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How Many Actively-Managed Unit Trusts Can Outperform The Index?

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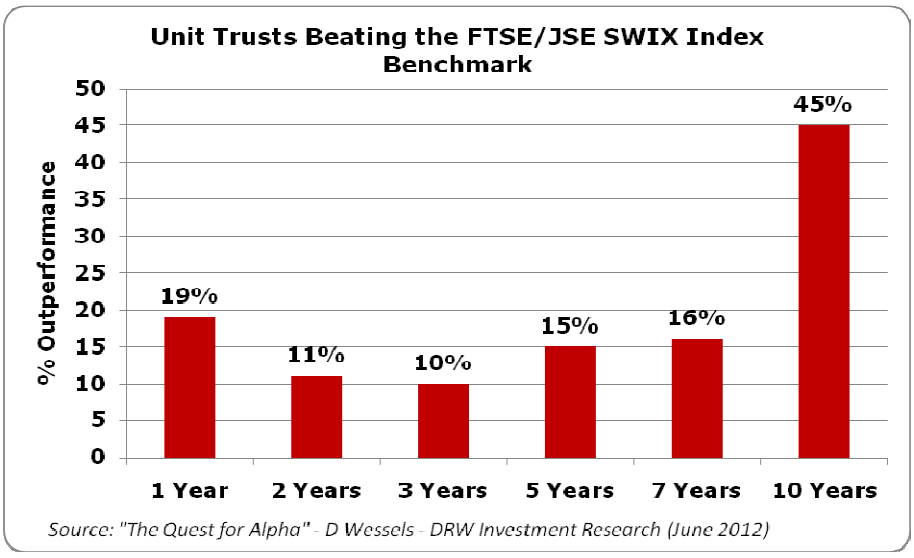
A recent Research Report, compiled by Daniel Wessels an independent financial adviser, called "The Quest for Alpha", finds that an average 20% or less of actively managed Unit Trusts were able to beat the FTSE/JSE SWIX index over periods ranging from 1 year to 7 years. These findings are shown graphically below.



These findings by Daniel Wessels appear to belie the claims by active managers that they invariably provide superior investment performance to the market average. In fact, the great majority of active managers, included in the Survey by Mr Wessels, are unable to beat a representative equity market performance benchmark. The full table from Mr Wessels' Performance Survey is shown below.

Percentage of Actively Managed Unit Trusts Outperforming Benchmark Indices

	1-year	2-year	3-year	5-year	7-year	10-year
Number of funds	99	92	89	73	55	44
Best performing fund	22,0%	22,8%	23,3%	11,0%	19,3%	22,0%
Worst performing fund	-0,5%	6,9%	8,5%	-2,4%	9,9%	13,4%
Top quartile	11,9%	16,8%	18,1%	6,6%	16,1%	19,2%
Median	9,4%	14,8%	16,7%	5,5%	14,5%	17,2%
Bottom quartile	6,2%	12,6%	14,8%	4,2%	13,3%	15,7%
Average	9,5%	14,9%	16,5%	5,4%	14,9%	17,3%
Benchmark: ALSI	9,2%	16,7%	18,4%	6,5%	16,4%	15,5%
% Funds outperforming ALSI	**51%**	**26%**	**22%**	**27%**	**22%**	**77%**
Benchmark: SWIX	13,3%	18,7%	19,6%	7,8%	17,0%	17,4%
% Funds outperforming SWIX	**19%**	**11%**	**10%**	**15%**	**16%**	**45%**

Notes:

1) Unit Trust funds surveyed includes all General, Value and Growth equity funds, plus the Coronation Top 20 Equity Fund. Total returns (with dividends reinvested).

2) Only actively-managed Unit Trust funds included. Index tracking Unit Trusts are excluded.

3) No "survivorship bias" is taken into account. By excluding such terminated funds, the longer term average performance of surviving funds is enhanced. For instance, over a 10 year period, about 50% of Unit Trusts will typically shut down. If this factor is taken into account the 10 year performance of actively managed funds would probably fall to the performance percentages for shorter time periods.

4) Data is collected from Morningstar Fund Performance Database for the period ended 30 June 2012.

5) Source: "The Quest for Alpha" – D Wessels – DRW Investment Research (June 2012).

I have the following comment on Mr Wessels findings.

- The **large variance** between the top and worst performing funds over most time periods indicates significant divergence in the views and performance of active fund managers. This wide performance differentiation adds additional risk for retail investors who have to choose between the large number of funds available, which offer wide variations in performance.

- The **average returns** for the actively managed unit trusts typically fall below the returns of the benchmark indices. Accordingly, the retail investor would, on average, enjoy a better performance return by simply buying an index tracking ETF or Unit Trust, which reflects the benchmark return.

- Active managers have a better record of beating the total returns of the **All Share index**, rather than the **SWIX index**. However, the ALSI index, which consists of 160 shares, many of them illiquid and with significant bid/offer spreads, is not a replicable benchmark for index tracking purposes. The SWIX index, which consists of only large capitalisation shares allocated by the shareholder adjusted method, which excludes any local shares held on foreign registers, is far more representative of the market performance replicable for local investors.

- The failure by a significantly large percentage of fund managers to beat the index, can probably be attributed to:
    - the South African equity market is **relatively efficient**, i.e. all price information is already in the price of the major shares in the market, leaving little room for active managers to identify undervalued or mispriced stocks; and
    - the **universe of investible stocks**, with sufficient liquidity to accommodate active tracking strategies, is relatively small and such stocks are mostly already included in the index.

- The evidence continues to mount that the average South African investor would enjoy superior performance and less risk by investing in a low cost index tracking ETF, rather than searching for the elusive active manager who can consistently outperform the average return of the market, i.e. the index or benchmark. The quest for alpha, i.e. above average investment performance, is indeed a lesson in frustration for many retail investors, as most professional asset managers fail to provide consistent returns above the market average.

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