YOUR GUIDE TO MUTUAL FUNDS

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Introduction

If investment instruments were considered as food, a mutual fund would be a pie. Much like a pie, a mutual fund is a collection of ingredients, only in this case, it contains investments such as stocks and bonds held with a fund.

Investing in a mutual fund is like buying a slice of the pie, the more you invest in a mutual fund that large the slice of the pie you own or are entitled to.

What is a mutual fund?

A mutual fund is very similar to a cooperative society. The fund manager or promoter pools together funds from various types of investors (individuals or corporates).

The fund manager then hires a portfolio manager whose job is to invest these funds in assets such as stocks, bonds etc. based on the objective of the mutual fund.

The returns on the investment are then distributed to each investor based on the proportion of their investment holdings in the fund, on periodic basis (i.e. quarterly, semi-annually or annually).

The investment objective of the fund which should be clearly stated from inception, determines the type of assets the portfolio manager can invest in.

For instance, an equity focused mutual fund would be restricted to invest in equity type investments only, while a real estate fund would be focused on real estate investments.

Types of mutual funds

Back to our previously mentioned pie, as there are different types and flavors to choose from, each fund has a different investment objective and strategy.

Whatever your investment taste, there's a flavor for you. There are several kinds of mutual funds, such as:

- Equity based funds which invest primarily in stocks.
- Bond or Fixed Income funds which invest in bonds and other fixed income assets, such as treasury bills and commercial papers.
- Balanced funds which invest in a balance of stocks and fixed income assets., commonly based on a 60:40 ratio.

- Money market funds which invest exclusively in liquid, short term fixed income instruments such as bank placements, commercial papers, treasury bills etc.

What are the benefits of a mutual fund?

- It provides you with the ability to diversify your risk because the fund typically invests in a pool of assets.

- It gives you access to professional portfolio managers who have more technical expertise in selecting and managing investments.

- Investing in a mutual fund provides a regular and steady passive income stream through distributions which are like dividend payments by the fund.

- These funds are typically characterized by a low minimum investment threshold, usually as low as ₦1000.

…….But how do you choose a mutual fund?

How to choose a mutual fund?

Investment Objective: The type of fund you select should depend on your investment goals and objectives.

When you decide to invest, use your goals as a guide, so you don't end up with a good fund that doesn't help you achieve your goals. For instance, investing your emergency fund in a mutual fund that does not ensure capital preservation and is relatively illiquid (not easily converted to cash) does not align with underlying rationale of maintaining an emergency fund.

Cost of the Fund: This usually known as the expense ratio or management expense ratio and is the total percentage of the fund's assets spent on administrative and operation costs.

This is charged by every fund, however, the percentage differs from fund to fund. It is advisable to invest in a fund that offers a high return at a relatively low cost in comparison to other funds. However, the cost should not form the sole basis for selecting a fund.

Fund Performance: The performance of a fund is also an important point to consider. When evaluating a mutual fund's performance, it is best to review its performance over a period of time, as well as in relation to similar funds.

In addition to this, be on the lookout for fund managers with good track record of delivering the required level of returns within the context of the asset classes the fund is investing in.

Ask a professional: Discuss your investment goals and objectives with a professional financial adviser who can recommend a mutual fund which adequately meets your needs.

WHAT NEXT?

If you have decided on a mutual fund to invest in, here's how you can begin:

Contact the fund manager of the fund as typically, subscriptions to mutual funds are managed by the fund manager.

You will be required to complete a subscription form and subsequently make payment for the units of the fund as often as you would like. You can either purchase units of the fund or a certain naira value. E.g. i could buy 5000 units or buy ₦5000 worth. It goes to say you can have a fraction of a unit.

I hope this helped you on your investment journey.

Good luck!!!

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FAQ on mutual funds

- ***How frequently can I subscribe to mutual funds*?**
  As frequently as you are comfortable with. This could be on a daily, weekly, monthly or yearly basis.

- ***What is an expense ratio?***
  This is the annual fee that all mutual funds charge their unit holders.

- ***Are mutual funds the same as Exchange Traded Funds ("ETFs")?***
  Mutual funds are quite like ETFs; however the major difference is that ETFs are sold on the stock market like regular stocks and you do not need to go through a fund manager.

- ***How do I sell my mutual fund shares?***
  This process is known as "Redeeming". The process is quite like the buying process. In most cases, you are required to fill a redemption form and the cash equivalent of the number of units you wish to sell is paid to you.

- ***Would you advise this for beginners?***
  Mutual funds are advisable for beginners with no experience in investment, particularly because investments in these funds are actively managed by fund managers.