



## TOTAL EXPENSE RATIOS AND UNIT TRUST INVESTMENT PERFORMANCE – THE SOUTH AFRICAN EXPERIENCE

By Mike Brown, Managing Director, etfSA.co.za

12 November 2010

High cost investment products, which in the case of unit trusts, will often comprise funds with performance fees or multi-tiered layers of asset managers (funds of funds), do not necessarily guarantee better investment performance. In fact, the opposite appears to be the case.

A study by Daniel Wessels, DRW Investment Research, "Total Expense Ratios and Fund Performances – A Work-in-Progress Report" (November 2010), which is attached, studies the relationship between the cost of equity based South African unit trusts and their investment returns, over the period 2007-2009.

It found that the most expensive amongst the 71 unit trust funds surveyed, had average total investment returns significantly lower than the least expensive funds. Furthermore, the lowest cost funds had a significantly higher average return (21,35%) than the average of the overall survey (14,89%). The table below summarises the empirical findings.

Equity Funds Ranked TER (2007-2009)		
Funds	Average TER	Total Return (%)
5 Most Expensive Funds	2,97	10,88
10 Most Expensive Funds	2,65	15,67
Overall Average	1,59	14,89
10 cheapest Funds	0,92	19,19
5 Cheapest Funds	0,72	21,35
Source: DRW Investment Research (November 2010)		

Wessels makes the following conclusion from his study:

*"Investors will do well to avoid the most expensive funds; simply because their actual performances do not justify the higher fees. Investors should rather, all else being equal, invest in low-cost funds and therefore stand a better chance of improving their returns.*

*From the analysis it is clear that the most expensive funds cannot claim a performance edge or superior skill. Likewise, the low-cost funds cannot be accused of inferior performances, investment processes and strategies. In fact, the evidence thus far points in the opposite direction!"*

Wessels also finds that multi manager funds (including fund of funds and broker funds) typically fall into the higher cost bracket and do not necessarily justify their higher fee, when compared with single manager funds, which would typically include passively managed funds.

Ranked Management (2007-2009)		
Funds	Average TER	Total Return (%)
Single manager	1,47	15,83
Multi-manager or FoF	2,27	9,75

The Wessels study on the relationship between costs and performance was inspired by a recent research report by Russell Kinnel, Director of Mutual Fund Research at Morningstar Inc Research in the US, which reached similar conclusions that the cheapest cost mutual fund products typically produced higher returns than the most expensive products. The Kennel Research Report and its findings were published on the etfSA website "Industry Insider Identifies Low Costs as the Best Predictor of a Fund's Performance" on 20<sup>th</sup> August 2010 and can be sourced in the News Archives on our site [www.etfsa.co.za](http://www.etfsa.co.za).

The Wessels study is for a relatively short term period – brought about by the fact that Total Expense Ratios as a common measurement of fund management cost were only introduced in 2007 in South Africa – but does appear to provide the same conclusions that were reached by Kinnel for US Mutual Funds. Costs do matter and low cost products, such as ETFs and passively managed unit trusts, appear to provide better performance, on average, than high cost products, particularly where multi-managers are involved.

---

**Terms and conditions:** Redistribution, reproduction, the resale or transmission to any third party of the contents of this article and this website, whether by email, newsletter, internet or website, is only possible with the written permission of etfSA. etfSA, its sponsors, administrators, contributors and product providers disclaim any liability for any loss, damage, or expense that might occur from the use of or reliance on the data and services provided through this website.