In Search of Better Returns in Investment Schemes

The nation has faced many challenges and calamities in 2005, and we have come out almost unscathed as 2006 arrives. One sure thing is that many new and unexpected challenges will be faced in 2006. After reflecting on the past, it's now time to look forward to do better in the future.

At the global level, there are some concerns to watch out for including the massive global imbalances with a possible slide in the US dollar, the prospects of continuously high oil prices, the rising interest rates, and the threat of the avian flu. Domestically, 2005 had been a tough year on income as there were two oil price hikes experienced by Malaysians, and this could continue in 2006. This had led to higher transportation costs and food prices, biting into the household budget quite painfully. Also, the softer economy means a more difficult time for the unemployed to get decent jobs.

After facing many challenges in 2005, we should consistently be prepared for unforeseen circumstances ahead. This could mean putting more money aside or saving for the unexpected rainy days ahead, or for retirement age as we now live longer on average and the EPF savings may not last long. Although data shows that Malaysia has a high national savings rate, most of them are in the form of mandatory savings in the Employees Provident Fund (EPF). The saving habit is already ingrained in the older generation after facing many hardships of life. However, the easier living of the younger generation makes savings a lesser priority, and they appear to be better at spending. News of younger generation falling into bankruptcy due to reckless credit card spending shows that the savings habit is dissipating among the younger generation.

Although it is often said that household spending can keep the economy going, it may not be sustainable if income does not grow at a faster pace. Furthermore, it is prudent spending that should be encouraged and not splurging. There needs to be a balance whereby investments too are being promoted, as their contribution to the economy can be more productive and lasting in the form of factories and plants. Having sufficient savings would make the funding of domestic investment activities less dependent on foreign funds, reducing the need for external borrowing and more debt.

The big question mark is where to put one's savings so as to optimise returns. Although interest rates have crept up lately, only the lending rate has edged up while the deposit rates remain about the same, increasing the burden on borrowers but without compensating savers. With the higher inflation rate, the real interest rate has turned negative. The stock market had been quite dismal in 2005 due to factors such as speculative outflows on the ringgit and recurring bad news coming from MAS and Proton. The KLCI was almost flat last year, declining by 0.84 per cent, following a good 14.3 per cent rise in 2004. Comparing this to the underlying economic indicator, the growth in the Gross National Product (GNP) is estimated at 9.1 per cent in 2005, slower than 14.1 per cent in 2004. Over the longer term (1991-2005), the KLCI had an average return of 8.5 per cent, compared to GNP growth of 9.9 per cent. In early 2006, with another round of speculative ringgit "play", foreign funds have returned to help push up the index higher.

But for the layman who has neither the expertise nor the time to monitor stock movements all the time, the second best option would be to let others do the investing for them. In the case of unit trust, people can invest a small amount of money at a time which makes it affordable for most ordinary people. Arguably, it is relatively more liquid, safer, and in the long run, may give better returns when compared to other passive investment such as fixed deposits. However, investors must remember that unit trust funds are also subjected to market risks and their performance depends on market movements. The stock market is sentiment-driven and can be irrational at times so it's better to have a longer-term perspective on investment. To ensure that one knows the risks involved, the fine prints in the prospectus of unit trusts should also be read carefully.

If the number of savers is large enough, then the funds would be huge enough for investments in a variety of instruments that an individual cannot afford. The pooled funds will be managed by professionals who will invest in various financial assets with varying risk levels. The stock market is considered more risky than the bond market, and there are other investment options such as the money market. Diversification into various financial instruments is one strong point that a unit trust fund has over the individual investor. As the saying goes, it is wise not to put all your eggs into one basket.

Further relaxation on capital controls announced by Bank Negara since 1st April 2005 has allowed 30 per cent of domestic funds in unit trust companies to be invested in foreign markets. More unit trust management companies are now gearing towards offering funds that are invested overseas, indicating that local fund managers are becoming more confident. This will add further “diversity” in the asset allocation across different countries and industries. As there is additional risk involved vis-à-vis currency fluctuations, the local fund managers have to work closely with overseas fund houses to be more acquainted with factors driving foreign markets.

One confusing aspect of saving in unit trusts is that there are so many different investment schemes in the market. There are growth funds, balanced funds, fixed-income funds, Islamic and non-Islamic funds to name a few out of the 335 funds (as at 31 October 2005) already approved and managed by 36 companies. Each of these funds is intended to appeal to people with diverse preferences and taste for risks. Those who are comfortable with more risks could go for growth funds where more money is invested in the higher-risk-higher-return stock market, and less so in the less volatile bond market, for example. In general, funds from unit trusts comprise close to 14 per cent of the Bursa Malaysia’s market capitalisation. This is much lower than more than 40 per cent share in many developed countries, suggesting that the potential for further expansion in unit trust investment is great.

The general public should also be mindful of the “dollar cost averaging” principle when investing in unit trusts. In a simple term, it requires the practice of investing a fixed amount of money on a regular basis, thus making one’s monthly investment vary inversely to the market price. By investing in such a way, the investor avoids placing all his funds in the market at either the top or bottom of the market cycle, thus reducing possible risks.

Aside from encouraging spending to support economic growth, it is important to ensure that there are sufficient savings to fund domestic investment opportunities. However, there is rising fear that the younger generation are living lifestyles different than their parents. The current promotion has been more about saving up and achieving financial independence, which requires one to start saving early in life. Given the many choices offering reasonable returns on savings, people will need to be knowledgeable enough to differentiate them. With the low deposit rates, and the recent relaxation on capital controls, unit trusts or mutual funds offer an alternative to the more passive investors who don’t want to lose sleep over their money. A small and consistent amount of savings could go a long way when age starts catching up on us.

The writer is research fellow with the Malaysian Institute of Economic Research (MIER)