Unit trusts

Unit trusts invest into assets including equities, bonds, cash and property and allow you to gain exposure to these assets without having to invest in them directly. They are also known as ‘funds’ or ‘Collective Investment Scheme portfolios’.

Each unit trust has a specific objective, which expresses what the investment manager aims to achieve, and an investment mandate that sets out how the manager may invest in order to achieve the objective. The return you are likely to earn depends on the assets you will be exposed to, which in turn depends on the investment objective and mandate.

The advantages of investing in unit trusts

Unit trusts allow you to gain exposure to a range of assets conveniently and cost-effectively, and allow you the benefit of the investment manager’s research, analysis and asset selection expertise. A wide variety of unit trusts are available that employ different investment strategies to meet different objectives.

Unit trusts are also popular because they offer:

- **Flexibility**

  You choose how much you want to invest and whether you want to invest via lump sums or debit order contributions, subject to the investment company’s minimum investment amounts. You can easily switch between unit trusts as your needs change and you can stop contributing at any time.

- **Accessibility**

  You can withdraw from your investment when you need to and you can transfer your investment to another company if you wish to. You can also transfer your units to another person or use your units as security for a loan. However, keep in mind that these transactions take longer to process than, for example, bank account withdrawals and transfers.

- **Transparency**

  All unit trusts must publish a fund factsheet that explains the investment objective, what the unit trust invests in, the fees and the investment performance.

- **Legal safeguards**

  Unit trusts are considered relatively safe investment options as they are registered under the Collective Investment Schemes Control Act and are regulated by the Financial Services Board (FSB).

How unit trusts work

Unit trust investment managers buy underlying assets on behalf of investors, within the limits set out in the investment mandate. Unit trusts are established under a trust deed with an independent trustee ensuring that the investment manager sticks to the mandate.

The value of all the assets the unit trust owns is divided into equal portions called units. You invest into a unit trust by buying some of those units. You then share in the return the unit trust earns, including capital growth or income, in proportion to the number of units you own.

Capital growth

The capital growth you earn depends on the difference in unit price between when you buy and sell your units. Depending on the underlying assets, the unit price may fluctuate while you hold units. Remember though that you only actually realise a return, or make a loss, on your investment when you sell your units.

Value of the fund = (Total value of underlying investments + interest and dividends) - Expenses

$$\text{Unit Price} = \frac{\text{Value of fund}}{\text{Total number of units}}$$

Income

If the unit trust earns income it is distributed among all investors who own units, in proportion to the number of units they own. You may choose to have your share of any income paid out or use it to buy more units. Reinvesting the income you earn increases your investment return.

Who should invest in unit trusts?

There is a unit trust for you no matter what your budget, risk profile, investment horizon or goal. They are suitable for investors who want the convenience of exposure to the assets of their choice, without having to buy those assets themselves.

They are also a good option for you if you want to invest relatively small amounts of money; some require a commitment of as little as R50 a month. However, if you need immediate access to your money, such as you would have when you withdraw from a bank account, unit trusts may not be appropriate as transaction times tend to be longer.

Selecting the unit trust(s) that best suit you

There are many unit trusts available that are categorised based on their investment mandates, i.e. according to the assets they invest in and whether they invest locally, offshore or both.

Your choice depends on your investment objectives and your risk/return profile. It also depends on how much control you want to have over the assets you're exposed to. In order to narrow down your options, it's useful to think about unit trusts in two broad buckets:

- **Building block unit trusts**

  These are unit trusts that invest into only one kind of asset and can be used to 'build' your own portfolio to match your objective and risk/return profile.

- **Asset allocation unit trusts**

  These unit trusts invest into a combination of asset classes and are sometimes known as 'solution' funds. The investment manager balances potential returns with risk and selects assets to achieve specific investment goals. This means that when you invest in these unit trusts you do not need to decide when and how much of your investment to allocate to different asset classes.

If you choose to build your own portfolio, you first need to decide which assets you want exposure to. You then need to select unit trusts that invest into those assets and allocate your investment between them.

But if you want to hand over the asset allocation decisions to an investment manager, you can choose an asset allocation unit trust by matching your investment objective to that of the unit trust.

Other types of unit trusts

Unit trusts that invest into other unit trusts

- Feeder funds: these invest into one specific underlying unit trust
- Funds of funds: these invest into a combination of underlying unit trusts

These structures are often used to access asset types or classes that the investment manager does not have expertise in selecting. For example, an investment manager that specialises in investing locally may gain offshore exposure by investing into a unit trust managed by an investment manager that specialises in offshore investing.

These structures can offer more efficiency and perhaps better return than you might earn by investing in the underlying unit trusts yourself. But, depending on how the fees are structured, they are often more expensive. The underlying unit trusts usually charge their own fees which can add to the unit trust's expenses and decrease its return.

Passive unit trusts

Most unit trust investment managers actively select the underlying investments and aim to provide a return that is higher than the overall return from the market, or combination of markets, of the underlying assets. However, there are also a variety of 'passive' unit trusts available that are designed to track the overall market movement of a specific asset class, or combination of classes and aim to deliver return similar to that of the market(s). These are often known as index trackers. Read more in the section called 'Passive investments'.

Tip:
You can find a list of all the unit trusts available in South Africa on the following websites:
The Association for Savings and Investments South Africa (ASISA)
The Financial Services Board (FSB)
The ASISA website also categorises each unit trust into specific sectors, which can help you narrow down your choices to the unit trusts that invest in the assets that match your risk/return profile.

Choosing the right investment manager

There may be multiple unit trusts that could meet your needs. Choosing an investment manager you trust is a good way to decide between them. It is important to understand the manager's investment philosophy or approach, to ensure that you choose the right unit trust for you. This will help you to stay invested without switching between unit trusts, unless your circumstances or priorities change, in order to benefit from the investment manager's expertise over time.

Accessing unit trusts

You can invest into a unit trust directly with the investment management company that offers it. Alternatively, you can choose to invest through an investment platform. This is a company that offers a range of unit trusts from different investment management companies, and therefore offers you a wider choice.

Investment platforms usually charge for the administration of your investment. Since the fees you'll pay affects the return you earn, when deciding between investing directly with an investment manager or via a platform, it's important to consider what you'll be charged.

You can also invest in unit trusts via investment products offered by various product providers, which have unit trusts as the underlying investment. Although your investment return will depend on the unit trust return, product features, such as tax rules, can affect your investment return. In addition, other products rules may determine, and often limit, what you're allowed to do with your investment when compared to investing directly into unit trusts.

Tip:
When deciding how to access a unit trust investment look at the total cost to you, including the unit trust costs and any additional fees such as platform or product fees. Some companies charge high or layered fees, which may not represent value for money. But sometimes a low additional fee may be worth the benefits of, for example, the convenience of an investment platform, especially if the platform negotiates lower unit trust fees for their investors.

What are the costs of investing in unit trusts?

The fees that apply to a unit trust investment are:

- Fund management fees
- Administration fees

These fees are usually charged as an annual fee percentage. Some unit trusts may also charge an initial fee, deducted from your contribution before it is invested.

Investment management companies often offer their unit trusts to different groups of investors, for example those who invest directly with them versus those who invest via an investment platform, at different fee structures. They do this by making the same unit trust available in different fee classes.

Fund management fees

These fees are charged by the investment manager for investment research and selecting the underlying assets. The fee is charged as a percentage of the total value of the unit trust and may be fixed, or may depend on the unit trust's performance.

Fund management fees are usually the biggest expense in operating a unit trust. Other fund expenses include VAT and other operating costs. All these expenses are deducted from the total value of the assets the unit trust owns in order to calculate the unit price. They're already accounted for in the unit trust's published performance figures – you don't need to deduct them again. The expenses for the last twelve months, including the fund management fee, are shown on the unit trust's fund factsheet as the total expense ratio (TER).

Tip:
Performance-based fees aim to align the interests of the investors with those of the company: The company benefits when investors benefit. However, not all performance-based fees are structured fairly. Make sure you understand how the fee works and how it will impact the unit trust's performance over time.

Tip:
The TER helps you decide whether a unit trust offers value for money. Look at the TER in the context of the unit trust's performance. A low TER is not necessarily a good thing if the return delivered is also low while a high TER may be worth it if the unit trust outperforms other unit trusts. However, a unit trust with a high TER that does not deliver superior performance is expensive without offering value.

Administration fees

The fees you pay for the administration of your investment depends on the company you choose to invest with and the class of unit trust you invest in. When you invest directly with an investment manager you usually invest in the 'A' class. This class has the standard fee structure applicable to retail investors: typically both the fund management fee and your administration charges will be deducted within the unit trust.

If you invest via an investment platform, both the amount you'll be charged and the way you'll be charged differ from one platform to the next. You usually access a different unit trust class from the one available directly from the manager, with a different fund management fee, administration fee or both.

Since the platform handles administration on behalf of the investment manager, if administration fees have been deducted within the unit trust, many investment managers pay the administration fee back to the platform as a 'rebate'. Investment platforms are required to disclose whether they receive rebates and whether they pass these on to investors by lowering their administration fees, or whether they keep them and charge additional fees.

You may come across 'clean class' unit trusts. These are unit trusts available via investment platforms where only the fund management fee is deducted within the unit trust; no administration fee component is deducted and no rebate is paid. The investment platform charges the only administration fee.

Comparing unit trust fees

Differing fee structures makes comparing unit trust fees challenging. Many companies quote a 'fee at benchmark' to help simplify comparisons. This shows what the fee would be if the unit trust matched the performance of its investment benchmark.

Fund management fees are reported to help you assess whether or not your unit trust offers value for money, in the context of how well it delivers on its objectives. The fee at benchmark is therefore a good way to compare similar unit trusts.

Tip:
Since administration fees may be deducted either within the unit trust or from your investment account by selling units, make sure you're comparing apples with apples by checking what has been included in the fee at benchmark.