Available online at www.elixirpublishers.com (Elixir International Journal)

Social Science

Elixir Soc. Sci. 54 (2013) 12659-12662

ISSN: 2229-712X

Wealth creation through unit trust investment in Malaysia: case study

Shashidhar Channappa[1] and Srota Pandya[2]

[1]Department of Social Work, The Oxford College of Arts, Bangalore, Karnataka, India.
[2]Department of Social work, Acharya Institute of Management and Sciences, Bangalore, Karnataka, India.

ARTICLE INFO

Article history:
Received: 22 November 2012;
Received in revised form:
15 January 2013;
Accepted: 24 January 2013;

Keywords
Wealth,
Unit,
Trust,
Goal.

ABSTRACT

Almost all of us received our income either in the form of salary or profit through business activities. However we must always bear in mind that we cannot work or conduct our business activity for our entire life and there will be a point where we have to stop or retire. Thus it is very important for us to have a proper financial planning. Financial planning is most commonly associated with the main goal of achieving financial freedom which is achievable with a proper investment planning. Some people thought saving and investing are the same things. Nevertheless, each requires a different approach and a different way of judgment and consideration. Saving is usually associated with low risk, low return and sometimes a short term goal. Saving is simply putting aside some of our disposable income for a temporary period of time prior to achieving actual long term goal setting. Saving is a conservative outlay approach, taking very little risk with our money. A bank account or cash management trust is usually sufficient to reach the savings goal.

Introduction

Almost all of us received our income either in the form of salary or profit through business activities. However we must always bear in mind that we cannot work or conduct our business activity for our entire life and there will be a point where we have to stop or retire. Thus it is very important for us to have a proper financial planning. Financial planning is most commonly associated with the main goal of achieving financial freedom which is achievable with a proper investment planning.

Some people thought saving and investing are the same things. Nevertheless, each requires a different approach and a different way of judgment and consideration. Saving is usually associated with low risk, low return and sometimes a short term goal. Saving is simply putting aside some of our disposable income for a temporary period of time prior to achieving actual long term goal setting. Saving is a conservative outlay approach, taking very little risk with our money. A bank account or cash management trust is usually sufficient to reach the savings goal.

Investing, on the other hand, is simply an assets acquisition for the purpose of producing income and capital gains for the owner. So we need to adopt a longer investment timeframe and a measured degree of risk. While a bank account may be suitable for short-term needs. History shows that saving in a bank account is inadequate for long-term goal such as funding your retirement or putting money aside for your children's need.

Why? Simply because of the returns is just too low, especially when we take into account the inflation rate and tax. To drive our money further, we need to invest in growth assets, such as shares and property, which have historically provided better long-term returns. Growth assets can also be more tax-effective than the other asset classes.

How Unit Trust can help in creating wealth

Direct Investment Vs Indirect Investment

Some people like to invest in shares through a stockbroker. Others like to buy property through a real estate agent. However these direct approaches to investing usually require considerable time and expertise. A potentially smarter and more rewarding alternative is to invest indirectly, by purchasing units in a managed investment. A notable example is unit trust, which will be the centre of discussion.

Basic features of Unit Trust

Unit Trust industry in Malaysia begun with the establishment of the first Unit Trust Management Company (UTMC) namely Malayan Unit Trust Limited in 1959. As at Feb 2012 Malaysia have a total of 42 UTMC and 605 funds. Unit Trust or also known as Mutual Fund can be defined as a scheme that collects money from various investors who have the same investment objective. Generally there are three parties involved in any Unit Trust fund, the fund manager, the trustee and investors. Fund managers are the one who will be managing the fund based on fund objective, policy and investment strategies agreed and outline in the trust deed. The fund manager is also the one who will be deciding where to invest, which companies, when and how. The investors have no say as to whatever decision made by the fund manager as long as it is managed in accordance with the deed and investment objective. Trustee on the other hand, is the custodian of the fund. The main role of the trustee is to make sure the assets are in good faith. Apart from monitoring the operation of the fund, all the fund assets will be under the trustee name. The trustee will collect all income and approve all financial transactions of the fund. The trustee also must be independent from UTMC, this is to ensure prudent management of public money and increase the confidence towards the industry.

Among term and charges that investors must be familiar with before investing in Unit Trust in Malaysia are Loaded and no load, Exit fee, NAV, management fee and trustee fee. What is loaded? If the fund you are investing is loaded, it means that the fund carries a service charge. For an example, if you started RM10, 000 worth of investment in a fund that imposes a 5% service charge you have to pay an extra RM500 in order for you to invest in the fund. This is the fee that will be paid to the

Tele:
E-mail addresses: shashidhar.channappa@gmail.com

servicing agent who will be monitoring and advising you as long as you remain as investors. A lot of people argue that service charge for Unit Trust is very high. A question you can ask yourself is, is it worth it? Say you stay invested for the next 25 year, with an investment of RM10, 000 you are just paying RM500 for 25 years of advice and monitoring from the agent so that you have a piece of mind. No load fund on the other hand carry no service charge, sound good isn't it? Normally this type of fund is made available to the public by the government to promote savings among the people in a developing country and also to support the capital market. In Malaysia No load funds are mainly managed and promoted by the government UTMC namely Permodalan Nasional Berhad (PNB). Which one is better? If there is no service charge can you expect service? The answer is no. Investing in a unit trust without service charge means you have to monitor and also equip yourself on how to manage the unit trust on your own. NAV or in full Net Assets Value is the size of the fund. If we take the NAV and divide it with the total number of units we will get the NAV per unit which is the price of the Unit Trust. The management fee is the fee that an investor pays for all the cost incurred in managing the fund for an instance brokerage fee, auditor fee, tax agent fee and many more. On average the management fee is about 1.5%. The trustee fee on the other hand stood at an average of 0.07% per annum. This fee is charged to pay trustee as the custodian of the fund where expenses incur in creating the units, canceling the unit and others.

Unit Trust invests in a variety of asset classes depending on the objectives of the funds. The 3 major assets that Unit Trust in Malaysia normally invests are the Equity, Bond and Money Market instruments. For every fund there will be a limitation in exposure for every asset class. For an example, an equity fund will normally have 75%-98% of exposure in Equity market and the remaining can be invested in Bond or Money Market instruments. Unit trust also can be divided into two categories, open-end fund or closed-end fund. Open-end funds are generally not quoted on the stock exchange and the size of the fund will increase with the creation of new units because of new investment into the fund. Closed-end fund on the other hand is quoted on the stock exchange thus buying and selling is between the buyer and seller. This also means that in order to invest in closed-end fund investors need to go through a stock broker.

Why invest in Unit Trust?

Investors who invest in Unit Trust can expect two types of return, the capital appreciation and distribution. Capital appreciation is the increase in NAV while distribution is a payout from the fund depending on the income or profit made from the fund investment. Investors can easily expect a return of 8%-10% per annum and based on historical record most of Unit Trust funds in Malaysia have been able to deliver more than that in the long term. Hence, the question you should ask yourself is; if there is any money that you are not using in the long term where do you put the money? If you deposited most of your money in the bank then you should consider learning more about unit trust. A very simple example using the rule of '72', say fixed deposit rate in Malaysia can give you a compounding rate of 3% you will take 24 years to double RM100, 000 to RM200, 00. On the other hand, if you invest in an instrument that give you a 10% return it will take you only 7.2 year to double your money which is 3 times faster.

Before any investors decide to invest in any investment instrument investors will have the question of whether or not the investment is safe and reliable. In Malaysia there many cases whereby the public is cheated with various Scam investments. For an example the one that was frozen by the securities commission in 2009 'Swiss Cash' have put a dent effect on public confidence on any investment scheme. Some of this scam scheme promises high return of 20%-30% a month which sound good but impossible. However with the current state of knowledge and understanding towards investment among the investing public in Malaysia they can easily be cheated. A very simple guide in identifying a Scam investment by SIDC (subsidiary of Securities Commission) is **T.I.P.U**. What is T.I.PU in Malay language? TIS 'tidak akan rugi' (no losses), I am 'indah khabar dari rupa (Everything is not what it seems), P is 'peluang hanya sekali' (you only have one chance, have to do it now) and U is 'Untung yang besar' (huge profit or return). Investment in unit trust is reliable because the industry is regulated by securities commission. When anybody deposited their money in banks why they are very confident that their money will be safe? It is because banks are regulated by Bank Negara. Same goes to Unit Trust industry. The ministry of Finance has entrusted the Securities Commission to regulate the securities industry and Securities Commission is supported by the self-regulatory body formed by the UTMC's namely the Federation of Investment Managers Malaysia. With the above discussion it is clear that the unit trust investment is safe and reliable investment instruments.

Benefits of Unit Trust investment

Unit trust can store the value of investment. What does it mean? Investment in unit trusts will not go to zero. Comparing the investment with share, if the company that we invest in goes bankrupt the value of investments will be zero. The unit trust fund is a well diversified portfolio where the investment is spread in many companies. It is quite impossible to have all the companies in different sectors to go bankrupt at the same time. You can ask yourself a question, have you ever heard investors who invest in the stock market lose money and they commit suicide? If yes, ask yourself another question, have you ever heard of the same in Unit Trust investment? The answer is No. It is obvious that Unit Trust is an investment instrument that has the ability to store the value and if you have a medium to long term investment you will be able to achieve your investment goal.

The ownership of unit trust is divided into units, thus investor can accumulate their wealth over the long term by acquiring the units on a monthly basis. Most companies in Malaysia allow investors to start as low as RM100 a month. This in turn allows investor to practice dollar cost averaging strategy which is quite difficult to apply in other investment. For an example, property is a very good investment. However, we cannot buy property on a monthly basis unless we take financing from banks. Share investment on the other hand, also allows investors to buy in small amount. This is because the ownership is also divided into units. However, it is not cost effective to buy small amounts as the brokerage fee imposed a minimum amount.

Unit Trust investment also allows investors easy access to funds. With the features of high liquidity, investors can withdraw their investment anytime they like and the UTMC is obliged to buy at market value. In addition you have professionally trained and experienced fund managers to manage your investment and the cost of this professionally manage fund is shared among investors. Thus investors enjoy economies of scale or low investment cost. Based on the above discussion we can summarize the benefits of unit trust investment into 7 as follows:

I. Storehouse of value
II. Accumulation of Wealth
III. Diversification and Investment exposure
IV. Professional Management
V. Affordable
VI. Ready access to funding
VII. Low investment cost

Disadvantages of Unit Trust Investment

Unit trust investment is exposed to the capital market namely the equity, bond and money market. This is the reason, it is exposed to the market risk. Market risk can be defined as the fluctuation of the instrument due to the up and down of the business activity and economic cycle. Equity especially is having the highest volatility among these 3 asset classes. Due to this reason, investing in Unit Trust must be made only with the aim of achieving long term financial goal. One of the disadvantages of unit trust is the initial service charge. It is very difficult for investors to recover the service charge in the short term. That is why it is advisable to invest in the log term. This can be related to opportunity cost as one of the major disadvantages in unit trust investment. Say an investor's start his investment in Unit Trust and 1 month later discover that his neighbor is selling their house below market value. It is very difficult to even recover the initial service charge in 1 month time. If the investor needs to withdraw the money to buy the neighbor's house the investors may be at a loss. One more set back in unit trust investment is that you have loss your control over the investment decision. This is because all the investment decision will be in the fund manager hand.

From the above discussion we can summarize the disadvantages into 4:

I. Risk
II. Fee and Charges
III. Opportunity Cost
IV. Loss of Control

Classification of Funds

Major classification of Unit Trust can be divided into 4. The equity fund, balanced fund, fixed income fund and money market fund. The Equity fund as the name implies invest mainly in the equity market where the fund will buy company shares. Shares are generally comes with high volatility as it is traded in the exchange market and it does not have fixed dividend. The general economic conditions and business environment will affect the fluctuation of the price. It focuses mainly on achieving capital appreciation or growth. As the economic business cycle takes about 3-5 years, investment in equity fund also should be at least 3-5 years in order to be on the safe side. Fixed income fund on the other hand invest mainly in corporate and government bond. What is a bond? A bond is a long term debt instrument issued by a government or corporation. Bond normally pays a fixed return which is also known as coupon payment. Because of the nature of the return is fixed the fluctuation of the price is also very much lower. Bond price is more stable thus fixed income fund NAV generally more stable compared to an equity fund. Investment in fixed income fund is useful as portfolio diversification to complement the investment in equity fund. Fixed income fund generally focused on the annual income as the instrument is able to provide fixed coupon annually. Balanced fund on the other hand posses a lower volatility as compared to equity fund and higher than fixed income or bond fund. This is because it normally has a balanced of shares and bond as the investment. Thus the balanced fund can provide both annual income and capital appreciation and of course the appreciations generally lower as compared to an equity fund. The money market fund invests mainly in short term money market instrument. Money market instrument generally poses the lowest risk among the 3 asset classes (equity, bond and money market). The money market fund is very useful as a short term parking place for investors as it is very stable and the volatility is very low.

Unit Trust Investment Strategy

In Unit Trust there are only two major investment strategies. First is the Dollar cost averaging and the second is asset allocation. Any unit trust consultant or financial planner should be familiar with these two strategies. As an investor, before you start your investment you should ask your consultant or advisor which strategy they are using for your investment. If they are not sure about the strategy then you should ask yourself again, can this consultant help you in achieving your financial goal. Unit Trust is a very simple investment instrument. You are not required to have knowledge of expertise or time to manage your investment as the investment will be managed by a professional fund manager. However it is very important to apply a proper strategy as your investment is tied to a long term investment commitment in order to achieve your financial goal. Either one of the strategy must be applied.

What is dollar cost averaging? It is simply a strategy where investors invest regularly where it can be done monthly, quarterly or semi-annually depending on the needs and investors' preference. The key word is regular investment. For an example, Adam start an investment in fund ABC with an initial investment of RM5, 000, cost averaging can easily apply by investing at least 10% of the initial investment monthly which is RM500 a month. By applying this strategy it is quite impossible for investors to have a negative return in the long term. Why? As discussed earlier, because of the economic business cycle the investment value in an equity fund will fluctuate. Investors who apply this strategy benefited by the low economic cycle as the NAV is lower investors manage to buy more units. Hence, when the economy recovers and the NAV increases investors investment value also increases. However not in all situations this strategy can be applied. For an example, say an investor starts the investment with an initial of RM150, 000. If the investor cannot invest regularly either monthly, quarterly or semiannually it is very important that the investor apply the second strategy which is the asset allocation. Generally many investors can start with a lump sum of RM150, 000 especially a more senior investors as they have accumulated the money in their earliest stage of life. Say the investor wanted to apply dollar cost averaging and willing to commit RM500 monthly. Just ask yourself a question, can RM500 average down the initial investment of RM150, 000. Definitely no. To average down the investment cost for an initial investment of RM150, 000 you need at least RM15, 000 a month which is not affordable by most investors. This is the reason, the investor has got no choice but to apply the asset allocation.

What is asset allocation? It is simply allocating investment in different asset classes. This is done depending on the investment horizon and the risk appetite and investment goal of the investor. For an example, with an investment of RM100, 000 that comes from bachelor who in his late 30's, investing in his retirement fund and falls under the category of moderate investor. The unit trust investment can be allocated with 70%-80% in equity funds and the remaining can be invested in fixed income funds. With 70%-80% portion of investment in equity the investors are still highly exposed to up and down of the economy. What happen when the economic is in the downturn? The NAV will drop thus the investment value will also decrease. During this situation investors can take the opportunity of the short term downturn by switching the investment in fixed income fund to equity fund. This will enable investors to accumulate more units as the NAV is lower and again when the economy recovers and NAV increases to the initial level investors value also increases. These two simple strategies can easily be implemented, however it needs proper monitoring and advice from the professional unit trust consultant or financial planner.

Unit Trust Investment as the mean to an end

Living in uncertain environment today, forces us to give more attention on having a nest egg that will grow over time and will not be affected by inflation. The stock market or equity has shown a tremendous vehicle which by far seen as the most suitable investment vehicle.

An investment expert will always advise investors to have a well diversified portfolio rather than investing in only one stock or company. This is to reduce risk and make sure one will achieve their financial goal with peace of mind. Having to say that, unit trust is just a perfect vehicle as it is by itself a well diversified portfolio. Furthermore, it is a perfect alternative mean of investment because of its economies of scale. In other word unit trust is a very convenient and low cost way of investing into the stock market. One can make their investment either by lump sum or monthly debit instruction to their bank account and fund manager will take care of all the hassle. One does not have to worry about whatever corporate activity for instance merger and acquisition or even changes in the management team. Not only that, the changes would cause little or no impact to our investment thus give us the peace of mind. By buying into a unit trust we obtain that balanced spread of risk for our tiny investment amount and we get daily, professional management of our investment portfolio.

Many investors have wrong perception towards unit trust investment. Unit trust is not a scheme that allows you to buy and sell frequently and make short term profit. It is very different from the investment in the stock market. One may argue that stock market investment should be the same as unit trusts. This is because unit trust also invests in the stock market thus it should have same characteristics as an investment in the stock market. While agreeing that there is a truth in the argument, we also have to look at other details and characteristic of unit trust that does not allow investors to profit by doing short term trading. Unit trust entails higher entry cost as compared to buying and selling shares. Unit trust in Malaysia can charge as high as 7% for the entry cost. The high entry charge does not allow investors to profit in the short term by buying and selling. It is obviously meant for long term investment. An investor who understands the advantage of unit trust investment will choose to invest in unit trust primarily to achieve their long term financial goal. This is done because traditional saving instrument like the bank deposit return after deducting the effect of inflation is just too insignificant.

Unit trust is just one of many vehicles that can help invest in achieving their financial goal. It is a collective investment scheme made available to the investing public so that everybody have the excess of the investment in capital market as in the long term equity is the instrument that can give the best return. However, understanding how it works and the mechanics of the investment are very important so that investors have the most appropriate fund and strategy in achieving their financial goals.

References

Aghion, P. & P. Howitt. (1992). A model of growth through creative destruction, *Econometrica 60*(2): 323-351.

Agrawal, G. D. (1992). Mutual Funds and Investors' Interest. *The Journal for Corporate Professionals, 22*(1). 23-24.

Balaji I. S. & Kumar Bhaskar R (2002). Investor's Psychology: A Study of Investor Behaviour in the Indian Capital Market. *Finance India, 26*(4), 1357-1375.

Banerjee A. (2006). Mutual Funds: Wealth Creation through Systematic Investment Plans. *ICFAI Portfolio Organizer*, 53-58.

Bogle, J. C. (1970). Mutual Funds Performance Evaluation. *Financial Analysis Journal, 26*(6), (November-December).

Deli, D. N. & Varma, R. (2002). Closed-end versus Open-end: The Choice of Organizational Form, *Journal of Corporate Finance, 8*(1), 1-26.

Klemosky. (1977). How Consistently do Managers manage. *Journal of Portfolio Management, 3*, 11-15.

Saunders H. & Piper M. (2011). Enhancing Indigenous Financial Capacity Programs, First Nations Foundation.

www.puclicmutual.com.my

www.fimm.gov.my

www.sc.gov.my