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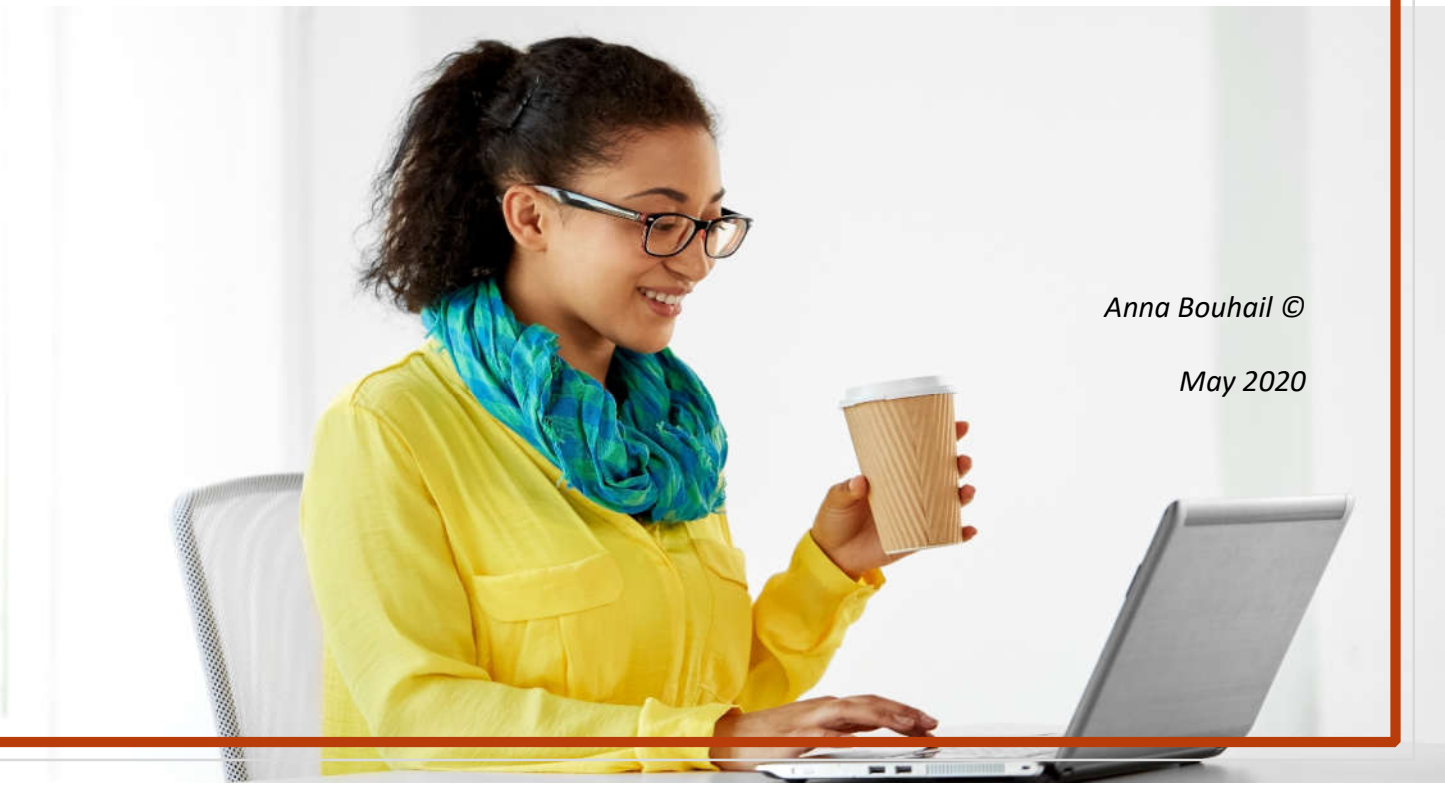
Study Guide

FUNDAMENTALS OF COLLECTIVE INVESTMENT SCHEMES: ONLINE CPD COURSE
2020 / 2021



May 2020

Course summary

The fundamentals of collective investment schemes is an on-line course considering the important concepts applicable to collective investment schemes. The course is an introductory /refresher course outlining concepts relating to collective investment schemes including the 2018 ASISA classification of collective investment schemes and financial products with underlying investments in collective investment portfolios.

Time allotted for course

The course consists of 4 topics with an assessment that needs to be completed. The time allotted for each aspect is as follows:

Topic number	Title	Word count	Level	Time allotted
Topic 1	Collective investment schemes defined	562	Intermediate	5 minutes
Topic 2	Collective investment scheme classification	5279	Intermediate	45 minutes
Topic 3	Market prices and fees	1959	Intermediate	20 minutes
Topic 4	Financial products with underlying investments in collective investment portfolios	4963	Intermediate	50 minutes
	Assessment			45 minutes

Total time	2 hours

Assessment and certification

After completion of the workshop the learner must complete an electronic assessment on the learning management system.

- **Form of assessment:** Multiple Choice Questions
- **Number of questions**: 15 questions
- **Duration:** 45minutes
- **Competency mark:** 60%

Upon obtaining a competency mark of 60% the learning will receive a certificate of completion. The learner will be afforded an opportunity to re-do the assessment up to a maximum of 3 times if the competency mark has not been achieved.

Course accreditation

CPD Category: Online program

COB Category: Investments

Financial planning component: Asset Management | Retirement Planning | Tax Planning

Advice component: Investments and Investment Risk | Pension and Retirement

Accreditation valid until: 31 May 2021

CPD Points allocated: 2 points/hours on completion and pass of online assessment

FPI approval number: FPI20050166

Table of contents

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TOPIC 1 COLLECTIVE INVESTMENT SCHEMES DEFINED

LEARNING OUTCOMES

After studying the topic, the learner should be able to-

- Define a collective investment scheme.
- Name the advantages and disadvantages of investing in a collective investment scheme.

1.1 Introduction

Collective investment schemes (CISs) is a generic term for any scheme where funds from various investors are pooled for investment purposes with each investor entitled to a proportional share of the net benefits of ownership of the underlying assets. A CIS consists of the following:

- Pooling of resources to gain sufficient size for portfolio diversification and cost-efficient operation
- Professional portfolio management to execute an investment strategy.

A portfolio of a collective investment scheme is essentially a pool of funds created through the contributions of a number of investors. The pool of funds (the portfolio) is managed by a professional manager who, depending on the mandate of the collective investment scheme will use the contributions of the investors to invest in listed shares, cash, property, bonds or other securities.

In exchange for their contribution to a portfolio of a CIS each investor receives a participatory interest in that portfolio which may be referred to either as shares or as units and which represent the investor's proportionate interest in the assets of the portfolio. The value of the investor's participatory interest in the portfolio will therefore increase or decrease in proportion to the increase or decrease in the value of the underlying assets held in the portfolio.

A single CIS could, based on the above definition, include more than one portfolio of underlying assets. The different portfolios within a scheme may represent different investment strategies of the manager of the scheme, may have different risk profiles or may be differentiated in terms of the types of assets included in the portfolio.

The proportionate ownership of the underlying assets in a portfolio of a CIS is one of the main advantages and attractions of investing in a CIS as it enables 'ordinary' investors to achieve a diversity of investment which would not otherwise be possible without vast amounts of investment capital.

1.2 Advantages of investing in a collective investment scheme

CISs make it possible for investors, including small savers, to obtain diversified investment portfolios with professional management at reasonable cost and to execute a widening range of investment strategies. In other words, the main benefits of CISs are:

- Diversification i.e., spreading the risk of investing over a range of investments
- Professional expertise to manage investors' portfolios
- Reasonable cost due to reduced dealing costs due to bulk transacting and cost-effective administration
- Choice in that there are increasing numbers of alternative funds from which to choose.
- Tax effective

In addition, CISs generally exist in a set of legal, institutional and market-based safeguards to protect the interests of investors.

1.3 Disadvantages of investing in a collective investment scheme

The disadvantages of investing in CISs are generally held to be as follows:

- Costs in respect of funds management and advice could be avoided if investors managed their own investments. This assumes investors have the expertise to so self-manage their investments.
- Although investors have a large variety of funds to choose from, they have no control over the choice of individual holdings within their portfolios.
- Investors have none of the rights associated with individual holdings e.g. right to attend the annual general meeting of a company and vote on issues impacting the company.

TOPIC 2 COLLECTIVE INVESTMENT SCHEME CLASSIFICATION

LEARNING OUTCOMES

After studying the unit, the learner should be able to-

- Explain the difference between open-end versus closed-end collective investment schemes.
- Outline the classification of collective investment schemes according to the Collective Investment Schemes Act.
- Outline the latest ASISA fund classification system.
- Differentiate between active and passive funds.

2.1 Open-end versus closed-end

CISs can be categorised as open-end funds or closed-end funds.

- Open-end funds publicly offer their shares or units to investors. Investors can buy and sell the shares or units at their approximate net asset value. The shares can be bought from or sold to the fund directly or via an intermediary such as a broker acting for the fund.
- Closed-end funds offer their shares or units to the investing public primarily through trading on a securities exchange. If closed-end fund investors want to sell their shares, they generally sell them to other investors on the secondary market at a price determined by the market.

2.2 Classification according to the Collective Investment Schemes Act

The CIS Act makes provision for five different types of CIS:

- *CISs in securities*: Schemes where the portfolio consists of shares, preference shares, bonds, futures, options, warrants and / or money market instruments.
- *CISs in properties (CISPs): S*chemes where the portfolio consists of property shares, immovable property and units in CISs in property in a foreign country. CISs in property are listed on the JSE.

- *CISs in participation bonds (CISPBs):* Schemes where the portfolio consists mainly of participation bonds. CISPBs pool funds received from investors and lend them out by granting first mortgage bonds over commercial, industrial or retail properties. The interest paid on these loans is passed on to participants in regular payments. Thus, CISPBs offer security and an interest income on a regular basis, which is why they are attractive to investors such as retired persons, charities and pension funds.
- *Foreign CISs*: CISs established outside South Africa. A Foreign CIS invites or permits members of the public in South Africa to invest in its portfolios. To carry on business in South Africa a Foreign CIS must obtain approval from the Registrar of Collective Investment Schemes. Only once it is approved, may a Foreign CIS solicit investment from members of the public in South Africa.
- *Declared CISs: CISs deemed by the Registrar of Collective Investment Schemes to be CISs.*

Each type of CIS listed above has specific administrative provisions in the CISCA which apply to it and are each restricted in terms of the type of assets which may be held in the underlying portfolios of the scheme.

2.3 ASISA fund classification

The ASISA Standard on Fund Classification for South African Regulated Collective Investment Portfolios ("ASISA Fund Classification Standard") establishes and maintains a classification system for CIS portfolios in South Africa.

The objectives of the ASISA Fund Classification Standard are as follows:

- Promote investor awareness and understanding of CIS portfolio types.
- Assist with the comparison of CIS portfolios within and across classification categories.
- Assist with the assessment of potential risks of investing in a particular type of CIS portfolio.

The purpose of the ASISA Fund Classification Standard is as follows:

- Ensure that CIS portfolios adhere to the classification category definitions.
- Standardise applications for approval of the classification of a CIS portfolio.
- Facilitate the timeous and appropriate classification and reclassification of CIS portfolios.

The classification uses a three-tiered system:

- Tier 1: Geographic classification
- Tier 2: Asset type
- Tier 3: Investment focus area

This is detailed in the Table below

ASISA fund classification

TIER 1 | GEOGRAPHIC |	TIER 2 | ASSET TYPE |	TIER 3 | CATEGORY |						
SOUTH AFRICA	EQUITY	GENERAL	LARGE CAP	MID & SMALL CAP	RESOURCES	INDUSTRIAL	FINANCIAL	UNCLASSI-FIED
	MULTI-ASSET	INCOME	LOW EQUITY	MEDIUM EQUITY	HIGH EQUITY	FLEXIBLE	TARGET DATE PORTFOLIOS	
	REAL ESTATE	GENERAL						
	INTEREST BEARING	VARIABLE TERM	SHORT TERM	MONEY MARKET				
WORLDWIDE	EQUITY	GENERAL	UNCLASSI-FIED					
	MULTI-ASSET	FLEXIBLE						
	INTEREST BEARING	VARIABLE TERM	SHORT TERM					
GLOBAL	EQUITY	GENERAL	UNCLASSI-FIED					
	MULTI-ASSET	FLEXIBLE						
	INTEREST BEARING	VARIABLE TERM	SHORT TERM					
REGIONAL	EQUITY	GENERAL	AFRICA	UNCLASSI-FIED				
	MULTI-ASSET	FLEXIBLE						
	INTEREST BEARING	VARIABLE TERM	SHORT TERM					

Source: www.asisa.com

2.4 Classification Category Definitions

2.4.1 First tier classification: South African Portfolios

These are collective investment portfolios that invest at least 60% of their assets in South African investment markets. These collective investment portfolios may invest a maximum of 30% of their assets outside of South Africa plus an additional 10% of their assets in Africa excluding South Africa.

Note: For the purposes of this first tier of classification, inward-listed equities are deemed to be South African assets.

The second and third tier classification of this first tier is considered in the subsections following.

(I) Equity portfolios

These portfolios invest a minimum of 80% of the market value of the portfolios in equities and generally seek maximum capital appreciation as their primary goal. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Equity – General portfolios:** These portfolios invest in selected shares across all industry groups as well as across the range of large, mid and smaller market capitalisation shares. While the managers of these portfolios may subscribe to different investment styles or approaches, their intent is to produce a risk/return profile that is comparable with the risk/return profile of the overall JSE equities market. The portfolios in this category offer medium to long-term capital growth as their primary investment objective. SA Benchmark: FTSE/JSE All Share index (J203T)
- **Equity – Large cap portfolios:** These portfolios invest at least 80% of the market value of the portfolios in large market capitalisation shares which have a market capitalisation greater than or equal to the company with the lowest market capitalisation in the FTSE/JSE Large Cap Index, or an appropriate foreign index published by an exchange. 100% of share purchases must be in this investable universe at time of purchase. SA Benchmark: FTSE/JSE Large Cap Index (J205T)
- **Equity – Mid & Small cap portfolios:** These portfolios invest at least 80% of the market value of the portfolios in shares which have a market capitalisation smaller than the company with the lowest market capitalisation in the FTSE/JSE Large Cap Index, or an appropriate foreign index published by an exchange. 100% of share purchases must be in this investable universe at time of purchase. Due to both the nature and focus of these portfolios, they may be more volatile than portfolios that are diversified across the broader market. SA Benchmark: FTSE/JSE Mid Cap index (J201T)

- **Equity - Resources portfolios:** These portfolios invest at least 80% of the market value of the portfolios in shares listed in the FTSE/JSE Oil & Gas and Basic Materials industry groups or in a similar sector of an international stock exchange. Up to 10% of a portfolio may be invested in shares outside the defined sectors in companies that conduct similar business activities as those in the defined sectors. Due to both the nature and focus of these portfolios, they may be more volatile than portfolios that are diversified across a wider range of FTSE / JSE industry groups. SA Benchmark: FTSE/JSE Resources index (J258T)
- **Equity – Industrial portfolios:** These portfolios invest at least 80% of the market value of the portfolios in industrial shares listed on the Johannesburg Stock Exchange or in a similar sector of an international stock exchange. Industrial shares include all companies listed on the JSE other than those shares listed in the FTSE / JSE Oil & Gas, Basic Materials, and Financials industry groups. SA Benchmark: FTSE/JSE All Share Industrials index (J257T)
- **Equity – Financial portfolios:** These portfolios invest at least 80% of the market value of the portfolios in shares listed in the FTSE/JSE Financials industry group or in a similar sector of an international stock exchange. Up to 10% of a portfolio may be invested in shares outside the defined sectors in companies that conduct similar business activities as those in the defined sectors. Due to both the nature and focus of these portfolios they may be more volatile than portfolios that are diversified across a wider range of FTSE / JSE industry groups. SA Benchmark: FTSE/JSE Financials index (J580T)
- **Equity – Unclassified portfolios:** These portfolios invest in a single industry or sector or in companies that share a common theme or activity as defined in their respective mandates. Due to both the nature and focus of these portfolios, they may be more volatile than portfolios that are diversified across the broader market. The performance of these portfolios cannot be compared to others in this category. Should it be considered appropriate, where five or more portfolios focus on a particular theme a new category will be created and the funds transferred.

(II) Multi-asset portfolios

Multi Asset portfolios are portfolios that invest in a wide spread of investments in the equity, bond, money and property markets to maximise total returns (comprising capital and income growth) over the long term. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Multi Asset – Flexible portfolios:** These portfolios invest in a flexible combination of investments in the equity, bond, money and property markets. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolio's mandate and stated investment objective and strategy. These portfolios may be aggressively managed with assets being shifted between the various markets and asset classes to reflect changing economic and market conditions and the manager is accorded a significant degree of discretion over asset allocation to maximise total returns over the long term.
- **Multi Asset - High Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to have an increased probability of short term volatility, aim to maximise long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 75% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.
- **Multi Asset - Medium Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to display average volatility, aim for medium to long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 60% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.
- **Multi Asset - Low Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to display reduced short term volatility, aim for long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 40% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.
- **Multi Asset – Income portfolios:** These portfolios invest in a spectrum of equity, bond, money market, or real estate markets with the primary objective of maximising income. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy. These portfolios can have a maximum effective equity exposure (including international equity) of up to 10% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio.

- **Multi Asset – Target Date portfolios:** These portfolios invest in a spectrum of equity, bond, money market, or real estate markets where the asset mix changes over time in a predetermined manner as the target date approaches. Due to the change in asset mix over time, portfolios in this category cannot be compared and consequently cannot be ranked.

(III) Interest Bearing Portfolios

Interest Bearing Portfolios are collective investment portfolios that invest exclusively in bond, money market investments and other interest earning securities. These portfolios may not include equity securities, real estate securities or cumulative preference shares. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Interest Bearing - Variable Term portfolios:** These portfolios invest in bonds, fixed deposits and other interest-bearing securities. These portfolios may invest in short, intermediate and long-dated securities. The composition of the underlying investments is actively managed and will change over time to reflect the manager's assessment of interest rate trends. These portfolios offer the potential for capital growth, together with a regular and high level of income. These portfolios may not include equity securities, real estate securities or cumulative preference shares SA Benchmark: JSE/ASSA All Bond index (ALBI).
- **Interest Bearing – Short Term portfolios:** These portfolios invest in bonds, fixed deposits and other interest earning securities which have a fixed maturity date and either have a predetermined cash flow profile or are linked to benchmark yields, but exclude any equity securities, real estate securities or cumulative preference shares. To provide relative capital stability, the weighted average modified duration of the underlying assets is limited to a maximum of two. These portfolios are less volatile and are characterised by a regular and high level of income. SA Benchmark: STeFI Composite index.
- **Interest Bearing - Money market portfolios**: These portfolios seek to maximise interest income, preserve the portfolio's capital and provide immediate liquidity. This is achieved by investing in money market instruments with a maturity of less than thirteen months while the average duration of the underlying assets may not exceed 90 days and a weighted average legal maturity of 120 days. The portfolios are typically characterised as short-term, highly liquid vehicles. SA Benchmark: STeFI 3-month index.

(IV) Real Estate Portfolios

Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Real Estate - General portfolios:** These portfolios invest in listed property shares, collective investment schemes in property and property loan stock and real estate investment trusts. The objective of these portfolios is to provide high levels of income and long-term capital appreciation. These portfolios invest at least 80% of the market value of the portfolio in shares listed in the FTSE / JSE Real Estate industry group or similar sector of an international stock exchange and may include other high yielding securities from time to time. Up to 10% of a portfolio may be invested in shares outside the defined sectors in companies that conduct similar business activities as those in the defined sectors. SA Benchmark: FTSE/JSE SA Listed Property index (J253T)

2.4.2 Worldwide Portfolios

These are collective investment portfolios that invest in both South African and foreign markets. There are no limits set for either domestic or foreign assets.

The second and third tier classification of this first tier is considered in the subsections following.

(I) Equity portfolios

These portfolios invest a minimum of 80% of the market value of the portfolios in equities and generally seek maximum capital appreciation as their primary goal. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Equity – General portfolios:** These portfolios invest in selected shares from equity markets. They do not subscribe to a particular theme or investment style and will be invested across all market sectors, as well as across the range of large, mid and smaller market capitalisation shares. The portfolios offer medium to long-term growth as their primary investment objective.
- **Equity – Unclassified portfolios:** These portfolios invest in both local and foreign markets, but only in a single industry or sector or in companies that share a common theme or activity as defined in their respective mandates. Due to both the nature and focus of these portfolios, they may be more volatile than portfolios that are diversified across the broader market. The performance of these portfolios cannot be compared to others in this category. Should it be considered appropriate, where five or more portfolios focus on a particular theme a new category will be created and the funds transferred.

(II) Multi-asset portfolios

Multi Asset portfolios are portfolios that invest in a wide spread of investments in the equity, bond, money and property markets to maximise total returns (comprising capital and income growth) over the long term. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Multi Asset – Flexible portfolios:** These portfolios invest in a flexible combination of investments in the equity, bond, money, or property markets. The portfolios have completed or stipulated limited flexibility in their asset allocation both between and within asset classes, countries and regions. No minimum or maximum holding applies to South African or offshore investment. These portfolios are often aggressively managed with assets being shifted between the various markets and asset classes to reflect changing economic and market conditions to maximise total returns over the long term.
- **Multi Asset – Income portfolios:** These portfolios invest in a spectrum of equity, bond, money market, or real estate markets with the primary objective of maximising income. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy. These portfolios can have a maximum effective equity exposure (including international equity) of up to 10% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio.

2.4.3 Global Portfolios

These are collective investment portfolios that invest at least 80% of their assets outside South Africa, with no restriction to assets of a specific geographical country (for example the USA) or geographical region (for example Africa).

The second and third tier classification of this first tier is considered in the subsections following.

- **Equity – General portfolios:** These portfolios invest in selected shares from equity markets. They do not subscribe to a particular theme or investment style and will be invested across all market sectors, as well as across the range of large, mid and smaller market capitalisation shares. The portfolios offer medium to long-term growth as their primary investment objective. Benchmark: MSCI All Countries World index (Total return)

- **Equity – Unclassified portfolios:** These portfolios invest in a single industry or sector or in companies that share a common theme or activity as defined in their respective mandates. These portfolios may invest in selected shares across all sectors of stock exchanges. The performance of these portfolios cannot be compared to others in this category. Should it be considered appropriate, where five or more portfolios focus on a particular theme a new category will be created and the funds transferred.

(I) Multi-asset portfolios

Multi Asset portfolios are portfolios that invest in a wide spread of investments in the equity, bond, money and property markets to maximise total returns (comprising capital and income growth) over the long term. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Multi Asset – Flexible portfolios:** These portfolios invest in a flexible combination of investments in international equity, bond, money, or property markets. The portfolios have complete or stipulated limited flexibility in their asset allocation both between and within asset classes, countries and regions. These portfolios are often aggressively managed with assets being shifted between the various markets and asset classes to reflect changing economic and market conditions to maximise total returns over the long term.
- **Multi Asset - High Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to have an increased probability of short term volatility, aim to maximise long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 75% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.
- **Multi Asset - Medium Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to display average volatility, aim for medium to long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 60% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.

- **Multi Asset - Low Equity portfolios:** These portfolios invest in a spectrum of investments in the equity, bond, money, or property markets. These portfolios tend to display reduced short-term volatility, aim for long term capital growth and can have a maximum effective equity exposure (including international equity) of up to 40% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy.
- **Multi Asset – Income portfolios:** These portfolios invest in a combination of equity, bond, money market, property or derivative instruments with the primary objective of maximising income. The underlying risk and return objectives of individual portfolios may vary as dictated by each portfolios mandate and stated investment objective and strategy. These portfolios may have a maximum effective equity exposure (including international equity) of up to 10% and a maximum effective property exposure (including international property) of up to 25% of the market value of the portfolio.

(II) Interest Bearing Portfolios

Interest Bearing Portfolios are collective investment portfolios that invest exclusively in bond, money market investments and other interest earning securities. These portfolios may not include equity securities, real estate securities or cumulative preference shares. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Interest Bearing - Variable Term portfolios:** These portfolios invest in bonds, fixed deposits and other interest-bearing securities from markets around the world. These portfolios may invest in short; intermediate and long-dated securities. The composition of the underlying investments is actively managed and will change over time to reflect the manager's assessment of interest rate trends. These portfolios offer the potential for capital growth, together with a regular and high level of income. These portfolios may not include equity securities, real estate securities or cumulative preference shares.
- **Interest Bearing – Short Term portfolios:** These portfolios invest in bonds, fixed deposits and other high interest earning securities in international markets, which have a fixed maturity date and either have a predetermined cash flow profile or are linked to benchmark yields, but exclude any equity securities, real estate securities or cumulative preference shares. To provide relative capital stability, the weighted modified duration of the underlying assets is limited to a maximum of two. These portfolios are less volatile and are characterised by a regular and high level of income.

(III) Real Estate Portfolios

Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Real Estate - General portfolios:** These portfolios invest in listed property shares, collective investment schemes in property and property loan stock and real estate investment trusts. The objective of these portfolios is to provide high levels of income and long-term capital appreciation. These portfolios invest at least 80% of the market value of the portfolio in real estate shares and may include other high yielding securities from time to time. Up to 10% of a portfolio may be invested in shares outside the defined sectors in companies that conduct similar business activities as those in the defined sectors.

2.4.4 Regional Portfolios

These are collective investment portfolios that give investors at least 80% exposure to assets in a specific country (for example the USA) or geographical region (for example Africa) outside South Africa.

The second and third tier classification of this first tier is considered in the subsections following.

- **Equity – General portfolios:** These portfolios invest in selected shares from equity markets in a specified geographic region. They do not subscribe to a particular theme or investment style and will be invested across all market sectors, as well as across the range of large, mid and smaller market capitalisation shares. The portfolios offer medium to long-term growth as their primary investment objective.
- **Equity – General – Africa Portfolios:** These portfolios invest in selected shares from equity markets in Africa excluding South Africa. They do not subscribe to a particular theme or investment style and will be invested across all market sectors, as well as across the range of large, mid and smaller market capitalisation shares. The portfolios offer medium to long-term growth as their primary investment objective.
- **Equity – Unclassified portfolios:** These portfolios invest in a single industry or sector or in companies that share a common theme or activity as defined in their respective mandates. These portfolios may invest in selected shares across all sectors of stock exchanges. The performance of these portfolios cannot be compared to others in this category. Should it be considered appropriate, where five or more portfolios focus on a particular theme a new category will be created and the funds transferred.

(I) Multi-asset portfolios

Multi Asset portfolios are portfolios that invest in a wide spread of investments in the equity, bond, money and property markets to maximise total returns (comprising capital and income growth) over the long term. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Multi Asset – Flexible portfolios:** These portfolios invest in a flexible combination of investments in regional equity, bond, money, or property markets to maximise total returns over the long term. The portfolios have complete or stipulated limited flexibility in their asset allocation both between and within asset classes, countries and regions. These portfolios are often aggressively managed with assets being shifted between the various markets and asset classes to reflect changing economic and market conditions to maximise total returns.

(II) Interest Bearing Portfolios

Interest Bearing Portfolios are collective investment portfolios that invest exclusively in bond, money market investments and other interest earning securities. These portfolios may not include equity securities, real estate securities or cumulative preference shares. Under this the second-tier equity portfolio, the following third tier portfolios are defined:

- **Interest Bearing - Variable Term portfolios:** These portfolios invest in bonds, fixed deposits and other interest-bearing securities from markets in a specified region. These portfolios may invest in short; intermediate and long-dated securities. The composition of the underlying investments is actively managed and will change over time to reflect the manager's assessment of interest rate trends. These portfolios offer the potential for capital growth, together with a regular and high level of income. These portfolios may not include equity securities, real estate securities or cumulative preference shares
- **Interest Bearing – Short Term portfolios:** These portfolios invest in bonds, fixed deposits and other high interest earning securities in international markets, which have a fixed maturity date and either have a predetermined cash flow profile or are linked to benchmark yields, but exclude any equity securities, real estate securities or cumulative preference shares. To provide relative capital stability, the weighted modified duration of the underlying assets is limited to a maximum of two. These portfolios are less volatile and are characterised by a regular and high level of income.

2.5 Active vs passive funds

Active fund management means that a professional asset manager/ fund manager makes tactical decisions to buy or sell certain assets in the fund, based on his/ her view of opportunities in the market, in order to try and achieve superior growth in the fund (better growth than the average growth in the market); or to protect investors' capital by losing less value when markets fall, by opting out of certain assets and exposure to certain market sectors.

Passive fund management, on the other hand, means that your fund will simply track the market, which is often represented by a specific index, for example the FTSE/ JSE Top 40 index, which tracks the 40 biggest companies on the Johannesburg Securities Exchange. Passive funds are essentially run by computer and will replicate all of the assets in a particular market, or represented in a particular index, to give you a return that mirrors the return in the market.

This approach is based on the efficient market hypothesis, which proposes that markets are efficient, since investors have free access to information on share prices, companies, social and political environment, etc. and price these factors in already when deciding to buy/ sell shares at certain prices. Therefore, over time, it is virtually impossible to beat the market.

Increasingly, fund managers are also trying to make the best of both worlds using a blended approach, where parts of a portfolio may be passively managed, whilst other parts may be actively managed.

2.5.1 Advantages and disadvantages of active fund management

Some advantages of active fund management include the following:

- It can provide peace of mind to the investor, knowing that a knowledgeable person is managing their investments.
- Active fund managers who get their investment decisions right, can beat average market growth, especially in times of good market performance.
- Active fund managers can also shield investors from the full extent of a market downswing by for example, switching assets to create less exposure to equities.

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Some disadvantages of active fund management include the following:

- Actively managed funds have high fees attached to them. Typically, the fees on an actively managed fund are at least twice as much as what you would pay for a passively managed fund. The risk is that, over time, the higher fees may have a significant negative impact on investment growth.
- Active fund managers may make bad investment choices or follow unsound theories in managing the fund, which will lead to poor investment returns (in addition to the higher costs).
- There have been numerous studies done covering different time periods to determine how successful active fund managers are at beating the market, and the majority of these studies have concluded that, although there are some funds that do tend to consistently beat the market, on the whole there seems to be more funds that underperform than outperform their benchmark index, especially over longer periods of time.

2.5.2 Advantages and disadvantages of passive fund management

Some advantages of passive fund management include the following:

- It reduces costs due to the passive buy-and-hold strategy, and this can have a significant impact on real returns (after deduction of costs), over time.
- Passive fund management can be said to provide simplicity, in the sense that the investor knows what they are getting – a replica of all the shares in the market or index being tracked.
- Passive funds offer a low-cost method of diversification, since shares representing the entire index are bought.
- In a passive fund, the investor is not at risk of being exposed to bad management decisions.
- Since passive funds are invested in an entire market, investors automatically benefit from upswings in that market.

Some disadvantages of passive fund management include the following:

- With passively managed funds, investors cannot ever outperform the market and, when costs are included, a passive fund will effectively always underperform the market.
- When the market experiences a downswing, investors automatically experience the full extent of the downswing in their investment, since there is no active fund manager that could shield them from full exposure to the market.

2.5.3 When is active and passive management an appropriate style for investors?

Active management is appropriate for investors who want to invest in specialised equity markets that require specialised knowledge and expertise, to take advantage of inefficient pricing. For example, emerging markets, small-cap stocks and companies involved in resources and metals mining. Active management may also be appropriate for investors who want an experienced professional to make tactical investment decisions to outperform the market, and to shield them from negative market volatility.

Passive management is appropriate for investors who want a well-diversified holding of well-known popular shares (such as large cap shares, for example, as tracked by the FTSE/ JSE Top 40 index), and who are comfortable to ride out the short-term market fluctuations.

TOPIC 3 MARKET PRICE AND FEES

LEARNING OUTCOMES

After studying the unit, the learner should be able to-

- Outline the fees applicable to collective investment schemes.
- Explain the differences in fees for different funds.

3.1 Market price

Unlike share prices which fluctuate throughout the day, collective investment portfolios have a fixed price for the day. With forward pricing, the price is established each evening, using closing prices of investments for the day, and then applied to all the transactions that took place during the same day. This means that all sales, repurchases and creation of new units can only be priced and processed at the end of the day

The per unit price of a collective investment scheme can be accessed by newspaper, other media, the fund manager website or the ASISA website.

The per unit price of a collective investment scheme is quoted as the nominal asset value (NAV) price together with the initial fee expressed as a percentage inclusive of VAT of the amount invested.

The constant NAV for collective investment schemes other than money market funds are calculated as follows:

$$NAV = \frac{Market\ value\ of\ all\ assets\ in\ portfolio + portfolio\ income\ - portfolio\ expenses}{Units\ issued\ in\ portfolio}$$

Refer to the following document for a full description on the standards set for pricing of collective investment schemes.

http://stage.asisa.org.za/tenakaDocuments/asisa-documents/ASISA-Standard-NAV-Calculation-for-CIS-Portfolios-November-2015.pdf

3.2 Fees

Collective investment portfolio fees and charges were deregulated on 1 June 1998. Prior to deregulation, collective investment portfolios were not legally allowed to charge more than 1% as an annual management fee and 5% for initial charges. After deregulation, the ceiling on annual fees was removed, meaning that funds launched after deregulation do not have the same restrictions imposed on them. Fees are thus determined by market forces and the actual costs incurred can differ from fund to fund.

Any level or type of fee may be changed, but the management company has to give its unit holders three months written notice of any increase in fees, additional fees or change in calculation of fees and charges.

Following the de-regulation of fees and charges, multiple classes of units were introduced. This allows management companies to identify different types of unit holders and to differentiate between the service offered to different clients and the annual fees they charge.

Collective investment portfolio management companies are obliged to disclose all fees and charges to their investors, and these are usually disclosed on all marketing material. Each collective investment portfolio fund has different fees and charges, but these costs can be broadly classified into two categories: once-off entry costs and on-going annual costs.

3.2.1 Once-off entry costs

Initial fees are levied when purchasing units, be it an initial lump sum, additional deposit or debit order. Generally speaking the higher the investment amount the lower the initial charge.

Initial fees are charged by the management company of which a portion is used to pay broker commission and the remainder covers marketing and administration costs. These fees are deducted from the amount invested and can range between 1% and 5%.

However, since deregulation has come into effect, there are no maximum restrictions in terms of initial charges. Some management companies do not charge initial fees at all which is in line with the international "no-load" trend.

Value added tax is levied on the initial charge at a rate of 15%

3.2.2 Ongoing annual costs

This is an ongoing fee levied by the management company for administering the units and managing the investments. Prior to deregulation, these charges had a ceiling of 1%.

VAT of 15% is payable on the service fee. These fees are calculated on a daily basis and are automatically deducted from income distributions on a monthly basis.

Some management companies pay broker fees out of the annual management fee. These are trailer fees, which are paid to brokers to provide on-going investment advice to their clients.

Performance-based fees have recently been introduced to the market. Instead of charging a fixed annual fee of say 1%, annual fees are linked to the performance of the fund. A maximum performance fee will be charged if the fund exceeds a given relevant benchmark, for example the JSE All Share Index, by a certain percentage. Should a fund under perform its benchmark, the annual fees may be waived entirely.

- Benchmark return e.g. JSE All Share Index - 5% per annum
- 20% outperformance of benchmark - 3% per annum (max annual fee)
- 20% underperformance of benchmark - 0% per annum (min annual fee)

(I) Total expense ratio

The total expense ratio (TER) is a measure of the costs that are deducted together with any transactions costs from the income distributions.

The total expense ratio is calculated as follows:

$$Total\ expense\ ratio = Investment\ management\ fee + other\ expenses + VAT$$

3.2.3 Switching fees

Fees are levied if an investor switches from one fund to another. Some companies charge a fixed fee for each switch, but most do not charge for switching between funds within the management company.

3.2.4 Exit fees

Some management companies do not levy initial fees or charge a reduced initial fee but levy an exit fee. This is a fee you pay if you sell an investment within a certain period i.e. within the first year and is based on the original capital as well as growth of the fund.

3.3 Differences in fees for different funds

3.3.1 Equity funds versus fixed interest funds

Generally, investment charges for equity collective investment portfolio funds are higher than the fees of fixed interest funds such as money market funds and bond funds, because investing in equity markets is riskier and more time consuming from a research perspective, than investing in fixed interest markets.

Although money market funds may require a high initial lump sum (anything from R20 000 to R50 000), no initial charges are levied. In addition, no commission is payable to brokers and no MST tax is levied.

3.3.2 Actively managed funds versus passively managed funds

Actively managed funds tend to charge higher fees than passively managed funds. Passively managed funds such as index funds follow a chosen index e.g. All Share index (ALSI) with the aim of replicating the stock market's performance. The only risk the investor is exposed to is market risk.

The fund manager need not select shares that may outperform the index. In essence no active decision-making is required for these funds and hence they can charge lower fees and charges. Conversely, fund managers of actively managed funds endeavour to outperform a given benchmark through superior stock selection, and a keen understanding of the market. This active management of the fund allows management companies to levy higher fees and charges.

3.3.3 Traditional collective investment portfolio versus a fund of funds

Funds of funds do have higher fees and charges than traditional collective investment portfolios. A fund of funds is a collective investment portfolio fund that invests in a range of other collective investment portfolios. These could be funds within a management company's own range (internal fund of funds) or a selection of funds managed by various management companies (external fund of funds). In the case of a traditional collective investment portfolio, one layer of fees and charges is payable i.e. an initial charge and an annual fee.

With a fund of funds, an additional layer of fees is payable i.e. in addition to the initial fee and annual charges applicable to the fund of funds, the management costs of the underlying funds must be accounted for too. To remain competitive, in-house funds of funds often do not charge the second layer of fees and charges and some management companies absorb the second layer of costs. Investors should check with the management company if and at what level underlying investment costs are payable.

3.4 Fact sheets

Source: www.allangray.co.za/latest-insights/personal-investing/how-to-read-a-factsheet/

The number of options when choosing a collective investment scheme can be overwhelming and is one of the most common barriers to investing. Factsheets provide a useful and comparable summary.

Legislation requires that all collective investment schemes produce a minimum disclosure document (MDD), which in many cases is called a factsheet. This document details how the collective investment scheme operates, its performance, its risk profile and the costs associated with it.

The sections of a factsheet are considered in the subsections following.

3.4.1 The collective investment scheme's objective and benchmark

This section lays out the definition of success for a collective investment scheme, by stating its goal and benchmark. A collective investment scheme measures its success in achieving its goal by comparing its return to that of a benchmark.

When appraising a collective investment scheme, the benchmark must be appropriate, as it may be used to determine the fees charged by the collective investment scheme. If it charges performance fees, a collective investment scheme with a lower benchmark than that of others in the same category may cost more as it more easily collects fees when it clears that benchmark.

3.4.2 Investment strategy and asset allocation

The mandate of a collective investment scheme dictates what types of assets it buys into, while the investment philosophy of the manager describes the way the manager invests.

A single factsheet won't show you whether the stated investment philosophy actually describes how the collective investment scheme manager behaves. But if you are choosing between a few final collective investment schemes, it is worth reading the investment commentaries written by the portfolio managers over time, to get a sense of whether or not they are sticking to a tried-and-tested method. If this is the case, their long-term performance is probably a reasonable indicator of future outcomes.

A positive long-term track record that shows reasonably consistent performance at similar points in different market cycles also gives some indication that a manager is applying a consistent investment philosophy and process.

3.4.3 The investment amount and costs

The factsheet will show the basis for calculating the fee and the average annual total fees and expenses in the fund over the last three years (the total expense ratio).

A factsheet will also include the minimum investment amounts.

3.4.4 Past performance

On every factsheet, somewhere in the fine print, you will have language saying something to this effect: 'Past performance is not necessarily a guide to future performance'. With this warning in mind, it is important to tread carefully when using performance as an indicator – especially when it is used in isolation. Read the performance figures alongside the investment philosophy and the risk numbers to get a clearer picture of how the collective investment scheme operates.

Having said that, over long periods, good performance is more likely to be an indicator of a good manager and is unlikely to be the result of pure luck. Short-term returns (less than three years) can vary widely and are often meaningless when it comes to selecting a collective investment scheme, but long-term returns can show a skillful manager.

3.4.5 Risk measures

Risk and performance are intertwined, and one cannot speak about one without mentioning the other. On a factsheet the relevant numbers to note will include:

- **Maximum drawdown:** The highest percentage decline the collective investment scheme has had.
- **Positive months:** The number of months the collective investment schemes has produced a positive return.
- **Monthly volatility (in some cases called 'Standard Deviation'):** How much the collective investment scheme's return varies statistically from its average over time.
- **Highest and lowest annual return:** The highest and lowest returns over a 12-month period.

Each of these measures show how well the manager has done to manage risk, but they also depend a lot on the type of assets the collective investment scheme invests into. Equity collective investment schemes will usually be the riskiest, followed by balanced (high and medium equity multi-asset) collective investment schemes, low equity collective investment schemes and then money market collective investment schemes.

TOPIC 4 FINANCIAL PRODUCTS WITH UNDERLYING INVESTMENTS IN COLLECTIVE INVESTMENT PORTFOLIOS

LEARNING OUTCOMES

After studying the unit, the learner should be able to-

- Understand the features of financial products with underlying investment in collective investment portfolios.

4.1 Introduction

Many investors invest in more than one fund in order to achieve the diversity required to spread investment risk. To meet this need for diversification, packaged products have been designed, which allow investors to invest in a single product consisting of a number of collective investment portfolios or investment portfolios bundled together to suit particular risk/return profiles. Packaged products include funds of funds, wrap funds, linked products and multi-manager funds - all of which have collective investment portfolios as underlying investments.

The basic principle behind all these products is that the client/individual invests in a single product, which consists of a number of underlying funds managed by an array of fund managers. These products, often known as split investments, claim to offer greater flexibility than a single investment product, as investors are not locked into one investment from one company

The sections following consider these packaged products.

4.2 Fund of funds

A fund of funds is a collective investment portfolio fund that invests in a range of other collective investment portfolios. These could be funds within a collective investment portfolio management company's own range (internal fund of fund) or a selection of funds managed by various collective investment portfolio management companies (external fund of fund). A fund of funds may not invest in less than two underlying collective investment portfolios.

When an investor invests in a collective investment portfolio, the investor buys units of a fund which in turn uses the money to invest in assets which may include shares, bonds and cash. The investor owns the units or a portion of the collective investment portfolio relative to the number of units bought. However, when an investor purchases units in a fund of funds, the investor only owns the units in the fund of funds and not in the units of the underlying collective investment portfolios which make up the fund of funds. These units in the fund of funds are subject to the same legislation as the underlying funds.

4.2.1 Advantages of investing in a fund of funds

The advantages of investing in a fund of funds are as follows:

- **Investing is made easier:** Investment decisions are easier as the investor does not have to decide on the mix of collective investment portfolios to spread his risk. A dedicated fund manager, with specialised investment expertise makes this decision on behalf of the investor. It is also an ideal investment tool for the inexperienced investor.
- **Investment in multiple funds with a single investment:** The investor is allowed to invest small amounts of money across a number of funds. This is an affordable way for the man on the street to invest in the stock market. Reporting is simplified.
- **Diversification with a single investment:** Diversification across different collective investment portfolio types and management companies within a single investment, which makes investment tracking much easier. The investors will also be advised periodically of any changes to the portfolio.
- **Risk of under-performing funds is reduced:** Risk is spread if a collective investment portfolio within the fund range should under-perform. Since these funds invest in a number of collective investment portfolios should one of the funds under-perform, the negative impact can be offset to a large degree by the performance of the other funds. These investments are a good choice for an investor who is concerned about choosing the wrong fund manager or fund.
- **Lower price volatility:** Through diversification, the unit price of a portfolio of funds will not fluctuate as much as the prices of the underlying funds, which means lower price volatility.
- **Regulated:** Regulated by Collective Investment Schemes Control Act and the Stock Exchanges Control Act and the Financial Markets Act. Self-regulation is ensured through ASISA. Transparency Fees and charges are available from the management company and fund performance figures are regularly published in the media.

- **Tailor-made to meet investor's risk profile:** A professional fund manager manages the fund, which is tailor-made to meet the risk profile of the investor.
- **Linked to other investment types:** These investment types can be linked to preservation funds, living annuities and retirement annuities. A retirement product can be tailored to meet the specific needs of the investor by way of a wrap fund.
- **Affordable**: Low minimum investment amounts are permitted.

4.2.2 Disadvantages of investing in a fund of funds

- **Higher costs:** Initial charges may be higher than a direct collective investment portfolio investment as an initial fee for the investment is payable as well as for each underlying collective investment portfolio. Investors may have to pay for the management of the investment and for the management of the underlying collective investment portfolios.
- **Averaging of performance:** Best performance can never match that of the best performing underlying fund as the performance of all the underlying funds are offset against each other.
- **Eggs in one basket:** Although the investor has a wide spread of investments, they are administered by a single company, which can increase his dependency on a single company or financial advisor.

4.3 Linked products

Linked investment services providers (LISPS) offers a range of investments linked to collective investment portfolios and other underlying investments. LISPs are not product suppliers as such but provide administrative systems to gain access to various suppliers of retail investment products including fund of funds, multi-manager funds and wrap funds.

LISPs can link collective investment portfolio investments with other investment products such as retirement annuities and provident funds.

LISPs develop investment packages comprising collective investment portfolios and other instruments in line with the investment needs of their client. They buy the units in bulk from collective investment portfolio companies, repackage them to provide investors with a choice of collective investment portfolios, and the opportunity to combine collective investment portfolios with other compulsory investment types such as retirement annuities or provident funds, or specialist plans. Buying in bulk allows LISPS to negotiate favourable initial charges and switching fees with the relevant Management Companies.

Products offered by LISPs can divided into three broad categories:

- **Voluntary contributions:** These are savings from after-tax income and are invested into growth/lifestyle funds or wrap funds.
- **Pre-retirement savings:** These include retirement annuities, pension and provident funds and preservation funds**.**
- **Retirement products:** These include living annuities and guaranteed income plans. New Generation Life Products are similar to LISP products but offer a choice of investments through an insurance policy and are offered by life companies. They offer additional access to the insurer's in-house investment portfolios.

4.3.1 Advantages of investing in linked products

The advantages of investing in a fund of funds are as follows:

- **Investing is made easier:** Investment decisions are easier as the investor does not have to decide on the mix of collective investment portfolios to spread his risk. A dedicated fund manager, with specialised investment expertise makes this decision on behalf of the investor. It is also an ideal investment tool for the inexperienced investor.
- **Investment in multiple funds with a single investment:** The investor is allowed to invest small amounts of money across a number of funds. This is an affordable way for the man on the street to invest in the stock market. Reporting is simplified.
- **Diversification with a single investment:** Diversification across different collective investment portfolio types and management companies within a single investment, which makes investment tracking much easier. The investors will also be advised periodically of any changes to the portfolio.

- **Risk of under-performing funds is reduced:** Risk is spread if a collective investment portfolio within the fund range should under-perform. Since these funds invest in a number of collective investment portfolios should one of the funds under-perform, the negative impact can be offset to a large degree by the performance of the other funds. These investments are a good choice for an investor who is concerned about choosing the wrong fund manager or fund.
- **Lower price volatility:** Through diversification, the unit price of a portfolio of funds will not fluctuate as much as the prices of the underlying funds, which means lower price volatility.
- **Tailor-made to meet investor's risk profile:** A professional fund manager manages the fund, which is tailor-made to meet the risk profile of the investor.
- **Linked to other investment types:** These investment types can be linked to preservation funds, living annuities and retirement annuities. A retirement product can be tailored to meet the specific needs of the investor by way of a wrap fund.
- **Reduced switching fees:** Linked product investors may pay lower switching charges than ordinary collective investment portfolio investors.
- **Reduced tax liability:** The possible inclusion of traditional retirement annuities and traditional life products enables the investor to make additional tax efficient investments.
- **Flexibility:** The investor can play an active role in the selection of his investments and can adjust his portfolio via a single transaction

4.3.2 Disadvantages of investing in linked products

- **Higher costs:** Initial charges may be higher than a direct collective investment portfolio investment as an initial fee for the investment is payable as well as for each underlying collective investment portfolio. Investors may have to pay for the management of the investment and for the management of the underlying collective investment portfolios.
- **Averaging of performance:** Best performance can never match that of the best performing underlying fund as the performance of all the underlying funds are offset against each other.
- **Eggs in one basket:** Although the investor has a wide spread of investments, they are administered by a single company, which can increase his dependency on a single company or financial advisor.

- **Complicated fee structure:** Complicated and variable pricing affect initial costs and annual service fees and there are three different kinds of broker's fee structures (tied agents, independent brokers and corporate brokers).
- **High broker fees:** Brokers fees are not regulated by the industry and as a result, costs can be high.
- **High levels of churning:** There is high degree of switching or churning because it is so easy to do.
- **Increased costs in the long run:** Linked products may have slightly higher costs over time as two annual fees are payable for linked products; one to the CIS management company and the other to the linked product company.

4.4 Wrap funds

A wrap fund is a portfolio consisting of a number of underlying investment tools wrapped into a single product. Wrap funds are not classified as funds of funds as the wrap fund itself is not a collective investment portfolio but is in fact a portfolio of separate collective investment portfolios and money market accounts/instruments. The underlying combination of investment tools or instruments is selected to target the risk/return requirements of individual investors. The combination of the underlying instruments may be conservative, balanced or aggressive.

With a wrap fund the investor has direct ownership of the underlying investments. Wrap funds are not regulated by the Collective Investment Schemes Control Act and do not have separate legal status. They are controlled by the same legislation pertaining to Linked Investment Services Providers (LISPs), namely the Stock Exchanges Control Act and the Financial Markets Control Act. Wrap funds can be managed by almost anyone provided they are registered with the Financial Sector Conduct Authority as a portfolio manager.

Wrap Funds are offered by some Linked Product Companies and Asset Management Groups. Any registered portfolio manager can establish his own wrap fund and act as investment advisors for that fund. Investors are advised as to which of the wrap funds is suitable based on their risk profiles and investment needs.

Wrap funds can be administered by two types of LISPS:

- **Discretionary LISPs:** The administration and investment function of the wrap are housed within the LISP.
- **Non-discretionary LISPs:** The administration is housed within the LISP and the investment function is outsourced.

4.4.1 Advantages of investing in wrap funds

The advantages of investing in a fund of funds are as follows:

- **Investing is made easier:** Investment decisions are easier as the investor does not have to decide on the mix of collective investment portfolios to spread his risk. A dedicated fund manager, with specialised investment expertise makes this decision on behalf of the investor. It is also an ideal investment tool for the inexperienced investor.
- **Investment in multiple funds with a single investment:** The investor is allowed to invest small amounts of money across a number of funds. This is an affordable way for the man on the street to invest in the stock market. Reporting is simplified.
- **Diversification with a single investment:** Diversification across different collective investment portfolio types and management companies within a single investment, which makes investment tracking much easier. The investors will also be advised periodically of any changes to the portfolio.
- **Risk of under-performing funds is reduced:** Risk is spread if a collective investment portfolio within the fund range should under-perform. Since these funds invest in a number of collective investment portfolios should one of the funds under-perform, the negative impact can be offset to a large degree by the performance of the other funds. These investments are a good choice for an investor who is concerned about choosing the wrong fund manager or fund.
- **Lower price volatility:** Through diversification, the unit price of a portfolio of funds will not fluctuate as much as the prices of the underlying funds, which means lower price volatility.
- **Tailor-made to meet investor's risk profile:** A professional fund manager manages the fund, which is tailor-made to meet the risk profile of the investor.

- **Linked to other investment types:** These investment types can be linked to preservation funds, living annuities and retirement annuities. A retirement product can be tailored to meet the specific needs of the investor by way of a wrap fund.
- **Greater impartiality**: Portfolio managers of wrap funds are usually not tied to any one asset manager.

4.4.2 Disadvantages of investing in wrap funds

- **Higher costs:** Initial charges may be higher than a direct collective investment portfolio investment as an initial fee for the investment is payable as well as for each underlying collective investment portfolio. Investors may have to pay for the management of the investment and for the management of the underlying collective investment portfolios.
- **Averaging of performance:** Best performance can never match that of the best performing underlying fund as the performance of all the underlying funds are offset against each other.
- **Eggs in one basket:** Although the investor has a wide spread of investments, they are administered by a single company, which can increase his dependency on a single company or financial advisor.
- **Complicated fee structure:** Complicated and variable pricing affect initial costs and annual service fees and there are three different kinds of broker's fee structures (tied agents, independent brokers and corporate brokers).
- **High broker fees:** Brokers fees are not regulated by the industry and as a result, costs can be high.
- **High levels of churning:** There is high degree of switching or churning because it is so easy to do.
- **Inadequate performance statistics:** Since wrap funds are relatively new, performance statistics are scarce, and comparisons of wrap funds cannot be made as some companies do not disclose performance information.
- **Not suitable for small investors:** Some wrap funds tend to exclude small investors e.g. investors with less than R50 000 to invest. High net worth investors with lump sum investments are targeted (debit orders are often not allowed).

- **No regulation:** The wrap industry is not regulated. Investors need to be aware of this as they have limited recourse.
- **Small investors may be prejudiced:** Some wrap funds may have a concentration of investments in a small number of collective investment portfolios that could result in large swings between collective investment portfolios prejudicing smaller investors in the funds

4.5 Multi-manager funds

Multi-manager is a method of managing a fund's assets. The multi-manager approach bundles asset managers together in different combinations to provide investors with choices designed to meet various risk profiles.

A multi-management collective investment portfolio invests in an actively managed blend of tailor-made specialist portfolios of equities and fixed interest instruments, by combining the investment styles of different fund managers into one investment product.

One fund is managed by numerous asset managers, each of them a specialist in a certain sector of the market, adopting different investment styles, favouring certain markets, trends or stocks. The choice of these external fund managers is a quantitative science, which involves the selection and blending of specialist portfolio managers who have been identified as being the "best of the best" in their particular investment style or approach.

The underlying portfolios are managed according to mandates set by the fund. To achieve the collective investment portfolio's risk and return objectives, fund managers are mixed using computer optimisation models to ascertain the extent of the exposure of each fund to each manager. As the market changes and as managers change their risk profiles by buying and selling stocks, the combination of managers in the fund is rebalanced using performance analysis to assess if the fund is on track.

The investor's tolerance to risk is assessed by striking a balance between the investor's expectation of return and his attitude towards risk. The multi-manager is then able to assess how aggressively or conservatively the investor's assets need to be managed, and thus which multi-manager best addresses the investor's requirements.

Some of the better-known styles are as follows:

- **Growth style managers:** These managers primarily interested in a company's earnings. Their bias is towards companies expected to exhibit profitability and shareholder earnings growth greater than their industry peers.
- **Value oriented managers:** These managers look for companies that they believe are worth more than the current value of their shares. They may purchase shares of companies that are currently out of favour with the market, believing that the shares are good value for the price based on future expectations of performance.
- **Market orientated managers**: These managers seek to develop well-diversified portfolios with average growth and valuation characteristics similar to the broad market. Many seek to add value by emphasising shares in economic sectors they believe have the most potential.

There are many more styles - for example, the strategic empowerment style, where managers focus on "black chips" and specific market sector styles.

4.5.1 Advantages of investing in multi-manager funds

The advantages of investing in a fund of funds are as follows:

- **Investing is made easier:** Investment decisions are easier as the investor does not have to decide on the mix of collective investment portfolios to spread his risk. A dedicated fund manager, with specialised investment expertise makes this decision on behalf of the investor. It is also an ideal investment tool for the inexperienced investor.
- **Risk of under-performing funds is reduced:** Risk is spread if a collective investment portfolio within the fund range should under-perform. Since these funds invest in a number of collective investment portfolios should one of the funds under-perform, the negative impact can be offset to a large degree by the performance of the other funds. These investments are a good choice for an investor who is concerned about choosing the wrong fund manager or fund.
- **Lower price volatility:** Through diversification, the unit price of a portfolio of funds will not fluctuate as much as the prices of the underlying funds, which means lower price volatility.
- **Regulated:** Regulated by Collective Investment Schemes Control Act and the Stock Exchanges Control Act and the Financial Markets Act. Self-regulation is ensured through ASISA. Transparency Fees and charges are available from the management company and fund performance figures are regularly published in the media.

- **Tailor-made to meet investor's risk profile:** A professional fund manager manages the fund, which is tailor-made to meet the risk profile of the investor.
- **Linked to other investment types:** These investment types can be linked to preservation funds, living annuities and retirement annuities. A retirement product can be tailored to meet the specific needs of the investor by way of a wrap fund.
- **Best managers are selected:** The best specialist manager in a specific investment area is selected for the various areas of the fund.
- **Compliance with investment mandate:** By closely managing the asset manager, the management company can ensure that the asset manager complies with the fund mandate. The fund mandate ensures that the asset manager's style is similar to the objective and risk profile of the fund.
- **Improved fund and manager performance:** The blend of the overall investment portfolio can be targeted in such a way as to enhance the value of the managers' abilities and it also allows management companies to remove under performing fund managers. Reduces overlap of different portfolios.
- **Consistency of performance:** Each fund manager manages a portfolio belonging exclusively to the multi-manager collective investment portfolio thus reducing the impact of the movements of other investors and ensuring consistent performance.
- **Exposure to a variety of fund managers and styles:** Multi-manager funds enable investors to select a single collective investment portfolio fund and to enjoy the exposure to a variety of fund managers and styles without investing in a variety of Collective investment portfolios

4.5.2 Disadvantages of investing in multi-manager funds

- **Higher costs:** Initial charges may be higher than a direct collective investment portfolio investment as an initial fee for the investment is payable as well as for each underlying collective investment portfolio. Investors may have to pay for the management of the investment and for the management of the underlying collective investment portfolios.
- **Averaging of performance:** Best performance can never match that of the best performing underlying fund as the performance of all the underlying funds are offset against each other.

- **Eggs in one basket:** Although the investor has a wide spread of investments, they are administered by a single company, which can increase his dependency on a single company or financial advisor.

4.6 Summary of packaged products

The table below summaries the features of a traditional collective investment portfolio and packaged products.

	Traditional collective investment scheme	Fund of fund	Linked product	Wrap fund	Multi-manager fund
Description & underlying investment	A collective investment portfolio that invests in local or offshore shares, bonds and cash	A collective investment portfolio that invests in a range of collective investment portfolios	Product provider who packages a range of chosen collective investment portfolios and other investment vehicles	A portfolio comprising units trusts and money market instruments - no separate legal status	A collective investment portfolio that blends investment styles of different Fund Managers
Investment decision taken by	Fund manager	Fund manager	Individual or broker	Fund manager	Fund manager
Selection criteria	Equities, bonds, cash, depending on the investment cycle	Collective investment portfolios that should perform well in the future	Depends on client or advisor	Collective investment portfolios that should perform well in the future	Top fund managers in desired market sectors
Investing offshore via asset swaps	Yes	Yes	Underlying collective investment portfolios can	Underlying collective investment portfolios can	Yes
Branding	CIS Management Company or white labeling e.g. Woolworths	CIS Management Company or white labeling e.g. Woolworths	All investment portfolios carry LISP brand name	Can have any brand. 'Own' brand very popular	CIS Management Company or white labeling e.g. Woolworths
Performance data in the media	Yes	Yes	No	No	Yes

	Traditional collective investment scheme	Fund of fund	Linked product	Wrap fund	Multi-manager fund
Daily pricing in the media	Yes	Yes	No	No	Yes
Governing legislation	Collective Investment Schemes Control Act Stock Exchange Control Act Financial Markets Act	Collective Investment Schemes Control Act Stock Exchange Control Act Financial Markets Act	FAIS Act	FAIS Act	Collective Investment Schemes Control Act FAIS Act
Costs (incl. VAT)	Up to 5.7% upfront 0.57% - 3.4% p.a.	Up to 7% upfront 2% - 4.5% p.a. plus cost of underlying funds	Up to 9% upfront 1.71% - 4.3% p.a. plus cost of underlying funds	Up to 8% upfront 1,8% -4.3 % p.a. plus cost of underlying fund	Up to 6% upfront 1.14% - 2.3% p.a. plus cost of underlying funds