

The Suitability of Investment Trust Funds for Individual Investors

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Recently, interest in investment trust funds (also known as mutual funds) has grown as an attractive investment vehicle for individual investors. The environment surrounding these funds is constantly changing as a result of the Financial Big Bang. This paper examines the characteristics and advantages of these funds from the perspective of individual investors, and considers criteria in choosing the right fund for investment.

1. Investment Trust Funds and the Big Bang

Japanese investment trust funds, like their European and American counterparts, are primarily aimed at small to medium institutional investors and individual investors. Due to their limited research capabilities and relatively small holdings, individual investors have difficulty achieving adequate risk diversification. By collectively investing the funds of individual investors, investment trust funds offer professional asset management expertise and risk diversification.

In the past, investment trust fund sales involved a repetitive pattern of encouraging customers to buy into a new fund, then later having them redeem the shares and buy into the next new fund. This practice of churning accounts—obviously for generating sales commissions—eventually causes the fund to diminish in size. The smaller size restricts the fund's management and thus hurts performance. Bitter experiences from this pattern have caused many individual investors to shy away from investment trust funds.

The Financial Big Bang is expected to increase competition in financial markets. Presently, the number of new investment trust fund companies is rising, offering a growing number and range of products and funds. Moreover, sales channels are proliferating in number and diversity as non-securities companies such as banks and life insurers begin selling funds directly. This competition is expected to stimulate demand for better products and services, forcing suppliers to improve their offerings. As a result, we should see questionable practices such as churning disappear and commissions drop. Recently, in fact, no-load funds have begun appearing in Japan.