CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT — EDUCATION PARTNER 2023 - 24

Unit 7: Investment Funds

Student Workbook

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT EDUCATION PARTNER 2023 - 24

Unit 7

Unit Aim: Understand the key features of futures, options and swaps.

Relevance of this unit to the course:
This unit builds on the previous financial assets units, as well as making connections to unit 2 and unit 8.

Learning Objective	Learning Outcomes	Chapter Section
7.1.1	Understand the potential advantages, disadvantages and risks of collective investment	1
7.1.2	Know the difference between active and passive (eg index) management	1
7.1.3	Know the purpose and principal features of UCITS / NURS	1
7.1.4	Know the types of funds and how they are classified	1
7.2.1	Know the definition and legal structure of a unit trust	2
7.2.2	Know the roles of the manager and the trustee	2
7.3.1	Know the definition and legal structure of an OEIC / ICVC / SICAV	3
7.3.2	Know the roles of the authorised corporate director and the depositary	3
7.4.1	Know how unit trusts and OEIC shares are priced, bought and sold	4
7.4.2	Know how collectives are settled	4
7.5.1	Know the characteristics of an investment trust, including; • Share classes • Gearing • Real estate investment funds (REITs)	5
7.5.2	Know the meaning of the discounts and premiums in relation to the price of investment trust	5
7.5.3	Know how investment trust shares are traded	5

How to use this student workbook

Throughout this student workbook, look out for the different icons to support your learning:

Understand and learn – these sections will help you to develop your knowledge and understanding of the assessed learning objectives.

Apply and practise – Practise and test your newly acquired learning by undertaking a range of activities to help you prepare for the multiple choice assessment at the end of the course.

Further your knowledge – Consolidate your understanding of key concepts by reading and interacting with current, credible resources to help further enhance your learning.

Introduction to investment funds

This unit looks at the asset management industry in the UK and explores the role of investment funds and the UK investment market. Watch the short CISI video explaining the purpose of the investment industry in the UK.

If you had a close friend who wanted to buy into an investment fund, what questions would you recommend they ask of themselves first? List your questions below.

The risk and rewards of investing

Watch the CISI video about the risks and rewards when investing.

Summarise the risks and rewards below.

Risks	Rewards

Module Learning Outcome 7.1 – Introduction

7.1.1: Understand the potential advantages, disadvantages and risks of collective investment

7.1.2: Know the difference between active and passive (e.g. index) management

7.1.3: Understand the purpose and principal features of UCITS/NURS

7.1.4: Know the types of funds and how they are classified

Collective investments

Investors can chose to do so either **directly** (i.e. buy shares in a particular company e.g. Apple) OR they can invest **indirectly** e.g. buy a stake in an investment fund.

Collective Investment Schemes (CISs) are an example of **indirect** investment. They pool the resources of a large number of investors. Read section 7.1.1 in the course workbook and list some of the benefits of the pooling of funds within CISs.

1.
2.
3.
4.
5.

Collective investments – A case study

Clive, 43, has recently inherited £30,000. He has already used his ISA allowance for this tax year and is considering putting some or all of the money into a collective investment scheme. His brother is doing the same and has told Clive about the importance of diversification.

1. What further information might you need from Clive before advising him on CIS investment

2. How would you explain the benefits of diversification to Clive?

3. Outline the disadvantages and risks of associated with collective investment schemes to Clive.

Active and passive management

There are a wide range of funds for an investor to chose between. Each fund will have its own:

- Investment objectives
- Style of investment
- Fund manager

Each fund will make clear what the fund manager will invest in (e.g. shares and/or bonds and/or property for example) as well as whether their style of investment is ACTIVE or PASSIVE.

In your own words, summarise the difference between active and passive management using section 7.1.2 of the course workbook to help.

Active and passive management

Active Management seeks to a predetermined over a time period. It does this by using fundamental and technical analysis to assist in the of future events. These events may be or specific to a company. The analysis is used to make decisions on the portfolios holdings and the timings of and .

Top Down investing is where a fund manager focuses on economic and industry , not on the prospects of particular companies.

Bottom Up investing is where a fund manager focuses on an analysis of a company’s net , future and cash flow, and other company specific .

Bottom up investment styles

Match up the following bottom up investment styles to their description:

Investment style	Definition
	Picking the shares of companies that are undervalued relative to their present and future profits or cash flows
	Picking the shares whose share price is rising on the basis that this rise will continue
	Picking the shares of companies that present opportunities to grow significantly in the long term
	Picking the shares that are 'out of favour' and may have 'hidden' value. The opposite of momentum investing.

Passive Management

Rosie would like to begin making a monthly contribution from her salary into an investment vehicle for the medium to long term. She describes herself as cautious and wants to minimise risk. She wants to know more about investing in index tracker funds.

Prepare for your meeting to Rosie by writing some notes for yourself outlining the main features of index tracker funds, including the advantages and disadvantages.

Combining active and passive management

Active and passive management styles are not necessarily mutually exclusive.

1. What is core-satellite management?

2. What are 'smart beta' funds?

Further your knowledge – Active vs passive investing

Log into the professional refresher section through your CISI learning platform and complete the active vs passive investing (1hr 15 mins) module.

The types of funds and how they are classified

There are almost 3,500 UK-domiciled investment funds available to investors and even more EU-based ones, plus a wide range of Exchange Traded Funds (ETFs).

1. Explain why these funds need classifying?

2. The IA (Investment Association) is the UK trade body for which industry?

3. The Association of Investment Companies (AIC) is the trade body for which industry?

4. What is the main broad categorisation that the IA's classification system uses?

5. What are the similarities shared by funds in each classified sector or category?

The types of funds and how they are classified

Study the example of bond fund sectors in section 7.1.4 of the course workbook.

Which funds make up the majority of the investments in each of the bond sectors below:

	Majority funds
UK Gilts	
UK Index Linked Gilts	
£ Corporate Bonds	
£ Strategic Bonds	
£ High Yield	

The purpose and principal features of UCITS/ NURS

UCITS are a series of EU regulations or directives originally designed to facilitate the promotion of funds to retail investors across the EU and the European Economic Area.

1. What was the aim of the regulations?

2. What are the implications for UCITS in the UK post Brexit?

3. How does the FCA intend to address this?

4. Which funds can be set up under the 'non' UCITS (NURS) regulations?

Creating a portfolio of shares

You are the fund manager of a newly established collective investment scheme. Using the FTSE all-share webpage, research different companies and create a **£100,000** portfolio of shares made up of companies within the FTSE All Share Index. Explain your reason for choosing these shares and remember not to put all your eggs in one basket!

What approach will you take?

- You could look at economic and industry trends to invest in particular companies (Top-down approach).
- You might decide to focus on particular companies and make decisions based on their finances and overall strategy, as a predictor for future success (Bottom-up approach).
- If you take a Bottom-up approach, will you create a portfolio which reflects the four different types of shares (Growth, Value, Momentum and Contrarian). Which of the shares you have chosen represent each type?

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Module Learning Outcome 7.2 – Unit Trusts

7.2.1: Know the definition and legal structure of a unit trust

7.2.2: Know the roles of the manager and the trustee

Unit Trusts

Watch the short video about unit trusts and answer the following questions.

1. What is a unit trust?

2. How do unit trusts work?

3. What are the three components of an investment return?

4. How are unit trusts flexible?

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Unit Trusts

Read the section about unit trusts in the course workbook and fill in the blanks using the terms below.

A unit trust is a type of Collective Investment Scheme. The is the legal owner is legal owner of the underlying assets and the are the owners.

A unit trust can be either authorised or unauthorised (only authorised funds can be marketed to the).

Investors pay money into the trust in exchange for .

The money is invested in a portfolio of assets. If the portfolio increases in value the value of units will If the portfolio falls in value, the units will in value.

Unit trusts are - ended. This means that the trust can grow as more investors buy into the fund, or shrink as investors sell units back to the fund. If investors sell units back to the fund, the units are either or to new investors.

The role of the Trustee and the Unit Trust Manager

Using section 2 in chapter 7 of the course workbook, describe the role of the Trustee and the Unit Trust Manager

Trustee	Unit Trust Manager

The structure of a unit trust

Using the image below about how a unit trust is structured, fill in the blank boxes with the correct title of individuals and the different functions they perform.

INVESTMENTS

Holds different types of assets – shares, bonds or both

UNIT TRUST MANAGER

TRUSTEES

UNIT TRUST

Holds and controls the unit trust’s assets

Purchase units

Delegates day-to-day investment decisions to separate fund managers

Buys and sells investments

Values and fixes the price of units

BENEFICIARIES

Purchases units back from holders wishing to sell

Receives income

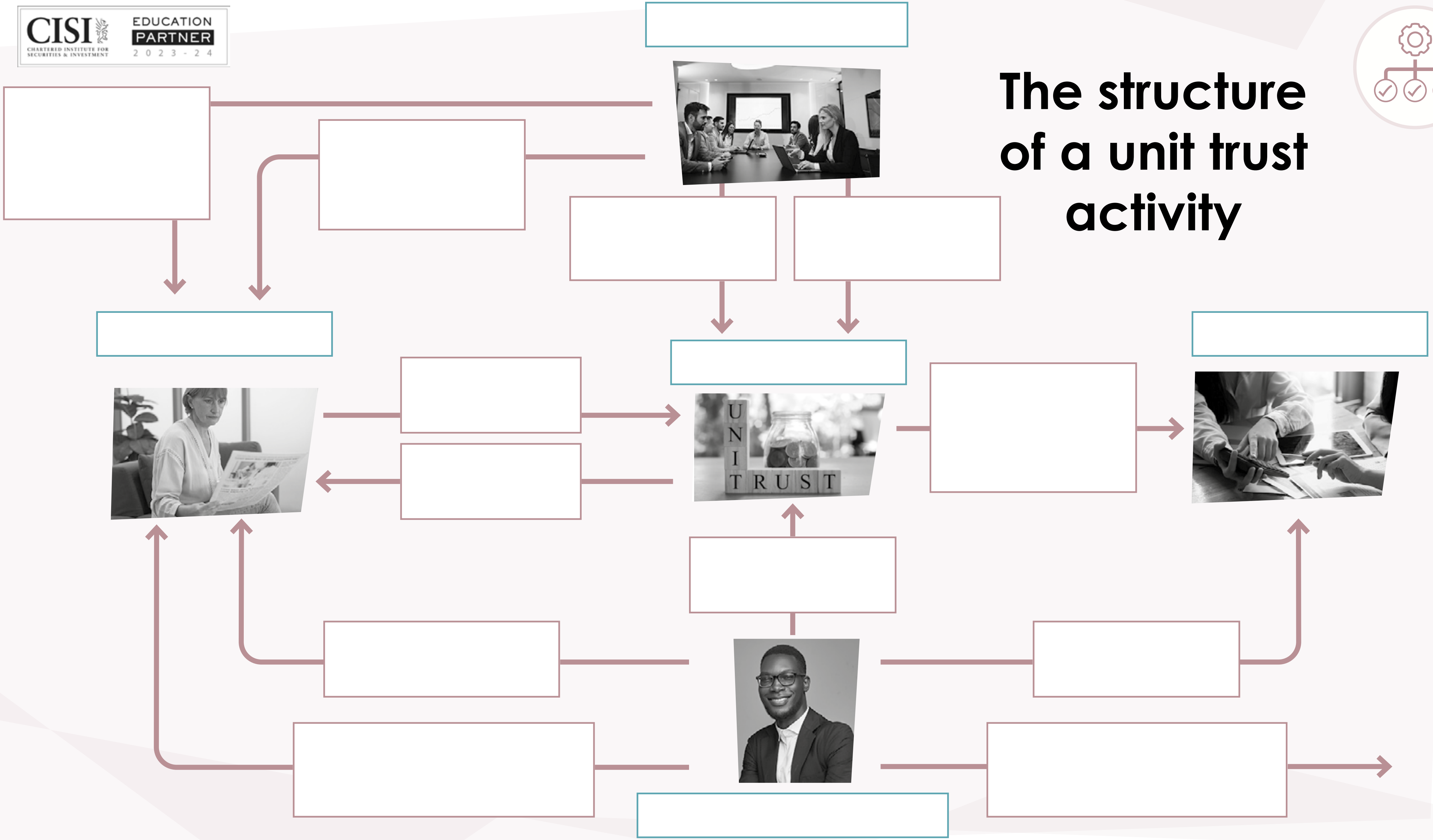
Approves any advertisements and marketing masterial

Sells the units to investors

Issues unit certificates to investors

Collectes and distributes income from trust assets

The structure of a unit trust activity



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The structure of a unit trust activity – Answers

TRUSTEES

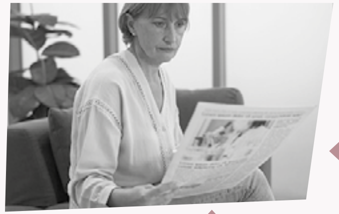
Collects and distributes income from trust Assets (dividends, interest)

Issues unit certificates to investors

Holds and controls the unit trust's assets

Approves any advertisements and marketing material

BENEFICIARIES



Purchase units

Receives income

UNIT TRUST

Holds different types of assets - could be shares, bonds or both

INVESTMENTS

Values and fixes the price of units

Sells the units to investors

Buys and sells investments

Purchases units back from holders wishing to sell

Delegates day-to-day Investment decisions to separate fund managers

UNIT TRUST MANAGER

Module Learning Outcome 7.3 – Open Ended Investment Companies (OEICs)

7.3.1: Know the definition and legal structure of an OEIC/ICVC/SICAV

7.3.2: Know the roles of the authorised corporate director and the depositary

The definition and legal structure of an OEIC/ICVC/SICAV

Read the section about Open-Ended Investment Companies (OEICs) in chapter 7 of the course workbook and fill in the blanks using the terms below.

An Open Ended Investment Company (OEIC) is also a type of Collective Investment Scheme (CIS). OEICs are authorised by the They are described as Investment Companies with (ICVSs) by the FCA.

An ICVC or OEIC commonly found in Western Europe is called a société d’investissement à capital variable (SICAV). They are typically set up in Luxembourg by asset management firms so that they can be distributed to investors across Europe or further afield.

OEICs are structured as , with the investors holding They are legislated in a special way, and not under the Companies Acts.

The OEIC invests shareholder’s money in a pool of assets.

As suggested in the name, OEICs are - ended. No share repurchase apply so they are able to create new shares and redeem exiting ones according to investor .

The role of the authorised corporate director and depositary

1. When an OEIC is set up, which roles are appointed?

2. What are the responsibilities of the Authorised Corporate Director of an OEIC?

3. Is the ACD able to delegate or outsource their responsibilities?

4. Do these requirements differ from those of a manager of an authorised unit trust?

5. What are the responsibilities of the depository of an OIEC?

The similarities and differences between unit trusts and OEICs

Using chapter 7 of the course workbook, identify the similarities and differences between unit trusts and OEICs below.

Similarities	Differences

Module Learning Outcome 7.4 – Pricing, dealing and settling

7.4.1: Know how unit trusts and OEIC shares are priced, bought and sold

7.4.2: Know how collectives are settled

Pricing of unit trusts and OEICs

Read section 4 in chapter 7 about pricing, dealing and settling and answer the following questions.

1. What are the prices for buying and selling units or shares in unit trusts or OEICs based on?

2. Who sets the prices?

3. What is single pricing?

4. What is dual pricing?

Pricing of unit trusts and OEICs

5. What is a dilution levy?

6. The maximum price for new units in an unit trust is prescribed by which body?

7. How is the maximum price comprised under dual pricing?

8. Where can investors find the prices of most individual funds?

Buying and selling units – true or false?

	True	False
Investors can buy or sell units in a unit trust directly with the fund manager?		
Investors can buy or sell shares in a OEIC via a financial adviser?		
Investors can buy or sell shares in CISs via a platform or fund supermarket?		
There is an active secondary market or stock market for CIS units or shares?		
Investors or their advisers/ intermediaries can purchase secondary shares (ie not new shares) from the fund managers?		
Fund supermarkets offer online dealing for investors in authorised unit trusts and OEICs?		
Once a fund manager receives instructions that an investor wants to sell units or shares they have to settle the sale immediately and remit proceeds to the investor?		
An investor has to give their instructions for sale in writing?		

Collective Investment Scheme Charges

1. Which charges are made explicit to an investor in a CIS?
2. Which other costs and charges might managers of a fund make under the terms of their management agreements?
3. What might these other charges impact?
4. What costs and charges are UCITS funds required to publish in their key investor information document?
5. What does a Total Expenses Ratio (TER) include?

Module Learning Outcome 7.5 – Investment Trusts

7.5.1: Know the characteristics of an investment trust, including:

- Share classes
- Gearing
- Real estate investment funds (REITs)

7.5.2: Know the meaning of the discounts and premiums in relation to the price of investment trusts

7.5.3: Know how investment trust shares are traded

Investment Trusts

Using section 5 in chapter 7 of the course workbook, write a brief description of each of the terms/features of Investment Trusts shown here.

Investment Trusts	Description
Preference Shares	
Closed Ended	
Pricing	
REITs	
Gearing	
Split Capital	
LSE	

Investment trusts

Read the section about Investment Trusts in the course workbook and fill in the blanks using the terms below.

Investment Trust companies generally trade at a discount to their NAV. The extent of the discount is calculated and shown in the business pages of newspapers.

The discount is a function of the view of the of the of the investment portfolio and it's of underlying investments

A discount (or even a premium) will be shown when investment trusts are nearing their or are about to undergo some corporate activity such as a or a takeover.

Some investment trusts have a date at which the trust will be wound up and assets returned to shareholders.

Example: ABC Investment Trust shares are trading at £2.30. The NAV per share is £2.00. ABC Investment Trust shares are trading at a which is 15% of the underlying .

Investment trusts – pricing, discounts and premiums

SCENARIO 1

ABC Investment Trust shares are trading at £2.30 each after a successful year under the stewardship of the current board. The net asset value per share is £2.00.

1. Are the shares trading at a premium or discount?

2. What is the percentage premium or discount?

SCENARIO 2

Fidelity Special Trust shares are trading at 119.5p in response to demand for shares. Its net asset value is 112.7p per share.

1. Are the shares trading at a premium or discount?

2. What is the percentage premium or discount?

Investment trusts – pricing, discounts and premiums

SCENARIO 3

As a result of a takeover bid, XYZ Invest Trust shares are trading at 95p. The net asset value per share is £1.00.

1. Are the shares trading at a premium or discount?

2. What is the percentage premium or discount?

3. How do you think the share price of an investment trust is determined?

4. Why might an investment trust's shares be trading at a premium or discount to the net asset value?

Further your knowledge – REITS Investment Principles

Watch the webinar on the CISI TV channel about REITS Investment Principles where the speakers discuss the key principles of REIT investment theory.

Module Learning Outcome 7.6 – Exchange-Traded Funds

7.6.1: Understand the main characteristics of exchange-traded funds, including:

- Trading
- Replication methods
- Synthetic/non-synthetic

Exchange Traded Funds

Watch the short video about ETF basics and complete the Exchange Traded Funds (45 mins) module in the professional refresher section of the CISI learning platform. This module explores the definition, background and structure of EFT's, the different types available and possible future developments.

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Tick only the statements that apply to ETFs:

☐ Index tracked: An ETF is usually designed to track a particular index eg the FTSE 100	☐ Portfolio managers do not make decisions about which securities to buy and sell
☐ The spread between buying and selling prices are often substantial	☐ Investors pay a stockbroker's commission when buying and selling
☐ ETFs seek to match the performance of a broad based market index	☐ ETFs share price essentially reflects the value of the underlying investments
☐ ETF share prices are influenced by supply and demand	☐ ETFs are actively managed funds
☐ The largest stocks in the index tend to have the biggest influence on the index's value	☐ ETF shares can trade at a premium or a discount to the underlying investments
☐ ETFs shares are subject to stamp duty	☐ ETF investor returns are in the form of dividends and or gains on disposal
☐ The portfolio of an ETF mirrors the index it is tracking	☐ ETFs do not pay dividends
☐ ETFs tend to trade at a discount to their NAV	

Exchange Traded Funds (EFTs) – Physical replication

ETFs track an index using either physical or synthetic replication. **Physical replication** employs one of three established tracking methods. Match the correct definition to the method

1. Full Replication
2. Stratified Sampling
3. Optimisation

KEY

A. uses computer modelling to find a representative sample which mimics the characteristics of the index tracked.

B. Requires each part of the index being tracked to be held in accordance with its index weighting.

C. Requires a representative sample of securities from each sector of the index to be held.

Exchange Traded Funds (EFTs) – Synthetic replication

Synthetic replication involves the fund manager entering into a swap (an OTC derivative) with a market counterparty to exchange the returns on the index for a payment.

1. What is the advantage of this approach?

2. What is the disadvantage of this approach?

Comparing investment companies

Complete the following table for each type of CIS listed below:

	Authorised Unit Trusts	OEICs	Investment Trusts including REITS	ETFs
Legal Structure				
Management				
Supervision				
Open or closed ended				
Pricing				
Trading				

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CISI TV Further your knowledge – EFTs

Log into the CISI learning platform and watch the webinar on the CISI TV channel about EFT trends.

Module Learning Outcome 7.7 – Alternative Investment Funds

7.7.1: Know the basic characteristics of hedge funds:

- Risks
- Costs and liquidity
- Investment strategies

7.7.2: Know the basic characteristics of private equity:

- Raising finance
- Realising capital gain

Alternative investment funds

Complete the Alternative Investments (1hr) professional refresher module on the CISI learning platform. This module considers hedge funds, private equity, real estate and commodities and other alternative investments.

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Hedge funds

Watch the introductory video about hedge funds and answer the following questions.

1. List the key features of a hedge fund.

2. Describe the 4 key hedge fund strategies that can be adopted

3. Explain the benefits and implications of hedge funds

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Hedge funds

Read section 8 in chapter 7 of the course workbook and describe the following features of hedge funds:

	Description
Regulation	
Minimum Investment	
Investments	
Investment Style	
Gearing	
Buying and Selling	
Liquidity	
Cost	

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Hedge funds – true or false?

	True	False
All hedge funds are high risk		
Traditional absolute return hedge funds attempt to profit regardless of the general movements of the market		
Hedge funds reduce market risk by going both 'long' and 'short' on the same or similar financial assets		
Investors can gain access to hedge funds through funds of hedge funds		
Hedge funds do not tend to borrow funds (gearing) as a means to enhance returns		

Further your knowledge – Hedge funds

Complete the Hedge Funds (1hr) professional refresher module on the CISI learning platform. This module examines the definition and background of hedge funds, the different types available, their risks and why and how they should be used.

Private Equity

Read section 8.2 in chapter 7 of the course workbook and answer the following questions.

1. Private equity offers what sort of timescale of finance in return for an equity stake in potentially high-growth companies?

2. A private equity firm usually profits through what type of return?

3. What is the main source of the capital raised by private equity firms?

4. Name 4 ways a private equity firm will realise a gain?

5. How are private equity arrangements usually structured these days?

Further your knowledge – Alternative Investment Fund Manager Directive (AIFMD)

Complete the Alternative Investment Fund Managers Directive (1hr) professional refresher module on the CISI learning platform. This module introduces the regulatory and supervisory framework which affects alternative investment funds.

End of Unit 7
Multiple Choice Assessment

Test your knowledge

1. How are unit trusts classified so that UK investors can properly evaluation them?

A. The London Stock Exchange records all UK unit trusts

B. The Investment Association maintains a system for classifying funds

C. The Financial Times maintains a list of authorised unit trusts daily

D. There is no like-for-like system to evaluation unit trusts

2. Which ONE of the following is compared to the current price to calculate the discount or premium that an investment trust share is trading at?

A. Open ended value

B. Last dealing price

C. Net asset value

D. Mid market price

Test your knowledge

3. Who is responsible for looking after the investments on behalf of shareholders within an ICVC?

- A. The investment manager
- B. The authorised corporate director (ACD)
- C. The Financial Conduct Authority
- D. The depositary

Test your knowledge

4. What is a dilution levy?

- A. A separate charge to recoup dealing expenses and commissions not accounted for in single-priced unit trusts and OEICs
- B. The maximum price at which a fund manager is able to sell new units as prescribed by the FCA
- C. A charge paid to trustees to create new units in a unit trust or OEIC
- D. A separate price to account for the spread between the market's bid and offer prices in a dual priced fund

Test your knowledge

5. Which of the following is a benefit of investing in a collective investment scheme?

- A. Access to shareholder perks across a range of companies
- B. Capital security from the greater number of investors
- C. Investor protection on deposits up to £85,000
- D. Access to geographical markets which might otherwise be inaccessible

6. Performance related fees are usually associated with which ONE of the following types of investment?

- A. ETFs
- B. Hedge Funds
- C. Investment Trusts
- D. OEICs

Test your knowledge

7. What is the role of a trustee in a unit trust fund?

- A. To act as custodian of the shares in the fund and any residual cash
- B. To be the legal owner of the fund assets
- C. To manage the organisation on a day-to-day basis
- D. To resolve any legal issues which may emerge in the course of business

8. All of the following are characteristics of ETFs, EXCEPT:

- A. There is a very small spread on prices
- B. There is an annual management charge
- C. Stamp duty of 0.5% is payable on purchases
- D. They are trade on the London Stock Exchange

Test your knowledge

9. In an OEIC, which ONE of the following undertakes the equivalent role to that of the manager in a unit trust?

- A. The custodian
- B. The nominee
- C. The depository
- D. The Authorised Corporate Director (ACD)

10. Which ONE of the following is an alternative term for an OEIC?

- A. ICVC
- B. ITC
- C. UCITS
- D. ISA

Test your knowledge

11. Which ONE of the following is a characteristic of ETFs:

- A. The shares are always traded at a discount
- B. The shares can only be traded with the manager
- C. They are open ended collective investment vehicles
- D. They issue units rather than shares

12. Which of the following is NOT an example of a bottom-up investment style?

- A. Growth investing
- B. Contrarian investing
- C. Indexation investing
- D. Value investing

Test your knowledge

13. Fund A is an authorised fund and Fund B is an unauthorised fund. This means that:

- A. Only fund A can be marketed to the general public
- B. Only fund A will benefit from tax relief
- C. Only fund B can accept overseas investors
- D. Only fund B will use accumulation units

14. Which of the following is true about the pricing of units and shares in authorised unit trusts and OEICs?

- A. They are always dual priced
- B. All funds have a choice of which pricing methodology they use, but whichever is chosen must be disclosed in the prospectus
- C. They are always single priced
- D. The bid price is always the same as the offer price

Test your knowledge

15. How long does a unit trust manager have to remit the proceeds of sale after receiving instructions from an investor?

- A. Five days from receipt of instructions
- B. Four days from receipt of instructions
- C. The manager must remit immediately
- D. A week from receipt of instructions

16. Which organisation prescribes the maximum price at which a fund manager is able to sell new units?

- A. FCA
- B. Bank of England
- C. The Investment Association
- D. No organisation is able to prescribe a maximum price

Test your knowledge

17. Which of the following is NOT an advantage of employing indexation?

- A. The fund's charges will typically be significantly lower than actively managed funds
- B. Relatively few active portfolio managers consistently outperform benchmark equity indices
- C. Once set up, passive portfolios are generally less expensive to run than active portfolios
- D. Indexed portfolios follow the index down in bear markets

Test your knowledge

18. The Association of Investment Companies (AIC) is the trade body for which industry?

- A. The UK authorised open ended funds industry?
- B. The investment trust industry (closed -ended companies)
- C. EEA UCITS funds
- D. All UK based collective investment schemes

19. Which of the following is an example of a combination of active and passive investment styles?

- A. A core-satellite investment strategy
- B. A contrarian investment strategy
- C. Holding both long and short positions
- D. An Indexation strategy

Test your knowledge

20. Which of the following would NOT be grouped together in the IA's classification system?

- A. Funds investing in similar asset categories
- B. Funds investing in the same stock market sectors
- C. Funds investing in the same geographic region
- D. Funds with the same investment manager

21. Which of the following was NOT part of the rationale for the introduction of UCITS?

- A. To ensure a level playing field through common standards of investor protection in funds to be sold across borders
- B. To improve customer choice of funds to be sold across borders
- C. To reduce the costs involved in investing in funds to be sold across borders
- D. To help HM Treasury recognise other country's funds' regimes

Test your knowledge

22. The register of shareholders in a ICVC is maintained by…?

- A. The Authorised Corporate Director (ACD)
- B. The trustee
- C. The depository
- D. The Board of Directors

23. Which of the following are NOT included as part of the OCF (ongoing charges figure) published by UCITS funds?

- A. Costs of the UCITS management company
- B. Costs for outsourced services
- C. Regulatory and audit fees
- D. Initial or Exit charges

Test your knowledge

24. A top down approach to investment management involves:

- A. Analysis of a company's financial statements
- B. A focus on a company's management and strategy
- C. A focus on economic and industry trends
- D. The tracking of a pre-determined benchmark

25. Which of the following statement best describes contrarian investing?

- A. Picking shares of companies most likely to grow in the medium and long term
- B. Picking the shares of companies that are cheap (undervalued) to their profits or cash flow
- C. Picking shares where the price is rising on the assumption it will continue
- D. Picking out of favour shares that may have hidden value

Monitoring my progress – Unit 7

My multiple choice assessment mark is / 25

I am happy with the progress that I made on the multiple choice assessment

○ Yes ○ No

To improve my knowledge and understanding, I now need to….

1.

2.

3.

Need more help?

If you feel that your multiple choice score can be improved further, complete the end of unit 7 multiple choice questions in the course workbook.

Answers

Page 7
Potential answers include:
- Economies of scale
- Diversification
- Access to professional investment management
- Access to geographical markets, asset classes of investment strategies which might otherwise be inaccessible to the individual investor
- In many cases, the benefit of regulatory oversight
- In some cases, tax deferral

Page 8
1. What further information might you need from Clive before advising him on CIS investment? Explain how a CIS investor might benefit from diversification? Questions could include asking about….
- the purpose of his investing
- how much money he'd like to invest
- if he needs the money in the shorter to medium term for any other expenditure
- his attitude to risk/ what risk he is prepared to take
- what timescale he is willing to invest for
- does he need income to be generated from the money

2. Benefits of diversification
- If an investor holds a diversified pool of investments in a portfolio, the risk of any single investment falling spectacularly can usually be offset by outperformance on the part of another investment held within the pool.
- The costs are reduced - if an individual investor wanted to invest in a diversified portfolio directly, they would have to pay investment costs/commission for each investment. If buying within a pool, the costs are reduced proportionally for each investment.
- An investor can invest in a wider range of sectors or a range of asset classes than if directly investing
- The investor will be able to access the investing skills of a fund manager

3. Disadvantages and risks.
- Fund managers will charge entry fees or initial charges to invest in their funds. They will also charge exit fees and annual management fees.
- Risks of CIS are the same as with all investments - there is no guarantee of investment performance or how the fund will perform in comparison with similar funds or benchmarks

Page 10
Active Management seeks to **outperform** a predetermined **benchmark** over a **specified** time period. It does this by using fundamental and technical analysis to assist in the **forecasting** of future events. These events may be **economic** or specific to a company. The analysis is used to make decisions on the portfolios holdings and the timings of **purchases** and **sales**.

Top Down investing is where the fund manager focuses on economic and industry **trends**, not the prospects of particular companies.

Bottom Up investing is where the fund manager focuses on an analysis of a company's net assets, future **profitability** and cash flow, and other company specific **indicators**.

Page 11
Growth Investing: Picking the shares of companies that present opportunities to grow significantly in the long term

Value Investing: Picking the shares of companies that are undervalued relative to their present and future profits or cash flows

Momentum Investing: Picking the shares of companies that present opportunities to grow significantly in the long term

Contrarian Investing: Picking the shares that are 'out of favour' and may have 'hidden' value. The opposite of momentum investing.

Answers

Page 12
Index Tracker funds -
- Construction of a portfolio to track or mimic the performance of a recognised index
- Assumes that securities markets are efficiently priced and cannot be consistently outperformed
- No attempt made to forecast future events or outperform the broader market

Advantages
- Relatively few active portfolio managers consistently outperform benchmark equity indices
- Fund's charges typically lower than actively managed funds
- Once set up, passive portfolios are generally less expensive to run than active portfolios, given a lower ratio of staff to funds managed and lower portfolio turnover

Disadvantages
- Performance is affected by the need to manage cash flows, rebalance the portfolio to replicate changes in index-constituent weightings and adjust the portfolio for stocks coming into, and falling out of, the index. This can lead to tracking error when performance does not match that of the underlying index
- Most indices reflect the effect of the value of dividends from constituent equities on the ex-dividend date
- Indexed portfolios may not meet all of an investor's objectives
- Indexed portfolios follow the index down in bear markets

Page 13
1. This is where a large part of the portfolio is indexed (the core) so as to minimise the risk of underperformance. The portfolio is then 'fine tuned' by investing the remainder in a number of specialist actively managed funds or individual securities (the satellite)
2. Smart beta funds don't just track and index but take into account other factors too, such as value or growth when creating an index that they will track. These funds are considered a mix of active and passive - active because it considers alternative factors.

Page 15
1. Classification allows investors to compare funds with similar objectives. Funds are classified into sectors which are aimed at the needs of the investor who has a desire to compare funds on a like-for-like basis. Sector classification provides groups of similar funds whose performance can be readily compared by an investor and their adviser.
2. The IA is the UK trade body for the UK authorised open ended funds industry.
3. The AIC is the UK trade body for the UK authorised closed ended companies (investment trusts).
4. The IA's classification system broadly categorises sectors into those designed to provide income and those designed to provide growth. The funds that don't easily fall under these headings are in other categories entitled capital protection, specialist fund, volatility-managed, absolute/target return and unclassified.
5. Each of the sectors will be made up of funds investing in similar asset categories, in the same stock market sectors or in the same geographical region.

Page 16
- UK Gilts - invest majority of assets in UK government securities (gilts)
- UK index linked Gilts - invest majority of assets in UK government index linked securities (index linked gilts)
- £ Corporate Bonds - invest in sterling-denominated (or hedged back to sterling) triple BBB-minus or above corporate bond securities (as measured by Standard & Poor's or equivalent agency). Excludes convertibles, preference shares and PIBS
- £ Strategic Bonds - invest in sterling denominated (or hedged back to sterling) fixed interest securities. Excludes convertibles, preference shares and PIBS.
- £ High Yield - invest in sterling denominated (or hedged back to sterling) fixed interest securities with at least 50% of assets in below BBB-minus fixed interest securities (as measured by Standard & Poor's or equivalent agency). Excludes convertibles, preference shares and PIBS.

Answers

Page 17

1. What was the aim of the regulations? To create a framework for cross-border sales of investment funds throughout the EU. This would allow an investment fund to be sold throughout the EU, subject to regulation by its home regulator, and would cut costs involved as well as improving customer choice and ensuring a level playing field through common standards of investor protection.
2. What are the implications for UCITS in the UK post Brexit? UK fund management firms are no longer able to establish a fund in the UK as a UCITS fund and then sell the fund across Europe. As a result, many UK fund management groups have set up subsidiaries in Luxembourg, Ireland and other countries. Additionally, EEA based funds encounter difficulties selling their funds within the UK.
3. How does the FCA intend to address this? The FCA intends to permit EEA UCITS funds to continue to be marketed to retail investors temporarily before requiring them to apply for recognition. As there are so many funds making individual recognition difficult, HM Treasury has introduced an overseas fund regime to allow them to recognise another country's regime for funds to enable funds from those countries to access the UK market
4. Which funds can be set up under the 'non' UCITS (NURS) regulations? Funds that are deemed by the UK regulator to be suitable for retail investors, but do not meet the more prescriptive rules of the UCITS directive, can be set up under NURS regulations.

Page 21

A unit trust is a type of Collective Investment Scheme. The **trustee** is the legal owner is legal owner of the underlying assets and the **unit holders** are the **beneficial**. owners.

A unit trust can be either authorised or unauthorised.

Investors pay money into the trust in exchange for **units.**

The money is invested in a **diversified** portfolio of assets. If the portfolio increases in value the value of units will **increase**. If the portfolio falls in value, the units will **decrease** in value.

Unit trusts are **open**- ended. This means that the trust can grow as more investors buy into the fund, or shrink as investors sell units back to the fund. If investors sell units back to the fund, the units are either **cancelled** or **reissued** to new investors.

Page 22

The unit trust manager decides, within the rules of the trust and the various regulations, which investments to include in the trust to meet it's investment objectives. They will also decide what and when to buy and sell. The unit trust manager often delegates or outsources this decision making to a separate investment manager. The unit trust manager deals with investors who wants to buy or sell units, carries out the daily pricing of units, based on the NAV (net asset value) of the underlying constituents.

Every unit trust must appoint a trustee (legal owner). The trustee protects the interest of investors by monitoring the actions of the unit trust manager. Whenever new units are created for the trust, they are created by the trustee.

Page 27

An Open Ended Investment Company (OEIC) is also a type of Collective Investment Scheme (CIS).

OEICs are authorised by the **Financial Conduct Authority.** They are described as Investment Companies with **Variable Capital** (ICVSs) by the FCA.

An ICVC or OEIC commonly found in Western Europe is called a société d'investissement à capital variable (SICAV). They are typically set up in Luxembourg by asset management firms so that they can be distributed to investors across Europe or further afield.

OEICs are structured as **companies**, with the investors holding **shares**. They are legislated in a special way, and not under the Companies Acts.

Answers

The OEIC invests shareholder's money in a **diversified** pool of assets.

As suggested in the name, OEICs are **open** - ended. No share repurchase **restrictions** apply so they are able to create new shares and redeem exiting ones according to investor **demand**.

Page 28

1. When an OEIC is set up, which roles are appointed?
   Authorised Corporate Director (ACD) and a depository are appointed.
2. What are the responsibilities of the ACD?
   The ACD is responsible for the day to day management of the fund, including managing the investments, valuing and pricing the fund, and dealing with investors
3. Is the ACD able to delegate or outsource these responsibilities?
   Yes the responsibilities an be delegated to specialist their parties
4. Do these requirements differ from those of a manager of an authorised unit trust?
   No there are the same
5. What are the responsibilities of the depository?
   The depository is responsible for looking after the investments on behalf of the OEIC shareholders and oversees the activities of the ACD

Page 29
Similarities

- Both are forms of CISs
- Both are open ended funds
- Unit trust managers (in the case of unit trusts) and authorised corporate directors (ACDs, in the case of OEICs) are able to delegate/outsource investment decision making and both are subject to the same requirements
- Both invest in a diversified portfolio of assets

Differences

- The legal owner of the underlying assets in a unit trust is the trustee and the unit holders are beneficial owners. With OEICs, they are structured like companies, the investors own shares and an independent depository owns the investments (in a similar role to the trustee in the unit trust)
- Unit trusts can be authorised or unauthorised whereas OEICs are always authorised
- With unit trusts, investors pay money into the trust in exchange for units whereas for with OEICs investors pay money into the trust in exchange for shares

Page 31-32

- What are the prices for buying and selling units or shares in unit trusts or OEICs based on?
  - The value of the fund's underlying investments (the net asset value or NAV)
- Who sets the prices?
  - The authorised fund manager is given the flexibility to quote prices
- What is single pricing?
  - The use of the mid-market prices of the underlying assets to produce a single price
- What is dual pricing?
  - Involves using the market's bid and offer prices of the underlying assets to produce separate pricing for buying and selling of shares/units in the fund. All funds now have a choice of which pricing methodology they can use.
- What is a dilution levy?
  - When a fund is single priced, there is no ability to recoup dealing expenses and commissions within the spread. Where necessary, such costs are recouped by applying a dilution levy as a separate charge. The alternative is to swing the daily price to a dual-priced basis depending on the ratio of buyers and sellers on any day.
- The maximum price for new units in an unit trust is prescribed by which body?
  - The FCA
- How is the maximum price comprised under dual pricing?
  - Comprised by creation price (ie price the manager must pay to the trustee to create new units: the value of the underlying investment plus an allowance for dealing costs) plus the fund manager's initial charge
- Where can investors find the prices of most individual funds?
  - In the broadsheet newspapers, alongside the numbers and addresses of fund managers.

Answers

Page 33

- Investors can buy or sell units in a unit trust directly with the fund manager? **TRUE**
- Investors can buy or sell shares in a OEIC via a financial adviser? **TRUE**
- Investors can buy or sell shares in CISs via a platform or fund supermarket? **TRUE**
- There is an active secondary market or stock market for CIS units or shares? **FALSE**
- Investors or their advisers/ intermediaries can purchase secondary shares (ie not new shares) from the fund managers? **TRUE**
- Fund supermarkets offer online dealing for investors in authorised unit trusts and OEICs? **TRUE**
- Once a fund manager receives instructions that an investor wants to sell units or shares they have to settle the sale immediately and remit proceeds to the investor? **FALSE**. They have 4 days from receipt
- An investor has to give their instructions for sale in writing? **FALSE**. Managers can accept instruction via the internet or phone also

Page 34

- Which charges are made explicit to an investor in a CIS?
  - o The initial charge and the annual management charge (AMC) which is applied to cover the ongoing costs of the management and administration of the fund will be made explicit
- Which other costs and charges might managers of a fund make under the terms of their management agreements?
  - o Those incurred in the necessary management of the fund including brokers' commission for trades undertaken, legal and audit fees, fees for specialist taxation advice
- What might these other charges impact?
  - o The performance on the fund depending on the size of the charges
- What costs and charges are UCITS funds required to publish in their key investor information document?
  - o An ongoing charges figure (OCF) which includes all types of expenses such as the costs of the UCITS management company, the depositary, the custodian and any investment adviser as well as costs for outsourced services as well as registration fees, regulatory and audit fees and payments to legal and professional advisers. it does not include any initial or exit charges or any performance fees.
- What does a Total Expenses Ratio (TER) include?
  - o This consists of the AMC and other charges such as the fees paid to the trustee, depositary, custodian, auditors and registrar. It also includes any performance fees, although they may be shown in a separate field.

Page 36

- **Investment Trusts:**
  - o A company not a trust
  - o Invests in a diversified range of investments
- **Closed-ended:**
  - o Unlike authorised unit trust or OEIC, number of shares likely to remain fixed for many years
  - o Cash from primary issue of shares invested in a number of other investments, mainly shares of other companies
- **Split Capital:**
  - o Some investment companies have more than one type of share and if so they are known as split-capital investment trusts eg ordinary and preference shares
- **Preference Shares:**
  - o Can be issued on different terms and may for example be used as convertible preference shares that are convertible into ordinary shares, or as zero dividend preference (ZDP) shares which receive no dividend.
- **REITS: Real Estate Investment Trusts**
  - o Investment companies that pool investors' funds to invest in commercial and, possibly, residential property.
  - o Provide access to property returns without the previous disadvantage of double taxation

Answers

- REIT pays no tax on property income or capital gains on property disposals as long as 90% of that income (after expenses) is distributed to shareholders each year
  - The property income distributions are then taxed in the hands of the investor as if they had received the income directly from
- **Gearing:**
  - Unlike OEICs and authorised unit trusts, investment companies are allowed to borrow more money on a long term basis by taking out bank loans and/or issuing bonds
  - This enables a process called 'gearing' - where they are able to i invest the borrowed money in more stocks and shares
  - The greater the level of gearing used by an investment trust, the great the risk
- **Pricing:**
  - The pricing of shares in investment trusts are not necessarily the same as the value of the underlying investments but rather based on the price someone is prepared to pay for it (which is very different to unit trusts and OEICs)
  - Because the share price is driven by supply and demand, it may be above or below the NAV
  - When investment trust share prices are above the NAV it is said to be trading at a premium
  - When investment trust share prices are below the NAV it is said to be trading at a discount
- **LSE: London Stock Exchange**
  - Shares in investment trust companies are bought and sold on the LSE using the SETS trading system or via a retail service provider (RSP)

Page 37
Investment Trust companies generally trade at a discount to their NAV. The extent of the discount is calculated **daily** and shown in the business pages of newspapers.

The discount is a function of the **market's** view of the **quality** of the **management** of the investment portfolio and it's **choice** of underlying investments

A **smaller** discount (or even a premium) will be shown when investment trusts are nearing their **winding-up** or are about to undergo some corporate activity such as a **merger** or a takeover.

Some investment trusts have a **pre-determined** date at which the trust will be wound up and assets returned to shareholders

Example: ABC Investment Trust shares are trading at £2.30. The NAV per share is £2.00. ABC Investment Trust shares are trading at a **discount** which is 15% of the underlying **NAV**

Page 43
The statements that DO not apply are:
- ETFs do not pay dividends
- The spread between buying and selling prices are often substantial
- ETFs tend to trade at a discount to their NAV
- ETF share prices are influenced by supply and demand
- ETFs are actively managed funds
- ETFs shares are subject to stamp duty

Page 44
1B
2C
3A

Answers

Page 45
What is the advantage of this approach?

Responsibility for tracking the index performance is passed on to the swap provider ad costs are lower

What is the disadvantage of this approach?

The investor is exposed to counterparty risk (namely that the swap provider fails to meet their obligations).

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	Authorised Unit Trusts	OEICs	Investment Trusts including REITS	ETFs
Legal Structure	Trust	Company	Company	Company
Management	Authorised Manager (Company)	ACD	Board of Directors	Management company
Supervision	Trustee	Depository	Board of Directors	Depository
Open or closed ended	Open	Open	Closed	Open
Pricing	Single/dual-priced	Single/dual-priced	Supply/demand	NAV
Trading	Authorised Manager	ACD	Stock Market	Stock market

Page 51
- Structure: most hedge funds are unauthorised and therefore unregulated.
- Minimum Investment: most hedge funds require minimum investments in excess of £500,000, some exceed £1 million
- Investments: Due to the lack of regulation, hedge funds are able to invest in whatever assets they wish (subject to compliance with the restrictions in their constitutional documents and prospectus) As well as being able to take long and short positions in securities such as shares and bonds, some take positions in commodities and currencies.
- Investment Style: Generally the style of hedge funds is aimed at producing 'absolute returns' - positive returns regardless of the general direction of market movements
- Gearing: Many hedge funds can borrow funds and use derivatives to potentially enhance their returns
- Buying and selling: Hedge funds buy and sell investments from, borrow from ad often entrust the safekeeping of their assets to one main wholesale broker, called their prime broker
- Liquidity: to maximise the hedge fund manager's investment freedom, hedge funds usually impose an initial 'lock in period between 1-3 months before investors can sell on their investments
- Cost: hedge funds typically levy performance related fees which the investor pays if certain performance levels are achieved, otherwise paying a fee comparable to that charged by other growth funds. Performance fees can be substantial, with 20% or more of the new 'net new highs' also called the 'high water mark' being common.

Answers

Page 52

- All hedge funds are high risk FALSE
- Traditional absolute return hedge funds attempt to profit regardless of the general movements of the market TRUE
- Hedge funds reduce market risk by going both 'long' and 'short' on the same or similar financial assets TRUE
- Investors can gain access to hedge funds through funds of hedge funds TRUE
- Hedge funds do not tend to borrow funds (gearing) as a means to enhance returns FALSE

Page 54

- Private equity offers what sort of timescale of finance in return for an equity stake in potentially high-growth companies?
  - o Medium to long term finance
- A private equity firm usually profits through what type of return?
  - o Capital gain
- What is the main source of capital raised by private equity firms?
  - o Large investing institutions
- Name 4 ways a private equity firm will realise a gain?
  - o the private equity firm selling shares back to the management of the invested company
  - o the private equity firm selling the shares to another investor (eg another private equity firm)
  - o a trade sale (sale of copay shares to another firm)
  - o the company achieving a stock market listing
- How are private equity arrangements usually structured these days?
  - o As limited partnerships

Test your knowledge

1B. The Investment Association maintains a system for classifying funds
2C. Net Asset Value
3D. The depository
4A. A separate charge to recoup dealing expenses and commissions not accounted for in single priced unit trusts and OEICs
5D. Access to geographical markets which might otherwise be inaccessible
6B. Hedge Funds
7B. To be the legal owner of the fund assets
8C. Stamp duty of 0.5% is payable on purchases
9D. The Authorised Corporate Director
10A. ICVC
11C. They are open ended collective investment vehicles
12C. Indexation investing
13A. Only fund A can be marketed to the general public
14B. All funds have a choice of which pricing methodology they use, but whichever is chosen must be disclosed in the prospectus
15B. 4 days from receipt of instructions
16A. FCA
17D. Indexed portfolios follow the index down in bear markets
18B. The investment trust industry
19A. A core- satellite investment strategy
20D. Funds with the same investment manager
21D. To help HM Treasury recognise other country's funds' regimes
22A. The ACD
23D. Initial or Exit charges
24C. A focus on economic and industry trends
25D. Picking out of favour shares that may have hidden value