

Investing through Mutual Funds: the right way



By Mashmoona Z Majeed

Chief Executive Officer
Mutual Funds Association of Pakistan

What Are Mutual Funds?

A mutual fund is a special type of investment vehicle that pools together money from many investors and invests it on behalf of the group, in accordance with a stated set of objectives and is managed by a professional asset management company.

This large pool of money gives each investor much greater purchasing power than they could possibly have investing on their own.

After paying operating costs, the earnings (dividends, capital gains or losses) of mutual fund are distributed to the investors, in proportion to the amount of money invested. While working according

to the adage "Don't put all your eggs in one basket" the holders of mutual fund units are collectively able to gain the advantage by diversifying their investments, which might be beyond their financial means individually.

Mutual funds vs. direct investments

Mutual funds are popular because they make investing in financial markets easy. From an investors' viewpoint mutual funds have several advantages, for example:

- Professional management and research to select quality securities
- Spreading risk over a larger number of stocks whereas the investor is limited to buy only a handful of stocks. The investor is, therefore, not putting all his eggs in one basket.
- Ability to add funds at set amounts and smaller quantities such as PKR 1,000/5,000 per month
- Ability to take advantage of the

stock market which has generally outperformed other investments in the long run.

- Ability to convert the Units into cash at any time and receive the amount within 6 working days.

Economies of scale: Because a mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than what an individual would pay for securities transactions.

How to start investing?

Generally, people are working in fields which are not related to investments. Therefore, they would have little time or know-how to properly research and explore investment options. These people should initiate their investment journey through mutual funds.

By doing so, they will be investing with a highly skilled and experienced investment team.

To select the appropriate mutual fund(s), the first step is to determine your objectives for savings/investments which include:

- Return needs: what kind of returns are you expecting from your investments
- Risk tolerance: How much risk are you willing to take (i.e how much loss in value can you tolerate)
- Time horizon: when do you need your money?
- Liquidity needs: when do you need your money? Do you need monthly income or can you let it grow?

Also ask yourself if you are an aggressive, moderate or a conservative investor?

And remember that you cannot have high returns with low risk. You must be wary of any such scheme which offers you high returns with low risk. Risk and Return are directly related. The higher the risk, the higher the potential for return and vice versa.

Based on the results of the above assessment, the mutual funds can be selected for your portfolio and you should monitor your

investments on periodic basis.

For Long Term Horizon: If you are saving for long term say more than 5 years, then to let your money grow faster, you should put at least a portion of your money in equity mutual funds. Saving for retirement, saving for children's education falls under the long term needs.

For Medium Term Horizon: For investors who do not need access to their money for one to five years. Since this time horizon leaves limited time to recover from a market downturn, caution has to remain a factor. You should look towards Balanced Funds and Income Funds.

For The Short Term Horizon: For purposes of investing, the best mutual funds' investment for the short term is those that have no restrictions and focus on very low risk investments (such as money market funds). Short-term investing is taken to mean a year or less which allows for very little time to recover from losses.