CHAPTER I

INTRODUCTION

1.1 Introduction to Unit Trusts

Many are attracted to the huge amounts paid out in the form of bonus units and dividends by Amanah Saham National (ASN) and Amanah Saham Bumiputra (ASB). One would be interested to know more about the unit trusts and its investment performances.

A unit trust company is an investment company that pools money from unit holders and invests in a diversified portfolio of investment. This may include cash, bond, deposits, shares, property and commodities.

The main benefit of investing in the unit trusts is diversification. Through diversification, the risk level can be reduced without jeopardizing the return.

By investing in the unit trusts, investors can access to a wider range of securities than they could on their own. This is simply because individual investor does not have sufficient financial resources to invest in a well diversified portfolio investment. He also does not have access to invest in certain investment instruments such as foreign stocks and money market instruments.

Another major benefit from investing in unit trusts is having a full time professional management team to manage the funds at low costs. This is because all the unit trust holders share the cost. An average investor does not have the time and information to manage the funds effectively. Furthermore, to obtain full benefit from the information, one should have the experience and knowledge to assess it.

One important feature in the unit trusts is the unit trust companies are obliged to repurchase units at the published bid price (applicable to open-ended unit trusts). This make investment liquid.

Trust Deed

Unit trusts managers cannot simply invest in anything they like. Furthermore, they cannot charge anything they like for their management services. They are bound by their unit trust's written constitution known as trust deeds, which is a unique feature of the unit trusts.

All unit trusts are monitored by trustees appointed under the trust deeds, whose job is to see that the managers abide by the deed. Trustees receive a fee for this service. Most of the trustees are affiliated to major banks or insurance companies.

The trustees hold the investments bought on behalf of the investors. As a safeguard for investors, unit trusts managers do not hold investments on their own. For the unit trusts, however, the trust deeds are formalized between the trustees and the management companies before the unit holders come into the picture. This does not allow much say to the unit holders who have to agree to the terms of the deed.

Regulations of unit trusts

The regulation of the unit trusts has now been vested to the Securities Commission ("SC") by the Parliament via the Security Commission Act 1993 ("SCA"). The law, however, is not satisfactory because the provisions regulating the unit trusts were already in existence before the passing of the SCA. They are contained in the Company Act 1965 ("CA"). When the SCA was passed, the Parliament in fact prescribed a second regulatory framework without dismantling the first. This creates a natural tension between the office of the Registrar of Company ("ROC") and the SC. The cooperation between the ROC and the SC has been worked out via the introduction of the guidelines on Unit Trust Funds effecting in 1st March 1994. This was further improved in the Securities Commission Unit Trust Schemes Regulations 1996, entitled "Guidelines on Unit Trust Funds and the Trust Deed". The guidelines and trust deeds also outline the authorized investments and the rights and responsibilities of the unit holders.

1.2 History of Unit Trusts in Malaysia

A company called Malaysian Unit Trust Limited introduced the first unit trust in Malaysia in 1959. As such, Malaysia has only four decades of history in the unit trusts industry.

Prior to 1980, the unit trusts industry was growing very slowly in terms of the units sold due to a lack of public interest. In the 1970s, the Government wanted to mobilize national savings for the development of the nation instead of relying solely on the foreign funds. It made sense because there is no reason for us to mortgage a part of our future when we can finance it from our own pockets.

In 1981, this marked the entry of the Government participation in the unit trusts industry when it launched Amanah Saham National Berhad ("ASNB"). The Government is determined to make the national unit trusts schemes a success. The setting up of ASNB was aimed to achieve the 30% Bumiputra share of corporate ownership in the Malaysian economy by 1990. The Government-sponsored funds become dominance in unit trusts industry since then. It has a total net asset value of RM30.173 billion against the private funds of RM9.602 billion as of 31/8/1999.

Table 1.1 Unit Trust Funds In Malaysia
(As of 31st August 1999)

No. of management companies*	33
No. of approved funds	104
Total approved fund size*	68.401 billion units
Units in circulation	48.166 billion units
No. of accounts	8,811,815
Total net asset value (NAV) of funds	RM 39.775 billion
KLSE market capitalization	RM 514.42 billion
% of NAV to KLSE market capitalization	7.73%
Government-sponsored funds*:	
No. of approved funds	29
Units in circulation	34.167 billion units
NAV	RM 30.173 billion
Private funds*:	
No. of approved funds	75
Units in circulation	13.999 billion units
NAV	RM 9.602 billion

* Included funds approved but not launched yet

** Source: Securities Commission

After 1990, the unit trusts industry has been growing fast in term of the number of new management companies established, as well as the growth in funds under management. The introduction of Guidelines on Unit Trusts and the enactment of the Securities Commission Act 1993 brought about public confidence in the unit trusts industry. Furthermore, the awareness of the public about the unit trusts has increased tremendously through advertisements.

1.3 The Objective of the Research

The main objective of this research study is to evaluate the performance of unit trusts during one of the worst financial crisis in Malaysia history. It is interesting to find out how unit trusts in Malaysia have performed during the recessional market. This is to determine whether they have done better or even worse than the stock market. There were many studies done during the boom market, which showed that unit trusts could not outperform the stock market.

The performance of the unit trusts will be evaluated against a market proxy, i.e. Kuala Lumpur Stock Exchange Emas Index ("KLEI"). The ranking among the unit trusts will also be evaluated.

The research will also evaluate how the government-sponsored unit trusts performed as compared to the private funds. One might think that the former should performed better because they have many privileges to invest their funds such as the Initial Public Offerings (IPOs) for new shares. Other benefit includes transferring of profitable companies from the States to both Federal and State agencies.

Another finding from the research is to determine how the size of funds affects its investments performances. It will be beneficial to the industry to find out the answer as there is a general impression that smaller size funds will perform better. This is because there are some degree of investment in flexibility associated with large size funds. The need to purchase stocks in very large blocks that may take substantial amount of time, thus the investment opportunity are lost. In addition, these purchases may drive up the prices of the securities involved beyond the levels at which they were initially attractive. Likewise, decision to sell which may push down the prices when a large amount of shares are being sold.

A different view of this phenomenon, however, is that the large funds with substantial assets will spend a smaller portion of its income on securities analyses or alternately by spending the same proportion, a large fund may obtain better analyses than a smaller size fund. This study attempts to determine which of these effects influence the investment performances on the sample of the unit trusts.

Lastly, the research will also discuss whether the unit trusts adhere to their stated objectives. The conclusion will be based on the performances of the funds. Aggressive funds such as the growth funds should generate higher returns, along with higher risks as compared to the balanced funds or income funds.

1.4 Source of Data

The data is obtained from the following sources:-

i) Risk-free interest rate – Three-month Treasury Bill from Bank Negara Malaysia Monthly Statistical Bulletin, October, 1999, Bill P-66.

ii) Market rate of return – KLSE Emas Index from Metastock and The STAR newspaper.

iii) Monthly closing price of each individual unit trusts from the Federation of Malaysian Unit Trust Managers, respective unit trusts companies' reports and prospectus and The STAR newspaper.

iv) Analyses of other investment companies from the Edge magazines.

1.5 Limitation of the Research

The financial crisis affected Malaysia beginning July, 1997, after the devaluation of the Thai Bath. As such, the evaluation of the unit trusts performances during the crisis can only be carried out from 1st of July, 1997 up to the latest data available in the research, which is 30th of November,1999. In order to compare how the unit trusts companies have performed before the crisis and during the crisis, the same number of data is obtained before 1st of July, 1997. This is to ensure the compatibility of the comparison. As such, the research is divided into two sub-periods. The first one is from 1st of March, 1995 to 30th of June,1999 and the second is from 1st of July,1997 to 30th of November, 1999. One might argue that these periods of study are relatively short to properly evaluate the performances of portfolios.

Nevertheless, the advantage of carrying out the research from 1995 is that more companies can be included into the research. Supposing, the study were to carry out from 1992, only 39 unit trusts can be evaluated, against 53 unit trusts in the research. This makes the research findings more conclusive.

Another reason is that since there were many studies carried out in topics similar to this before 1995, interested readers can refer to the previous studies to know how the unit trusts have performed in the early years.

Although the research covers most of the unit trusts existed before the date of first data collected, i.e. 28th of February, 1995, the total number of companies evaluated is only about 50% of the total existed in the market at the time of research. This is because there are tremendous growth in the number of unit trusts lately as shown in Table 1.2. As such, one might argue that it is not appropriate to draw any general conclusion on the performances of the unit trusts industry as a whole. However, this is unavoidable, as in order to evaluate the performances of unit trusts, sufficient historical data is needed and the Malaysian unit trusts industry has a relatively short history.

Another limitation is that the evaluation is carried out based on monthly returns. Some might argue that this is not appropriate as the investments in unit trusts is long term, thus yearly returns are more appropriate. However, monthly returns were chosen due to several reasons. Firstly, the length of sub-period studied will give sufficient data to perform the analysis as compared to if yearly returns are used. Secondly, since the performance is evaluated against the share market return, stock market investors will be very interested to know the unit trusts monthly returns, as many of investors invest in short to middle term basis. This research will provide some indication whether to invest in stock market or unit trusts market, based on monthly basis. There were even some studies carried out on weekly basis (Koh and Koh,1987; Ariff, M., and Johnson, L.W, 1990).

Table 1.2 - Malaysian Unit Trust Industry Statistics

	1992	1993	1994	1995	1996	1997	1998	Aug. 1999
Number of Management Companies	13	16	20	27	30	31	32	33
Number of Approved Funds*	39	44	52	67	77	84	95	104
Units in Circulation (Billion Units)	14.356	17.029	25.121	31.937	38.983	45.035	46.539	48.166
Total NAV of Funds (Billion RM)	15.72	28.134	35.716	44.134	59.955	34.124	38.728	39.775
% NAV to KLSE Market Capitalization	6.36	4.54	7.02	7.8	7.43	9.07	10.34	7.73
Government-sponsored Funds:								
Number of Approved Funds*	19	20	24	26	27	27	28	29
Units in Circulation (Billion Units)	13.916	15.923	21.008	25.658	31.595	35.916	35.512	34.167
Total NAV of Funds (Billion RM)	15.334	26.699	31.678	38.506	52.888	28.612	32.325	30.173
Non-Government Funds:								
Number of Approved Funds*	20	24	28	41	50	57	67	75
Units in Circulation (Billion Units)	0.437	1.106	4.114	6.28	7.388	9.344	11.026	13.999
Total NAV of Funds (Billion RM)	0.386	1.435	4.038	5.828	7.067	4.96	6.403	9.602

* Includes funds that are approved but not yet launched

Source : Securities Commission

1.6 Organisation of the report

This report consists of four chapters. Chapter 1 provides an introduction to the characteristics of unit trusts. Historical background on the evolution of unit trusts in Malaysia is then discussed, followed by the objective of the research, sources of data and limitation of the research.

Chapter 2 discusses about Data and Methodology. It begins with an introduction on the concept of measuring portfolio performances. Then a brief discussion on empirical studies done in Europe, United States , Singapore and Malaysia. More emphasis will be put on studies done in Malaysia. This provides an idea on how the unit trusts performed in the past. Methods of measurement of returns are then discussed, followed by a discussion on the measurement of risk.

Chapter 3 provides the results of finding. It begins with a comparison of performances of unit trusts before and after the financial crisis. Then it evaluates the performances of the Government-sponsored against the private funds. The performances of unit trusts by size will then be evaluated. Lastly, the unit trusts will be evaluated as to whether they have adhered to their stated objective based on risks and returns.

Chapter 4 lists the general conclusion of the findings and the implication of the research. Lastly, suggestions and recommendations for future research are discussed.