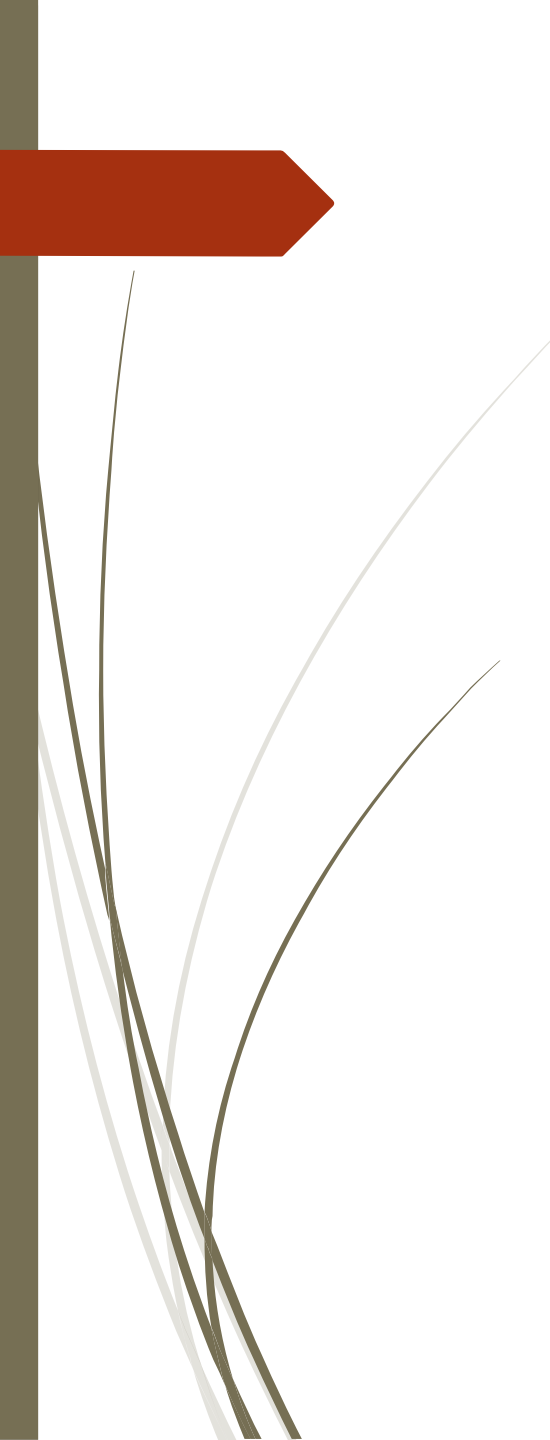




How to Choose Fund

By Xu Zhao, CFA, CIPM



Investment horizon and your risk profile

- ▢ Long term - more than 5 years; pension, children's education or for your grandchildren: Free money, higher risk tolerance, higher expected returns, more asset classes to choose
- ▢ Short term - 1 to 5 years; save money for housing or other purposes you have planned: Free money, lower risk tolerance, lower expected returns, less asset classes to choose
- ▢ Speculation - day trader; risk tolerance = expected loss that you still can sleep sound without any concerns



Asset Classes (risk and return)

- ▢ Traditional (high liquidity and cheaper to invest in)
 - ▢ Equity, equity funds (currency hedged or unhedged)
 - ▢ Bond, bond funds (Investment grade and high yield)
 - ▢ ETF (exchange traded fund)
 - ▢ Balanced (a combination of equity and bond funds the manager chooses and rebalances for you according to their market views)
- ▢ Alternative (might be low liquidity and expensive to invest in)
 - ▢ Hedge fund (market neutral, macro, etc.)
 - ▢ Real estate (not direct investment in houses)
 - ▢ Private equity (broad aspect of funds)
 - ▢ Direct lending
 - ▢ etc.



Investment styles

- ▢ Passive:
 - ▢ Pure Index funds: cheapest (0.1% + management fee)
- ▢ Quantitative: cheaper (around 0.3-0.5% + management fee)
 - ▢ Smart indexing by using factors
 - ▢ Algorithmic or factor models: buy and sales followed by rules
- ▢ Active: expensive (>1.5% + management fee + performance fees)
 - ▢ Do company research and stock picking by either bottom up or top down



Risk adjusted return

- ▮ Return: absolute, or relative to a benchmark
- ▮ Risk: volatility, tracking error
- ▮ Sharp ratio: the higher the better
 - ▮ $(\text{expected return} - \text{risk free interest rate}) / \text{volatility}$
- ▮ Information ratio: the higher the better
 - ▮ $(\text{expected return of fund} - \text{expected return of BM}) / \text{tracing error}$
- ▮ Keep in mind: historical returns are not guarantee for expected future returns. Underperformed funds might perform better in the future and vice versa



Where to find funds

- Morningstar.com
- Nordea.no (have some reports available)
- Nordnet.no
- Netfund.no
- Keep in mind your portfolio should be diversified (not concentrated)
 - Mix of index funds and active funds
 - Region balanced
 - Sector balanced
 - Some hedge fund



What to look first when you select funds

- Watch a video
 - https://members.morningstar.com/Register/PortfolioPHX?referid=A3657&HID=MKT_PFL100&vUrl=
- Historical returns, sharp ratio, information ratio and Morningstar stars
- Investment style, currency hedging
- Management team
- Costs (only fixed fees or any performance based fees?)
- Region and sector