How do Managed Funds work? ¯_(ツ)_/¯

If you want to diversify your investment portfolio to spread your risk across different asset classes, sectors or geographic markets, you may be limited by the amount of money you have available to invest.

Managed funds are popular with investors looking to build their wealth over the long-term. By pooling your money with a group of investors, you can tap into much wider opportunities (such as infrastructure or overseas markets) that would be out of reach as an individual investor.

Want to invest in Brazil's economy, or agribusiness ventures? You're likely to find a managed fund that will give you access to that investment opportunity.

What is a managed fund?

A managed fund pools multiple investors' money into a fund, which is professionally managed by specialist investment managers. You can buy into the fund by purchasing units, or 'shares'. The unit's value is calculated daily, and changes as the market value of the assets in the fund rises and falls.

Each managed fund has a specific investment objective, typically focused on different asset classes and a specific investment management philosophy to provide a defined risk/return outcome.

For example, the investment objective of a fixed interest managed fund may be to provide income returns that exceed the return available from other cash investments over the medium term.

Why invest in a managed fund?

There are three key advantages a managed fund brings to your investment portfolio:

1. Diversify to reduce risk

By investing across different assets classes – and within different types of shares within asset classes – you can spread the risk of your investments falling due to market volatility. You can also balance different investment timeframes and income returns.

For example, investing $1,000 in a managed fund could give you exposure to 50 different company shares in an Australian equities managed fund. But to invest that amount in 50 companies as an individual would limit you to companies with low share prices (and cost a significant amount in brokerage fees).

2. Expert fund managers

Selecting individual stocks is also time consuming and requires a certain level of market knowledge. Professional fund managers have access to information and research and have the processes and platform access to manage your money effectively.

3. Reinvesting brings compound benefits

You can invest regular amounts into your fund, just like a savings account. And by reinvesting your fund's distributions you could 'compound' your investment returns. Effectively, any future interest payments will be a percentage of a growing amount.

Are managed funds good for income or growth?

You usually get two types of returns from a managed fund:

- Income is paid to you as a 'distribution', which you can easily reinvest back into the fund
- Capital growth if the unit price of your investment grows over time

If you're more interested in capital growth, you'll need a longer timeframe for investing – and these funds usually carry a higher risk.

Types of managed funds

When you're comparing managed funds, look at the asset allocation to understand its risk profile and potential performance.

- Income funds – low risk of capital loss, focus on defensive, income generating investments such as cash and fixed interest.
- Growth funds – longer-term (5+ years) investments, focused on capital growth rather than income and weighted towards securities and equities.
- Single sector funds – specialise in just one asset class, and sometimes a sector within that class (such as Australian small companies).
- Multi-sector funds – diversified across a range of asset classes, with varied risk levels.
- Index funds – aim to achieve performance returns in line with a market index, such as the ASX 200. Also known as exchange traded funds (ETFs) or passive funds.
- Active funds – an actively managed index fund that aims to outperform that index.

There are also multi-manager funds, which invest in a selection of other managed funds to spread your investments across different fund managers.

Who should I talk to about managed funds?

To find out more about managed funds, please contact our office.

Source: Colonial First State