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PRESCIENT BALANCED FUND, ONE OF SA'S LEAST EXPENSIVE MULTI-ASSET HIGH EQUITY FUNDS

Over the last few years a lot of focus has been placed on investment costs. Investors are asking more questions about how much they are paying their fund managers, and what they are getting in return.

This issue has become even more significant in the current environment of low returns. Investors are appreciating that whatever they are paying their asset manager is effectively reducing their return, and they are recognising that this matters.

In years when South African balanced funds were returning 20%, paying a fund manager a 3% fee might not have seemed excessive. But when the return is only 5% or 6%, that same fee suddenly looks quite different.

An argument is sometimes made that returns are always calculated after fees, so it doesn't really matter what fee an investor is paying as long as the return they see is acceptable. However, that ignores the critical question of who is benefiting most from the relationship between the asset manager and the client.

Any fund manager's primary responsibility should be towards the people whose money they are looking after. They have a duty to invest it prudently so that the client sees the most benefit.

It is very hard to argue that they are doing that when they are taking a large chunk of the returns they are generating as fees. Effectively what they are then doing is using their clients' money to benefit themselves.

To highlight how much of a problem this can be, Moneyweb conducted an analysis with the help of data from Morningstar to identify South Africa's most expensive multi-asset high-equity funds. This is the most popular category of unit trusts amongst local investors.

The table below lists the 20 managers that currently have total investment charges (TICs) of more than 3%. Their three year returns to the end of June are also given to show what investors have received in return.

SA'S MOST EXPENSIVE MULTI-ASSET HIGH-EQUITY FUNDS		
Fund	**TIC**	**3 year annualised return**
Long Beach Managed Prescient Fund A1	5.08%	8.96%
RECM Balanced Fund A	3.84%	-4.56%
CS BCI Aggressive Prudential FoF A	3.65%	4.78%

Absa Prudential FoF	3.57%	4.63%
Florin BCI Managed Fund A	3.44%	
Element Balanced SCI Fund A	3.43%	5.73%
CS BCI Prudential FoF A	3.37%	4.85%
Baobab BCI Prudential Managed Fund A	3.35%	
Autus BCI Balanced Fund A	3.28%	4.98%
Instit BCI Managed FoF A	3.28%	
Vital BCI Balanced FoF A	3.26%	
Kanaan BCI Balanced FoF	3.22%	3.13%
Contego MET Wealth Creator FoF A	3.21%	5.19%
Perpetua MET Balanced Fund A	3.21%	
Warwick MET Balanced FoF A	3.18%	2.02%
Anchor BCI Diversified Growth Fund A	3.16%	
Old Mutual Multi-Managers Aggressive Balanced FoF A	3.08%	
Simplisti BCI Managed Protector FoF	3.06%	4.54%
Efficient BCI Prudential High FoF A	3.05%	3.49%
EFPC BCI Balanced Fund A	3.04%	-0.42%

Source: Morningstar

This 3% threshold is rather arbitrary. In fact, Morningstar calculates that the average TIC for funds in this category is 2%, and therefore anything above that number could be deemed 'expensive'. This list is therefore far from exhaustive, and merely highlights the funds charging the most.

Also, not all the funds on this list have three-year return figures, as they do not yet have track records long enough. Costs are also usually calculated on an annualised three-year basis, so it's important to note that the charges shown for funds that have not been around that long are not necessarily directly comparable, since they are over a shorter period.

Nevertheless, investors looking at these numbers should be asking some serious questions. The average TIC of funds on this list with three year track records is 3.46%. Their average return is 3.64%.

In other words, over the last three years, these asset managers have collectively taken 49% of the returns they have generated in costs. Put another way, investors are only seeing half of what their money has actually earned.

Also worth noting is that the average return of all funds in this category for these three years according to Morningstar is 4.94%. Only three of the above funds have performed better than that. That is a very simple way to tell that investors are simply not getting what they are paying for.

A few in particular stand out. The TIC on the Long Beach fund of over 5% is very high by any measure. It must be noted that this unit trust was the second best performing multi-asset high-equity fund over this period, however it comes in behind a fund with a TIC that is over 50% lower at 2.35%.

Had Long Beach had a TIC at the same level, it would have been able to show an additional 2.73% return. That would have made it comfortably the top-performing fund in this category.

This is significant, because it is surely more beneficial over the long term for an asset manager to build a top track record than to charge high fees. Ultimately, eroding investor returns only diminishes their own value proposition.

Perhaps of even greater concern are the two funds that appear on this list despite producing negative returns over this period. RECM and EFPC must be hard pressed to explain to investors why it has cost them so much to lose money.

Looking at these figures, it is hard not to wonder if the way that asset managers charge for their services is broken. There is no sensible relationship between what investors are paying and what they are getting.

Nothing confirms this point more than looking at the other end of the spectrum. The table below shows the five funds in this category with three-year track records that have TICs of below 1%:

SA'S LEAST EXPENSIVE MULTI-ASSET HIGH-EQUITY FUNDS		
Fund	**TIC**	**3 year annualised return**
Prescient Balanced Fund A2	0.58%	6.71%
Nedgroup Investments Core Diversified Fund B	0.62%	6.07%
Sygnia Skeleton Balanced 70 Fund A	0.65%	5.85%

Gryphon Prudential FoF B	0.86%	6.54%
NFB Ci Balanced FoF A	0.99%	7.60%

Source: Morningstar

All five of these funds outperformed every fund on the above table, bar one. Clearly it doesn't take a lot to work out where investors should really be looking for value for money.