WHAT ARE FUNDS WITHOUT CAPITAL PROTECTION?

Most funds are **Undertakings for Collective Investments in Transferable Securities (UCITS)**. Each UCITS is effectively a separate company, and its goal is to collect the savings of a great many different investors in one big pot. For each fund, there are managers that invest the collected savings in accordance with predetermined strategies and conditions. The manager can invest in products such as shares (i.e. equities), bonds, derivatives, real estate etc. Often, investments are made in a mix of these products.

As soon as you have chosen a fund, you can buy **units or shares** in that fund. The price you pay depends upon the **net asset value**. If the fund ends the day with a closing value of €200 per share and you wish to invest €5000, then you will receive 25 units in that fund for that amount (not including costs).

If you invest in **distribution shares**, you will receive a dividend at regular intervals. In most cases, this is done annually, but there are also funds that pay out a dividend on a monthly basis, for example. The dividend consists of the revenues realised by the fund minus the costs incurred by the fund. The revenues can come from the products in which the fund invests: dividends from shares, interest from bonds, capital gains, etc.

The fund will pay out a dividend only if two conditions are fulfilled. First, the company must make a profit or have accumulated reserves; second, the management company must decide to pay out a dividend. If these two conditions not met, you will not receive any dividend.

If you choose for **capitalisation shares**, you will not receive any dividend. In that case, the fund uses its annual revenues for new investments. You receive the revenues, i.e. the capital gain, when you sell your units in the fund. The revenues are then reflected in the value of the fund.

Funds can also be divided into open and closed funds. An **open-ended fund** (investment fund with variable capital) is one where it is possible, within certain limits, to deposit money into the fund and take money out of it when you wish to do so. When you put money in, the fund buys new investment products with your money. When you take money out of the fund, the fund sells part of your investment products to cover the amount of your withdrawal.

A **closed fund** (investment fund with fixed capital) has a fixed number of units. It's more difficult to sell units in a closed fund. The fund rarely buys back its own units, which means that they must be sold to other investors on the exchange.

You can also realise a profit or a loss when you sell a unit in a fund. If you sell your unit for a higher price than the price at which you purchased it, you realise a **capital gain**. However, if you suffer a loss, you sustain a **capital loss**.

Features

Management company: the company that issues and manages funds.

Diversification: a fund invests in a variety of investment products to spread its risk over a range of products. If one product in the portfolio performs less well, the income from the other products will limit the loss if everything goes well. Funds are sometimes also referred to as bond funds, equity funds, etc., which is an indication of the products included in the fund. If a fund is referred to as a strategic fund, it indicates that the fund manager invests in line with a predetermined strategy.

Professional management: The fund in which you invest is managed by a manager. Within the framework of the predetermined strategy and conditions, he will actively manage the portfolio of the underlying investment products in order to optimise its return and adjust it to changing market conditions.

Dividend: if you invest in distribution shares, then you will receive dividends if the fund makes a profit.

Capital gain: just like a bond or a share, you can realise a capital gain if you sell your unit in the fund. For funds, we call it a capital gain if you sell your unit for a higher price than the price you bought it for. If you buy capitalisation shares, the capitalised profit is also referred to as a capital gain.

Term: some funds have a final maturity date. On that date, the fund ceases to exist. Everyone who has invested in the fund is paid back on the final maturity date. The exact amount paid depends upon the value of the investment products present in the fund on the final maturity date.

However, most funds do not have a final maturity date. In these funds, you can decide for yourself when it is best for you to put money in or take money out. It's a good idea for you to take the minimum recommended investment horizon into account. After a few days or weeks, you will then have the money you invested back again.

Currency: funds can be issued in a foreign currency.

Risks

Currency risk: a fund in a foreign currency constitutes a currency risk against the euro. Each time that you buy or sell a unit in the fund, your euros are converted into the foreign currency or vice versa. In other words, due to fluctuations in exchange rates, the amount in euros that you receive if you sell it may end up being less or more than the amount you originally invested.

Liquidity risk: 'liquidity' is an indication of how easy it is to buy or sell an investment product. The liquidity risk for funds is very small. In the case of open funds, the units are repurchased by the issuing institution. Units of a closed fund are traded on the exchange. The liquidity on the exchange differs from share to share.

Interest rate risk: changes in interest rates can have an indirect influence on the performance of a fund. This depends heavily on the products in which the fund is invested. Interest rate risk is higher for a bond fund than for an equity fund.

Capital risk: as there is no capital protection, you run the risk of receiving less than your original investment when your units are sold. However, this is much less likely to happen than if you, for example, invest in a single share.

Price volatility risk: we say that the unit price is volatile if it fluctuates greatly. The price volatility depends primarily on the products in which the fund invests and its investment strategy. Accordingly, an equity fund has a higher volatility risk than a bond fund.

Every fund is assigned a **risk score** of 1 to 7. This score gives an indication of the global risk of price fluctuations for the investment products in which the fund is invested.

The upward and downward price movements of the underlying investment products can have various causes: the exchange rates of foreign currencies, an increase or decrease in the interest rates, and of course also the stock market price trends. Funds with a high market risk are given a score of 6 or 7. Funds with a lower market risk are given a lower score. 1 or 2. This score is regularly updated.

Performance risk: this risk does not play a role if you invest in a capitalisation fund, as it does not pay out any dividends. But if you invest in a distribution fund, it is possible that the fund will not pay out any dividend, which means that you will receive less income than you expected.

Costs and taxes

If you buy or sell units in a fund, you should also take into account the costs and taxes that you need to pay. After all, these will influence the return on your fund units.

COSTS

Custody fee: most banks charge fees for holding your units in a custody account.

Current costs: the current costs include the expenses of the management committee and the performance committee. You do not have to pay these costs when buying units in the fund: they are deducted annually from the return realised.

Entry and redemption fees: entry fees (commission) are one-off costs that you incur when buying units of a fund. They are usually expressed as a percentage of the capital that you invest. If you buy €15,000 worth of units in a fund and the entry fees amount to 3%, then your banker or financial intermediary will deduct €450 from the amount you invested. You do not pay any redemption fees when you sell your units.

TAXES

Tax on stock exchange transactions (TOB): For most funds, you must pay a tax on exchange transactions if you sell your units in the fund. As your banker or financial intermediary in which situations you must pay a tax on exchange transactions.

Withholding tax on dividends: You have to pay a tax on the dividends from distribution shares: withholding tax.

Withholding tax on capital gains: the capital gain on funds that are invested for more than 25% in debt-claims (such as bonds) are also subject to withholding tax.

Would you like to know more about funds?

Read our *Information brochure on financial instruments* at www.bnpparibasfortis.be. Some sections of this document were taken from www.wikifin.be.

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