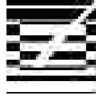


A dip into pooled investments

Last week we looked at the key considerations involved in investing equities with initial emphasis on investing directly in the stock market. This week Kevin Walsh* looks at the options available to those who wish to invest in equities through pooled investment vehicles. One of the great benefits of this type of investment is the reduction in costs and risks involved, when compared to an individual buying securities on his own.

This coupled with the professional service of a fund manager who makes the investment decisions, means pooled investments can be an attractive option. We will look at the features of some of the most familiar pooled funds available in Ireland, namely unit-linked and unit trust funds.

Investing directly

Many people invest by buying shares or property directly from stockbrokers or estate agents. There are advantages to this approach, such as:

- the choice of which individual shares or property to invest in
- individual tax advantages especially with property investments
- the ability to use your personal capital gains tax allowance and to offset losses
- a lower level of transaction costs if you are only holding a small number of assets.

However, investing directly means incurring transaction charges and handling all the tax requirements yourself. For the smaller investor, this can be a disadvantage.

Pooled investments

'Pooled investments' are an alternative that can reduce both the cost of investing and the paperwork involved.

In simple terms, a group of investors pool their money to gain the benefits of being a single, large investor. This enables them to invest in a wider range of investments and to employ a professional fund manager. Pooled investments can hold all four major asset classes.

There are three broad categories of pooled investments that are available in Ireland:

- pooled funds (also known as unit trusts or unit-linked funds)
- with-profit bonds
- tracker bonds.

With-profit bonds and tracker bonds will be covered later in the series, so let's concentrate on pooled funds.

Pooled Funds

Unit trusts

Unit trusts are probably the simplest way of investing in stock markets. They involve a group of investors, a fund manager who looks after the selection of the underlying assets and a trustee who supervises the fund manager and makes sure the job is done properly.

Unit-linked funds

A unit-linked fund is very similar to a unit trust. The difference is that the unit-linked fund has a life assurance policy attached to it and does not have trustees. Both are now taxed similarly (although this was not the case historically).

How do they work?

When you invest in pooled funds, your money buys a certain number of units. The value of these units goes up and down as the value of the underlying assets change. These investments are also sometimes known as Mutual Funds.

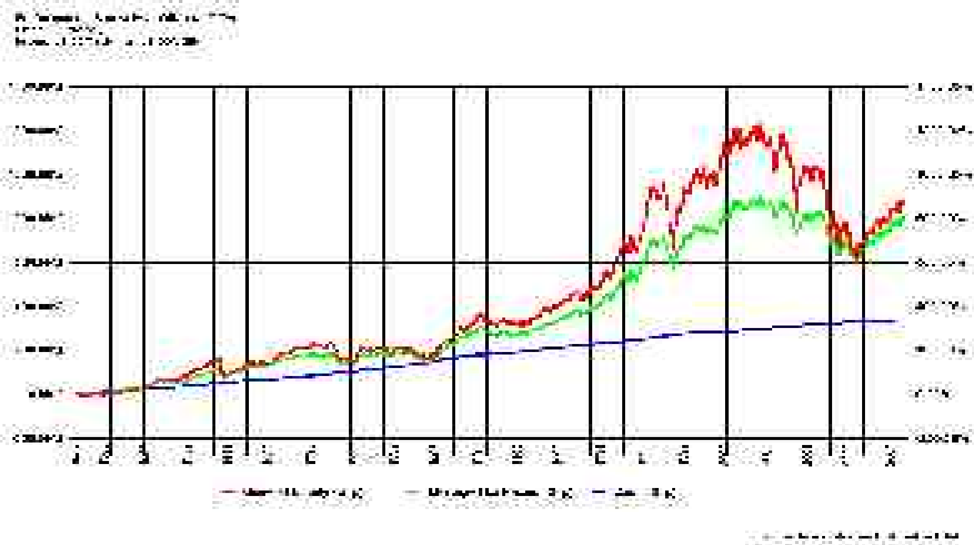
The choice of funds on offer is very wide, so there is something for everyone. Generally, however, they fall into one of three categories:

Secure funds (low risk)
These invest in very secure, generally short-term investments, to provide a degree of capital growth. Examples include cash funds, fixed income funds, and a mixture of the two.

Balanced funds (medium risk)
These invest in a wide range of assets, both at home and overseas, with a view to providing enhanced capital growth. As a rule of thumb, these funds generally invest approximately 60-70% in equities, with the remainder split between fixed income, property and cash.

Specialist funds (higher risk)
These invest in a specific asset class, such as company shares or property, or a specific region, such as the UK, Ireland, or the US, with the objective of providing superior long-term growth. These funds tend to be suitable for the more adventurous investor who may have a high level of income or a long way to go to retirement age.

The power of long term investing



Average returns on Irish pension funds from 1st May 1984 to 1st May 2004. Source: Moneymate

As you would expect, the lowest risk funds tend to generate lowest returns in the long run, and the highest risk funds generate the highest return. The graph above shows how low risk cash funds, medium risk balanced funds and higher risk equity funds have performed in relative terms over the last twenty years.

We strongly recommend that independent tax advice should be sought in relation to any type of investment.

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