
# HOW TO MAKE MONEY INVESTING IN MUTUAL FUNDS

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A mutual fund (unit trust) is a pool of money that is professionally managed for the benefit of all shareholders. As an investor in a mutual fund, you own a portion of the fund, sharing in any increases or decreases in the value of the fund. A mutual fund may focus on stocks, bonds, cash, real estate, money market instruments, or a combination of these asset classes. It is simply an investment vehicle that seeks to employ the perceived professional skill of a fund manager to invest on behalf of diverse investors who pool their funds together for that purpose. In adopting this investment strategy, such investors save themselves the rigour of selecting and managing their investments by themselves, rather trusting in the competence of the professional fund manager to do so in their place.

To illustrate how a mutual fund works, let's imagine you want to invest N10,000 in a mutual fund that sells for N100 a unit. Your money, which will buy you 100 units in the fund, is pooled with that of many other investors in the fund and invested by a professional manager. Suppose after a year, the value of the fund's investments increase by 30%. That means the value of each unit you own has increased from N100 to N130. This is a simplified example of how a fund works.

When you invest in a mutual fund, you receive a certificate of ownership of a certain number of units of the fund, not the specific stocks, bonds or any other investment assets of the fund. It is the responsibility of the fund manager to choose assets to invest in and the individual investor is not consulted. However, to protect investors and indeed meet their investment aspirations, each fund has its defined investment perimeter. In effect, what areas of investment it can undertake and the range of possible asset allocation to each asset class, are usually spelt out in its approved prospectus. The investor therefore generally knows the investment sectors his money is being channeled into but not necessarily the specific assets. Such assets are in the name of the fund, not the individual investors. While there is collective ownership of the underlying fund assets by all the fund investors (in proportion to units of fund held), no investor has ownership of specific fund assets. Investors will therefore only be able to sell their units of the fund, if they choose to realize investment.

Mutual funds are regulated by the Securities and Exchange Commission (SEC) which scrutinises and approves applications to operate such schemes. SEC therefore has the primary duty to protect investors in such funds and, so far, its ability to discharge that regulatory role has not been questioned. The law also requires the appointment of qualified trustees to further oversee the operation of a unit trust and see to the protection of the funds and the interest of the investors.

In an open-ended mutual fund, you can invest anytime meaning there is no closing date. You can also redeem your investment anytime. In a closed-ended mutual fund, once the subscription period is over you can not buy into it. This type of fund is listed in the Managed Funds sector of the Nigerian Stock Exchange official listing of traded equities. They are traded like stocks and you can buy them on the exchange.

**YOU INVEST IN MUTUAL FUND IN TWO WAYS**:

- **Lump sum.** You can invest any amount you want at one time, as long as you meet the minimum requirements of that fund. Some funds have no minimum for opening an account or no minimum for additional share purchases, while others do.
- **Automatic investment.** Most funds offer plans that allow you to transfer set amounts on a regular basis automatically from your bank account or paycheck. This is a great way to save money on a routine basis.

With automatic investing, you get the benefits of cost averaging. That is, when you make regular investments in a mutual fund, such as investing N5000 every month, you can take advantage of both the ups and downs of the market. When the market is down, your monthly investment typically buys you more shares of the fund, helping to increase your ownership in the fund. When the market is up, your monthly investment typically buys you fewer shares of the fund, helping you avoid buying too many shares at higher prices. Over a long period of time, the end result is that the average cost of your fund shares is lower than the average price of the fund shares during the same period.

## YOU MAKE MONEY IN A MUTUAL FUND IN THREE WAYS:

- **Appreciation**: The value of a fund share can appreciate or go up in value. (Of course, it can also go down in value.) When the total value of the securities owned by the fund rises, the value of your fund shares rises with it. Again, the reverse is also true.
- **Dividends**: If the fund receives dividends from stocks, interest from bonds, or other investment income, it distributes those earnings to shareholders as a dividend according to the terms outlined in its prospectus. Depending on the fund, these distributions can be monthly, quarterly, or annually.
- **Capital gain distributions**: Every time the fund manager sells securities at a profit, the fund earns capital gains. Funds are required to distribute these gains to the shareholders at regular intervals, typically once or twice a year. You can choose to have the fund automatically reinvest the money in more fund shares, keep it as cash in your account, or send the money to you.

## ADVANTAGES OF MUTUAL FUNDS

- **Diversification.** A mutual fund spreads your investment around better than you could do by yourself. This diversification tends to lower the risk of losing money. Diversification usually results in lower volatility, because when some investments are doing poorly, others may be doing well.
- **Professional management.** Many people don't have the time or expertise to make investment decisions. A mutual fund's investment managers, however, are trained to search out the best possible returns, consistent with the fund's strategies and goals. In essence, your mutual fund investment brings you the services of a professional money manager.
- **Cost efficiency.** Putting your money together with other investors creates collective buying power that may help you achieve more than you could on your own. As a group, mutual fund investors can buy a large variety and number of specific investments. They can also afford to pay for professional money managers and fund operating expenses, where they wouldn't be able to afford it on their own.
- **Liquidity.** With most funds, you can easily sell your fund shares for cash.

## RISKS

Because mutual funds typically hold a large number of securities, their level of diversification provides them with a lower level of risk than investing in a single stock or bond.

However, investing in mutual funds still contains a number of risks that you should consider before investing, including:

- You could lose money
- Your money may lose buying power
- You may not achieve your goal
- Your investment may rise and fall in value
- Other risks

You could loose your money.
Every mutual fund prospectus will highlight this point. It's the most obvious and feared risk of investing. There are, however, many strategies for managing this risk, particularly over the long term.

Your money may lose buying power.
This risk is also known as inflation risk: as prices increase, your investments must increase in value at least at the same pace, or you'll lose purchasing power.

You may not achieve your goal.
Probably the biggest, yet most overlooked risk of investing is the risk of not achieving your goal. It's probably overlooked so often because so few investors actually set goals, and many others set unrealistic goals. Furthermore, many investors don't buy the right investments to help them achieve their goals. This type of risk is often called shortfall risk (falling short of your goal).

Your investment may rise and fall in value.
Almost all investments have the potential to gain and lose value. This is known as market risk. In other words, the price of any investment, whether it's stocks, bonds, mutual funds, or any other, is likely to rise and fall over time. Seasoned investors tend to ignore the relatively small price movements in their investments, preferring to try and capture the more significant fluctuations they can better anticipate. If you invest for longer periods of time, market risk may become less dangerous to you. That's because, over the long-term, most investments tend to rise in price. Market risk, however, can place investors at a significant disadvantage if they are forced to sell at a time when prices happen to be down.

## CHOOSING A MUTUAL FUND

Choosing the right funds and trusting your decisions enough to back them with your money is challenging. To keep from getting overwhelmed, be sure you understand what you want for your money (protection, income, growth), then look only at the funds that aim for the same thing. But where can you look for information?

Look at the fund prospectus. The prospectus is essentially the user's manual for a mutual fund. It has the reputation of being dense and complicated to read, but recent changes in regulations have required funds to make every prospectus much simpler, especially in the key areas of understanding performance and expenses. Simply looking at the charts and tables in the first few pages will tell you a lot you need to know.

What's in a prospectus? The SEC requires every fund to publish a prospectus and update it annually. It covers all of the important elements, such as the history, management, financial condition, performance, expenses, goals, strategies, types of allowable investments, and policies.

- **Performance**. Each fund must tell you how much it has increased or decreased in value in each of the past 10 years (or for every year of its existence, if shorter). This is labeled in the prospectus as "performance" or as "annual total return." Fund performance is required to be shown against a relevant industry benchmark, a performance measure used by the industry of how the market segment has performed as a whole compared to the investments in that segment held by the fund. Typically, the benchmark will be an "index" for that category.
- **Average annual return.** While every fund has to show its annual performance, every fund also must to tell you its average return on a yearly basis. Average annual return is important because it keeps funds from promoting their best years and ignoring their worst years. It takes the total returns

for each year and averages them across the number of years the fund has been in existence.

- **Fees and expenses.** The prospectus will tell you if a fund charges a sales charge or is a "no-load" fund, meaning that there is no up-front sales charge. All funds charge management fees and expenses, which will be described in the prospectus.

Some good mutual funds are:

1. The Discovery Fund – Managed by Asset Resources Management Company. Their head office is at 68C Coker Road by Town Planning/Coker Junction, Ilupeju Lagos. Tel: 234-1-4718282, 4718169. They have branches across the country. Visit www.armdiscoveryfund.com to know more about them and their other locations. You can subscribe to the fund through any branch of GTBank Plc.
2. The IBTC Nigerian Equity Fund – Managed by the investment arm of StanbicIBTC Bank. To invest in this fund, visit any branch of StanbicIBTC Bank.
3. The Nigerian International Growth Fund (Nigfund) – Managed by Fidelity Bank Plc. To invest in this fund, contact any branch of Fidelity Bank Plc.
4. Legacy Fund – For more information about investing in this fund, contact any branch of FCMB Plc.

Also visit the websites of Zenith Bank Plc and UBA Plc to know about their funds.

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