

Picking the right manager is key

As more investor cash flows in, the choice of asset manager becomes critical

Gareth Stokes

Asset managers have a tough job. In order to secure investors' cash they have to consistently outperform their chosen benchmarks and industry peers. The pressure to generate market-beating returns has escalated in recent years due to the unprecedented volatility of global markets. And the gap between the best and worst long-term performers is widening by the day. "In a world where investors are forced to take responsibility for their own financial wellbeing in retirement, such divergences represent an opportunity cost that can no longer be ignored," says Coronation Fund Managers head of personal investments, Pieter Koekemoer.

To illustrate his point he considered the five-year performance of 36 of South Africa's so-called balanced funds, to 31 December 2010. The 'gap' between the best and worst performing manager (as measured by individual fund performance) was a staggering 11.6% per annum.

This represents a difference of more than R800 in additional capital per R1 000 invested at the beginning of this five year period. "This proves how important choosing a fund manager has become," says Koekemoer. "Investors and their advisers must conduct a thorough due diligence exercise before selecting a fund manager and deciding on which investment mandate best meets their needs."

Private investors keen on entering the domestic unit trust space face a dizzying array of investment choice.

Even if we ignore the market volatility mentioned in the opening paragraphs, the investors have approximately 934 unit trust funds from which to select.

Critical decisions include which asset class meets the investors' specific risk/return requirements and

which asset manager offers the best solution for that asset class. And that's why the average Jane investor 'buys' unit trusts with assistance from a trusted financial adviser.

The financial adviser, in turn, has to place his trust in the asset or fund manager in charge of each fund. How should they pick the cream from the available product universe?

"Given the market volatility, it is difficult to suggest guidelines that might help retail investors select an appropriate fund manager," says Miranda van Rensburg of Absa Multi Management. "But generally, the current situation highlights the value of strong asset allocation skills – an investment manager capable of getting the right mix of equities, bonds, cash and property."

Once this strength is confirmed you will want to stick with asset managers with a strong stock-picking ability, those who commit to fundamental research can work wonders with a portfolio. Koekemoer reckons there are three points to consider when selecting an asset manager to invest your capital.

The first step is to assess a particular asset manager's long-term performance. Various market commentators define the concept differently, but for such an assessment a five to 10-year period is an adequate time frame.

Why five to 10-years? The reason is unit trust companies tend to trumpet their short-term performances, thereby luring unsuspecting investors into their products based on 'once off' performances. "Unit trust

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performance surveys, industry awards and the financial press tend to emphasise performance over the preceding one to three years," says Koekemoer. Investor flows mimic this performance. Coronation Fund Managers says more than half of the flows into their unit trusts are motivated by the preceding 12-month performance.

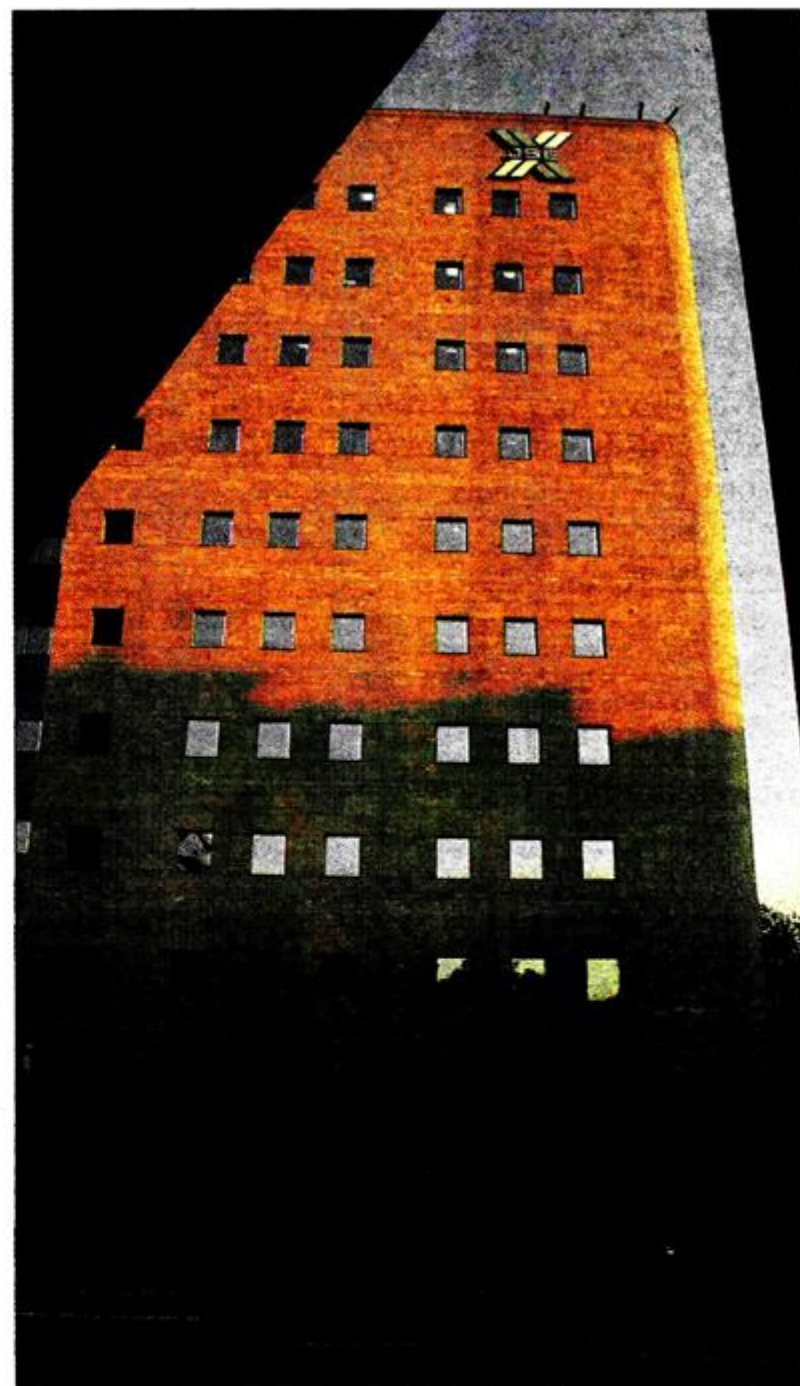
Unfortunately short-term performance is not a true measure of skill. All managers have good and bad years. Thus a one-year return is incontrovertibly random, while it is statistically unlikely that an asset manager will not have at least one good year in a five-year period. You have to assess performance over meaningful periods of five or 10-years to single out the handful of asset managers who deliver consistently.

The second important step is to have realistic expectations of what a fund manager can deliver. It makes little sense to expect or demand a 20%-plus return from an equity fund when the market is only delivering 15%.

It makes even less sense to expect a conservatively positioned Asset Allocation fund to outperform an aggressive equity-only fund. And you cannot expect a given fund to repeat its latest 12-month return.

It is for good reason that unit trusts disclaim that past performance cannot be used to gauge future performance. "The past decade has been an outlier for all the major domestic asset classes," observes Koekemoer. South African investors achieved real returns regardless of whether they invested in bonds, cash equities or listed property. Not even a shocking 2008 performance (from equities) could unseat the long-term averages.

Future return expectations should be tempered because you cannot bank on a similar performance from domestic asset classes over the next decade. Coronation Asset Managers expects muted returns from all domestic asset classes over the next decade. Investors will have to moderate their expectations and ensure that they are aligned with what can



The past decade has been an anomaly for investments . Photo: Ayanda Sitole

reasonably be expected given the risk budget deployed by their chosen funds.

The third requirement is to stick with your chosen asset manager. It is a rule investors must learn early in the game. You cannot afford to chop and change each time your chosen fund performs poorly.

The costs of selling one investment and buying into another outweigh the benefits of remaining invested with a carefully selected fund. "Any long-term manager with a good track record will inevitably experience many challenging years," says Koekemoer.

The odd bad year comes with the territory. Investors must remember that poor performances could relate to a particular fund positioning in

undervalued opportunities, as presented by the market.

Instead of taking corrective action by switching managers during periods of underperformance, Koekemoer believes investors should stick to their guns and remain invested with a manager for the long term, to benefit from wealth-creating opportunities.

The pressure to chop and change mounts for the 'all eggs in one basket' type investor. "Investors who are overexposed to a single manager will be under tremendous pressure to switch to a different manager during periods of underperformance," says Koekemoer. "An investor's portfolio should never have more than 30% of the available capital allocated to a single manager."