

The Package or the Contents?

Gareth Morgan's recent tirade has focused attention on unit trusts and whether this structure serves investors' best interests. This attention is ill directed and misses the real issue. The real issue is not the clothing that the investment is dressed up in, but the investment itself – this is where investors should focus their attention.

Unit Trusts are not evil creations of the financial services industry. They are simply a convenient way to package the interests of thousands of smaller investors together to deliver cost effective investment solutions. They are a form of savings vehicle that is not unique to New Zealand - they are often known as mutual funds and have been used all around the world for many years. Unit Trusts have a number of features that offer real benefits to investors. All assets in the Trust are owned on behalf of investors rather than owned in your fund manager's name – this offers an important protection – even if your fund manager were to fail, your assets would be safe. They require an independent trustee to oversee a manager's activities. And lastly they are cost effective to run which is important as excessive costs really impacts your long term returns.

Where you should focus your attention is the assets held *within* the Trust. This is what determines success or failure of your investment. The high profile unit trust failures – the ING high yield fund being the poster child – didn't fail because of the unit trust structure. They failed because they invested in highly geared, high risk (and hard to understand) CDO equity tranches and were marketed as moderate risk fixed income products. It didn't matter what structure you invested in, these CDOs were toxic.

There are three simple rules to follow when investing in managed funds (actually these apply in general) –

- do you understand what fees you are paying?
- do you understand exactly what your fund manager is investing in?
- and what risk does this expose you to?

Unless you can answer these three questions, you should leave your money in the Bank.

But do not be put off by sweeping generalizations about all things financial – there are, and always will be, attractive investment opportunities.

Don't forget it doesn't matter what the wolf wears – sheep's clothing, a flowery dress or a unit trust structure – it is still a wolf. Contents and not their packaging is what counts.