A Snapshot Analysis of Unit Trust Performances:
The Big Winners and Small Losers in the Equity and Asset Allocation Categories

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May 2009

Prelude

It is said that Bill Clinton won the 1992 U.S. presidential election because his campaign strategy was built around reviving the U.S. economy which was then in the grips of an economic recession. His presidential campaign coined the phrase: "*It's the economy, stupid*". Clinton understood what mattered most to the voting public at the time were "bread and butter" issues and that he was a better choice than George Bush to fix the economy going forward.

What matters most for investors are returns, especially those that are persistent over longer holding periods. Glossy fact sheets and smart marketing campaigns are helpful, but of lesser importance. Simply, why are some unit trust funds attracting the bulk of the inflows (new investments) at any given point in time while others are dwindling in size or gradually fading into obscurity? Is it only because of nice advertisements or smart marketers? No, *it's the performance, stupid*!

1. Objectives

The purpose of the study is to identify the major trends in unit trust (collective investment) performance data, more specifically focusing on equity and asset allocation funds. A number of performance criteria were evaluated in this study; for example: How do *average* fund performances compare with *weighted average* and *median* performances? How do the funds perform against appropriate *benchmarks*? Are *single manager* funds doing better than their *multi-manager* peers? Are *well-known* branded funds performing better than the *lesser-known* brands? Are *larger size* funds achieving better results than *small-sized* funds?

2. Methodology

Performance data and fund information were collected from *Morningstar* for the period ended 31 March 2009. Only equity and asset allocation fund categories were considered in the analysis, since these categories represent arguably the major long-term holdings for most investors.

Different review periods were considered from the *Morningstar* data, namely 3-year, 5-year, 7-year and 10-year holding periods, where applicable. In all instances, total returns (capital growth and dividends re-invested) were used to compare the different evaluation criteria.

The following terminology is used throughout the report with a brief explanation of each concept:

Weighted average fund performance is different from the *arithmetic average* in that fund size (as at 31 March 2009) is used to determine a relative weighting allocated to the performance of each fund in a category. The larger a fund, the more weight that fund's performance will contribute towards the category's average. Arguably, it may represent a better indication of the average fund performance experienced by all investors.

Median performance is the midpoint where 50% of all fund performances are better or worse.

Top quartile performance refers to the point where 75% of all fund performances are below; similarly, *bottom quartile* indicates where 75% of all fund performances are better.

The *ALSI* and *SWIX* benchmarks refer to the FTSE/JSE All Share Index and FTSE/JSE Shareholder Weighted Index, respectively. In the latter index dual-listed shares are down-weighted in the index (a strategic portion of shares are held by foreign investors, therefore, such shares are not available to South African investors) and portrays a fairer reflection of the investment universe available to especially large, institutional investors.

Single manager funds refer to funds that are managed by one asset manager only as opposed to funds that mandate different asset managers to manage each a portion of a fund's assets (*multi-manager*) or a fund that uses a combination of different funds (*fund-of-funds*).

Well-known brands refer to funds offered by the main stream financial institutions and specialist investment managers in South Africa. Typically, these funds dominate assets under management (large asset size funds). All other funds available are categorised under *lesser-known brands*.

For equity funds the performances of the top 10 funds in size (assets under management)– which represent about 65% of all assets invested in the equity category – were compared with the smallest 25 funds that constitute less than 5% of the category assets. In the asset allocation categories l*arge funds* are those funds that manage 75% and more on aggregate of all the assets per category, while *small funds* own 5% and less of category assets.

DISCLAIMER:

The validity of the findings depends on the accuracy of the original data. Furthermore, the findings are applicable for the sample period and do not necessarily represent an accurate indication of future trends. Note that records of funds that ceased to exist over the course of time – typically, these would have been small and/or unsuccessful funds – are no longer part of the current database and are excluded from the results. Invariably, an element of survivorship bias would skew the findings, perhaps making the findings appear better than the actual results.

3. Analysis of Fund Performances

3.1 Equity Funds

All the unit trust funds categorised under the *general equity*, *growth* and *value* categories were bundled together and represent by far the most significant portion of assets under management for equity funds. Sector-specific or specialist equity funds are excluded from the analysis.

Table 1: Analysis of equity fund performances

Criteria and Period	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Average fund performance	0.25	15.92	15.78	14.81
Weighted average fund performance	1.82	17.40	18.09	18.91
Median fund performance	0.00	15.31	15.53	13.84
Top quartile fund performance	2.86	17.60	17.70	17.62
Bottom quartile fund performance	-1.83	14.04	13.16	11.47
Best fund performance	7.96	22.66	24.49	25.13
Worst fund performance	-6.72	10.91	9.44	6.84

Table 2: Comparative Analysis

Analysis: Benchmark	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
ALSI	3.01	17.14	12.57	16.50
SWIX	2.55	18.05	14.96	N/A
Average fund performance	0.25	15.92	15.78	14.81

Analysis: Management Style	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Single manager	0.50	16.21	16.17	14.84
Multi-manager/FoF	-1.10	14.41	13.00	13.82
Average fund performance	0.25	15.92	15.78	14.81

Analysis: Brands	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Well-known brands	0.54	16.54	16.24	15.25
Lesser-known brands	-0.09	14.65	14.61	13.17
Average fund performance	0.25	15.92	15.78	14.81

(Table 2 continued…)

Analysis: Fund Size	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Top 10 funds (asset size)	1.27	16.85	17.36	18.02
Smallest 25 funds (asset size)	-0.40	14.54	13.53	13.67
Average fund performance	0.25	15.92	15.78	14.81

Results from Analysis:

- A wide dispersion of fund performances is found among equity funds, as shown by the differences between the *best* and *worst* fund performance or *top quartile* and *bottom quartile* performances.

- No single fund showed a negative performance over 5-, 7- or 10-year holding periods.

- The *weighted average* performance is significantly better than the *average* fund performance over all periods; implying that large funds – which contribute *pro rata* more to the *weighted average* – outperformed the smaller funds. This tendency is confirmed by Chart 1, which shows the relative size and performance of the five largest equity funds compared with the median fund. Undoubtedly most of the category's assets are housed in a few large funds.

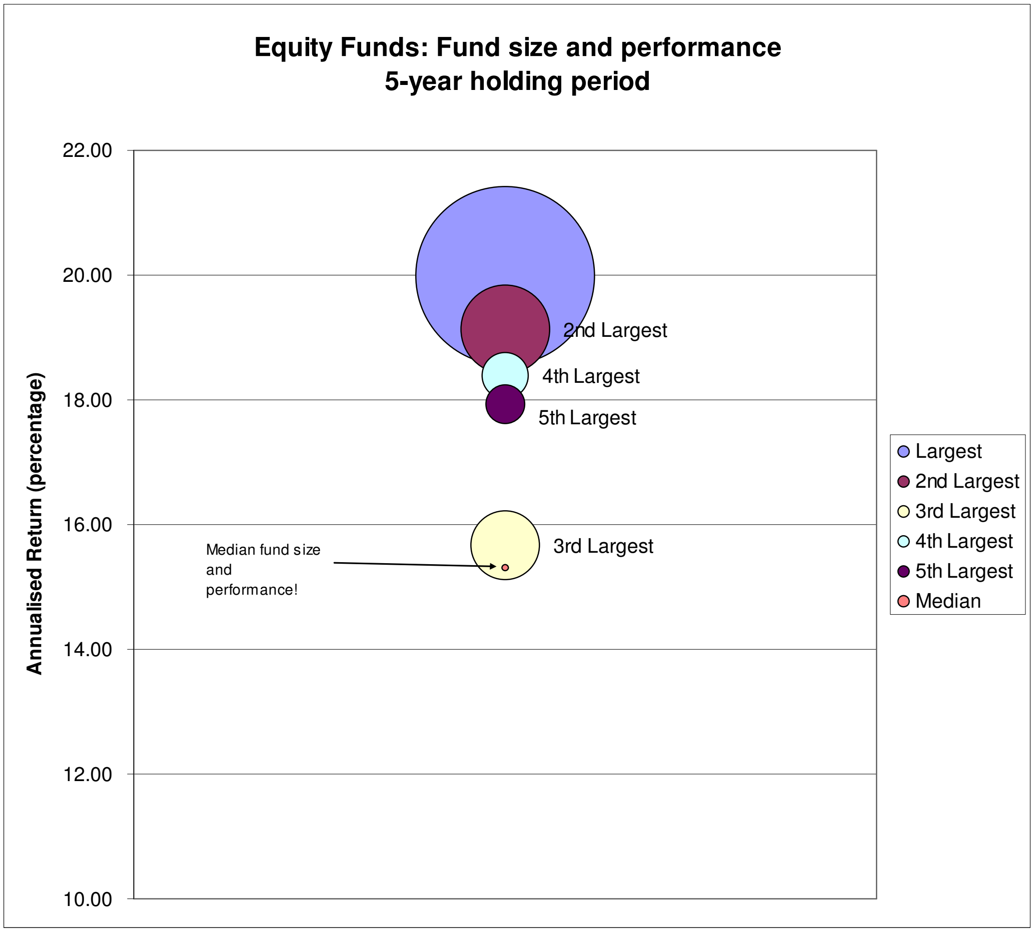


Chart 1:

- On average equity funds underperformed the *ALSI* benchmark over all periods, except over the past 7-year period. When using the *weighted average* performance of equity funds as a yardstick, equity funds did outperform the *ALSI* index over the longer holding periods. The *SWIX* benchmark proved to be a tougher hurdle to beat than the *ALSI* benchmark during its 7-year existence.

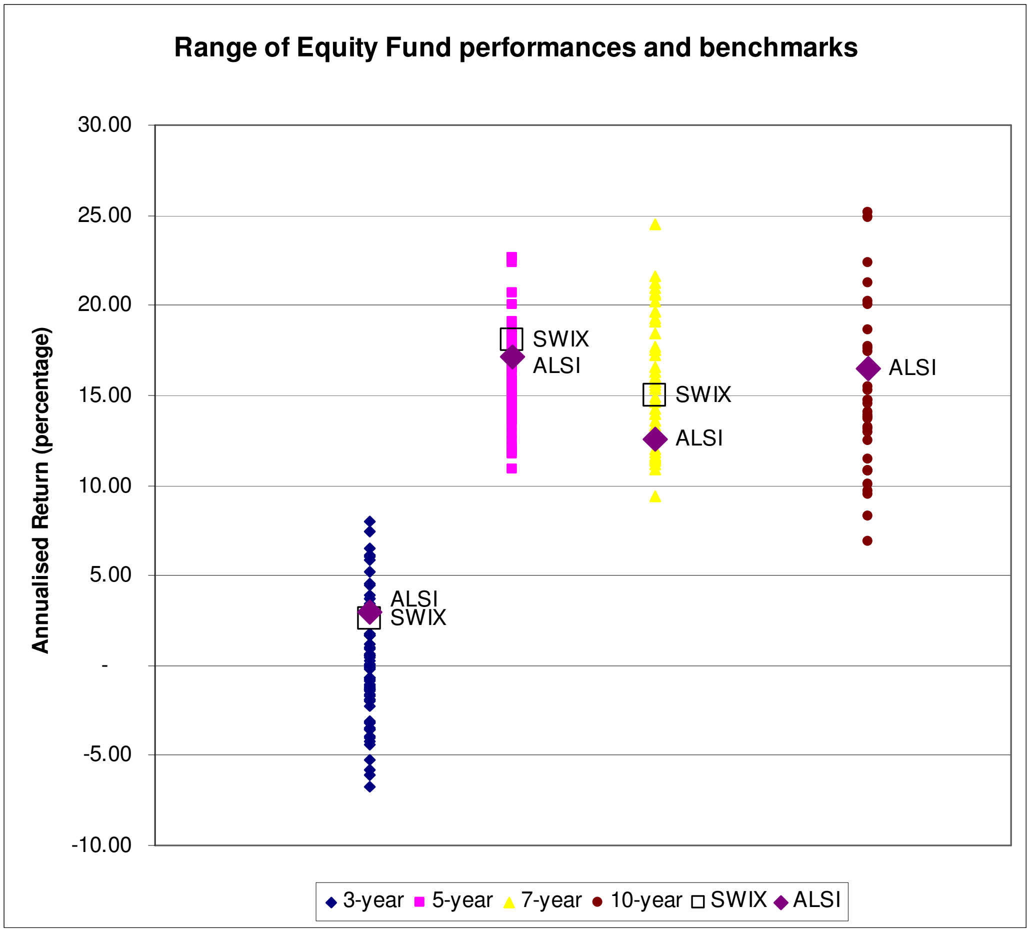


Chart 2:

- *Single manager* funds *on average* comfortably outperformed *multi-manager* and *fund-of-funds* over all review periods.

- *Well-known brands on average* outperformed the *lesser-known brands* over all review periods.

- The *top ten* largest funds *on average* comprehensively outperformed the *smallest twenty five* funds over all review periods.

3.2 Asset Allocation Strategies

Asset allocation funds are classified into six different categories according the funds' mandate and objectives, namely: *prudential high equity*, *prudential medium equity*, *prudential low equity*, *prudential variable equity*, *targeted and absolute return* and *flexible asset allocation*. The *prudential low equity* and *variable equity* categories are, in terms of assets under management, the two most important asset allocation categories. The *prudential high equity* and *prudential medium equity* categories are excluded from the analysis because of the relative insignificant size of the assets under management.

Table 3: Analysis of asset allocation fund performances

	% Return	% Return	% Return
Prudential Low Equity	**3-year**	**5-year**	**7-year**
Average fund performance	5.67	10.89	11.12
Weighted average fund performance	10.24	14.13	14.66
Best fund performance	11.98	14.44	14.88
Top quartile fund performance	6.81	12.06	12.16
Median fund performance	5.83	10.44	10.98
Bottom quartile fund performance	3.83	9.20	9.11
Worst fund performance	2.69	8.86	8.45

	% Return	% Return	% Return	% Return
Prudential Variable Equity	**3-year**	**5-year**	**7-year**	**10-year**
Average fund performance	3.61	14.40	13.69	13.32
Weighted average fund performance	6.42	16.38	16.73	14.00
Best fund performance	11.71	17.98	18.84	15.85
Top quartile fund performance	4.78	15.18	14.77	14.86
Median fund performance	3.48	14.76	13.98	13.85
Bottom quartile fund performance	2.81	12.76	12.50	12.68
Worst fund performance	-4.28	10.57	7.55	7.96

	% Return	% Return	% Return	% Return
Targeted and Absolute Return	**3-year**	**5-year**	**7-year**	**10-year**
Average fund performance	6.06	10.81	11.56	8.78
Weighted average fund performance	6.85	10.94	12.84	9.04
Best fund performance	11.19	15.28	14.51	9.91
Top quartile fund performance	7.46	12.71	12.87	9.35
Median fund performance	6.64	10.69	12.39	8.78
Bottom quartile fund performance	4.77	9.12	9.98	8.22
Worst fund performance	-1.50	6.70	8.05	7.65

(Table 3 continued…)

Flexible Asset Allocation	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Average fund performance	2.60	14.45	14.33	11.72
Weighted average fund performance	4.47	16.12	17.00	16.20
Best fund performance	12.48	19.16	18.38	17.42
Top quartile fund performance	4.77	15.23	16.06	13.46
Median fund performance	2.20	14.28	13.63	11.78
Bottom quartile fund performance	-0.08	12.53	12.56	10.04
Worst fund performance	-6.50	11.89	11.21	5.88

Results of Performance Analysis:

- All funds delivered positive performances over 5-, 7- and 10-year holding periods, but not necessarily meeting their objective, namely to outperform inflation by a considerable margin.

- The *weighted average* fund performances are in all instances higher than the *average* fund performances; implying that the larger funds outperformed the smaller funds. Charts 3-6 confirm the relative outperformance of the largest funds relative to the median fund performance and size. Moreover, it shows the relative concentration of the category's assets in a few large funds.

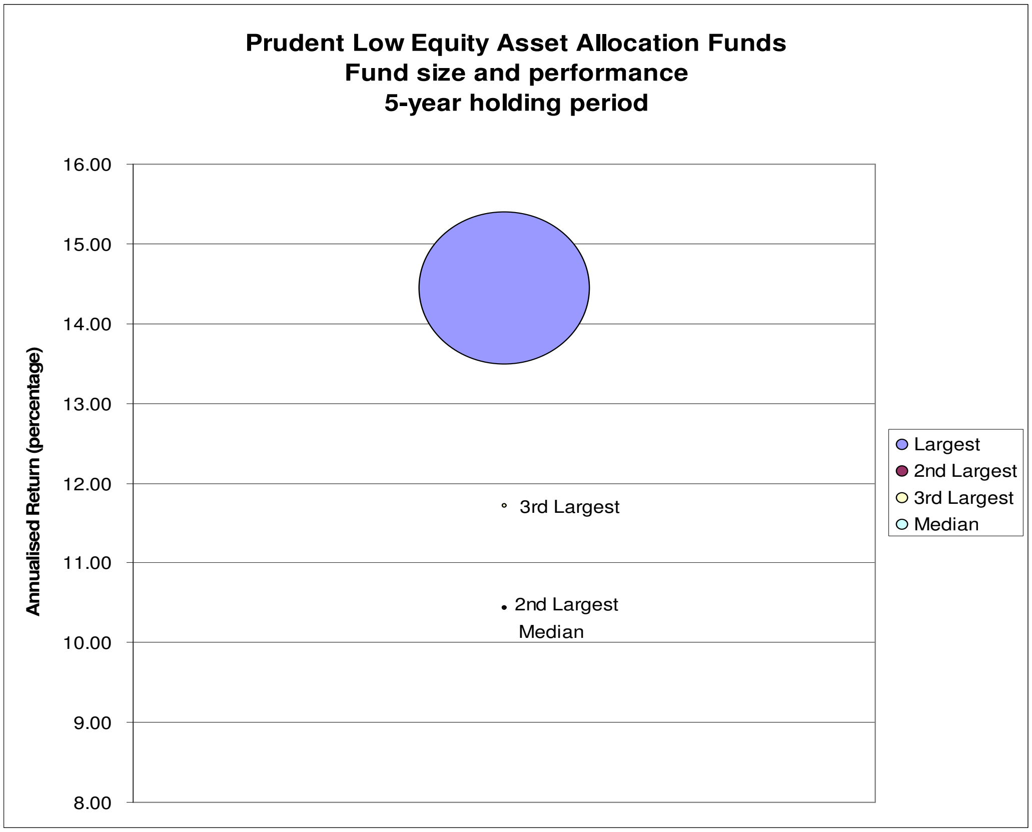
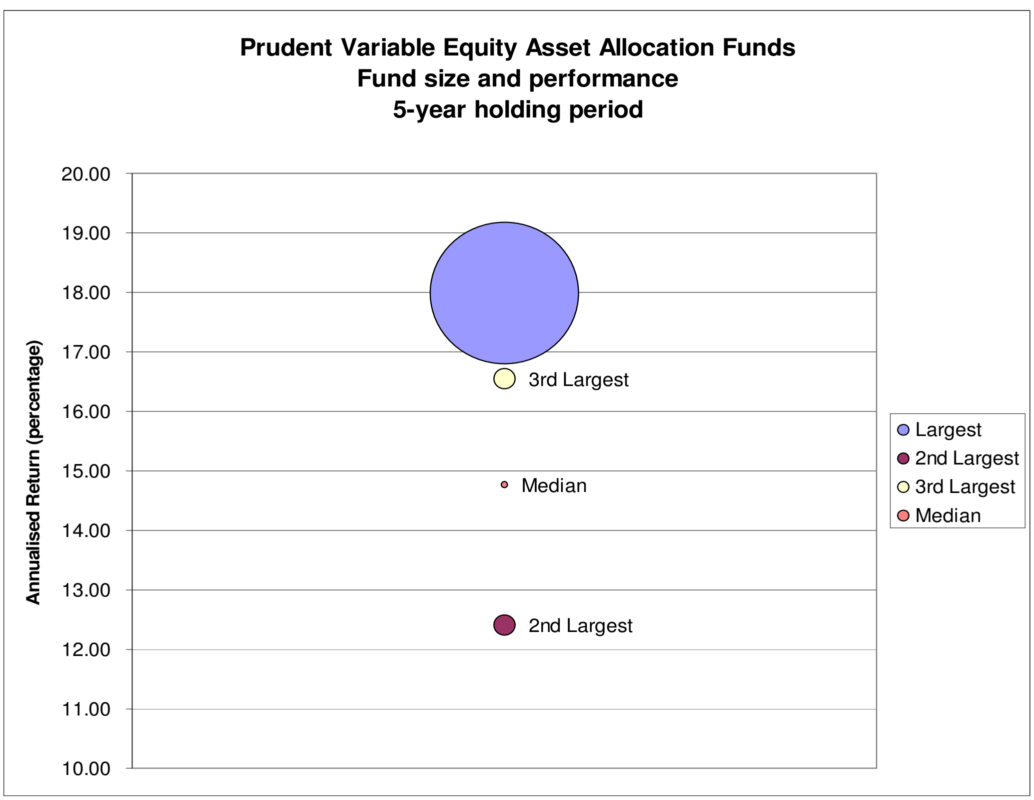


Chart 3:



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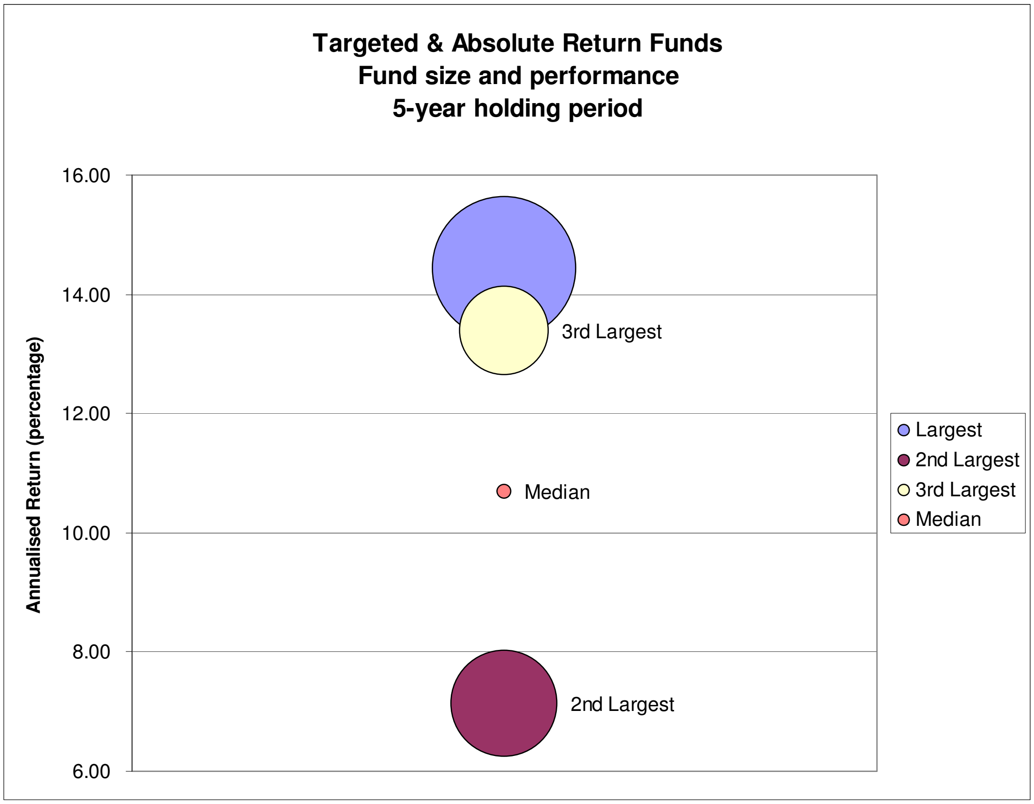

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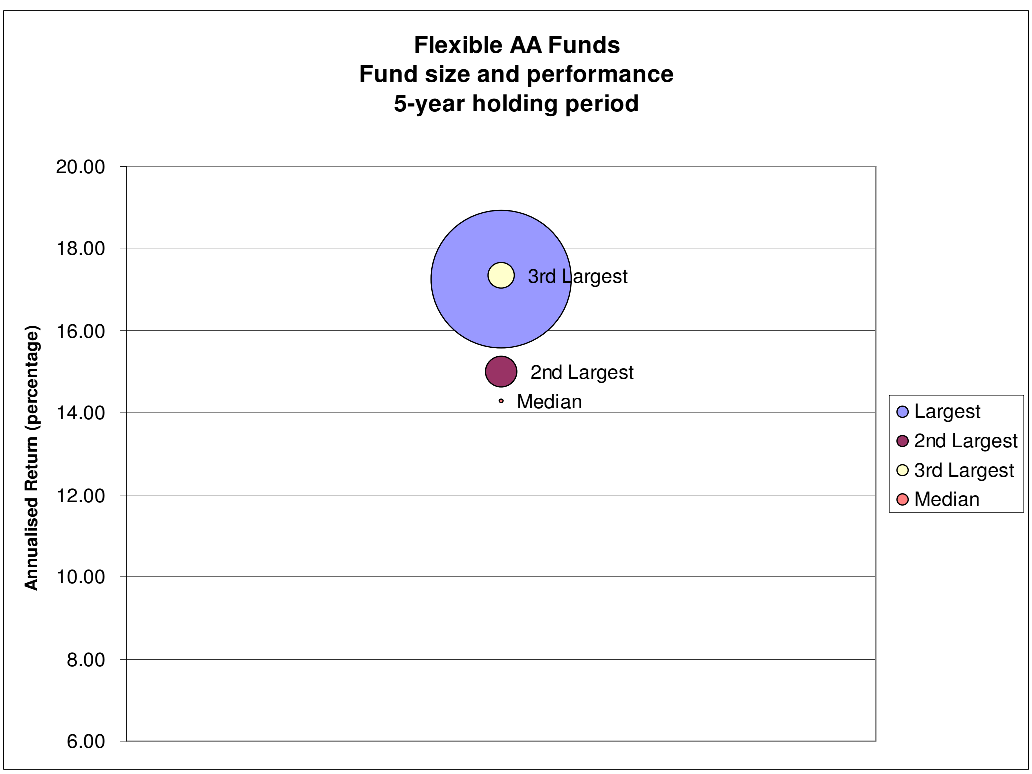


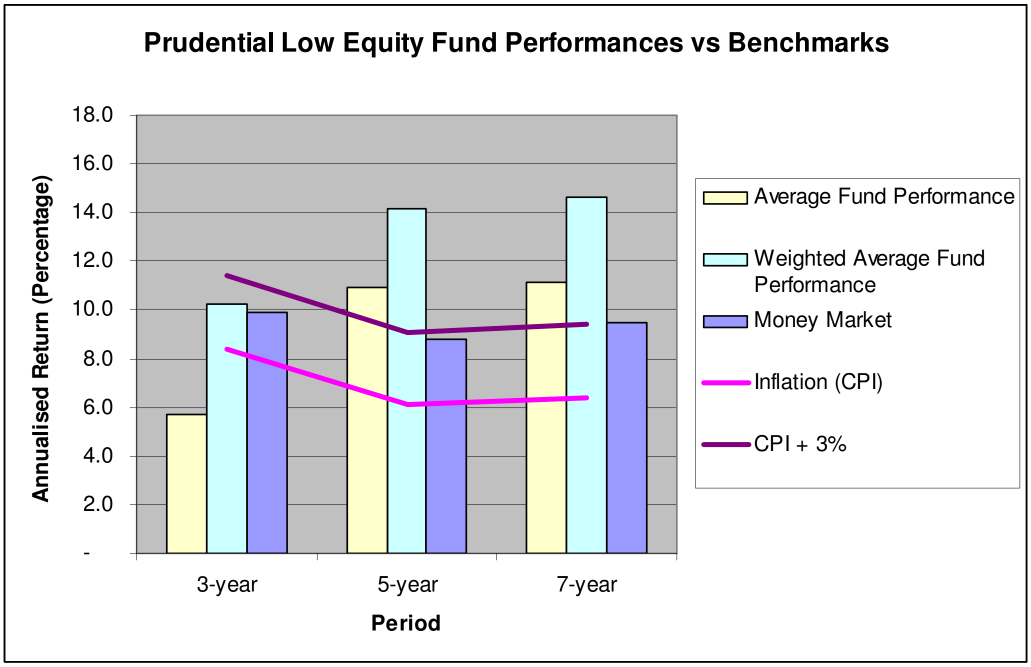
Chart 6:

- A wide dispersion of fund performances are found among the p*rudential variable equity* and f*lexible asset allocation* categories; implying the relative importance of correct (or incorrect) asset allocation strategies in so far fund managers have the relative freedom to select their exposures to different asset classes. Where the manager's "freedom of choice" is limited by the fund's mandate, the dispersion of fund returns is markedly less, as seen in the other two asset allocation categories.

- The t*argeted and absolute return* category averaged significantly lower returns over longer holding periods than the other three categories which in turn achieved more or less similar average performances. This result is somewhat surprising and ironic, given that investors experienced three major bear markets over the past ten years (1998, 2002-2003 and 2008-to date). Moreover, over a 10-year holding period the category did not outperform money market investments on average. The obvious question is: How much are investors paying for the "protection" of their capital?

Comparable Analysis of Asset Allocation Strategies

Asset allocation strategies endeavour to offer inflation-beating returns to investors, but at the same time to limit the downside risk of investing through asset class diversification and hedging strategies (reduced volatility). In essence, asset allocation presents a "total investment solution". Different grades of volatility are permissible as per fund mandate; depending on a fund's relative exposure to equities as the most risky investment class. Hence different asset allocation categories exist with different inflation-beating benchmarks. For the purpose of this analysis, irrespective of the actual funds' benchmarks, the *prudential variable equity* and *flexible asset allocation* categories are set to target *inflation plus 5%* per annum, while the benchmark for *prudential low equity* and *targeted and absolute return* categories is set at *inflation plus 3%* per annum.



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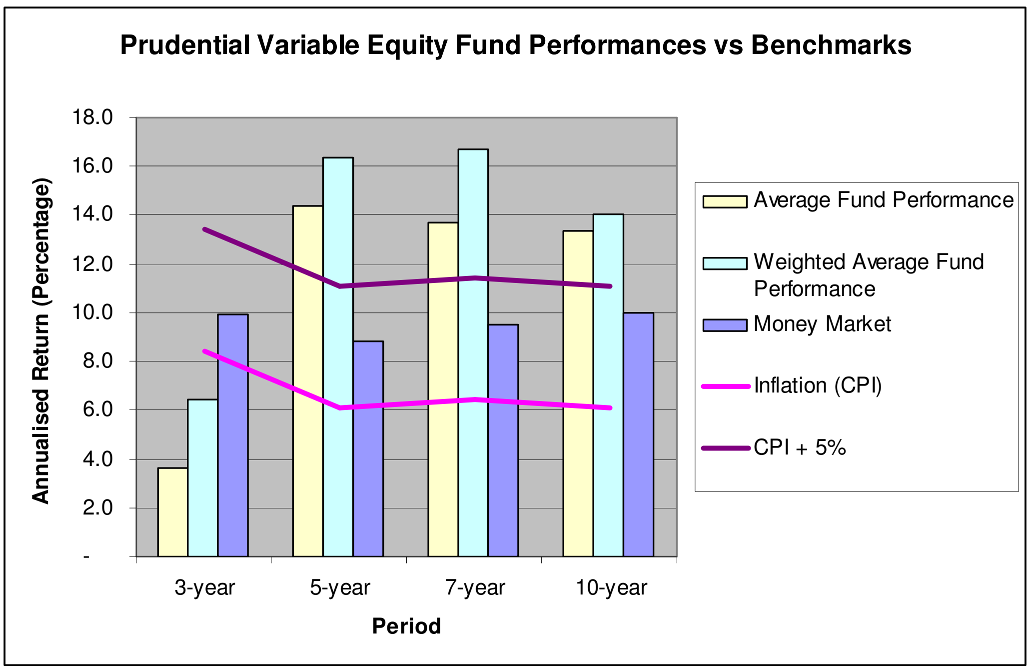

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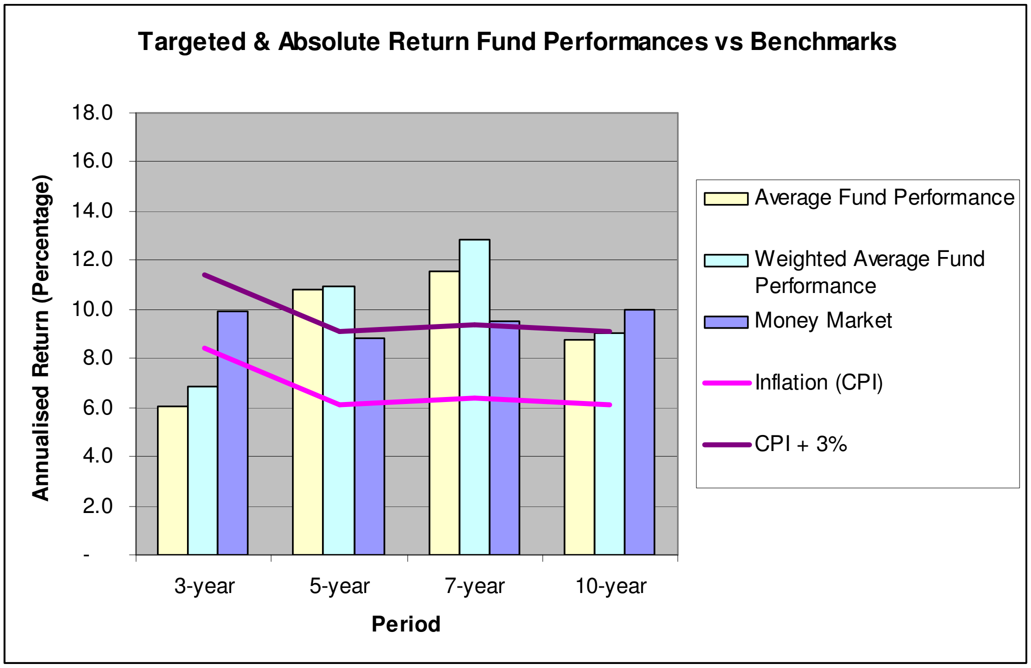

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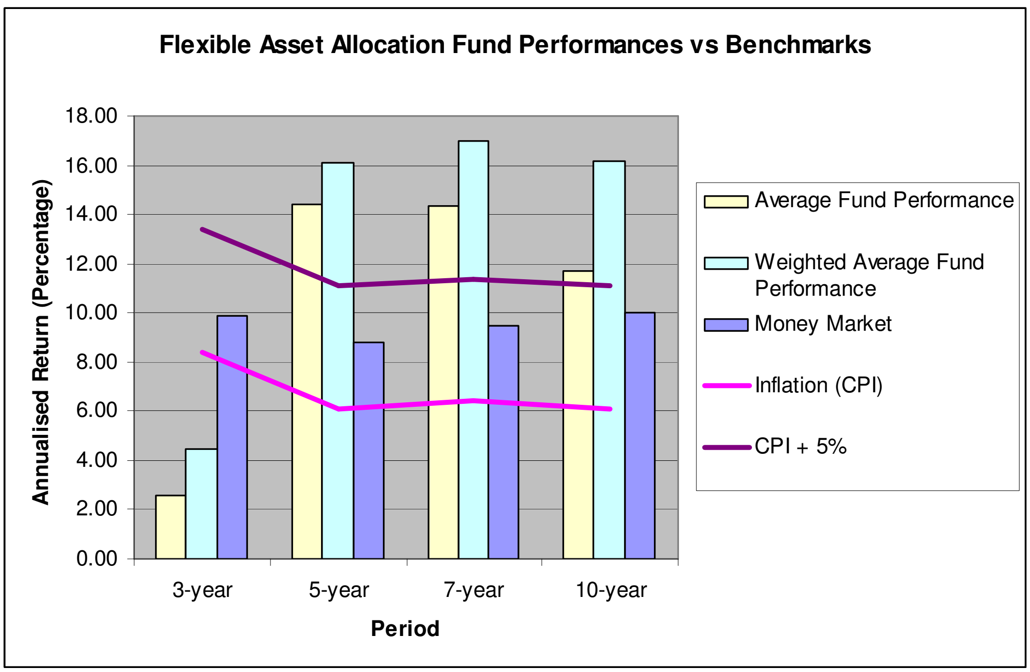

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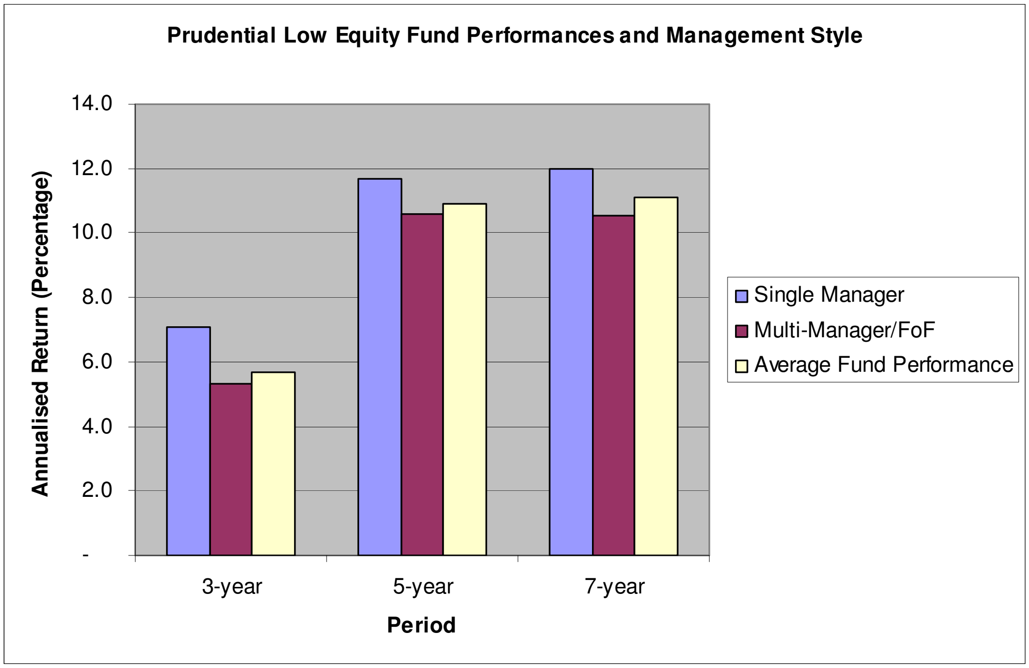

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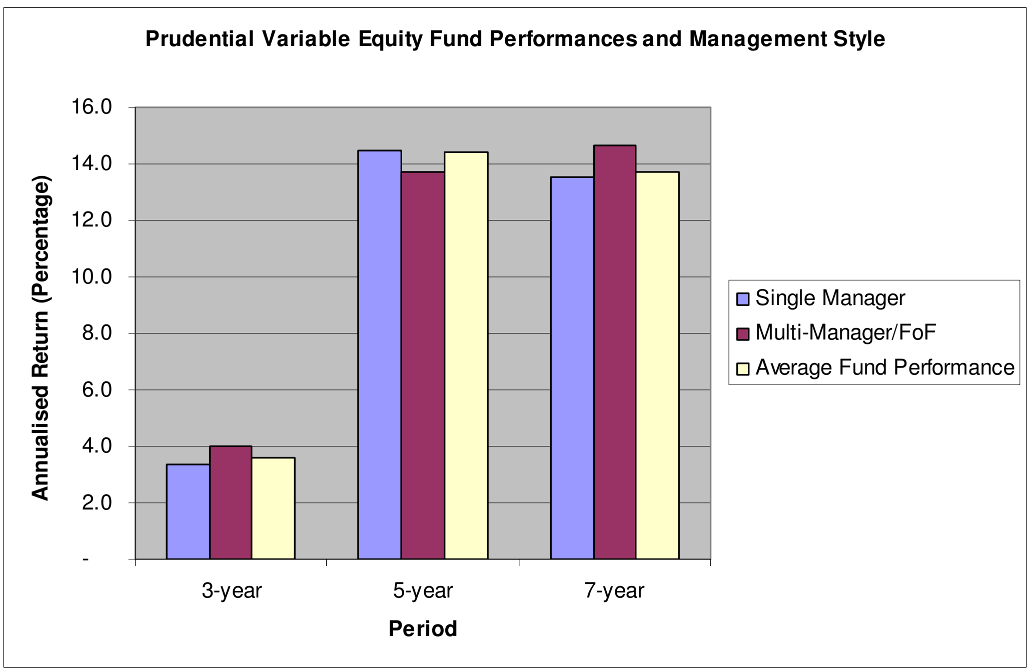

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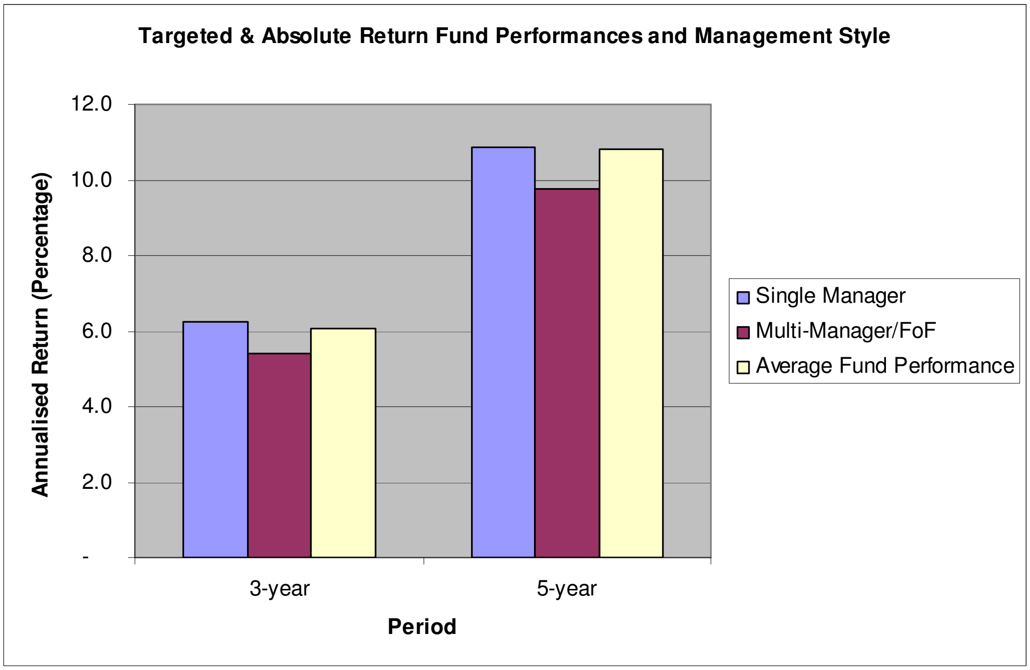

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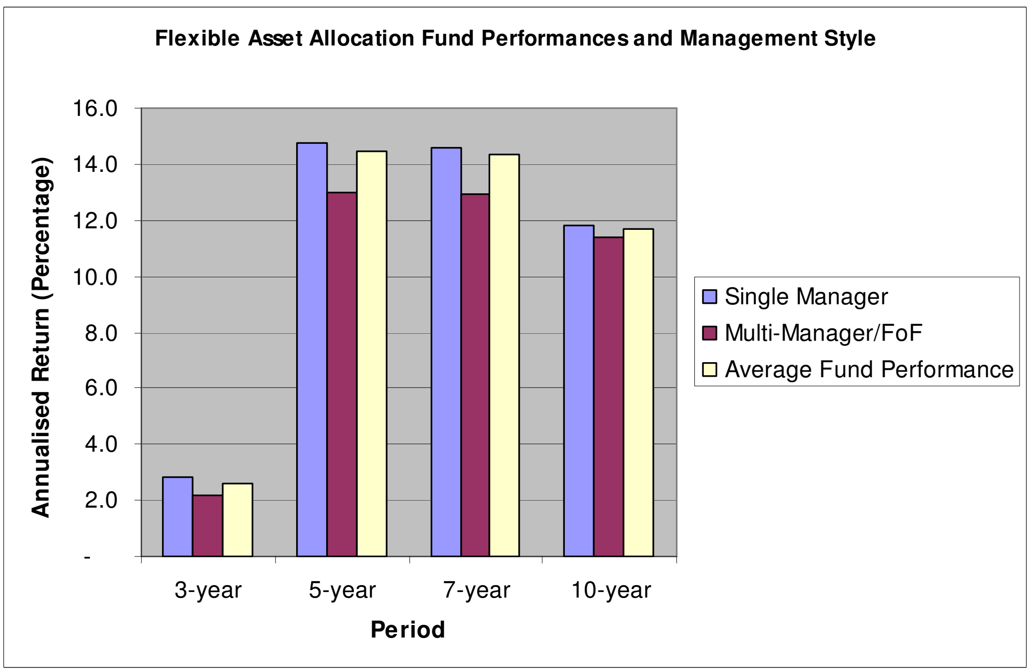

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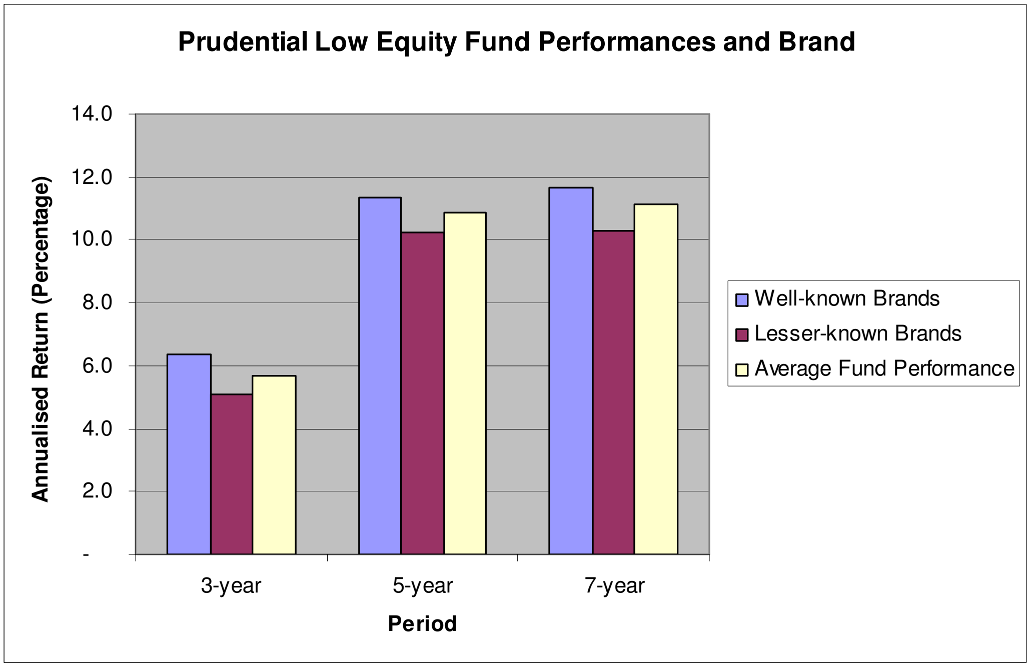

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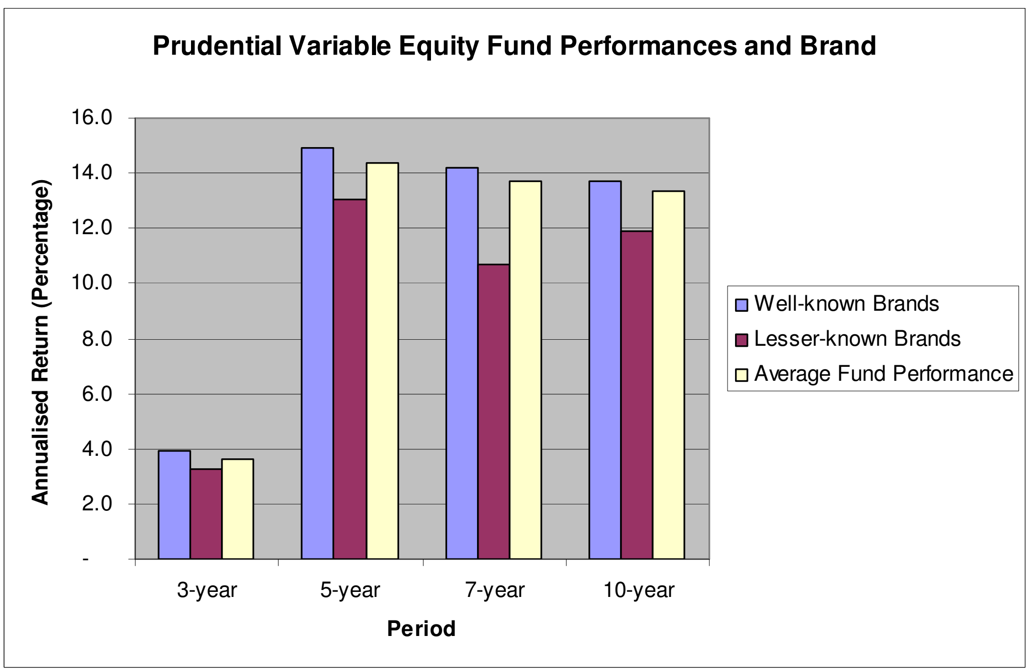

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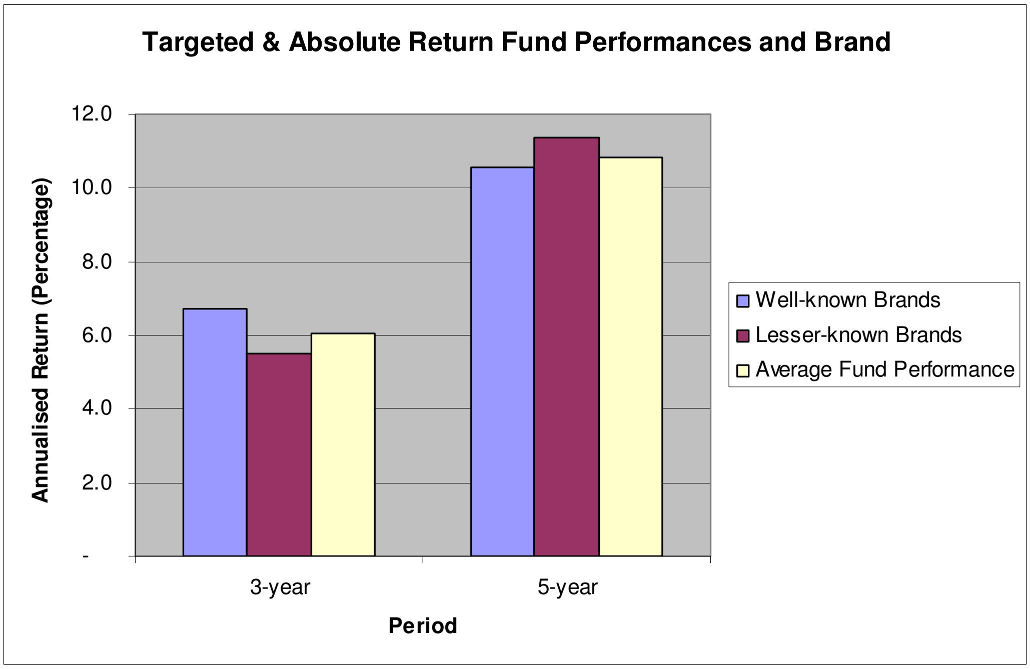

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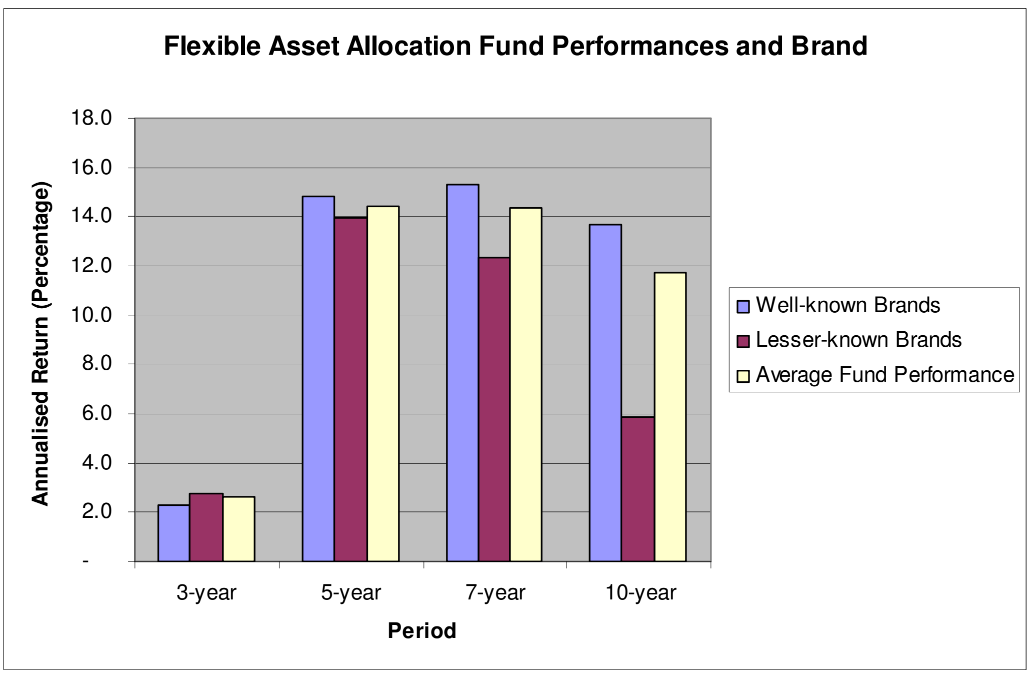

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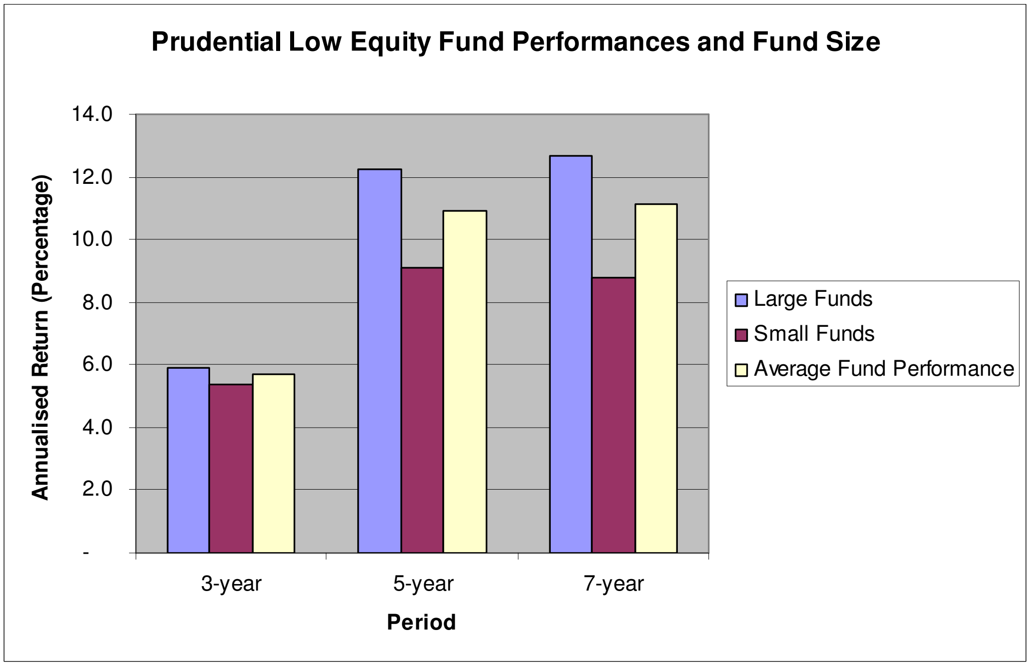

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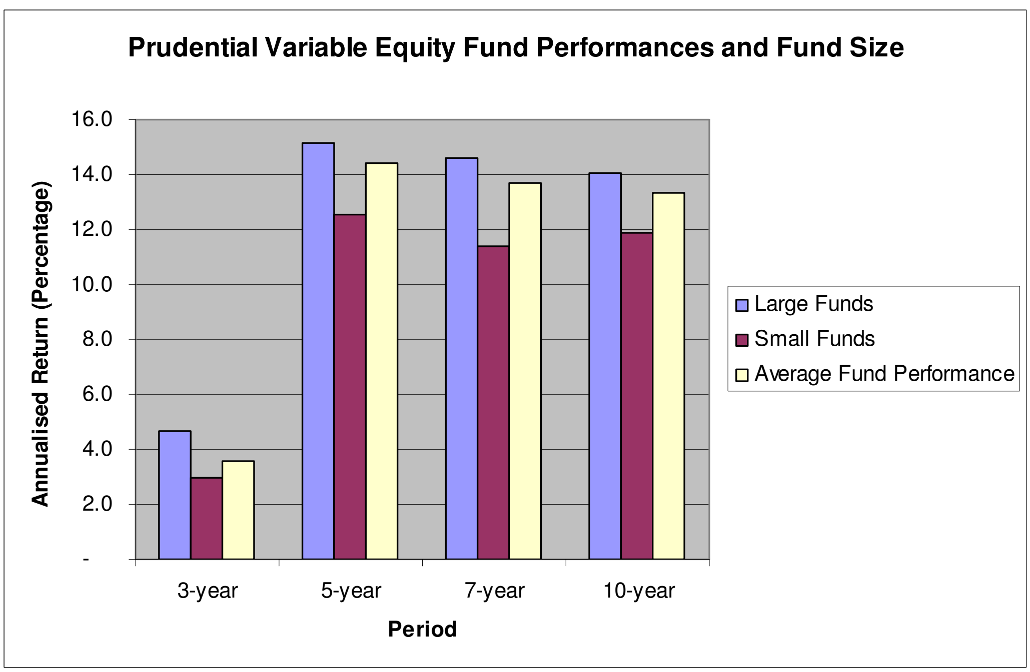

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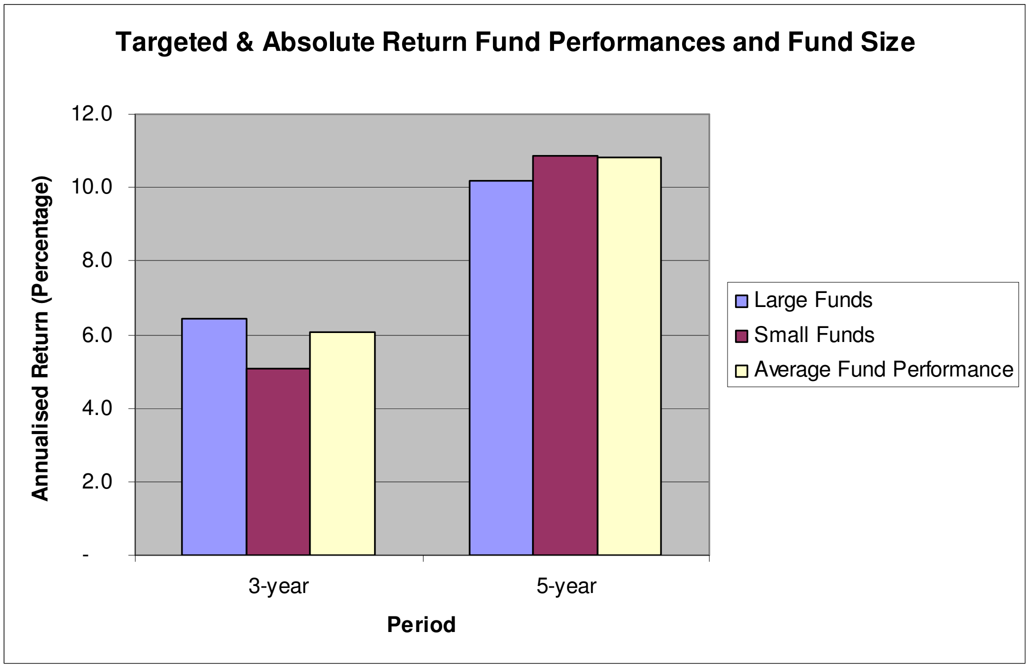

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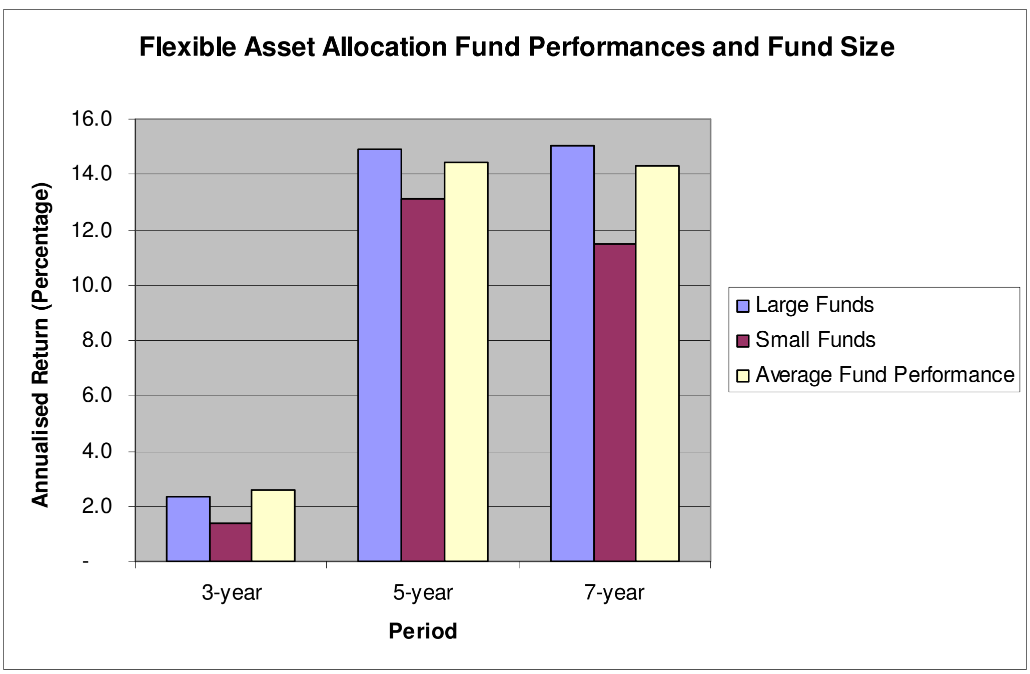


Chart 22:

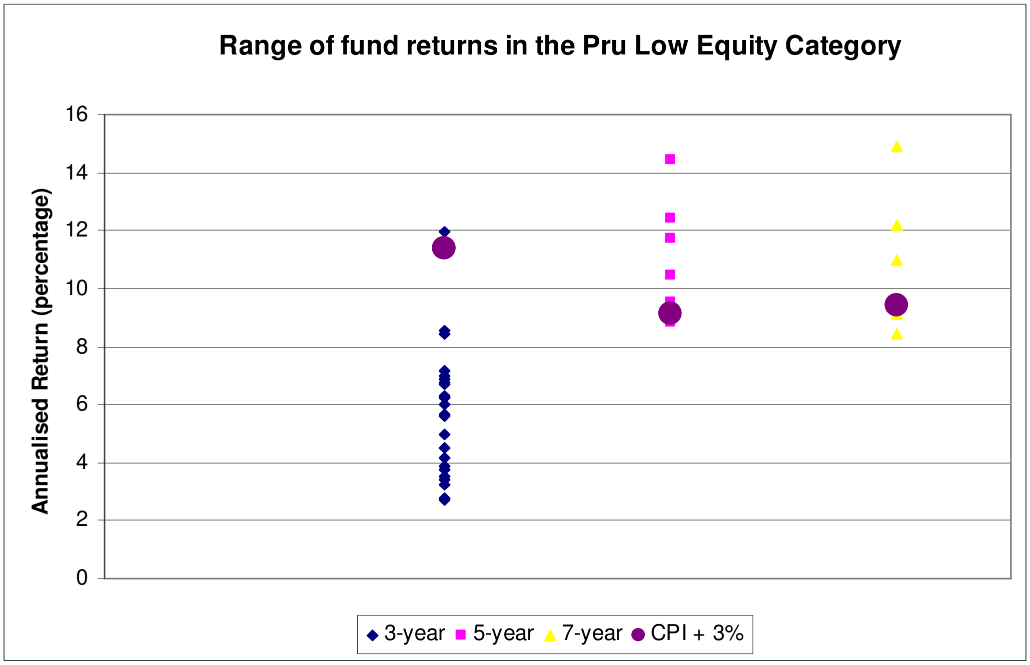
Results from Comparable Analysis:

- All categories, except the t*argeted and absolute return* category were able *on average* to meet and surpass their inflation-adjusted benchmarks for all longer term holding periods. The past 3-year holding period, however, proved to be a *nemesis* for most funds; a period that was characterised by high inflation (interest rates) and poor equity returns.

- In general *single managers* tend to outperform *multi-managers* and *fund-of-funds* across all categories and holding periods.

- *Well-known brands on average* outperformed their *lesser-known* counterparts over most holding periods.

- The largest funds *on average* outperformed the smallest funds for all categories over most holding periods.



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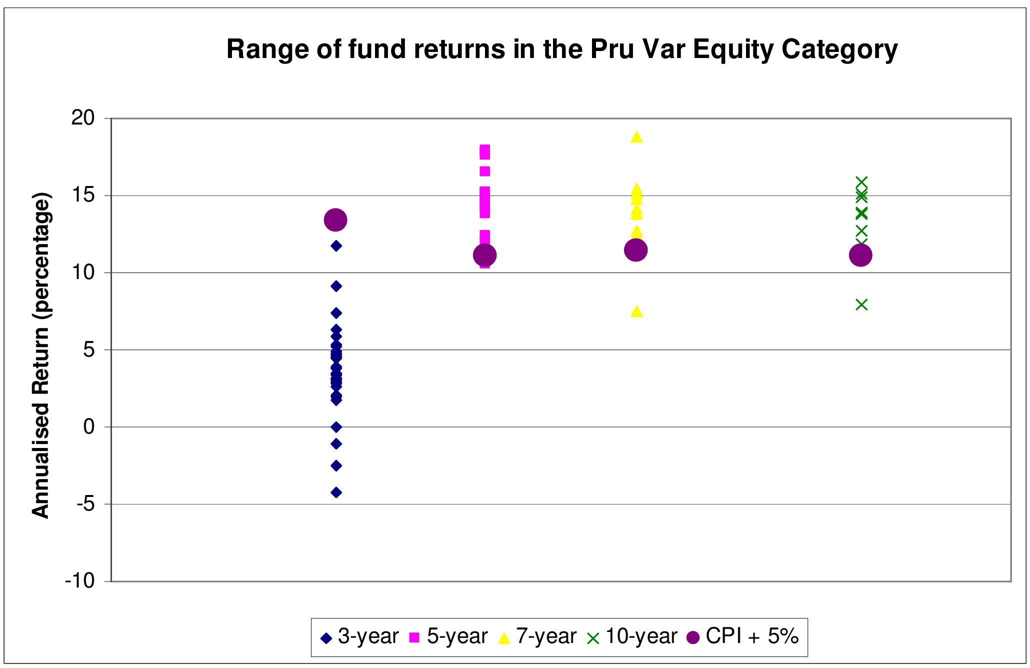

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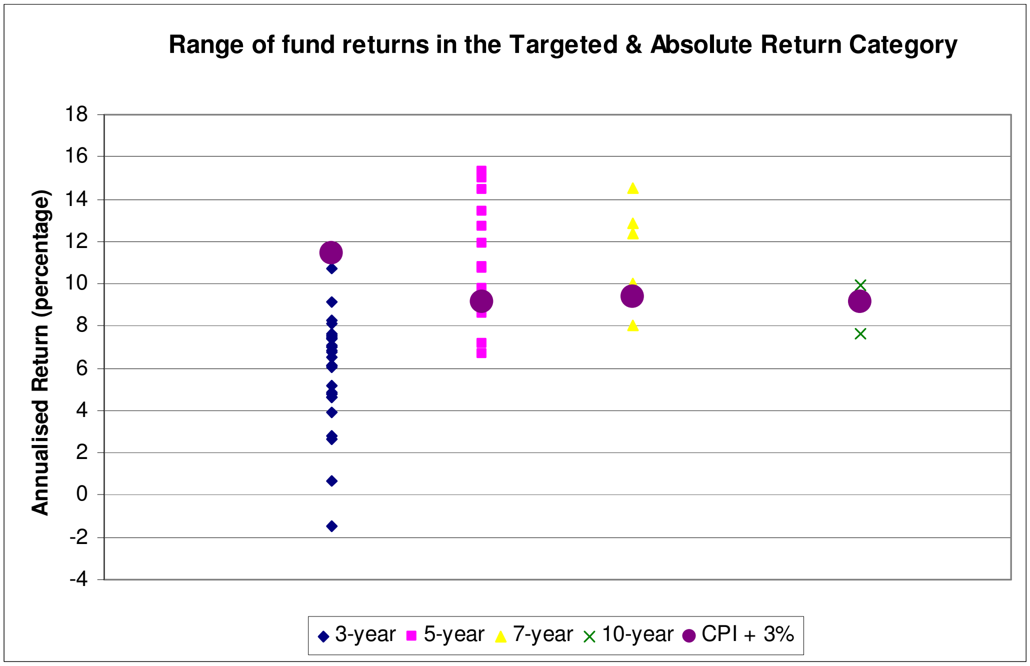

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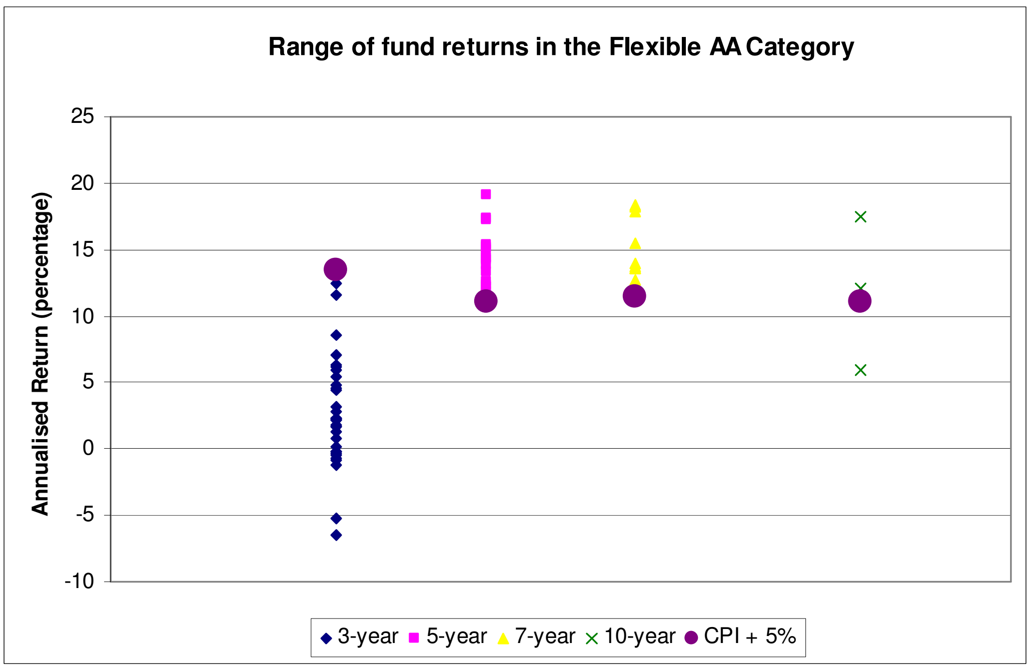


Chart 26:

4. Points to Ponder

1. Larger funds outperformed *on average* the smaller funds. This tendency is confirmed by the *weighted average* performance being higher than the *average* performance reported over most holding periods. Moreover, well-known brands – typically the larger funds – have done better *on average* than the lesser-known brands.

2. Most of the equity and asset allocation categories' assets are housed in a few large funds. This level of asset concentration can be explained twofold: *One*, "success breeds success", i.e. past successes draw new inflows, and *two*, familiarity with brand names installs confidence and trust among investors. Hence we observe a tendency that a few well-known funds with proven track records attract the bulk of new investments.

3. Single manager funds outperformed *on average* multi-managers and fund-of-funds in both equity and asset allocation categories. While reasonable motivations, such as diversification of managers and performances, could be made to justify the multi-management style of investing the ultimate proof for investors is in the returns. The duplication of cost structures (underlying fund management fee plus multi-management fees) may be a serious impediment in some instances to a noble investment idea.

4. Investments in the asset allocation categories have enjoyed in general very good inflation-beating returns over longer holding periods, except perhaps for the t*argeted and absolute return* category. Nonetheless, the most recent experience (three-year holding period) indicates that the level of relative outperformance may decline in forthcoming longer-term holding periods. Thus fund managers may have a tough prospect in fulfilling their performance targets and a wider dispersion of relative performances may be expected.

5. Further concentration of investors' monies in a few large funds can be expected. This trend may be further supported by the possible closure and consolidation of many smaller funds in future. For example, during the recent bull market a host of new funds, notably "broker" and "boutique" funds were launched to capture the upside of the stock market's performance. However, the drastic changes in market sentiment and general poor returns will make the outlook and viability for these "new funds" less rosy.

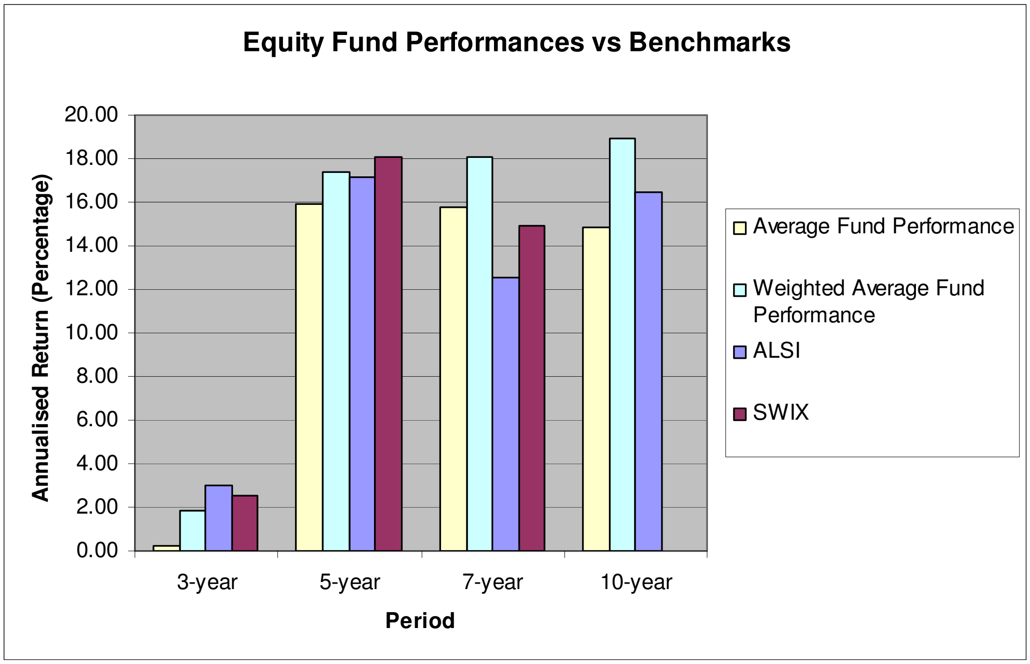
6. Why should large funds outperform smaller ones? Is it because of the presence of a greater skill set and research capabilities in-house than the smaller players? Maybe so, yet managers of smaller funds often claim that because of large funds' sheer size strategies/holdings cannot easily be changed (the tanker ship analogy), whereas small funds are able to make rapid changes to their portfolios. Or, if a fund becomes too large it will become nothing else than an "index hugger" – meaning that because of investment limitations large funds are forced to take large positions in large cap shares and not necessarily out of conviction.

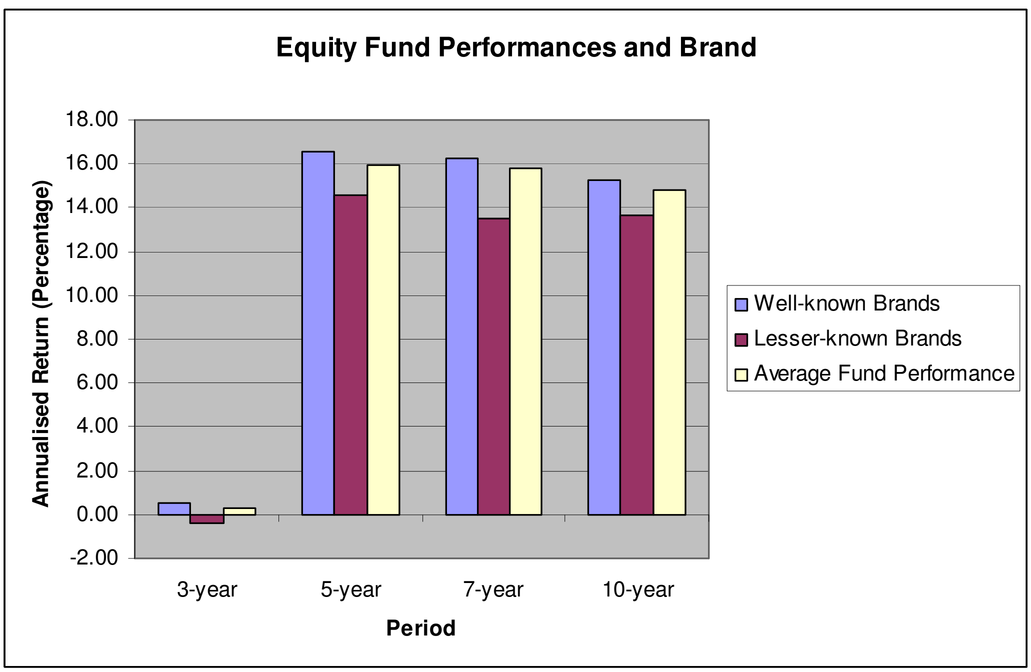
Therefore, all else being equal, small funds should have a comparative advantage over large funds. Again, maybe this is a valid point for investing rather in smaller funds, at least in theory. Or, maybe it could be pure luck or a coincidence that large funds outperformed others over the sample periods. In another period a different outcome could have been possible. Asset management skill is much more difficult to prove, at least on a scientific (statistical) basis than most asset managers would readily concede.

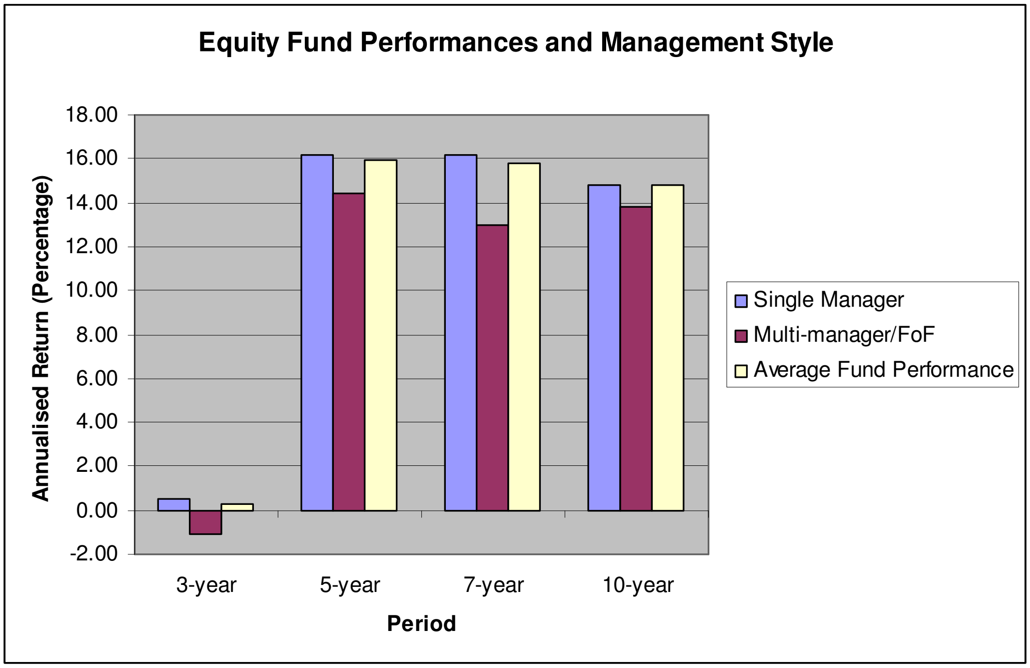
Maybe then it is a combination of both luck and skill, but what matters is the scoreboard. *Alas*, a rugby match is not necessarily won by the "best" game plan; execution (management process) and bounce of the ball (stock picks) do matter. The unit trust scoreboard shows large funds are the winners and will, therefore, continue to attract investors' monies.

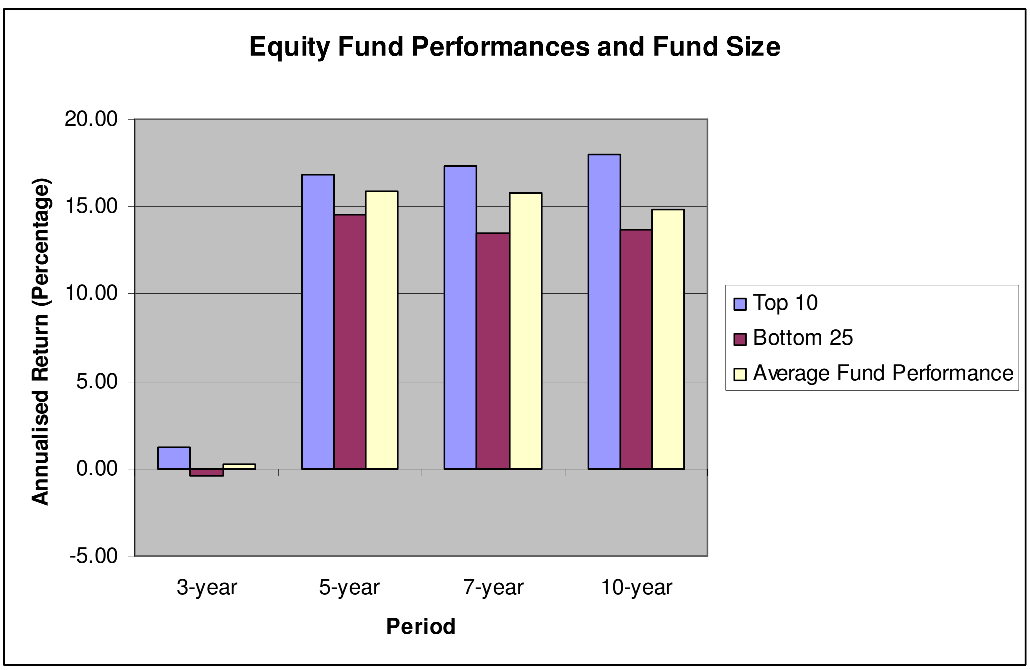
APPENDIX 1

COMPARABLE ANALYSIS: EQUITY FUNDS






Equity Fund Performances and Management Style
Annualised Return (Percentage)
18.00
16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
-2.00
3-year
5-year
7-year
10-year
Period
Single Manager
Multi-manager/FoF
Average Fund Performance


Equity Fund Performances and Fund Size
Annualised Return (Percentage)
20.00
15.00
10.00
5.00
0.00
-5.00
3-year
5-year
7-year
10-year
Period
Top 10
Bottom 25
Average Fund Performance

APPENDIX 2

COMPARABLE ANALYSIS: Asset Allocation and Benchmark

Prudential Low Equity	% Return 3-year	% Return 5-year	% Return 7-year
Money Market yield	9.9	8.8	9.5
Inflation (CPI)	8.4	6.1	6.4
Average fund performance	5.7	10.9	11.1

Prudential Variable Equity	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Money Market yield	9.9	8.8	9.5	10.0
Inflation (CPI)	8.4	6.1	6.4	6.1
Average fund performance	3.6	14.4	13.7	13.3

Targeted & Absolute Return	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Money Market yield	9.9	8.8	9.5	10.0
Inflation (CPI)	8.4	6.1	6.4	6.1
Average fund performance	6.1	10.8	11.6	8.8

Flexible Asset Allocation	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Money Market yield	9.9	8.8	9.5	10.0
Inflation (CPI)	8.4	6.1	6.4	6.1
Average fund performance	2.6	14.5	14.3	11.7

APPENDIX 3

COMPARABLE ANALYSIS: Asset Allocation and Management Style

Prudential Low Equity	**% Return 3-year**	**% Return 5-year**	**% Return 7-year**
Single Managers	7.1	11.7	12.0
Multi-Managers / FoF	5.3	10.6	10.5
Average fund performance	5.7	10.9	11.1

Prudential Variable Equity	**% Return 3-year**	**% Return 5-year**	**% Return 7-year**
Single Managers	3.4	14.5	13.5
Multi-Managers / FoF	4.0	13.7	14.7
Average fund performance	3.6	14.4	13.7

Targeted & Absolute Return	**% Return 3-year**	**% Return 5-year**
Single Managers	6.2	10.9
Multi-Managers / FoF	5.4	9.8
Average fund performance	6.1	10.8

Flexible AA	**% Return 3-year**	**% Return 5-year**	**% Return 7-year**	**% Return 10-year**
Single Managers	2.9	14.8	14.6	11.8
Multi-Managers / FoF	2.2	13.0	12.9	11.4
Average fund performance	2.6	14.4	14.3	11.7

APPENDIX 4

COMPARABLE ANALYSIS: Asset Allocation and Brand

Prudential Low Equity	% Return 3-year	% Return 5-year	% Return 7-year
Well-known Brands	6.3	11.4	11.7
Lesser-known Brands	5.1	10.3	10.3
Average fund performance	5.7	10.9	11.1

Prudential Variable Equity	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Well-known Brands	3.9	14.9	14.2	13.7
Lesser-known Brands	3.3	13.1	10.7	11.9
Average fund performance	3.6	14.4	13.7	13.3

Targeted & Absolute Return	% Return 3-year	% Return 5-year
Well-known Brands	6.7	10.6
Lesser-known Brands	5.5	11.4
Average fund performance	6.1	10.8

Flexible AA	% Return 3-year	% Return 5-year	% Return 7-year	% Return 10-year
Well-known Brands	2.3	14.8	15.3	13.7
Lesser-known Brands	2.8	13.9	12.3	5.9
Average fund performance	2.6	14.4	14.3	11.7

APPENDIX 5

COMPARABLE ANALYSIS: Asset Allocation and Fund Size

Prudential Low Equity	% Return	% Return	% Return
	3-year	5-year	7-year
Large funds	5.9	12.2	12.7
Small funds	5.4	9.1	8.8
Average fund performance	5.7	10.9	11.1

Prudential Variable Equity	% Return	% Return	% Return	% Return
	3-year	5-year	7-year	10-year
Large funds	4.7	15.2	14.6	14.0
Small funds	3.0	12.6	11.4	11.9
Average fund performance	3.6	14.4	13.7	13.3

Targeted & Absolute Return	% Return	% Return
	3-year	5-year
Large funds	6.4	10.2
Small funds	5.1	10.9
Average fund performance	6.1	10.8

Flexible AA	% Return	% Return	% Return
	3-year	5-year	7-year
Large funds	2.4	14.9	15.0
Small funds	1.4	13.1	11.5
Average fund performance	2.6	14.4	14.3

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