

Shedding Light on the Local Mutual Fund Industry

The mutual fund industry in Trinidad & Tobago has grown at a phenomenal rate since the establishment of Unit Trust Corporation of T&T (UTC) in 1981. Assets under management in domestic mutual funds grew by approximately 500% between 2000 and 2005, over 14 times the growth rate of the worldwide industry over the same period.

The buoyancy in the energy sector and a favourable macroeconomic environment has resulted in the accumulation of significant wealth in T&T. Savings are being increasingly channelled away from traditional bank deposits towards mutual funds which offer professional management and diversification at minimal cost.

Given the growing importance of the mutual fund sector, the Trinidad & Tobago Securities and Exchange Commission (TTSEC) have begun an ambitious program to strengthen the regulatory framework of the industry. The authorities recognize that the current mutual fund supervision is inadequate, particularly in respect of disclosure and continuous reporting. The draft Securities Industries Act (SIA), if enacted, will provide for comprehensive TTSEC supervision of all mutual funds.

The main objectives of this legislation are the protection of investors and the promotion of fair, efficient and transparent markets. There is strong emphasis on mandatory disclosure of information that investors should consider in connection with investment decisions. Disclosure requirements relating to mutual funds include the provision of a prospectus at the time an investor purchases units in a fund, and the ongoing provision of financial statements to unit shareholders.

As with any investment decision, it is important to consider a number of factors before making an investment in a mutual fund. Most of this information can be found in a fund's prospectus, including the risks and objectives of the fund, past performance and fees. The *Guidelines for Collective Investment Schemes* published by the TTSEC in April 2006, emphasises the value of making available any information considered to be important to a prospective investor in the fund's prospectus.

Unfortunately, most prospectuses are too long and too technical for anyone other than a sophisticated investor to comprehend. However, you don't have to read every word to understand the nature and risk of the investment. Understanding mutual funds – and choosing the one that's right for you – isn't that complicated once you know what to look for.

Don't fall into the trap of focusing on promises of a high return. As with any investment, a fund's past performance is no guarantee of its future success. Historic returns are only useful when evaluating how the fund has behaved in different market conditions over longer periods of time.

There is little value in looking at the past performance of a fund with a track record under five years. A fund's track record should only be considered if it validates the consistency of the investment manager in generating superior returns when compared to other funds with the same investment objective.

While past performance does not necessarily predict future returns, it can tell you how volatile a fund has been. Generally, the more volatile a fund, the higher the investment risk. If you'll need your money to meet a financial goal in one year, you probably can't afford the risk of investing in a fund with a volatile history because you will not have enough time to ride out any declines in the stock market.

Understanding risk is critical to being an informed investor. Markets can go up and down, and you can make or lose money in any investment. Thinking about your long-term investment strategies and tolerance for risk can help you decide what type of fund is best suited for you. A fund's rates of return are meaningless unless you factor in the risks taken to achieve those returns.

Similarly, a strong fund performance record may not mean much if most of it was compiled by a now-departed manager. At present, the names and experience of the individuals principally responsible for managing local mutual funds are not usually disclosed in the fund's prospectus. Hopefully, the TTSEC will move towards enforcing greater transparency with regards to the fund manager's track record.

Until then, don't be afraid to ask your financial advisor about a manager's credibility or any recent changes in the fund's operations. Though a new fund manager may be just as good or better, it is important to realize that all the fund statistics from before may not be relevant.

Your financial advisor can also offer valuable insight into the fees and other costs of owning a particular fund and how they compare to comparable funds. Fees and expenses are important factors to consider when buying a mutual fund since seemingly small differences in costs can result in large differences in returns over time.

Understanding the costs involved can be the most confusing aspect of investing in mutual funds, but with the help of a financial advisor, you can develop a better understanding of what you are paying for and make a well-informed decision. Eventually, the TTSEC should give more thought as to how expense disclosures can be simplified by enforcing a standardised format to make it easy to understand and compare different funds.

Making "apples to apples" comparisons is an important part of investing whether you are evaluating returns, risks or expenses. Make certain that you compare funds within the same asset class by considering the funds' investment strategy, including portfolio assets and investment restrictions.

Never assume that funds with similar names have the same goals, objectives or holdings. The names of many domestic funds are misleading as regards to their investment strategy. The TTSEC's *Guidelines for Collective Investment Schemes* aims to address this issue by applying strict nomenclature rules.

Fund companies will no longer be able to include as part of a fund's name, words that suggest the pursuit of a particular investment strategy unless a minimum percentage of the fund's assets are invested in pursuit of that strategy.

"Money Market" funds, for example, must not have less than 90% of their portfolio assets invested in cash and short-term debt securities that have a remaining term to maturity of less than 12 months.

Under these new standards, many local funds are incorrectly characterised as money market funds and will eventually have to change their name or investment strategy. Once enforced, this requirement will drastically improve the consumer's assurance that "money market" funds offered by different companies have the same objectives and holdings.

These requirements are intended to protect mutual fund investors by providing consistency and preventing misleading sales communications. Investors should remain wary of financial advisors and never confuse a sales pitch with impartial advice that is suited to your particular goals and risk tolerance.

If your broker seems overtly eager to put you into an in-house mutual fund, ask whether he or she will receive any extra commission or other incentives for selling a certain product. You have every right to ask a financial professional why he or she is making a certain recommendation to you, what the alternatives are, and how much he or she will be paid for the transaction.

We commend the TTSEC for their efforts to improve the mandatory disclosure requirements of mutual funds. When fully implemented, these measures will bring the regulation of mutual funds in T&T closer to the level of international best practice and provide consumers with the information they require to make informed decisions. The onus is still on the investors to

protect their own interests by carefully reviewing the prospectus before making a mutual fund purchase.