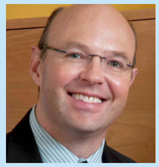
previously published in 2004 in
Calculated Statements,
The Business Journal



Nigel Roberts, MBA, CFA **is the president of Bluenose Investment Management Inc.** Bluenose provides comprehensive investment counselling and portfolio management services to individuals and institutions. For other articles visit **www.bimi.ca**
To contact Nigel, call 250-548-3232 or email: nroberts@bimi.ca

Classifying Mutual Funds

A MUTUAL FUND is a pool of money that has been entrusted to an investment manager to invest under a stated investment mandate. Mutual fund investors that understand how their money is being invested can roughly determine their personal asset allocation, or how much of their money is invested in equity, fixed income and cash. This information is important because it can be used to calculate expected investment returns and is an indicator of how much risk is being taken in their portfolio.

With the thousands of mutual funds currently available, it can be confusing trying to interpret the mandate of a particular fund based only on its name. There are, however, some key words that are often used that can provide clues for making an educated guess.

CASH — Money Market funds are the most conservative mutual funds and are considered cash because they invest in high quality short-term (less than 1 year) securities. Their unit price is constant, typically at $10.

FIXED INCOME FUNDS — Bond funds invest in the debt issues of governments and companies. Canadian bond funds invest in investment grade bonds with both short and long term maturity dates. Canadian short-term bond funds invest in investment grade bonds with an average maturity of typically no more than 5 years. These funds are less risky than a general bond fund and have relatively low risk. Short-term bond funds will perform better (worse) than general bond funds when interest rates are rising (falling). High yield bond funds have more risk because they invest in lower credit quality bonds with the goal of obtaining a higher return. Foreign bond funds invest in bonds that are denominated in a foreign currency and therefore expose the investor to exchange rates.

Mortgage funds primarily hold residential first mortgages that mature within 5 years. These are conservative funds that have investment characteristics that are similar to short-term bond funds.

EQUITY FUNDS — Equity funds are primarily invested in common equity shares (stocks). The objective of these funds is to earn a relatively high return and therefore generally have more risk than fixed income funds. These funds will often have other descriptors to identify a mandate in terms of a particular geographic region, sector or style. Canadian equity funds primarily invest in Canadian companies, international funds in companies outside both Canada and the US and global funds the Americas, Asia and Europe. Sector funds such as precious metals, financial services, healthcare, science and technology and resources invest only in companies in their particular sector. Sector funds are generally very volatile with periods of strong performance followed by periods of weak performance. Small capitalization funds invest in smaller companies that typically have higher growth rates and more volatile share prices. Large capitalization funds are usually more conservative because they invest in large companies most of which are well established and have a long track record.

Income trust and monthly high income funds are primarily invested in income trust units. These funds attract investors that want a regular income. These are high yielding equity funds that can have volatile price changes.

Dividend funds are typically invested in the common shares of dividend paying, blue chip Canadian companies. They are very similar to large capitalization Canadian equity funds.

OTHER DESCRIPTORS — Balanced funds invest in a combination of stocks, bonds and cash. The manager has discretion as to the exact allocation between the asset classes. Asset allocation funds are similar to balanced funds but the manager has more flexibility in the permitted weighting in each asset class. A balanced fund will typically always have some equity and fixed income investments, whereas an asset allocation fund could be 100% in cash one week and 100% in equity the following week. With both of these fund types it is hard to determine the asset allocation because of the flexibility granted to the manager. Many of these funds currently have an equity weighing of around 60% equity, 30% fixed income and 10% cash.

Asset allocation and balanced funds are attractive to investors that want to only hold one fund while having exposure to different asset classes in a mix that is done for them by a manager.

Growth and Income funds have investments in both equities and fixed income and therefore can be classified as asset allocation or balanced funds.

Index funds attempt to replicate the performance of a specific index such as the TSX composite or S&P 500.

There are other descriptors and fund types that are beyond the scope of this article. For more information the website **http://www.globefund.com** is a good resource for providing general information on mutual funds. It also contains a chart that shows the recent asset allocation for most funds.

To roughly calculate your own asset allocation, make a list of all the funds you own and then draw 3 columns labelled equity, fixed income and cash. Go down your list of funds one at a time, and using the guidelines above, write the dollar amount you have invested in the appropriate column(s). When you are finished, added up the columns and then divide the total for each column by the total value of your portfolio to obtain your percentage allocation to each asset class.

In my next column I will discuss asset allocation in further detail and how to interpret the results of your analysis.