returns than money in the bank is to invest in investments which have a higher risk profile. And make no mistake about it, ALL investments have some element of risk attached to them. That's why it is a breach of the Securities Act for any investment to be promoted as "safe" or free from risk.

One of the problems with extended bull markets is that people can develop unrealistic expectations and expect the good times to keep rolling on. They never do. Markets all follow cycles.

There are no free lunches when it comes to investing, but there are some pretty good deals to be found. Take shares. Some sharemarkets last year fell 20%, 30%, 40% or more. Have the markets hit the bottom yet? No one knows. But regardless of whether they have now bottomed out or fall a little further, there is currently a significant number of cheap investment out there and there is also a fair amount of dross you'd want to avoid. Researching the markets to identify the quality bargains from the investments you'd want to avoid is what fund managers do for a living.

The key to successful investing is to do your homework before committing your money and don't invest on faith or in anything you don't fully understand. Test before you invest.

Promoters of managed funds are required to issue offer documents called Investment Statements. These aren't just glossy marketing brochures, but they contain all the information which a "prudent but non-expert investor" would want to know in order to make an informed decision. Information such as: what sort of investment it is, who is offering and running it, how much do you need to pay and what are the charges, what kind of returns you could expect, what risks you would be taking, how you get your money back, who you contact with any questions and who you can complain to if you have any problems.

Investment Statements follow a set format to make easier for prospective investors to compare one investment with another.

New Zealanders who are serious about wanting to achieve their financial goals should have a good look at managed funds.

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