

See all 'Economy' articles

## Why many fund managers aren't worth the fees you pay: Boyd

Friday 31 July 2009 11:41

Tony Boyd



Another title bout in a series of contests to find out whether index funds are better than active equities managers was held in Sydney today and it turned out to be a fizzer.

Crispin Murray, head of equities at BT Investment Management, was knocked out before he got in the ring. That left Roger McIntosh from index manager Vanguard Investments able to raise his arms in victory.

Murray was hit by a haymaker from stockmarket index provider Standard & Poor's, which released its inaugural index versus active funds scorecard for Australia.

The S&P study, called SPIVA, found that 66% of Australian equity funds could not beat the S&P/ASX 200 index over five years.

The percentage of active funds outperformed by the index was 56% over three years and 50% in the year to date.

The SPIVA report should be a catalyst to shake Australian retail investors out of their complacency and rethink investments in poor performing actively managed equity funds.

It is the second time in a few weeks that retail investors have been reminded to ask themselves if they are in the right fund. The Australian Prudential Regulation Authority earlier this month questioned whether active managers were adding value.

Considering an active retail equity fund has fees of about 1.8% and an index fund has fees of about 0.9%, investors have little reason to remain complacent.

Australia has more active equity funds on offer per head of population than anywhere else in the world, according to the author of the report, Simon Karaban, who is director of research for S&P's index services.

There are clearly too many fund managers not adding value but charging good money for it.

The SPIVA report is unique in that it makes a survivorship bias correction and it also shows both equal and asset weighted averages.

Correcting for survivorship bias means that actively managed equity funds that are liquidated or merged during the performance measurement period are included up until the time they close. If the closure occurs during the measurement period, they are considered to have failed.

This is an important inclusion because it means that investors are getting a true picture of the active managers offering services at the time when the investment decision is made.

Most reports purporting to show active fund performance start off with the funds in the category at the end of the period and then take the average of the historical returns.

Asset weighted returns are important because they show the returns of the average invested dollar. It removes the bias in equal weighting, which results in returns of a \$10 billion fund affecting the average in the same manner as a \$10 million fund.

Equal and asset weighted average returns for Australian general equity funds showed that the active funds lagged the index returns over the past five years.

Over five years the index returned 6.86% but the equal weighted peer group was 6.21%. The asset weighted return over five years for the index was 6.86% and the active funds were 6.31%.

The only redeeming feature for active Australian equity managers was that over a one year period, 70% of active managers beat the index.

The report, which can be found **here in PDF format**, will be released half yearly.

It draws on data from research house Morningstar. S&P refuses to reveal its raw data as this might be seen as a recommendation for particular funds.

However, it is no secret that Kerr Neilsen's Platinum Asset Management is the reason why the asset weighted peer group returns for international equity managers were significantly better than the index over the past five years.

The MSCI World Ex-Australian index fell -2.63% over five years while the asset weighted active managers rose 0.46%.

Over the five year period, about 76% of active international equity managers were outperformed by the index.

The debate between Murray and McIntosh concluded with agreement on at least one thing. The Australian market is a hard place for the 150 active equity managers to operate in because the market is efficient and heavily researched with the top 20 stocks comprising 67% of the index.

This article first appeared on ***Business Spectator***.

**Read more on:**

- Economy
- Investing
- BT Investment Management
- Crispin Murray
- Vanguard Investments