Unit trusts investing in turbulent times

These are difficult times we are living in. The financial world is going through some major upheavals, and the U.S, which is the world's largest economy is experiencing a recession. Some are comparing this financial crisis to the Great Depression of the 1930s. Whether we like it or not, there is bound to be negative impact on our Malaysian economy; as unemployment rise and business activities slow in the U.S and elsewhere, our exports for one, will certainly decline. There will be spillover effect on domestic consumption, and business activity. Further, as the global equity markets were ravaged, investors have seen their wealth and savings being eroded significantly. There is fear in the air, as they contemplate whether to stay invested with their investments, or move to safety by keeping cash.

It is difficult to predict short-term market movements, in the best of times, but more so now, as the volatility is high. But, most financial experts agree that over the next 5, 10 or more years, the equity markets which set record lows this year, will be again be setting record highs. Companies which are sound, and well run will once again prosper and produce quality earnings growth in the future.

So, why should you consider staying invested in unit trusts funds? Or, for those holding cash now, to invest when others are fearful of the bad market situation?

Here are a few possible reasons why you should contemplate being invested in unit trust funds.

You can't time the market. If the world's greatest investor, Warren Buffett has publicly declared that he can't predict the short-term movement of the stock market, what are the chances of the average investor trying to do so, successfully? Probably pretty slim. What is likely he says, is that the stock market will move higher, perhaps substantially so, before either the sentiment, or the economy turns up. Hence, one of the possible ways to capture this upside is to invest in equity funds with at least a 3-to-5 year investment horizon, and not to pay attention to the 'noises' which may detract you. Being able to do so, could well reward the investor handsomely.

Cash is not an option. Cash is a medium for the storage of value and is often described as the worst asset to hold in any scenario, but particularly so in periods of rising inflation. It pays virtually nothing sitting in your current account, and a mere 3.7% or so in fixed deposits. With official inflation rate in Malaysia running at 8.2% (in August 08), this will erode your purchasing power over time. Globally, as U.S and European central banks continue to embark on the rescue of banks, this could see inflationary pressures in these countries continue to remain high. It is more than likely that investing in equity unit trusts fund now will outperform your return on cash over the next 10 years.

Non-emotional and objective. When the stock market is experiencing a high degree of volatility such as during this credit crisis, it is very difficult for investors to remain objective about their investments. In particular if they are dealing with their own money; emotions may run high, and tend to prevail over objectivity when making buy or sell decisions. As a result, they tend to sell when the market is falling and buy when the market is peaking. And in so doing, they never really make any substantial returns. With unit trust funds, professional managers who are paid to be removed from their own emotions can better make these difficult decisions. Further, most funds have set investment strategies in place, which include cut-loss provisions, to limit the losses. And, appropriate strategic asset allocation in this current low market conditions, could also ensure that investors are well-positioned for any possible rebound in the future.

Diversifying risks. In these turbulent times, investors tend to focus more on risks rather than on potential returns. And rightly so, given that they are more concerned about the return of capital versus the return on capital. The importance of risk management for unit trust funds is magnified during periods of increased uncertainty. Fund managers with more resources available are better able to manage risks, for example, default risks for bonds, and risk of bankruptcy for companies. A well-diversified portfolio, which seeks to reduce portfolio risks would be able to cushion against such negative impact much better. For individual investors, it would be very difficult to manage a diversified portfolio on their own as the costs involved would be prohibitive, and requires a disciplined approach to investing.

Equities give you the best upside. Most of the world's equity indices have recorded significant losses this year. From U.S, Europe to Asia, the major indices are down year-to-date between 35-50% (from 1 Jan 08 to 23 Oct 2008). Valuations of global stocks are beginning to look very cheap – the MSCI World Index[1] is now trading at 12 times price-earnings, compared to its historical average of 26 times[2]. As mentioned, equities will almost certainly outperform the other asset classes, especially cash over the long-term. Further, we have seen prices of stocks in the key markets like the U.S, and Europe, declining to historical lows. Investing in equities (or equity funds) would be the investors' best chance to recoup any paper losses that they may have incurred. This may well be one of those rare opportunities, to truly practice the often quoted, but seldom executed axiom in investing of: 'buy low and sell high'.

Finally, Warren Buffett sums up why one should look to invest now rather than later, by saying: "If you wait for the robins, spring will be over".

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[1] MSCI World Index is a capitalization weighted index that monitors the performance of stocks from around the world.

[2] Source: www.bloomberg.net