



DRW
INVESTMENT RESEARCH

How Much of the Unit Trust Fund Returns Do Investors Get on Average?

By Daniel R Wessels

May 2008

“Surprise! The returns reported by mutual funds aren’t actually earned by mutual fund investors.”

John C. Bogle

The Little Book of Common Sense Investing, 2007

“The fault, dear investor, is not in our stars – and not in our stocks – but in ourselves...”

Benjamin Graham

The Intelligent Investor, 2005 (Revised Edition)

1. Introduction

Unit trust investors pride themselves on their selection of top-notch performing funds in search of excellent investment returns. These investors are aware, however, that fund performances are variable, both in absolute and relative terms, and therefore regularly screen the unit trust performance tables as published by media sources to assess whether their selection of funds is still making the grade. At the same time new star-performing funds are noticed and if their performances seem relatively persistent switches to such funds are likely to follow.

Are these switching activities rational? In other words do investors on the aggregate create additional returns by constantly switching to the latest top-performing funds? More specifically, how much of the reported fund returns do investors capture on average? In fact, are they not destroying wealth by chasing the top performers or popular themes/styles?

This study evaluates the unit trust return of the average investor – as defined by the growth in asset value of unit trust funds (capital appreciation) accounting for both inflows (sales) and outflows (repurchases) of unit trust funds over a specific period – versus the reported average fund performances over similar time intervals. Basically, the former refers to investors' actual return on capital employment and cash flow over time, while the latter yardstick is relevant for lump sum investments with no transactional flows over similar time intervals.

Could this return difference, if any, then be explained by the difference in return between lump sum investing and periodic/regular investing (*time-weighted* differences) or is there perhaps a more structural issue at play, namely irrational decision-making (buying and selling of units at the wrong times) by investors on average?

I will first provide a framework of the quantitative methodology that will be followed in the study. This will be followed by an overview of the results of international studies done in recent years investigating this “mismatch” phenomenon.

Thereafter, the results of the comparative analysis using the fund performance and cash flow (inflow and outflow) data of South African unit trusts will be discussed. In conclusion will be presented some possible explanations why large deviations in investors' return from the reported fund performances are possible.

2. A Conceptual Framework

Table 1 provides an explanation of the methodology used in determining the average investor's return versus the fund return and how some return differences might arise due to *time-weighted* and/or *asset-weighted* (*rand-weighted*) differences.

Table 1a illustrates the scenario where an investor made a lump sum investment with no transactional flow (buying or selling activities) during the review period. The investor's return will equal the fund return (9%).

In tables 1b and 1c it is assumed that the investor contributes or withdraws on a regular basis. In this case the investor's return will not exactly match the fund return due to *time-weighted* differences, i.e. monies that have been gradually invested to share in market growth as opposed to lump sum investing.

Table 1a: Lump sum investment

Date	Contribution (-) Withdrawal (+)	Fund Return per quarter	Investor's fund balance
Start value			1,000
Quarter 1	0	12.0%	1,120
Quarter 2	0	6.0%	1,187
Quarter 3	0	-15.0%	1,009
Quarter 4	0	8.0%	1,090
End of Period	Annualised Return	9.0%	9.0%

Table 1b: Regular contribution

Date	Contribution (-) Withdrawal (+)	Fund Return per quarter	Investor's fund balance
Start value			1,000
Quarter 1	-50	12.0%	1,173
Quarter 2	-50	6.0%	1,295
Quarter 3	-50	-15.0%	1,147
Quarter 4	-50	8.0%	1,291
End of Period	Annualised Return	9.0%	8.2%

Table 1c: Regular withdrawal

Date	Contribution (-) Withdrawal (+)	Fund Return per quarter	Investor's fund balance
Start value			1,000
Quarter 1	50	12.0%	1,067
Quarter 2	50	6.0%	1,080
Quarter 3	50	-15.0%	871
Quarter 4	50	8.0%	889
End of Period	Annualised Return	9.0%	9.9%

Tables 1d and 1e describe the scenario where variable net contributions and net withdrawals are made at different time intervals, thus not exhibiting a regular pattern as before. In such cases the actual rand amount contributed or withdrawn at a specific time – the *rand-weighted* factor – plays an integral role in determining the investor’s return versus the reported fund return (based on lump sum). Generally, it is described as a market timing issue – making bets in anticipation of the future direction of market returns.

For example, in table 1d the investor significantly lagged fund performance due to the dominant influence of poor market timing, while the investor in table 1e has enjoyed superior returns since the opposite bets were made.

Table 1d: Variable amounts invested and withdrawn

Date	Contribution (-) Withdrawal (+)	Fund Return Per quarter	Investor's fund balance
Start value			1,000
Quarter 1	-100	12.0%	1,226
Quarter 2	-50	6.0%	1,351
Quarter 3	-100	-15.0%	1,241
Quarter 4	25	8.0%	1,314
End of Period	Annualised Return	9.0%	7.7%

Table 1e: Variable amounts invested and withdrawn

Date	Contribution (-) Withdrawal (+)	Fund Return Per quarter	Investor's fund balance
Start value			1,000
Quarter 1	100	12.0%	1,014
Quarter 2	50	6.0%	1,023
Quarter 3	100	-15.0%	777
Quarter 4	-25	8.0%	866
End of Period	Annualised Return	9.0%	10.7%

The above tables resemble the cash flow pattern of investors to unit trust funds in general. Thus, if investors on average significantly underperform the fund return, it means that investors on aggregate probably displayed poor market timing skills and *vice versa*.

To further illustrate this concept real data are extracted from the *Quarterly Survey of Unit Trusts* and published by the Association of Collective Investments. The total net cash flow and the net asset value of all unit trusts categorised under general equity funds for the period December 2006 to December 2007 are exhibited in table 2.

Table 2: Asset values and net flow to General Equity Funds

Date	Contribution (-) Withdrawal (+) (Rm)	Average Fund Return per quarter	Investors' Fund NAV (Rbn)
Start value (31/12/2006)			100,759
Quarter 1	-208	10.3%	109,688
Quarter 2	988	3.6%	112,032
Quarter 3	39	3.8%	115,124
Quarter 4	845	-1.0%	113,244
End of Period (31/12/2007)	Annualised Return	17.4%	14.1%

Unit trust investors on average lagged the average fund performance by 3.3% per annum; 14.1% versus 17.4% as reported by the average performance of general equity unit trusts over this period. The return difference can only arise because of *time-weighted* issues, as shown in tables 1b and 1c, and/or *rand-weighted* issues as discussed in tables 1d and 1e.

The *time-weighted* variable can be isolated by rebasing the average fund performance to a level quarterly contribution instead of the lump sum assumption. The average fund performance with regular quarterly contributions – I assume a quarterly contribution of 5% of net asset value – would then have been 16.6% instead of 17.4% per annum; with the remaining return difference of 2.5% then explained by the *rand-weighted* factor (market timing).

3. The International Experience

Individual investors actively re-allocate their money across different mutual funds. Individuals tend to transfer money from funds with low recent returns to funds with high recent returns. In addition to looking at past returns of funds, individuals also may consider economic themes or investment styles in reallocating funds. Numerous studies have investigated the notion whether investors' re-allocations to unit trust funds (mutual funds) are leading to superior returns in the long run.

For example, Zheng (1999) investigated whether investors in their purchasing and selling decisions were able to predict funds' future performances, thus whether investors in general were smart in selecting funds. Evidence was found that funds that received more inflows subsequently perform significantly better than those that have had a net outflow.

Zheng (1999) referred to previous studies which reported that money flows into past good performers and flows out of past poor performers. The studies by Goetzmann and Ibbotson (1994) and Carhart (1997) suggested that past performance persisted at least over the short term. These two phenomena indicated that active fund investors might exhibit selection ability, otherwise known as the "smart money" effect. Investors were able to select funds by divesting from poor performers and investing in good performers as the latter group outperformed the former over the short term.

However, Zheng (1999) reported that when a portfolio of funds with net inflows was constructed, no abnormal positive returns over the market returns were evident. Investors' cash flow could not be used to predict or earn abnormal returns, thus the "smart money" effect carried no information value.

Oosthuizen and Smit (2002) applied the same evaluation techniques used by Zheng (1999) to establish whether South African unit trust investors displayed *ex ante* selection ability of invest to funds that would perform better. The results from the analysis indicated that investors on aggregate displayed a weak, but statistically significant, skill in identifying winners. Nonetheless, no evidence was found that investors could beat the market by investing in funds with positive money flows. Thus, similar to the findings of Zheng (1999), the "smart money" effect carried no information value.

Karceski (2000) noted that mutual fund investors chase returns through time, precipitating unusually large inflows into mutual funds after dramatic market run-ups. Furthermore, in each period mutual funds compete with each other where the highest performing funds capture the largest fraction of the aggregate inflows. The interaction between these two flow-performance relationships induces an asymmetry in payoffs to mutual funds. Furthermore, since high-beta

stock tend to outperform low-beta stock in bull markets, managers tend to tilt their portfolios toward high-beta stock, in effect reducing the expected return to these securities.

Frazzini and Lamont (2005) researched whether over the long term investors are earning higher returns as a result of their re-allocation across funds. In contrast to the “smart money” hypothesis they found that fund flows are in effect “dumb money” – by re-allocating across different mutual funds, investors reduce their wealth in the long run. Retail investors direct their money to funds which typically invest in stocks that from existing price levels have low future returns. Not surprisingly, Frazzini and Lamont are of the opinion that to achieve higher returns, it is in fact best to do the opposite of what these investors are doing!

Friesen and Sapp (2007) examined the timing ability of mutual fund investors using cash flow data at the individual fund level. They conclude that over the period 1991 – 2004 the timing decisions by equity fund investors reduced the average investor’s return by 1.56% per annum. Underperformance due to poor timing is greater in load funds and funds with relatively large risk-adjusted returns. In fact, poor timing largely offsets the risk-adjusted alpha gains by funds performing well. Furthermore, investors in both actively managed funds and index funds exhibit poor investment timing and their results are consistent with investor return-chasing behaviour.

Apart from academic studies two fund performance tracking services in the U.S.A., namely *Morningstar* and *DALBAR Research* have reported on the difference between the returns of the average investor and the returns reported by mutual funds.

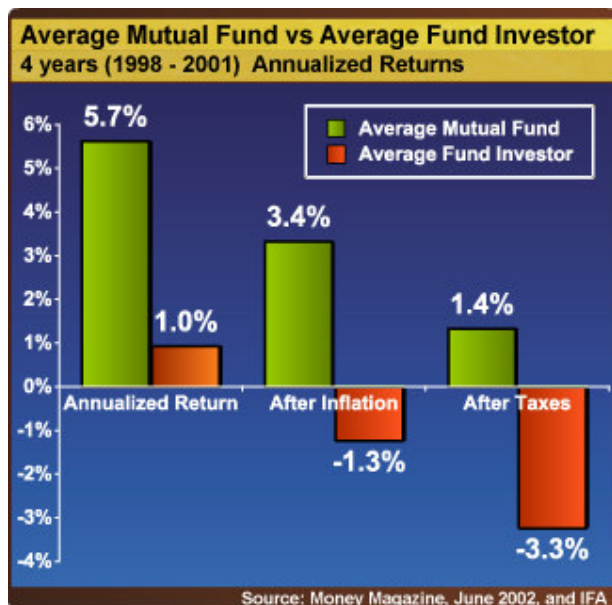


Chart 1: An example of a comparison between fund return and investors’ return

Source: *Index Fund Advisors, 2008*

For example, *DALBAR Research* compiles an annual report – *Quantitative Analysis of Investor Behavior* – which demonstrates the vast differences between the average investor’s returns versus fund returns and the index benchmark. Their studies showed that the average fund investor earned much lower returns than the S&P 500 or the average mutual fund (see chart 2). Clearly, investor behaviour can have a far more negative impact on investment performance than most investors realize.

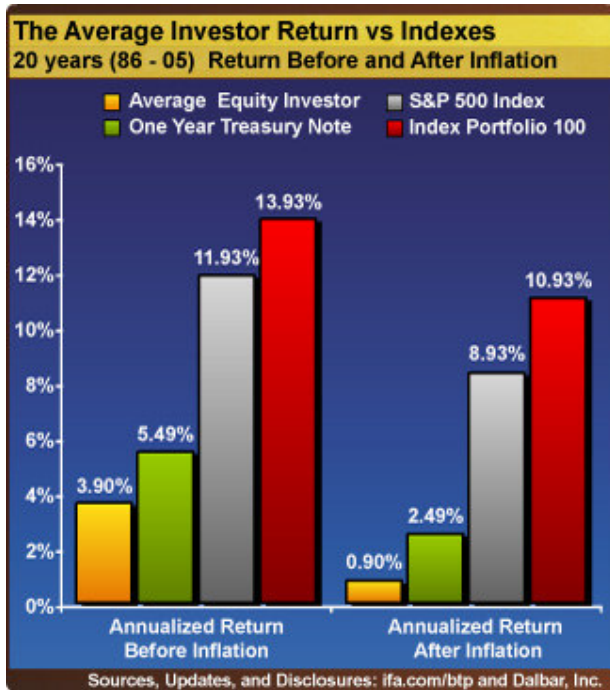


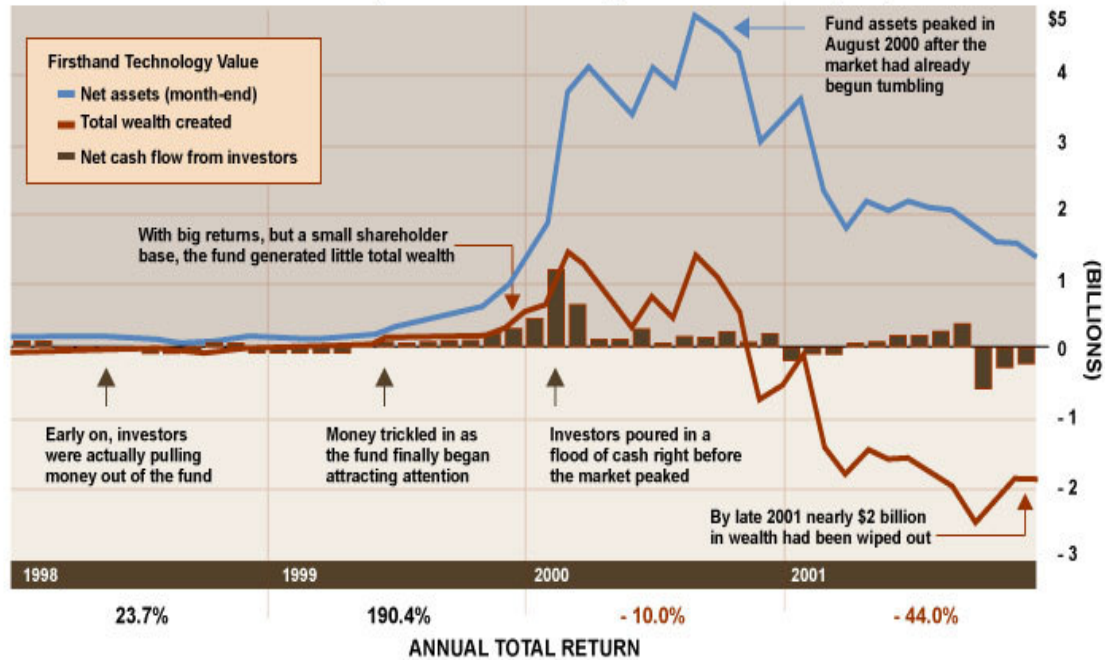
Chart 2: The average investor return

Source: *Index Fund advisors, 2008*

For example, it is noted that in one particular mutual fund, the *Firsthand Technology Value* fund, despite its impressive annualised return of 16% from 1998 to 2001, the average investor return over this period was a devastating 31.6% loss. In total it was estimated that investors lost \$1.9 billion in this fund over this period, simply because they took oversized bets in technology at the wrong time (see chart 3).

HOW FUNDS CAN EARN BIG RETURNS BUT STILL LOSE MONEY

At some funds, investors missed the glory days and piled in just in time for disaster. Firsthand Technology Value earned fantastic returns for a relative handful of early investors. But fund's late, giant losses were shared by many more.



Source: Calculations by Charles Trzcinka, Lawrence Siegel and Timothy Aurthur; MONEY research; Firsthand annual reports

Chart 3: Irrational investor behaviour

Source: *Index Fund Advisors, 2008*

The reason for this gap in actual performance is attributed to active investors who follow destructive behavioural patterns. These include waiting for funds to have a good year or two followed by an inflow of cash just before the fund reaches its peak. Then as fund performance starts to dwindle they sell near the bottom.

Chart 4 illustrates the typical investor behaviour and emotions in response to price changes.



Chart 4: An emotional roller-coaster ride

Source: *Index Fund Advisors, 2008*

The key findings of *DALBAR Research's* first study in 1994 remain true today: "Investment return is far more dependent on investor behavior than on fund performance. Mutual fund investors who hold their investments are more successful than those that time the market."

In their latest report (2007) *DALBAR Research* describes the two principal reasons for the mismatch between fund returns and average investor's returns as:

"Mutual fund performance reports assume a lump sum investment made once and held for the entire period being reported."

"Current industry practices are to report a mutual fund's returns based on a lump sum investment at the start of the time period being measured (one, three, five, ten years, etc.). While mathematically useful, there are virtually no investors that exhibit this behavior, making the published returns applicable to no one. Investors are buying and selling and they rarely have the discipline or the cash to make a single lump sum investment without the need to withdraw from, or desire to add to their investment."

“Investors are motivated by greed and fear – not by sound investment practices.”

“Close examination of investor behavior reveals that as markets rise, investors pour cash into mutual funds, and a selling frenzy begins after a decline. Tracking the dollars going into and out of mutual funds over a given month compared to market performance proves the correlation: as markets rise, cash flows swell; as markets decline, cash flows deflate. Additional factors that influence investor behavior are new funds, funds that surge in popularity and funds that close. While the effects of these cannot be quantified, the allure of new or popular funds do cause investors to switch. The announcement of fund closings cause some withdrawals. These behaviors lower investor returns, depending on when they occur.”

Will South African unit trust investors on average act differently than their U.S. counterparts? We know the respective markets differ in size, breadth and perhaps efficiency, yet investors on the aggregate tend to exhibit similar investment behavioural patterns across all markets. Let the figures speak for themselves.

4. The South African Experience

4.1 Data

The study specifically focussed on the major equity-linked unit trust sectors, namely equity unit trusts and asset allocation (multi asset class) unit trust funds. For each sector the following major categories in terms of asset sizes were identified:

- Equity unit trusts – general, growth, value, and large cap equity;
- Asset Allocation unit trusts – prudential low equity, prudential medium equity, flexible, and targeted absolute and real return.

Data were collected from the statistical database available on the website of the Association of Collective Investments (ACI) and published quarterly. The evaluation period spanned December 1999 to December 2007; in total a seven-year review period for the equity unit trust category. Since a new classification of asset allocation funds was introduced in 2003 the evaluation period for this category spanned a period of four years.

The following data were gathered for each category at quarter-end: average fund performance per category (annually and quarterly, where available), total assets per category (net asset value) at quarter-end, total sales and repurchases reported for each quarter and thus the net inflow/outflow of investors' monies during each quarter.

The average investor's return for a period was calculated by using the *Internal Rate of Return* (IRR) methodology. For example, the average investor's return for the general equity fund category for the three year-period ending December 2007 was calculated by using the net asset value of all unit trust funds in the general equity category as at December 2004 as the initial investment value; the ensuing quarterly inflows/outflows as investors' contributions or withdrawals during this period, and the total net asset value of the general equity category at the end of December 2007 as the final investment value. The average return attained by investors for each period was then compared with the reported average fund returns over the same period.

4.2 Results

4.2.1 Equity Unit Trusts

Asset Size and Net Flows¹

- Assets under management in equity unit trusts at the end of December 2007 amounted to R176 billion, which is about 30% of the total assets under management in unit trusts (including fixed interest and money market funds).

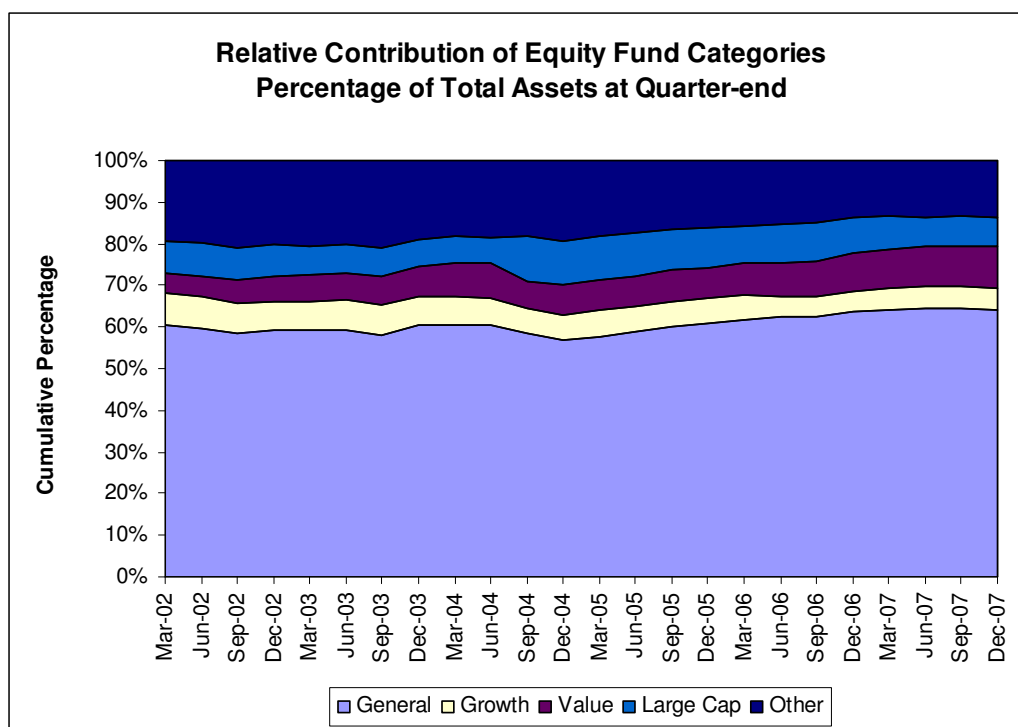


Chart 5: The major equity fund categories

Source: *Quarterly Survey of Unit Trusts, ACI*

- The four equity fund categories under review, namely general equity, growth, value and large cap equity unit trusts make up 85% of the total assets invested in equity funds.

¹ See Appendix 1 for a detailed graphical analysis of the net flow of funds to each equity category

- General equity funds are the dominant category within the equity fund sector; 65% of all assets are housed in this category. The relative dominance thereof was maintained over other categories in recent years.
- Specialist equity funds, like sector-specific equity funds – branded here as “Other” – became less popular in recent years as investors in general preferred a more diversified approach to equity investments.

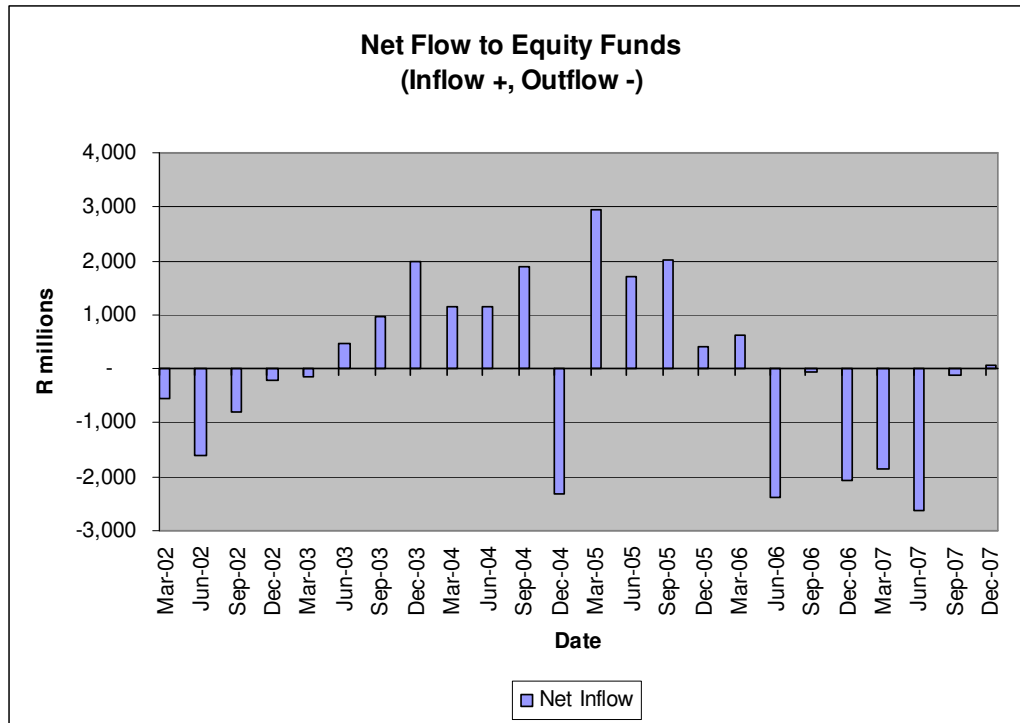


Chart 6: Net flow to equity funds

Source: Quarterly Survey of Unit Trusts, ACI

- The net flow (sales – repurchases) to equity funds was inconsistent; predominantly a net inflow during the early and middle part of the recent bull market, while a net outflow occurred during the late stages of this bull market.

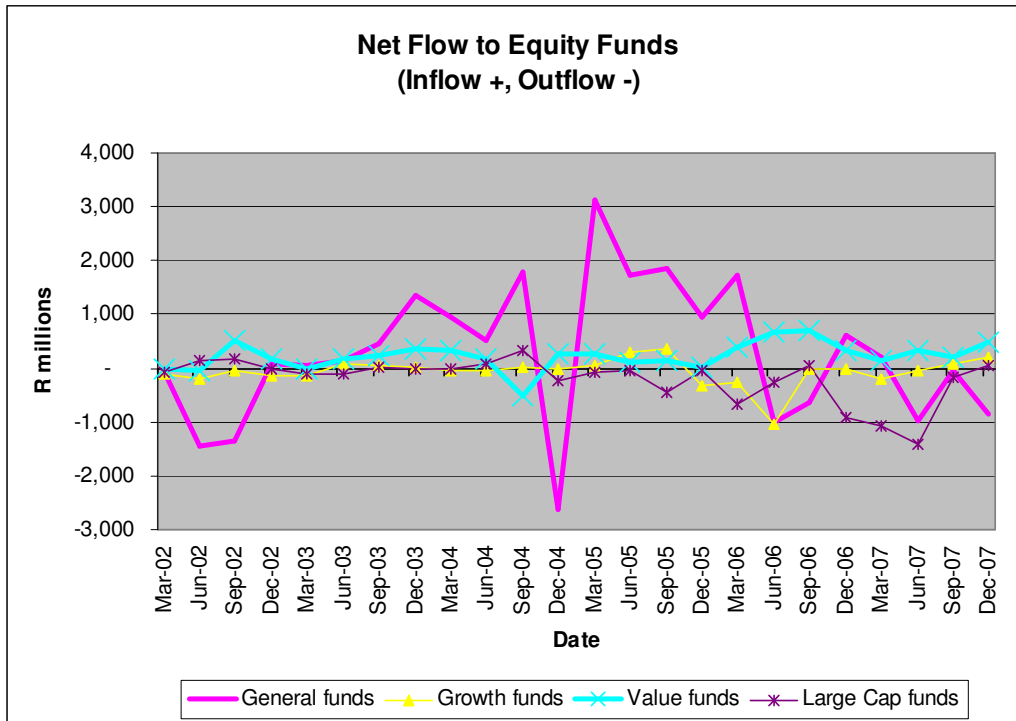


Chart 7: Net flow per equity fund category

Source: Quarterly Survey of Unit Trusts, ACI

- Value equity funds made significant gains in recent years as a popular investment destination among investors as assets under management increased six-fold since 2002. Unlike the general equity funds, which experienced an erratic flow of funds, a relatively constant inflow of investors' monies was allocated to this category.

A Comparison of Annualised Returns

The average investors' return for the different equity unit trust categories, computed using the cash flow data available at each quarter-end was compared with the reported average fund performance data for each equity category.

a) Based on Level Quarterly Contributions*

Table 3: Average Investors' Return and Average Fund Performance

General Equity	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	18.3%	16.6%	15.5%	14.1%

Growth	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	18.3%	20.3%	19.7%	17.9%

Value	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	18.3%	16.6%	15.1%	13.8%

Large Cap	Index Benchmark (Top 40)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	18.1%	16.8%	17.5%	13.2%

* Quarterly performance data only available since September 2006

b) Based on a Lump Sum Investment ²

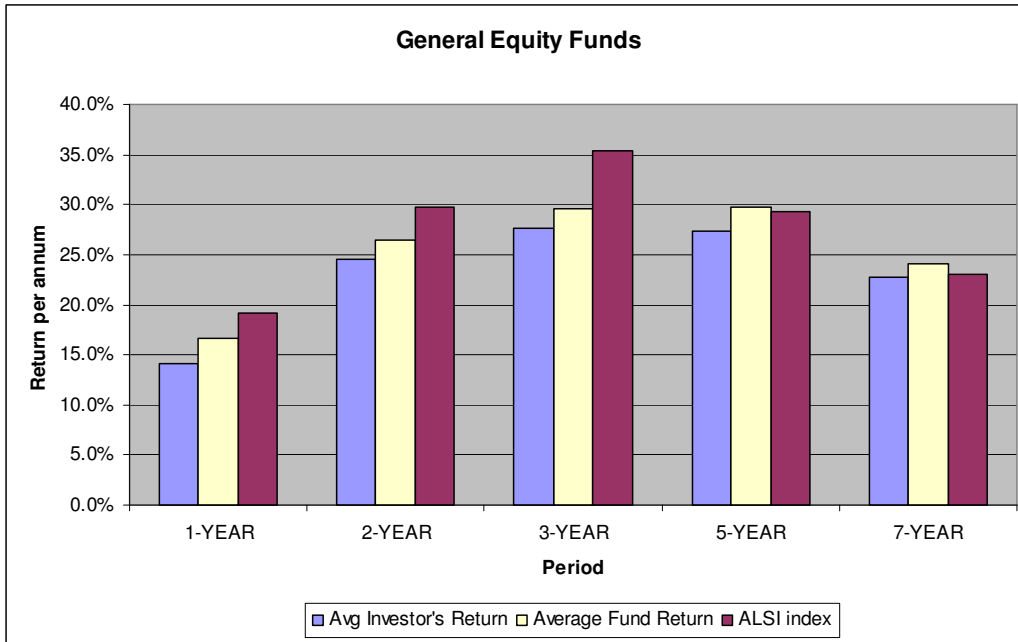


Chart 8: General Equity

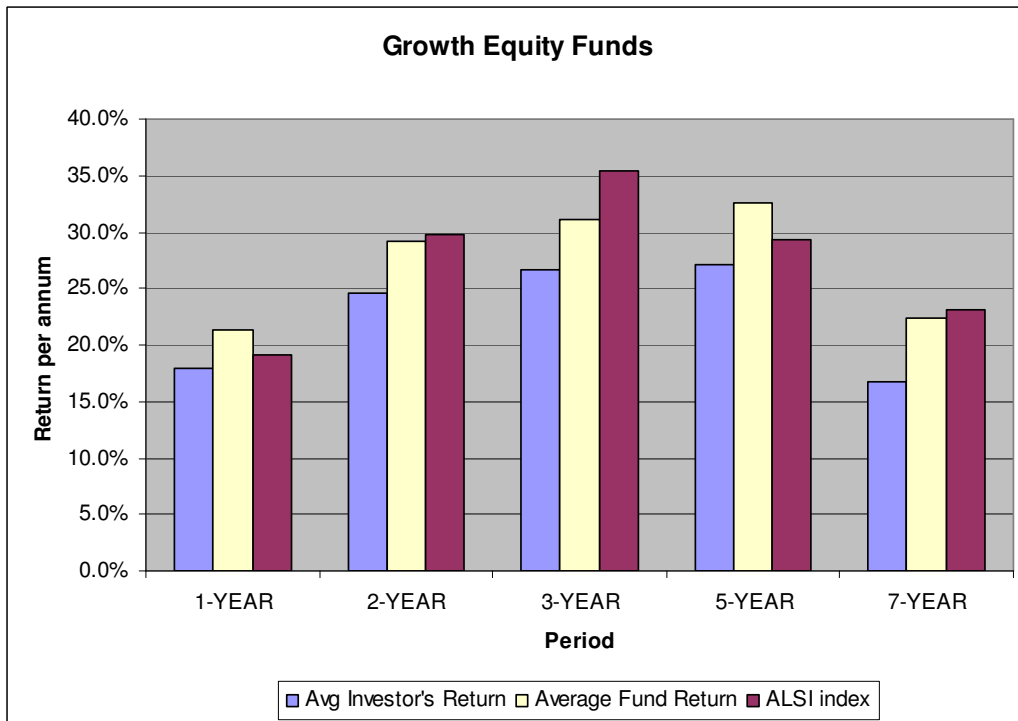


Chart 9: Growth Equity

² See Appendix 2 for a tabulated comparison of the different equity fund categories

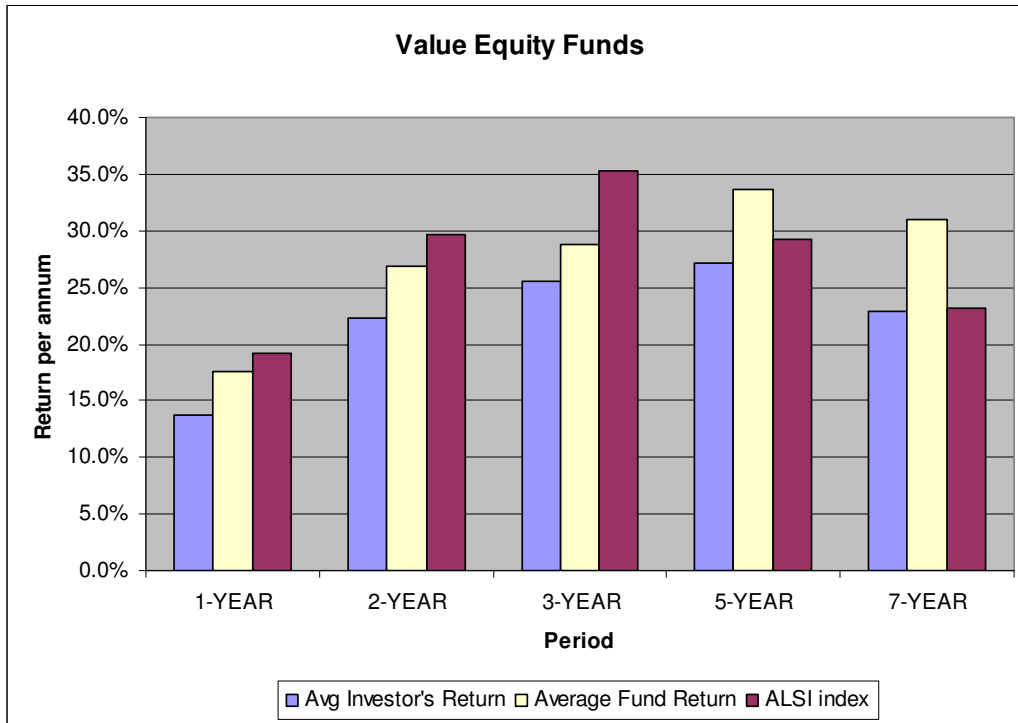


Chart 10: Value Equity

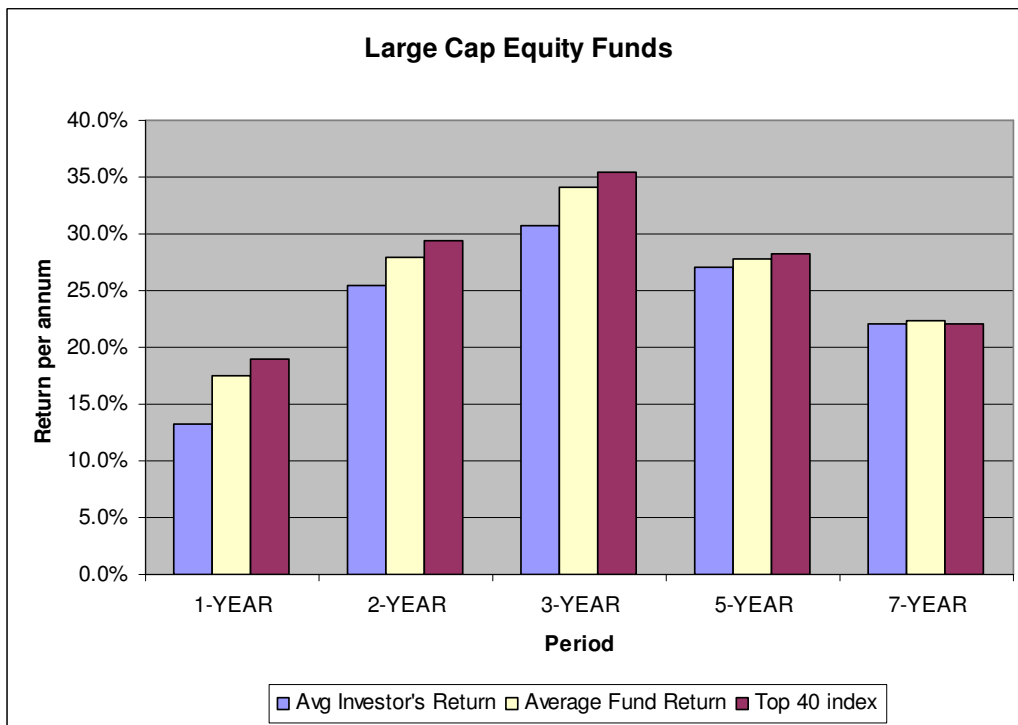


Chart 11: Large Cap Equity

- Investors on average underperformed the reported average fund performance for each equity category over all review periods.
- Investors on average did not outperform the respective index benchmark (ALSI or Top 40) over any period, despite the reported average fund performance for some categories faring better than the index over certain investment periods.
- General equity and large cap equity investors did share on average a fairly high percentage – more than 90% – of the average fund performance, especially over the longer investment periods.
- In contrast, value and growth equity investors did share on average 70–80% of the reported average fund performance for these two categories.
- The return differences in the lump sum comparison (Appendix 2) consist of *time-weighted* and *rand-weighted* variables. The level quarterly contribution (table 3) explains the *time-weighted* return difference, but it is apparent that most of the return differences are explained by the *rand-weighted* variable. Thus, poor market timing by investors on average led to reduced returns compared with fund returns.

4.2.2 Asset Allocation Unit Trusts

Asset Size and Net Inflow³

- Assets under management in the asset allocation unit trust category at the end of December 2007 amounted to R147 billion, which is about 25% of the total assets under management in unit trusts (including fixed interest and money market funds).

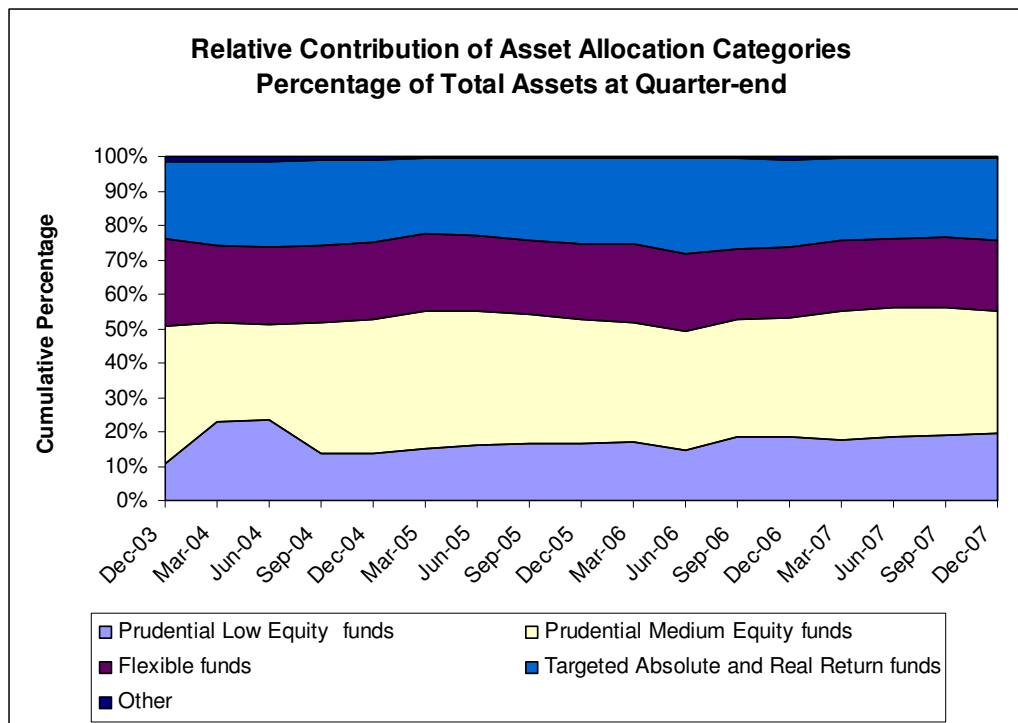


Chart 12: The major asset allocation categories

Source: *Quarterly Survey of Unit Trusts, ACI*

- The four asset allocation categories under review, namely prudential low equity, prudential medium equity, flexible, and targeted absolute real return funds make up basically all the assets (99.8%) in the asset allocation category.
- Prudential medium equity funds are the largest category of the asset allocation funds – 35% of assets – which remained relatively constant during recent years.

³ See Appendix 3 for a detailed graphical analysis of the net flow of funds to each asset allocation category

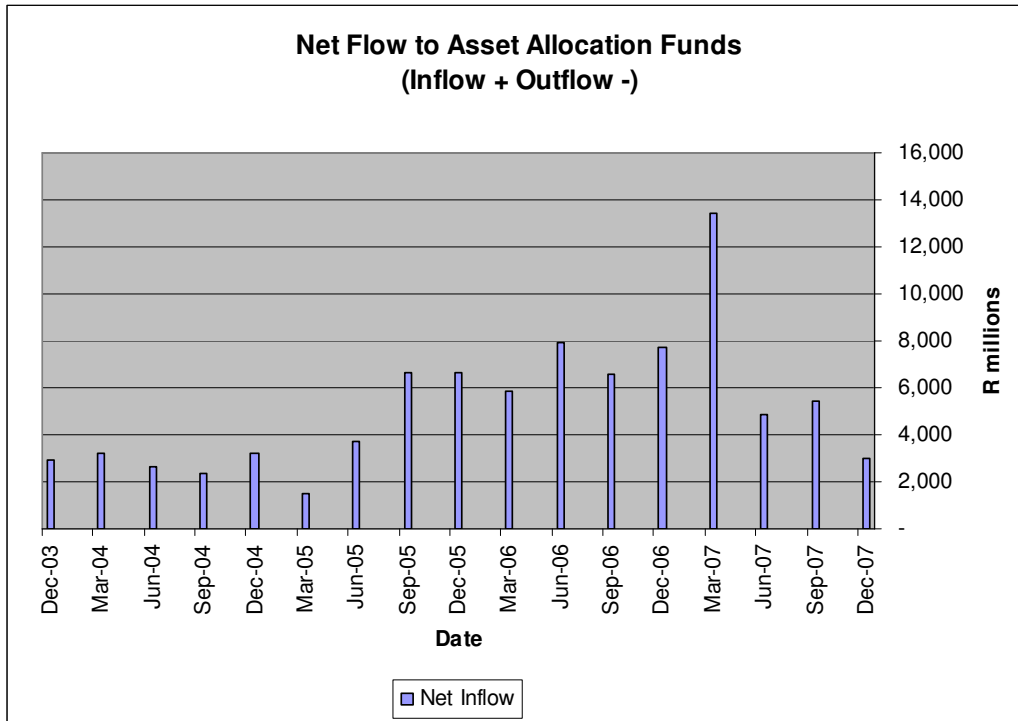


Chart 13: Net flow to asset allocation funds

Source: Quarterly Survey of Unit Trusts, ACI

- Unlike the net flow to equity funds, asset allocation funds received a constant net inflow, accelerating from the middle of 2005 until the middle of 2007. Furthermore, net inflows to asset allocation funds were at times at least two to three times the net inflow of equity funds; confirming investors' preference for diversified investment portfolios.

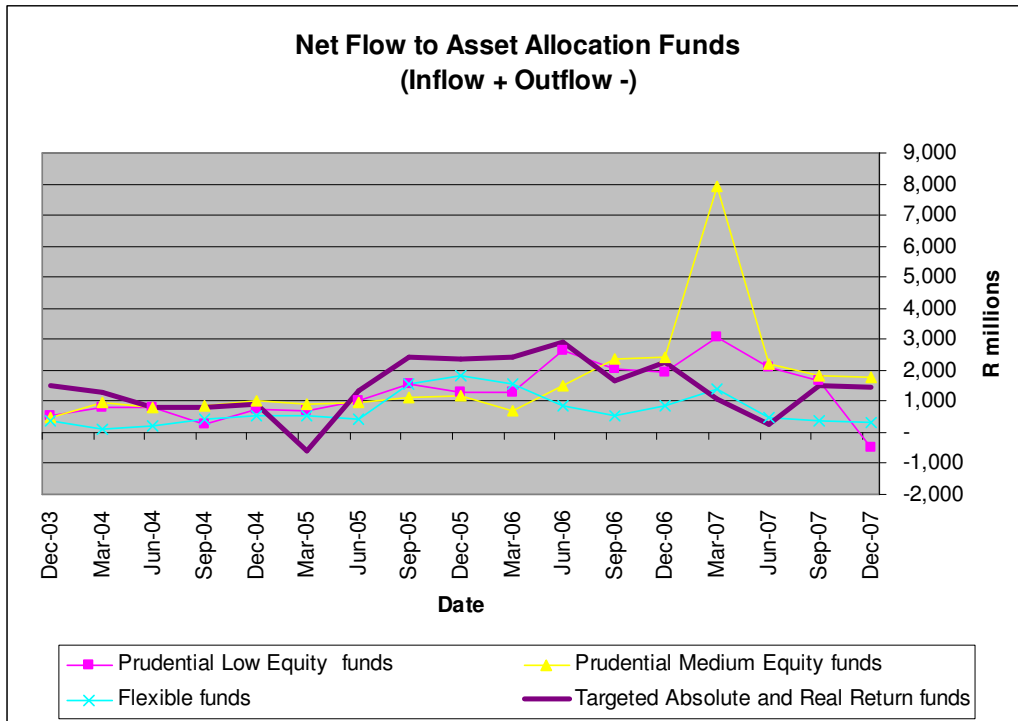


Chart 14: Net flow per asset allocation category

Source: Quarterly Survey of Unit Trusts, ACI

- Targeted real return funds received relatively large net inflows during the recent market turmoil which started around the middle of 2007, while the flow to the other fund categories relatively declined or stagnated.

Comparison of Annualised Returns

a) Based on Level Quarterly Contributions*

Table 4: Average Investors' Return and Average Fund Performance

Prudential Low Equity	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	9.3%	9.1%	0.3%

Prudential Medium Equity	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	11.6%	11.4%	-6.8%

Flexible	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	15.2%	13.7%	13.9%

Targeted Real Return	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	9.9%	9.3%	2.3%

* Quarterly performance data only published since September 2006

b) Based on a Lump Sum Investment ⁴

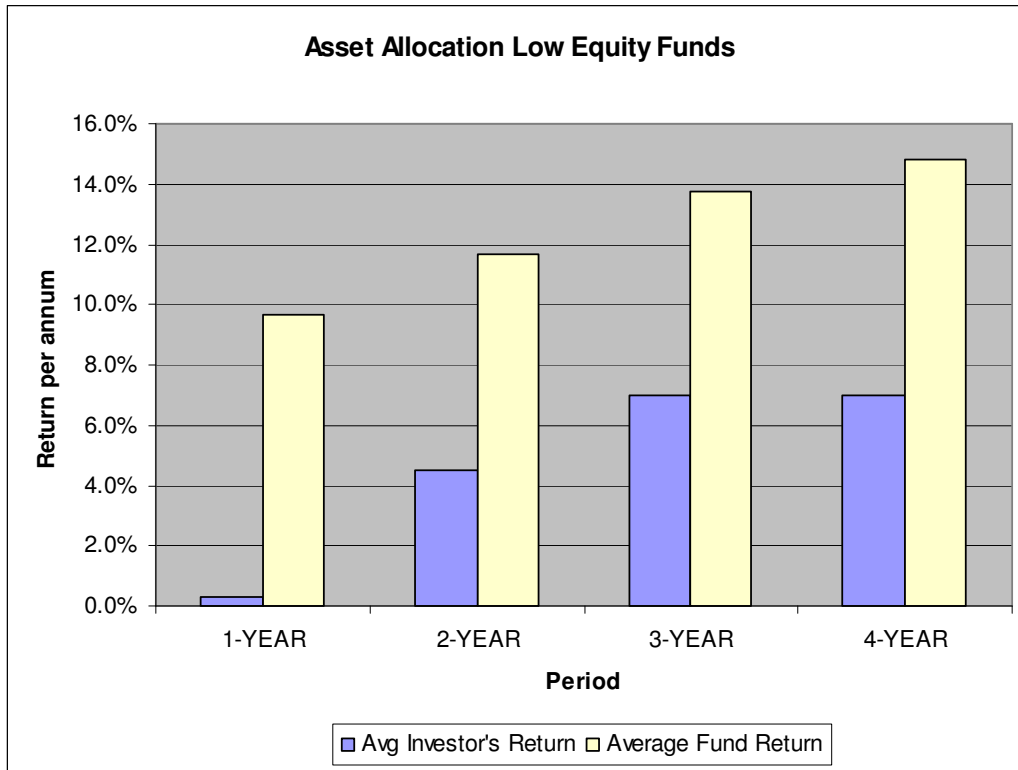


Chart 15: Prudential Low Equity

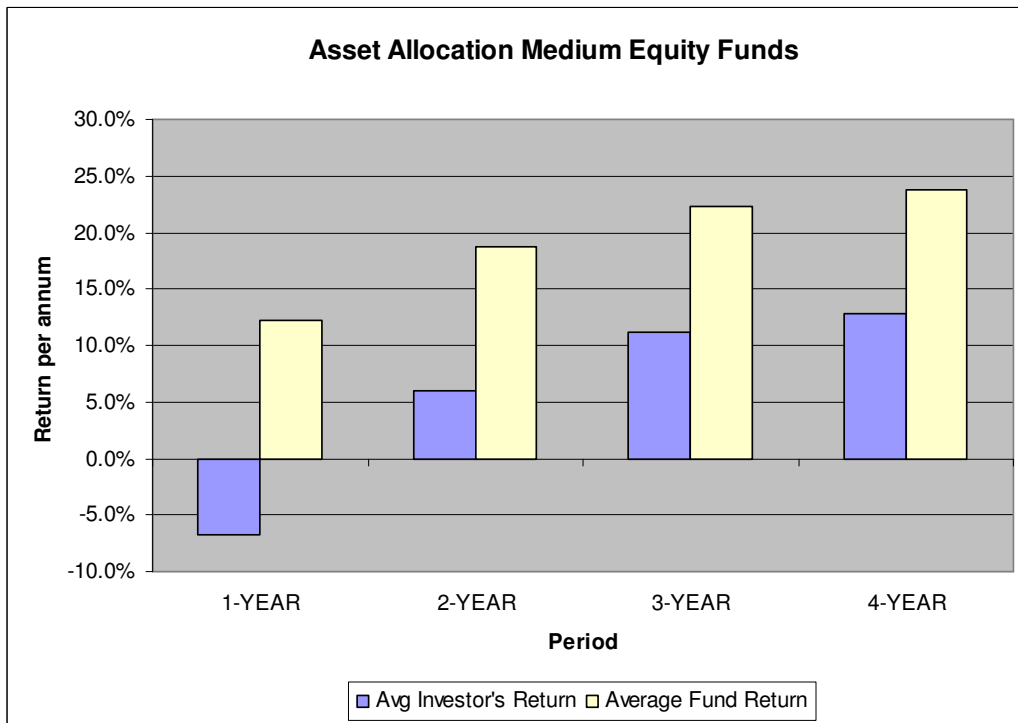


Chart 16: Prudential Medium Equity

⁴ See Appendix 4 for a tabulated comparison of the different asset allocation fund categories

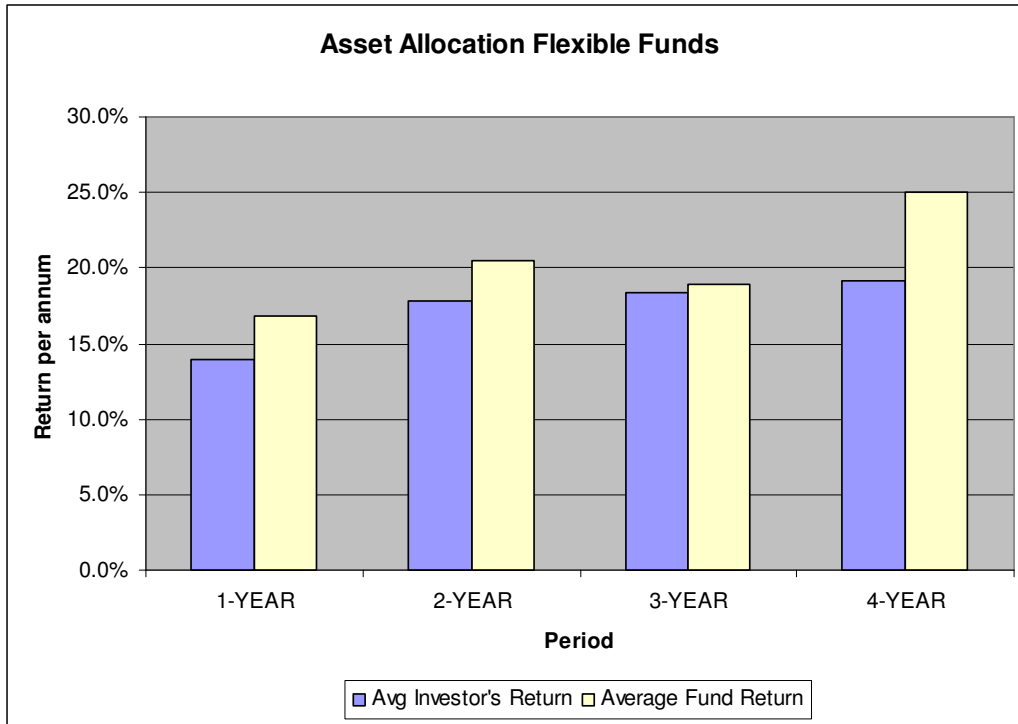


Chart 17: Flexible Funds

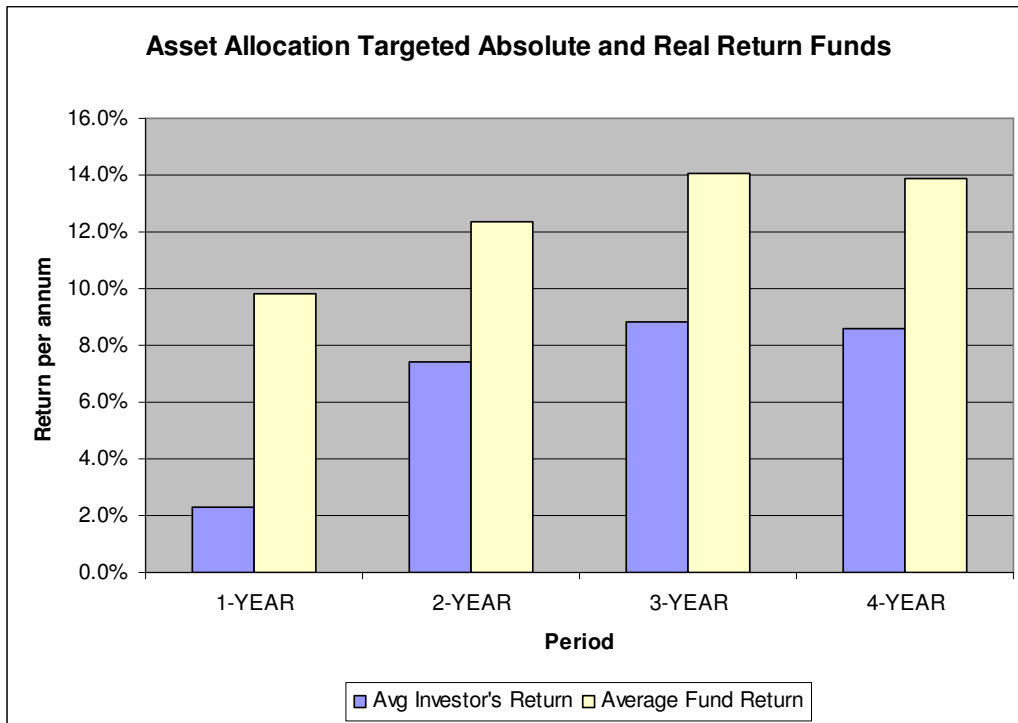


Chart 18: Targeted Absolute and Real Return Funds

- Compared with equity fund investors, asset allocation fund investors on average fared poorly in capturing the performances of their funds.
- Investors in the low equity, medium equity and targeted real return funds on average only shared in 40-60% of the reported fund returns over most review periods.
- Notably, investors in flexible asset allocation funds shared in more than 80% of the reported fund returns.
- The return differences in the lump sum comparison (Appendix 4) consist of *time-weighted* and *rand-weighted* variables. The level quarterly contribution (table 4) explains the *time-weighted* return difference, but it is apparent that most of the return differences are explained by the *rand-weighted* variable. Thus, poor market timing by investors on average led to reduced returns compared with fund returns.

4.3 An Analysis: Explaining the Difference

Some possible explanations could be put forward why investors on average shared a larger portion of fund returns with some funds than they did with other funds.

On average, investors captured a larger portion of equity fund returns than they did with asset allocation funds. Charts 19 and 20 illustrate that transactional activities (sales and repurchases) as a percentage of fund assets were higher in the asset allocation funds than in the equity funds. Investors' return in asset allocation funds would consequently be more accentuated by actual cash flow movements than it would have been with equity funds, thus the *rand-weighted* effect would largely explain return differences.

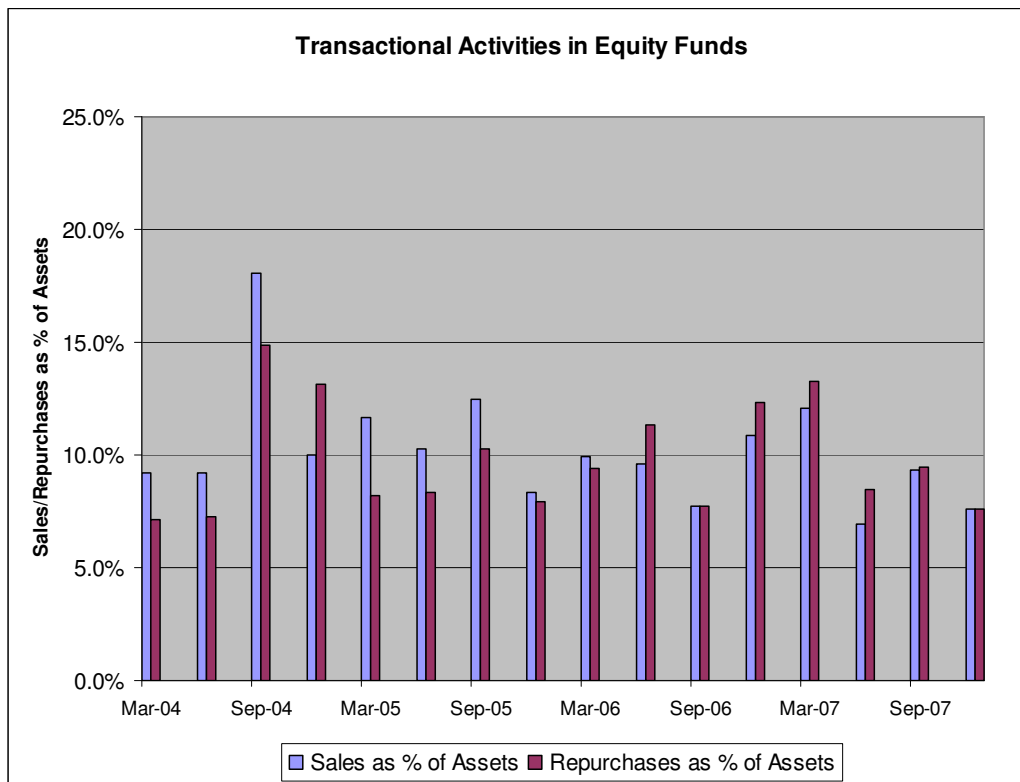


Chart 19: Sales & repurchases of equity funds as a percentage of assets under management

Source: Quarterly Survey of Unit Trusts, ACI

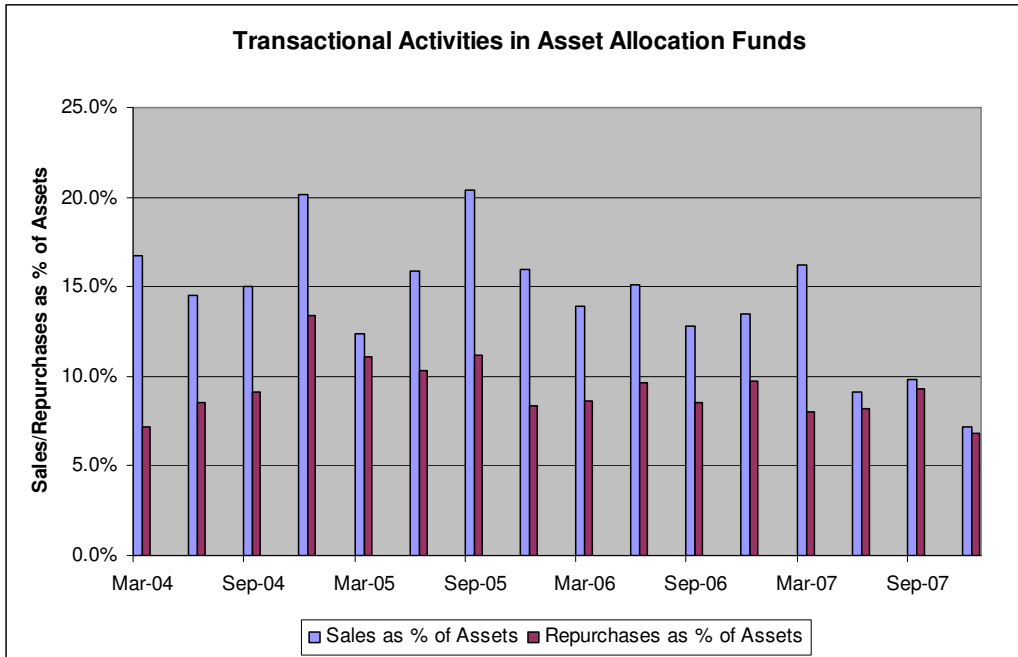


Chart 20: Sales & repurchases of asset allocation funds as a percentage of assets

Source: Quarterly Survey of Unit Trusts, ACI

Repurchasing activities in equity funds surpassed sales from the middle of 2006 onwards; investors probably moved into more market defensive positions, like asset allocation funds, and effectively captured the profits they would have made in equity funds.

In contrast, investors in asset allocation funds were net buyers throughout the whole review period. The difference between sales and repurchases (net inflow) of asset allocation funds only started to dwindle towards the middle of 2007.

The *rand-weighted* effect can be further illustrated by analysing cash flows to the different unit trust categories. For example, investors on average shared almost fully in the average reported returns of large cap equity funds, while value equity fund investors on average did worse – about 70-80% of the reported returns.

Chart 21 depicts the net flow to large cap and value equity funds respectively. While large cap equity investors were net withdrawers of their funds despite stellar investment returns, value funds received net inflows almost every quarter. Yet, the reported returns from value funds were not that different from or superior to large cap equity funds to justify such opposing investor behaviour.

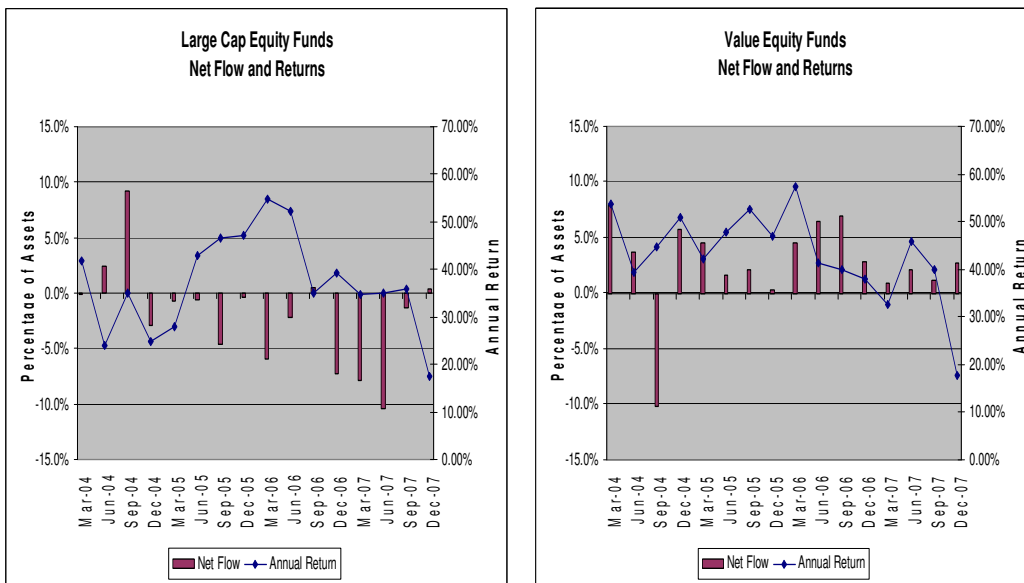


Chart 21: Difference in net flow to equity funds and annual return

Source: Quarterly Survey of Unit Trusts, ACI

Chart 22 shows in another example how the *rand-weighted* effect will dictate investors' return. Investors in medium equity asset allocation funds shared in only 40-60% of fund returns, while sharing in about 80% of the fund returns of flexible asset allocation funds. The reason therefore can be found in the proportionally large inflow of monies to medium equity funds during the first quarter of 2007 while fund returns for the remainder of the year declined from its high base. Although flexible funds continued receiving net inflows they remained subdued relative to the assets under management.

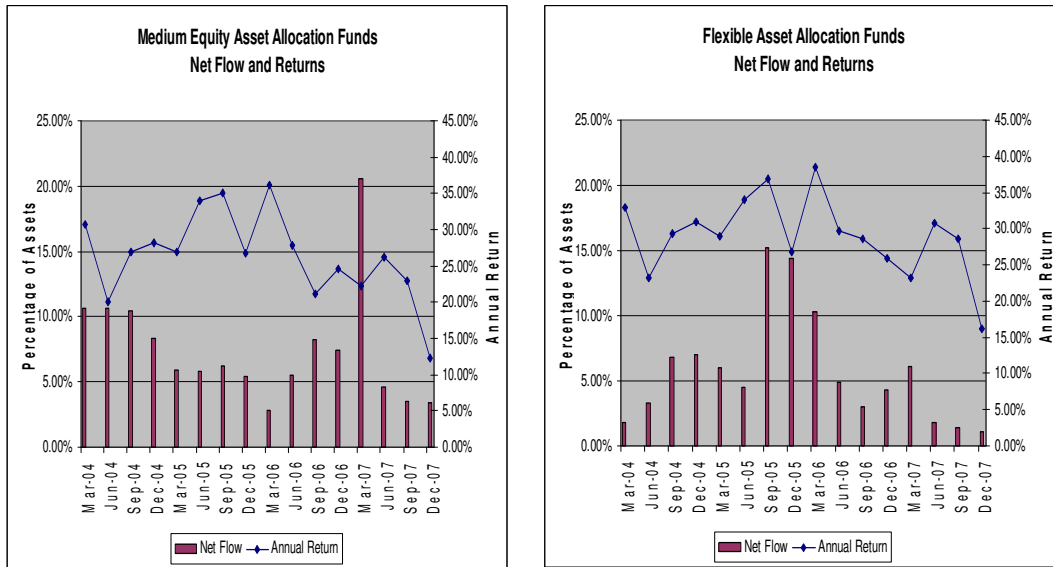


Chart 22: Difference in net flow to asset allocation funds and annual returns

Source: Quarterly Survey of Unit Trusts, ACI

5. Synopsis

Investors in equity funds on average captured a relatively large portion of the reported fund returns. This is mostly explained by the net outflow of monies from the equity fund sector in recent quarters coupled with a declining trend in equity returns. Thus, investors' returns relative to the reported fund returns were enhanced by the *rand-weighted* effect.

Contrary to the above, investors in asset allocation funds on average shared significantly less in the reported fund returns. This is largely attributed to relatively large inflows towards asset allocation funds while market returns were in a declining trend. Thus, the *rand-weighted* effect worked against the average investor's return.

Hence, a strong argument could be put forward that a unit trust investor should not "follow the crowd"; i.e. allocate monies to popular destinations at specific times.

Investors on average do not match the reported fund returns. From time to time they do make ad hoc investments, withdrawals or switches to new funds. This specific cash flow pattern of contributions and withdrawals may significantly affect the actual return.

Basically, while an investor may think that his/her investments are invested with top-notch performing funds, the actual return may be very different from the reported fund performance. It could most likely be significantly worse than the investor might have thought.

6. Further Comments

1. Fund performances reports as supplied by the various management companies or performance tracking services are normally based on lump sum investment assumptions. Most often investors base their investment decisions on past performances of funds, as if an investment in a “winning” fund would automatically make them part of the “winning formula”.
2. A “winning” fund seldom remains a winner all the time. Many variables are at play that affect market or sector-specific returns. Some of these variables may not make sense at a particular time or some variables may produce an unexpected outcome compared with historical outcomes.

For example, think of the apparent “value” that bank shares are offering today. Many fund managers have for some time now called bank shares a “good buy” and subsequently have gone overweight in them in their portfolios. Guess what? Bank shares have only become “an even better buy” as the deteriorating economic and inflation prospects played havoc with bank share prices.

Now consider commodity stocks. Every fund manager and his dog have called them “expensive” in historical terms and said that “sharp retractions in commodity prices are most likely to follow soon”. Well, most of them have been painfully wrong for at least two to three years now and have cost their investors dearly compared with an ordinary market index portfolio!

3. Generally, investors pay little attention to why a particular fund has been successful in the past, as if fund managers have some magical tools at their disposal to generate returns “out of the blue”. Investors’ research efforts are very often focussed on past performances as the sole criterion. This deficiency gives rise to destructive behavioural patterns such as active switching and chasing returns.
4. Investors should be aware that investing in a “winning” fund does not necessarily mean that their actual returns would match the reported top-notch performance. In fact, it may easily be that other less popular alternatives could have given better results for their specific investment flow pattern, especially since the outperformance of a specific fund over prolonged periods is very seldom persistent.

Furthermore, there is simply no way that any investor could confidently predict that his/her fund selection would outsmart market returns. Then, given the lack of

performance persistency and predictability, why bother with active switching and pursuing top performing funds at regular intervals?

5. Investors are very often prone to another classic form of destructive behaviour, namely to anticipate future market returns and then to make structural changes to their asset allocation strategies.

For example, with the advent of market volatility, as we have seen of late, investors frequently elect to switch their investment portfolios into low-risk or “protected” funds, anticipating severe market pull-backs. While that certainly can and do happen, the rapidity of a market recovery is normally underestimated. In fact, the market could perform even with economic conditions deteriorating – investors often forget that markets are forward-looking, while economic reporting is mostly retrospective, i.e. about what happened in the past.

An important point to remember is that the market is not collectively “stupid”; it may be wrong *some* times, but not *all* the time. Market timing and predicting returns very seldom work. Hence, the investor would be best off by sticking predominantly to his/her predetermined asset allocation strategy.

6. Any investor should start with an appropriate investment strategy in place, namely what the objective of the investment strategy should be, for example a real return of 5%, the time horizon for these objectives to be met, and an appropriate asset allocation structure to meet these objectives. Actively switching from one “winning” fund or investment theme to the next should not form an integral part of a prudent investment strategy. In fact, more time and effort should go into the planning process than the actual implementation and monitoring thereof. Basically, “plan your play and then play your plan.”

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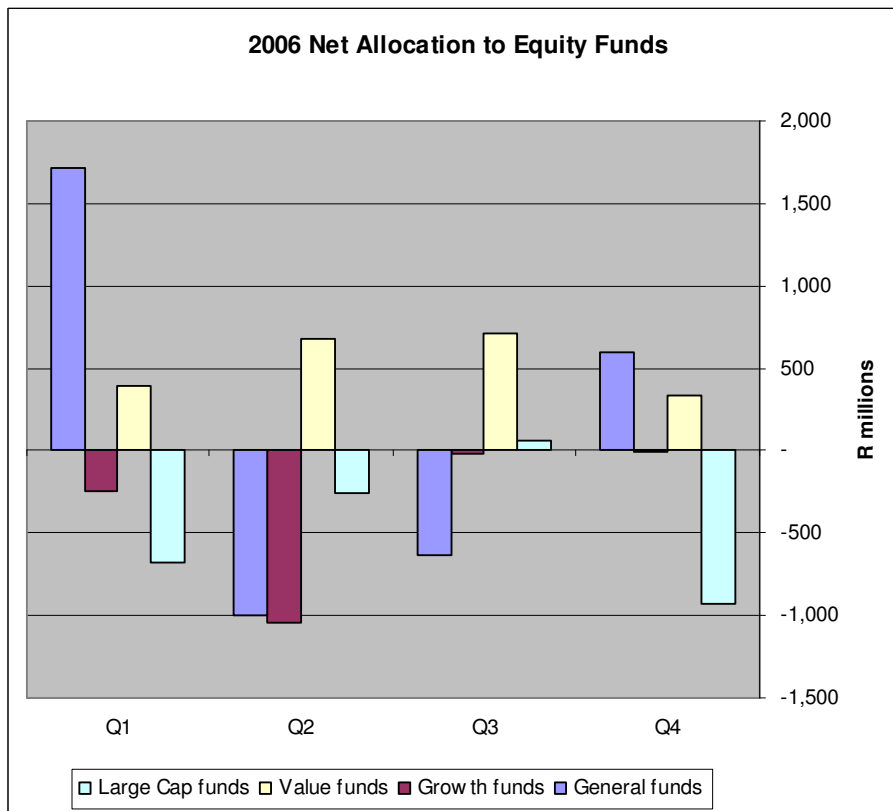
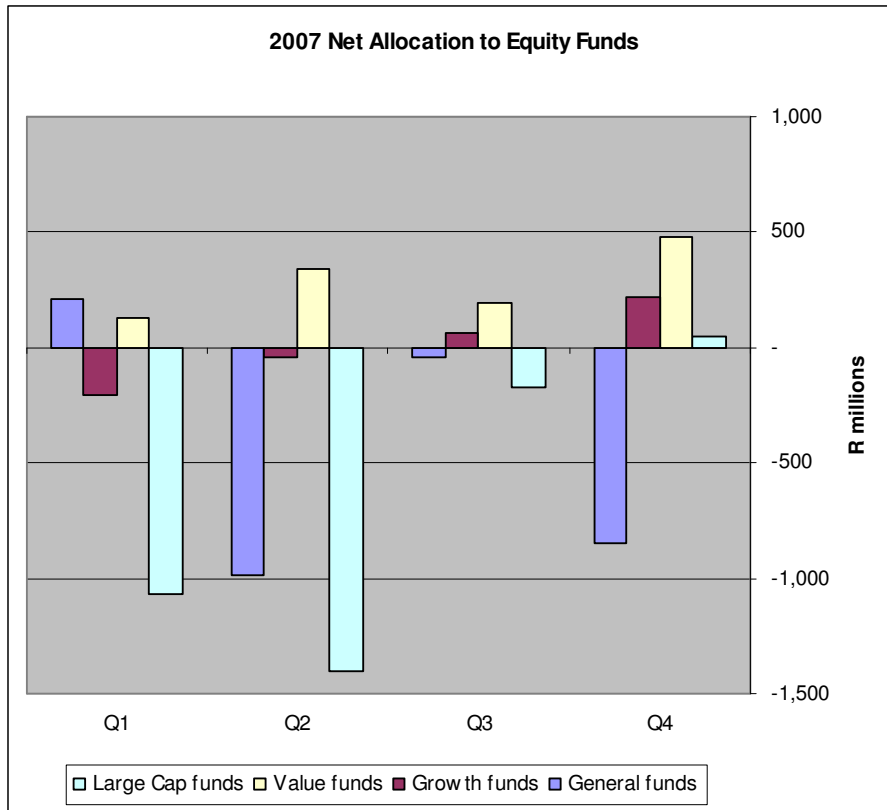
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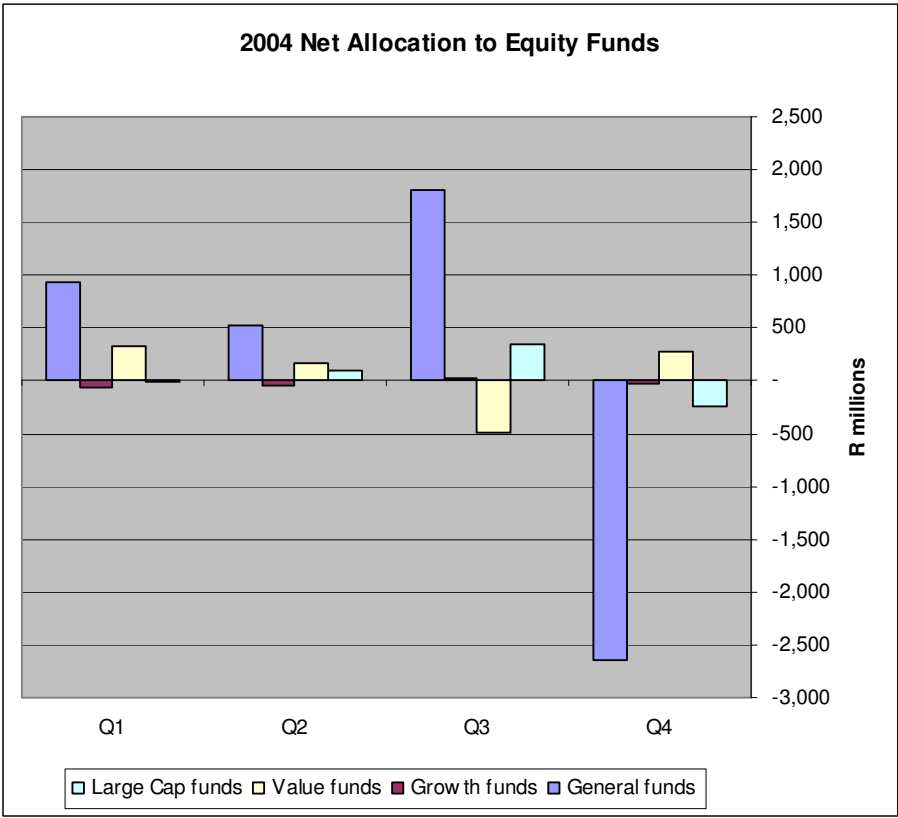
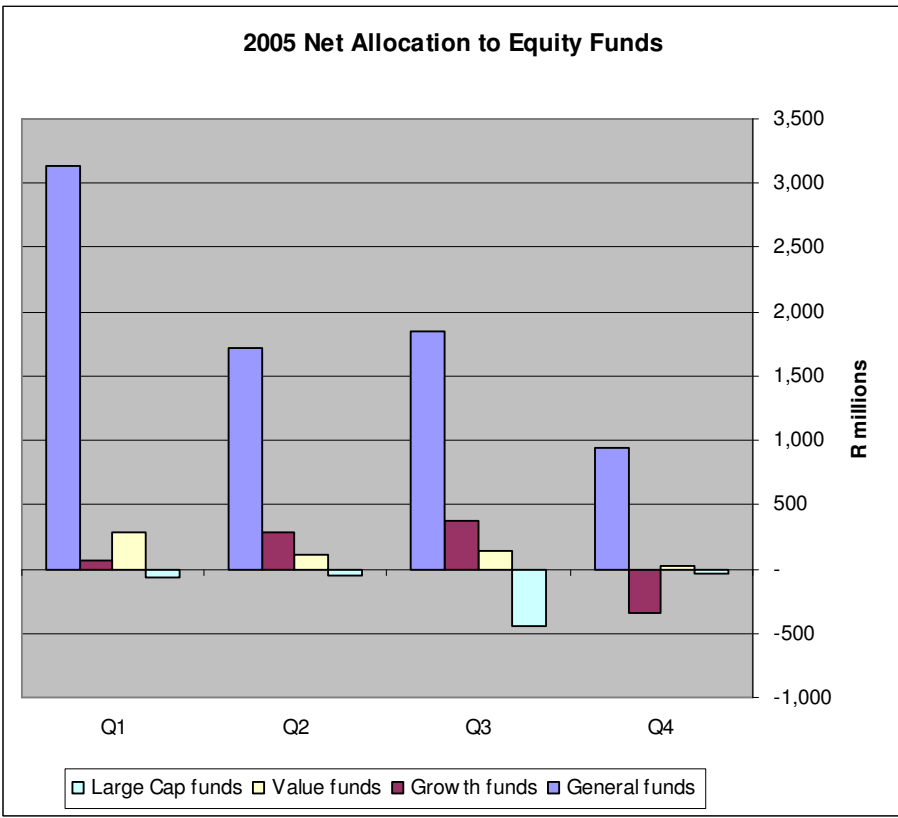
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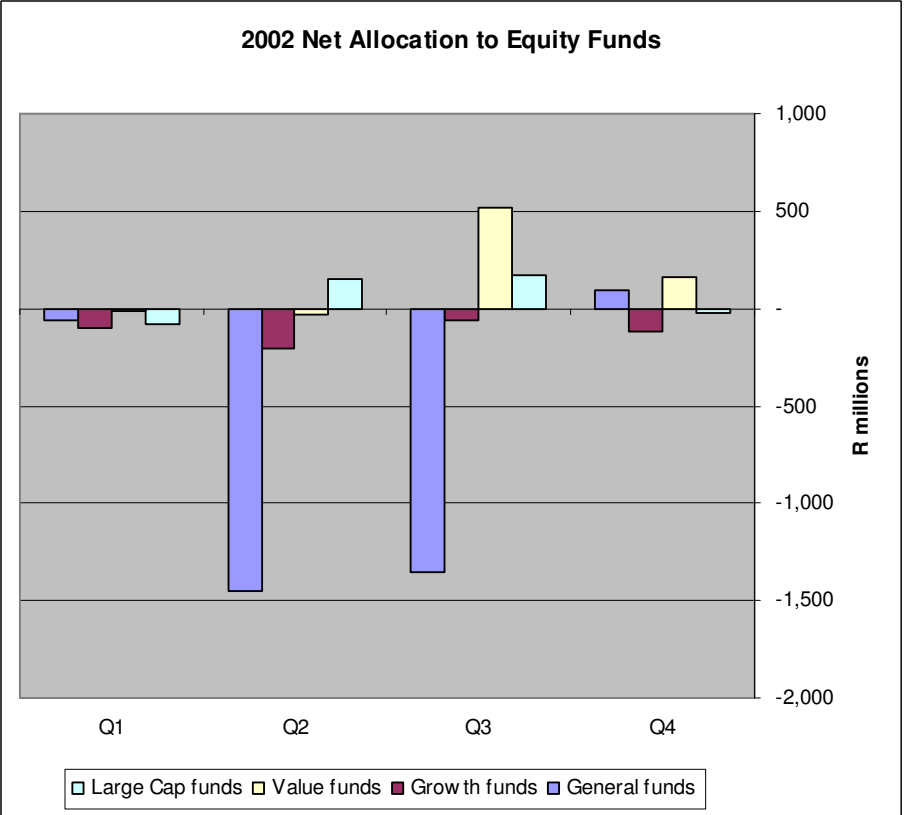
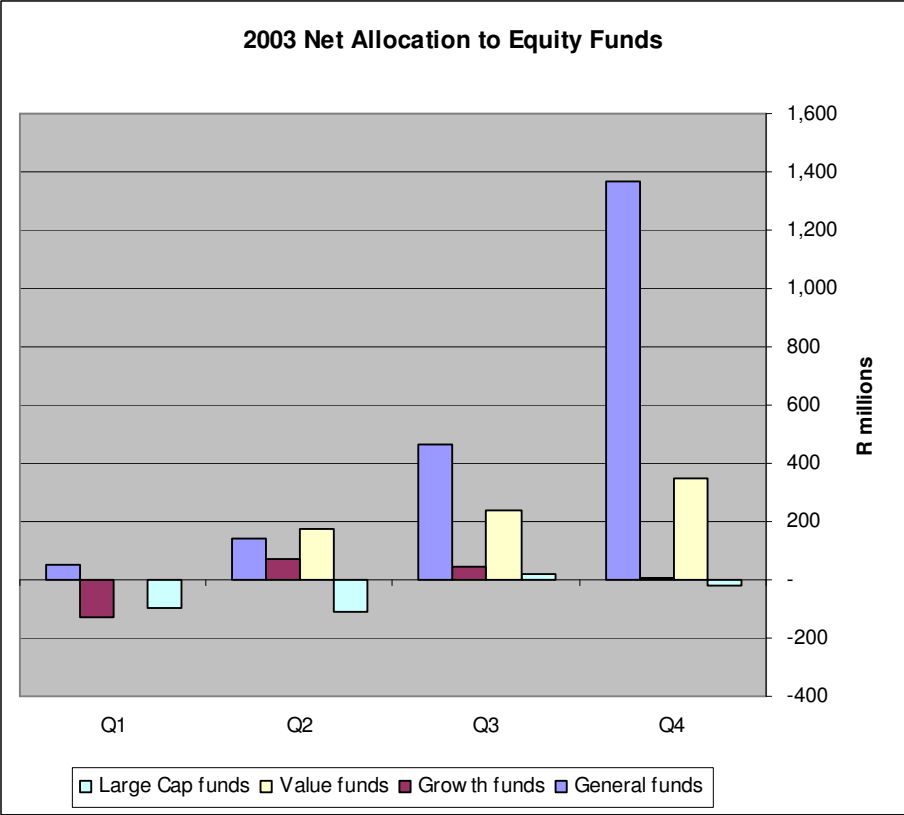
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Appendix 1







Appendix 2

Comparison of Annualised Returns: Equity Unit Trust Category

Based on Lump Sum Investment (Period ending December 2007)

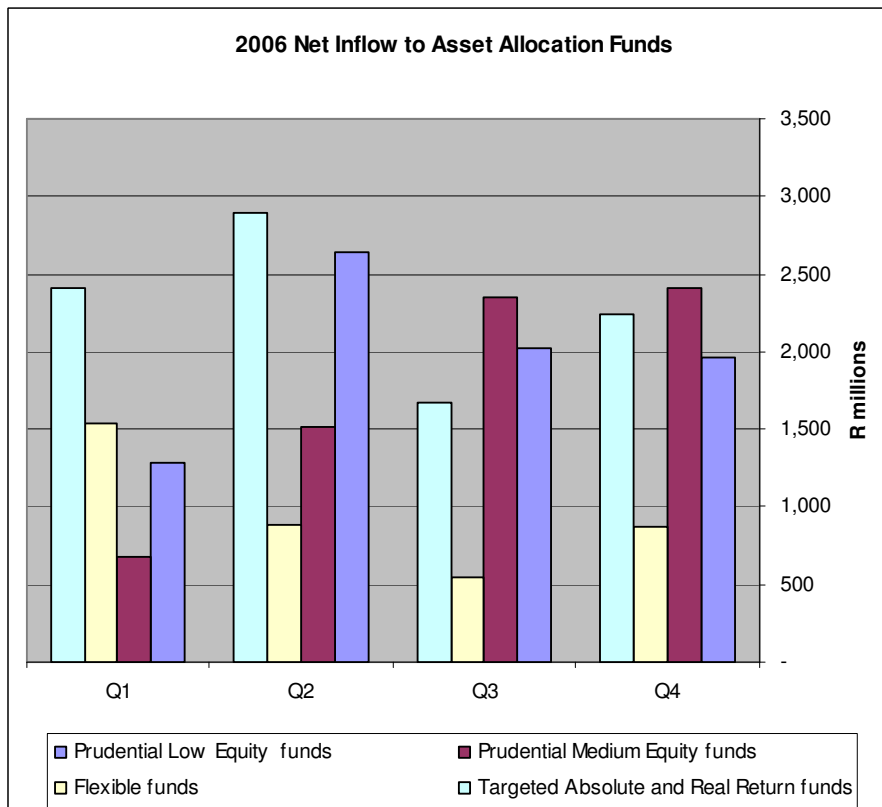
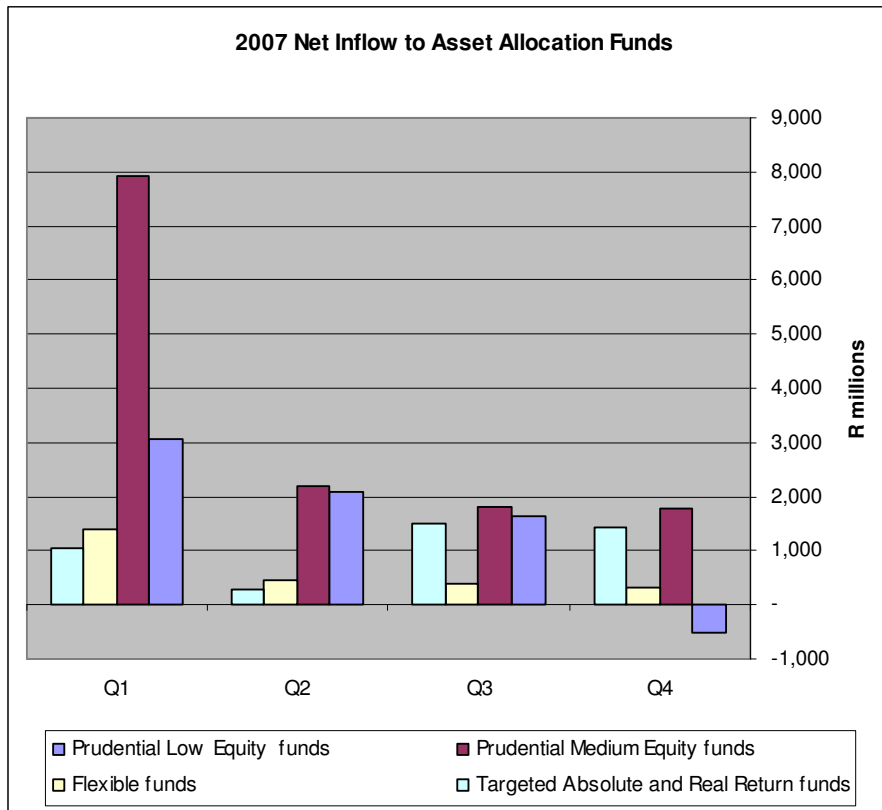
General Equity	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	19.2%	16.7%	16.0%	14.1%
Two-year	29.7%	26.4%	25.9%	24.6%
Three-year	35.3%	29.6%	29.2%	27.7%
Five-year	29.3%	29.7%	29.3%	27.3%
Seven-year	23.1%	24.1%	22.9%	22.7%

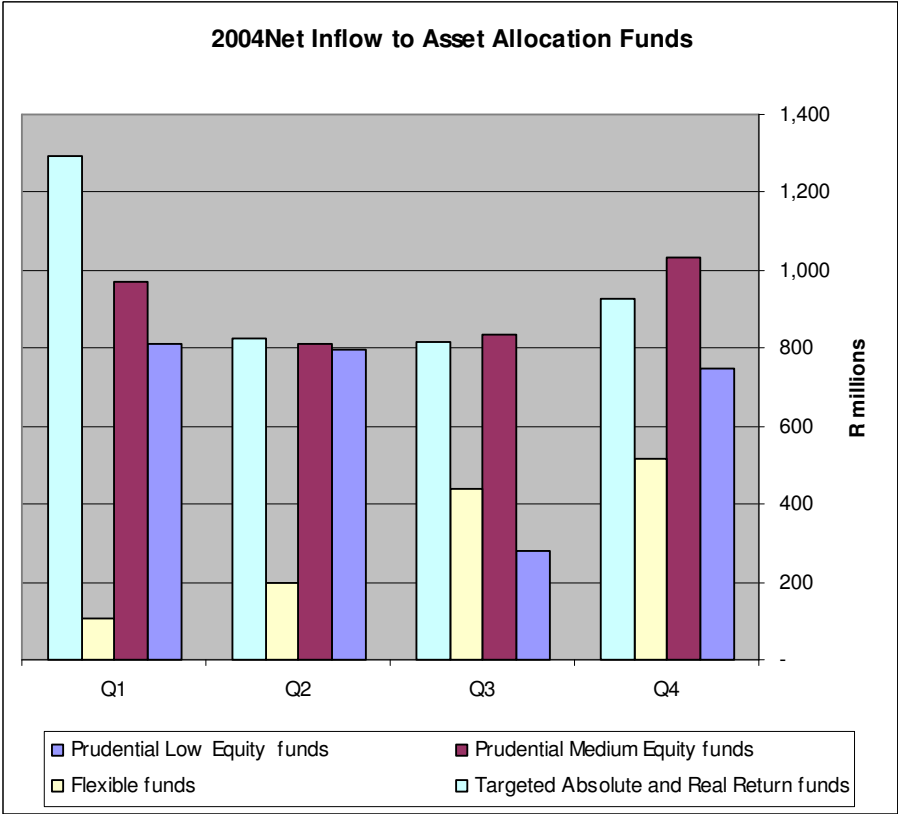
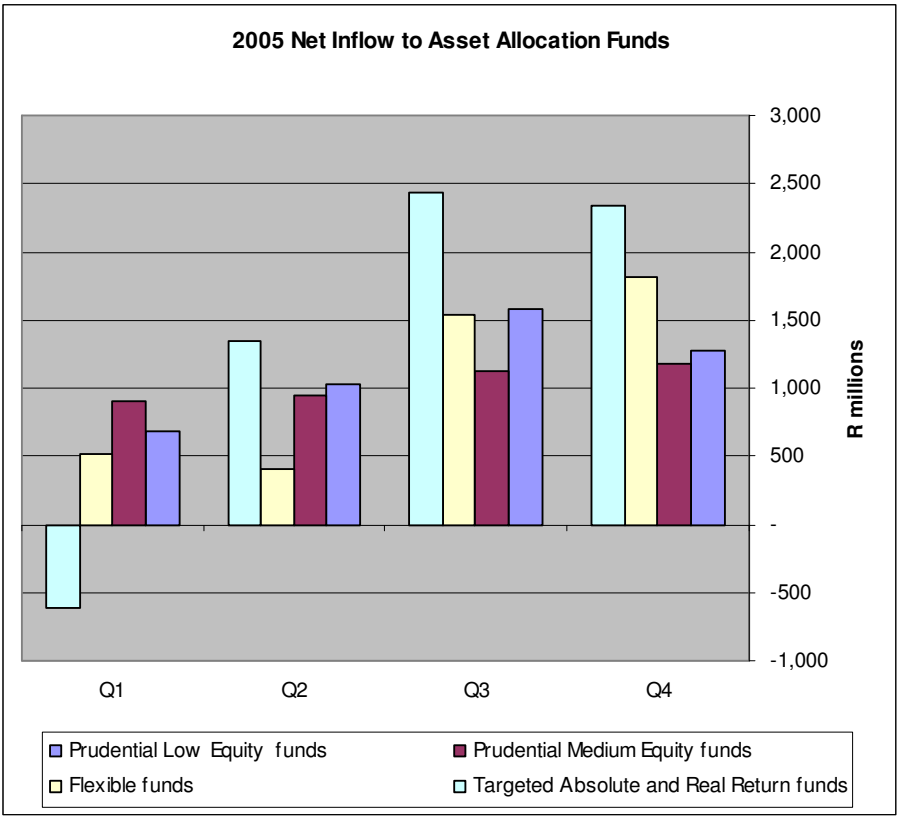
Growth	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	19.2%	21.3%	20.9%	17.9%
Two-year	29.7%	29.2%	27.9%	24.6%
Three-year	35.3%	31.2%	31.8%	26.6%
Five-year	29.3%	32.6%	32.6%	27.1%
Seven-year	23.1%	22.3%	22.3%	16.8%

Value	Index Benchmark (ALSI)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	19.2%	17.6%	16.4%	13.8%
Two-year	29.7%	26.9%	25.5%	22.3%
Three-year	35.3%	28.9%	28.4%	25.5%
Five-year	29.3%	33.7%	33.6%	27.1%
Seven-year	23.1%	31.0%	30.9%	22.9%

Large Cap	Index Benchmark (Top 40)	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	19.0%	17.6%	17.7%	13.2%
Two-year	29.5%	28.0%	28.0%	25.5%
Three-year	35.4%	34.1%	33.9%	30.7%
Five-year	28.3%	27.9%	27.6%	27.0%
Seven-year	22.1%	22.3%	21.4%	22.1%

Appendix 3





Appendix 4

Comparison of Annualised Returns: Asset Allocation Unit Trust Category

Based on Lump Sum Investment (Period ending December 2007)

Prudential Low Equity	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	9.7%	9.8%	0.3%
Two-year	11.7%	10.9%	4.5%
Three-year	13.8%	13.8%	7.0%
Four-year	14.8%	15.0%	7.0%

Prudential Medium Equity	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	12.3%	11.7%	-6.8%
Two-year	18.7%	18.1%	6.0%
Three-year	22.3%	21.5%	11.2%
Four-year	23.9%	23.0%	12.8%

Flexible	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	16.8%	14.3%	13.9%
Two-year	20.5%	20.0%	17.8%
Three-year	18.9%	22.7%	18.4%
Four-year	25.1%	24.6%	19.1%

Targeted Real Return	Fund Average (reported)	Fund Median (reported)	Investors' Return (IRR)
One-year	9.9%	9.5%	2.3%
Two-year	12.4%	12.4%	7.4%
Three-year	14.0%	14.0%	8.8%
Four-year	13.9%	14.8%	8.6%



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