

understanding investment funds

This 'principles of investment' factsheet looks at investment funds.

Topics covered include:

- what are investment funds?
- equity funds
- bond funds
- balanced funds
- specialist funds
- global funds
- emerging market funds
- risk and return
- charges

what are investment funds?

Building and maintaining a diversified portfolio of investments that spreads the risks of investing requires a great deal of effort and investment knowledge. The majority of investors lack the time or experience to give a portfolio the attention it demands. For such investors, investment funds, combined with the 'know-how' of a financial adviser can present a sound, individually tailored investment solution.

Stock market investing can be risky and we're constantly told not to put all our eggs in one basket. Investment funds

offer an investor the capability to achieve diversification across a range of investments by simply investing into one fund. Sometimes referred to as a Collective Investment Scheme, this fund, under the supervision of a fund manager, pools together money from many investors to collectively invest in a selection of stocks, bonds, properties or other financial instruments; thus ultimately providing a diversified investment. Of course, a portfolio can then be diversified further still by investing into many different investment funds that invest in different areas or in different types of investments.

Each collective fund has an objective outlining what it aims to achieve for its investors. This allows investors to choose funds that are appropriate to the level of risk they are prepared to take. The objective can be found on the fund factsheet or prospectus. It is the fund manager's job to create a portfolio that blends different types of shares, bonds and other financial instruments to achieve the objectives of the fund.

As with all investments of this nature, the most important thing to remember is that investment funds should be viewed as a long-term investment.

active or index funds?

Funds can differ in the way they are managed. Most funds are **actively managed** by a professional fund manager who decides which assets should be bought and sold, based on detailed research and monitoring of the stock market.

The alternative is an **index fund**, also known as a passive or a tracker fund. Technically, index funds do have managers - but their involvement is significantly reduced. They simply buy all the assets in a chosen index with the goal of matching its performance.

But what is an index? It's a group of stocks chosen to represent a certain market segment, for instance, the FTSE 100™ (an index of the share prices of the UK's 100 largest companies). Index funds do not attempt to outperform the equities market, they simply seek to come as close as possible to equalling it.

Your financial adviser will be able to recommend whether actively managed funds or index funds best suit your specific investment needs.

equity funds

Equity funds invest in diversified portfolio of shares of different companies and industries.

Depending on the investment strategy, some may only invest in large companies and some only in medium to small companies. There are also funds that will only invest in particular sectors, such as health and telecommunications - offering the investor a diversified investment into a particular favoured industry.

Every fund manager is different; however, there are three broad archetypes when it comes to investment strategies: **value**, **growth** and **blend**. (See the separate factsheet, 'understanding the equity market'.)

In general, value funds seek to discover cheap or undervalued shares. This may include shares that the fund manager believes are having short-term problems and are priced low relative to their earnings potential. Whilst there is potential for growth, there is also the risk that these 'undiscovered gems' will remain undiscovered.

Growth funds, on the other hand, as their name implies look for the fastest growing funds on the market. Growth stocks, per definition, are shares in companies that are growing faster than earnings on the broad market. Managers of growth funds are willing to take more risk to achieve above-average earnings momentum. If growth remains strong, these funds reap the benefits, however, as growth slows these funds are likely to fall the furthest. As the most volatile of the three investment styles, growth funds are for long-term investors with enough time to make up for short-term losses.

Some funds may be a mixture of both value and growth stocks ie a **blend fund**. In order to judge whether a fund is a good investment for your needs you need to examine the objective and make a judgement - your financial adviser will be able to help.

bond funds

In general terms bond funds invest in a diversified portfolio of fixed interest securities, for example, Government bonds and Corporate bonds. The securities within the fund will give the investor an income due to the coupons or interest paid out.

Funds that invest in Government bonds are generally considered to be less risky than funds that invest in Corporate bonds. However, rates are not guaranteed, they can still go up as well as down. (See the separate factsheet, 'understanding the bond market'.)

balanced funds

Balanced funds have the advantage of investing in a mixture of both equities and bonds. It would be common for a balanced fund to have the majority of the portfolio invested in a mixture of these assets, with the remainder held in other classes such as Property and Cash. However, this varies depending upon the objective of the fund.

It is important to be aware of the split between stocks and bonds, in order to fully understand the risks and rewards inherent within that fund.

specialist funds

Specialist funds give the investor the ability to invest in a specific sector of the economy for which they may have a preference. No matter which sector you are interested in investing in, chances are there is a fund that invests in it. Examples of sectors include: Health; Telecommunications; IT and Technology; Property; Natural Resources; etc.

global funds

Investment funds can also provide the investor with a geographically diverse portfolio investing in foreign company shares from all over the world.

A truly diverse portfolio should take full advantage of global diversification opportunities; the US market is still the largest and makes up more than half the world market. Europe makes up nearly 21% while the UK accounts for only 11% (according to MSCI World Index, May 2005).

If you do not have any specific preferences of countries or region to invest in, global funds are the easiest way of 'going global'.

the innate diversification qualities of investment funds, combined with the 'know-how' of a financial adviser can present a sound, individually tailored investment solution.

emerging market funds

An emerging market fund invests in less developed countries that might, potentially, have very high economic growth. Examples are Brazil, Malaysia, Russia, Taiwan and also larger economies like China.

This high growth potential may be due to a number of factors, such as political or structural changes in the country, for example: privatisation; liberalisation of trade or better access to capital. The main risks, on the other hand, are political instability and higher reliance on external capital. The financial markets in such countries can, therefore, fluctuate quite dramatically. For a private investor it can be difficult to keep track of what is happening within these markets.

risk and return

As with all investment, there is a degree of risk. Of course, investment funds can go down as well as up in value. It is important that the investor is comfortable with an investment fund's risk profile and susceptibility for short-term volatility.

So, once you have identified suitable investment funds for your risk profile - how will you be able to follow your investment?

measuring performance

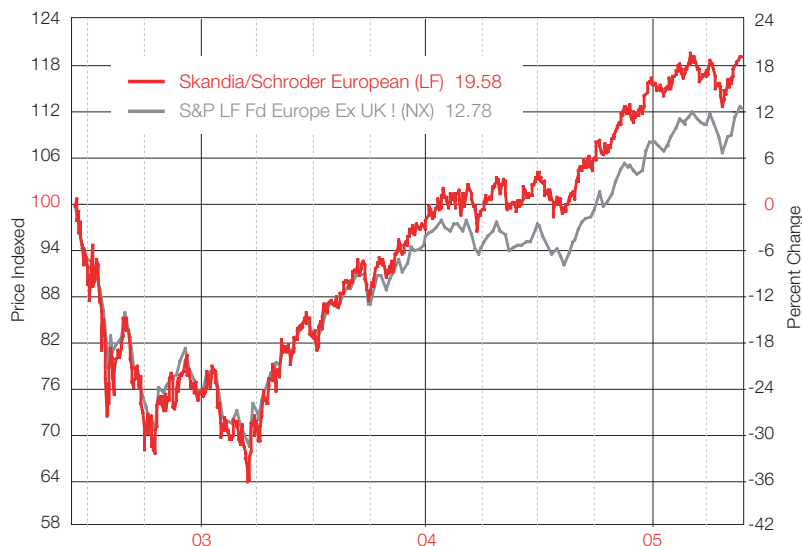
You can find fund performance figures in the financial press showing cumulative performance for one year or even up to 10 years. Your adviser will also be able to provide you with fund performance information.

performance figures

self select (investment)

Investment	1 Year	3 Year	5 Year	10 Year
Skandia Schroder European (LF)	19.58	12.78	12.78	12.78
S&P LF Fd Europe Ex UK (NX)	12.78	12.78	12.78	12.78

31 May 2002 To 31 May 2005, Bid-Bid, UK Basic Rate, Based In UK Sterling, Calculation Indexed



Off-bid uses actual prices. Currency-change uses bid-bid adjusted for current spread. The value of your units may go down as well as up. Past performance is not necessarily a guide to the future.

The performance of your investments will depend on when you invested. Again, this is something your financial adviser can help you with.

The performance of a fund is often compared with a benchmark index and/or with sector average performance. Sector averages denote the average performance of all funds within that particular sector. The graph to the left shows an example of a fund, the Skandia Schroder European fund, compared to its relevant sector, the Europe Ex UK over a three year period.

The performance and subsequent sector rank of a fund is an indicator of how good a fund is in comparison to funds with similar investment objectives, however, past performance is not a guide to future performance. Investing in funds is a long-term investment and it is, therefore, more important to look for funds and fund managers that consistently out-perform the sector average over a sustained period of time. Remember, a fund may outperform its sector, but if the sector average is negative, the actual return on the fund could also be negative.

In addition to analysing the performance, it is wise to consider how that performance was achieved and how much risk was taken to generate

the returns. There are a few measures that your adviser might use in assessing which fund is right for you in terms of risk. These are shown below.

risk measures

Standard Deviation – is a widely used risk measure. Generally speaking, it measures how far the performance of a fund deviates from its average performance over time. A high standard deviation indicates a greater fluctuation of the fund performance, indicating higher volatility.

Beta – another way of gauging the volatility of the fund is to measure how much it fluctuates in comparison with the overall market or its benchmark. A beta of less than one indicates lower risk than the market; a beta of more than one indicates higher risk than the market.

Alpha – is a measure of the return which is achieved, regardless of the market risk. An Alpha of 1.22 shows that the investment should rise by 22% in a riskless market.

charges

Professional management and diversification are two significant benefits gained by investing in investment funds, but you need to know how much it will cost you.

An investor typically pays a management fee for these services of between 0.5% and 2% a year. On top of this, they will also pay the fund's 'additional expenses' such as distribution fees and servicing costs. These two charges combine to

represent the total expense ratio (TER), which is taken from your funds' performance on a daily basis, rather than an annual charge.

There may also be a product charge if purchased within a life product.

so, what do you get with an investment fund?

Professional Fund Management, with the expertise, time and resources to manage your money.

Diversification. Investment funds can provide exposure to more stocks than can be practically accessed by an individual investor.

Liquidity. Like individual stocks, an investment fund can be converted into cash upon your request.

and finally...

There is no doubting that investment funds offer the potential for growth and a convenient way to diversify risk. However, with such a wide choice of funds available, all with varying performance, objectives and risk profiles - it's important to choose wisely.

To become adept at analysing investment funds and various fund manager strategies, you must have a broad understanding of how investment works.

Your financial adviser will be able to recommend investment funds that are suitable for your own needs and that best fit your specific risk profile.

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This factsheet sets out the basics of investment funds. It is not designed to be investment advice and should be not be interpreted as such. Other factors may need to be taken into account before making an investment decision. Your financial adviser will be able to offer you advice on this.

The value of investment funds may fall as well as rise. Past performance is not a guide to the future.

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

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