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Why Unit Trusts

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A look at the advantages of using this as the sole or main allocation vehicle for equity investments

One first needs to determine what is "investible capital". By investible capital, I am referring to excess funds that can be set aside for at least 3 to 5 years. For some aggressive investors, this can include monies that might be needed as long as they are in easily liquidated instruments. Assuming a strategic asset allocation has been done and the desired exposure to equities has been determined, the rhetorical question is now whether to achieve this via stocks, equity funds or both.

To answer this question, take an honest look at yourself as an investor. Are you a hands-on person with a keen interest in the factors that drive stock prices? Do you have the discipline and conviction to stick to a particular strategy? Have you amassed enough capital to build a properly diversified stock portfolio? Do you have the time and energy to monitor your stock portfolio?

Many people naturally get started on stocks by trading on their domestic stock market. It is tempting to treat the stock market as a virtual casino where one can punt for a quick buck, and unfortunately many do. Some can get carried away doing margin trading, which is essentially borrowing to trade, and lose a lot more than they can afford. If one can focus on the objective of wealth accumulation, avoid over-trading or trend-trading, and understand the fundamentals that drive long-term performance, it is entirely possible to allocate a large percentage of investible capital into individual stocks.

Many beginners and even experienced stock investors are likely to conclude that individual stocks are too volatile or risky for purposes of consistent wealth accumulation. They may be too busy with career or family to devote time to research and plan stock purchases. Or they may not have access to timely information to manage their shareholdings properly. Rather than making hasty investment decisions and risking capital loss, full-time professional managers can be "appointed" to manage money intended to be invested into equities on your behalf. This is in essence the idea behind unit trusts.

More than half of American households have a significant portion of wealth invested in unit trusts (they are known as "mutual funds" in the US). Investors purchase unit trusts primarily because they don't have the time or expertise to manage their own portfolios.

Over the past 20 years or so, unit trusts have gained recognition as efficient vehicles for pooled investments, allowing the man-in-the-street to access a whole investment universe that would otherwise be unavailable to him.

Apart from the benefit of professional management, investors enjoy immediate diversification by buying just one unit trust. For the same amount of capital, it would be very difficult for the average investor to buy a meaningful number of individual stocks to spread risk. This observation is even truer if an investor wished to buy bonds, as the minimum amounts for bonds are much higher than stocks. A unit trust would also enjoy economies of scale and lower transaction costs compared to an individual investor. Most unit trusts are also priced daily and have no liquidity restrictions, unlike some stocks that see little or no trade on the exchange, making it difficult for you to sell your holdings at the desired price.

Therefore, it is entirely credible for one to choose unit trusts as the sole or main allocation vehicle for equities. There are unit trusts catering to different asset classes, regions, countries, sectors and themes, allowing the average investor to participate in investment ideas outside his or her home country. Information on unit trusts is easily available, though it can be a bit more difficult to evaluate the fund manager's real skills. With the help of a good financial adviser, one can build and manage a robust portfolio withstanding the tests of time, especially if it is rebalanced regularly.

Speaking as someone who used to have a pure stock portfolio, I have chosen the ubiquitous 80-20 rule in favour of unit trusts. It is simply simpler to manage. For those who relish the adrenaline rush, joys and heartache of trading individual counters, by all means continue to do so, but limit your capital to no more than 20% of investible funds if your main intent is to grow your wealth, not be a hotshot stock trader.

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