

The hypocrisy of the fund management industry

At our recent seminars I made a presentation to show how past performance and active fund management does not work for investors. This is a message that is backed up by an absolute pile of academic evidence, and supported by Nobel Prize winners.

Most Advisers deluding themselves

Unfortunately, the vast majority of Advisers and stockbrokers are still wedded to the belief they can identify talented fund managers who can beat the

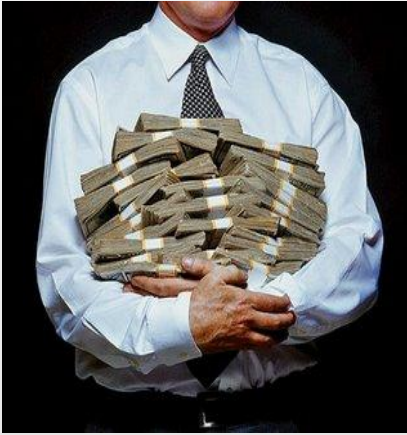
market through stock selection.

This is the idea of buying only the shares which are likely to outperform the market and either avoiding, or selling, those that are likely to underperform the market in the future.

I have no argument with the idea that there are a few managers who can outperform, but inconveniently for us, it is impossible to identify them in advance! I guess the reason the academic evidence is so often ignored is that most fund managers and stockbrokers earn substantial fees from their clients for trying to beat the market.

There is more monkey business with an active fund manager





Not that much money left for the client

They still earn a high fee when they fail so it is only the client who suffers wealth damage.

A Startling Revelation

As I have said, it is the job of many fund managers to try and beat the market by gambling with other people's money, but it is known within the industry, that many of these managers invest all of their own money in low cost passive funds, also known as Index trackers, which we favour due to their low costs and reliable returns. So there are two sets of rules - one for them and one for the customer.

As you would expect, it has been very difficult to get these managers to own up in public as their careers depend on taking high fees for trying to 'outperform'. This leads me to the surprise confession appearing in the Citywire publication 'New Model Adviser'.

Manager admits hypocrisy

In this publication, Miller, who was New Star's chief investment officer, confirmed he has always believed in passive investing! Miller, who apparently earned £3.3million in 2003

as the Chief Investment Officer and manager of New Star's Hedge Fund, confirmed he invests his own money in index trackers and has done for years; while earning massive fees and bonuses for gambling on the market with other people's money.

Miller went on to say what we have been shouting from the rooftops for years, is that,

"In every single study you see the average manager underperforms. Very few have consistent outperformance through their stock selection. You are better off not taking that risk."

He also went on to say

".....the cost would also be lower than the high charges incurred by traditional active managers, which he said are often hidden from investors."

So there you have it, straight from the horse's mouth.

The Citywire editorial comment can be found at <http://www.citywire.co.uk/adviser/-/blogs/the-new-model-adviser-blog/content.aspx?ID=341843>

Our newsletters last year covered the failure of New Star with its funds managed by the industry stars, and yet the whole enterprise failed, with some shocking fund returns.



“...there is more and more evidence stacking up against active fund management”.

Financial Times experts

The weekend Financial Times has a “My Portfolio” regular column. The resident expert private investors tell us how they run their portfolios and share their wisdom with us. The authors are billed as active private investors, writing about their own investments, and presumably selected because they are seen to be good at what they do.

Unfortunately two out of the three who reported this time had not done their job at all well. One is quoted as saying “I prefer to draw a veil over my portfolio’s performance during the recent strong rally”. Another is quoted as saying “Cash may be safe, but it is partly responsible for this poor performance”.

In fact, the FT had plenty of column inches implying there are plenty of professional fund managers who have suffered poor performance this year, as they have missed the stock market rally of the past two months.

In other words they have all underperformed.

Market timing does not work

The difficulty they have is clear.

No one seems to have told them there is no reliable way of predicting the best times to avoid the downswings.

If you have a bit of luck missing some of the fall by selling out, you are then likely to miss out on the upswing. All their problems have stemmed from the unsupported idea that you can identify when it is a good time to get in and out of the stock market.

In the ‘Serious Money’ column of the FT it was stated that more than half of the 135 managers surveyed by Lloyds TSB UK Private Banking said they planned to increase their shareholdings in the coming months. It then went on to state that more managers are jumping off the fence to come into the market.

It would be very easy to overlook the observation I am making here, which is that all of these fund managers must have been sitting on cash during a very strong market rally. So they have lost the 20% and more return available from the stock market forever and they are now playing catch-up.

To add insult to injury, investors will have been paying these people 1.5% a year to sit on cash during a big market rally, and in addition losing the costs of trading in and out of the market.



The low cost alternative

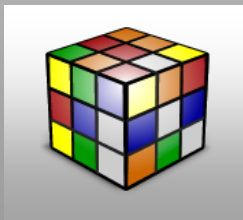
The smart investor would have been able to participate in all the market recovery by holding index funds and with one quarter of the cost.

It seems that every time you open the paper at the weekend, any weekend, there is more and more evidence stacking up against active fund management. We don't actually need any more, as the evidence we have already shows it isn't all it's cracked up to be.

A problem for the reader is being able to recognise all these failures for what they are and to know there is an alternative.

I do not know, but perhaps we need a few more financial journalists prepared to do a bit more study, or to at least admit they are just in the entertainment business. For example, how much money you could have made with the benefit of hindsight!

<http://www.ft.com/yourmoney/serious> □



**Don't keep
us a
secret**

Regulated and Authorised by the
Financial Services Authority.
Registered in England 1661236. Vat
Registration No 7332486 Michael Barr
& Co. Ltd cannot accept any
responsibility for loss incurred by any
person acting or refraining from
acting as a result of any views
expressed in this publication. The
price and income from some
investments can go down as well as
up and investors may not get back the
full amount invested.

