



ASSET MANAGERS

# THE LIES THEY SELL

By Marc Ashton

**T**he quote alongside from Rowan Williams-Scott, a former portfolio manager at Old Mutual, African Harvest and Prudential Portfolio Managers, is perhaps an apt way to launch into the sensitive subject of the asset management industry in South Africa.

Over the past 10 years – and with the launch of high-profile financial news portals and television stations – SA’s asset management industry has seen itself playing catch-up to the United States and European markets, where asset managers, economists and other “talking heads” have rapidly become minor celebrities in their own rights.

Yet for all the perceived glamour the sector was dealt a blow when local exchange-traded fund (ETF) guru Mike Brown, of etfSA.co.za, released some damning research that showed that the Satrix 40 – which offers mechanical investing principles as opposed to active decision-making – outperforms 85% to 93% of actively managed unit trusts over periods of six months to five years.

While there was some bluster from the industry in response to those statistics, what surprised *Finweek* was that most asset managers weren’t really all that surprised by the findings of Brown’s data.

Perhaps the answer lies in a culture of “asset gathering” as



**To be blunt, it’s my contention that a large percentage of market analysts operate in a world of quite remarkable self-delusion. They catastrophically overestimate their foresight even though legions of evidence point to mortal human beings’ abilities to forecast the future as being dismal.\***



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opposed to “asset management” in SA, which is a relatively small and concentrated market.

Much of SA’s “wealth” is tied up in a handful of highly profitable major players in the asset management industry. With many of the smaller firms not listed, profits are difficult to calculate. However, last year Stanlib contributed the better part of R400m in operating profit to parent Liberty Holdings, Investec Asset Management took home around R540m in SA alone, Old Mutual’s South African business earned R958m (up 4% year-on-year despite just a 1% increase in assets under management) and Coronation Fund Managers earned R210m for the year, although that figure is expected to come in closer to R450m for the full year after interim results to March showed a sharp rise in profits.

“There’s no doubt the core strategy of the mainstream asset management industry is to gather as many funds as possible and to make a living off the fixed annuity fees,” says Paul Theron, of asset management firm Vestact. Theron adds: “To achieve that they hug the market indices and actively try to avoid taking on significant portfolio concentrations or index variant position weightings. That’s because they long since learned that shooting for first

quartile industry performance is a bad idea, because it’s normally followed by fourth quartile underperformance.”

Wayne McCurrie, of RMB Asset Management, says gathering assets is important to build sustainable asset management companies but adds that one of his pet hates is the claim of managers to be “adding value”.

“What is adding value? My definition is to deliver a good – slightly above average – return over time, with lower risk and avoiding disasters,” McCurrie says.

Even before Brown released his findings on how passive tools such as ETFs were wiping the floor with their actively managed counterparts, Craig Chambers, MD of Dibanisa Fund Managers, was warning that most of SA’s “actively” managed portfolios were little more than quasi-index trackers due to the small pool of potential investments.

Chambers says of the aggregated equity portfolio of the top 11 managers there are only 119 shares and the largest 80 shares made up 96% of that aggregated portfolio. By contrast, equity managers in the US have a universe of 5 000 potential stocks in which to invest.



Says Chambers: "These days most equity managers use the FTSE JSE shareholder weighted index (SWIX) as the benchmark they have committed to beat. When we compare the return of that index to the aggregated after-fee return of the general equity unit trust sector from December 2002 to April 2010 we see the index is starting to outperform the managers quite substantially. That clearly shows the tyranny of compounded fund management fees."

Chambers adds: "It should also be noted this isn't a resources biased index – so managers can't use the excuse their underperformance can be attributed to being structurally underweight mining stocks."

Two highly regarded industry specialists who disagree with *Finweek's* "asset gathering" assertion are Geoff Blount, of Cannon Asset Management, and Andrew Joannou, of Afena Capital. Both point out that while size may hamper outperformance it's part of building a sustainable firm.

"It just isn't as easy to perform when you're trying to invest large quantities of money," says Joannou.

Blount comments managers are too often driven by larger corporate masters whose focus is on the asset gathering side of the equation, which discourages managers being prepared to take risk. "The concept 'Don't underperform enough to get fired' drives decision-making rather than the concept 'Let's create alpha'."

One major issue facing SA's industry is the lack of competition coming through the ranks.

Simon Pearse, CEO of Marriott Asset Management, says high levels of regulatory costs prohibit new entrants to the asset management industry. He also questions the remuneration structures of asset managers. "You may question the

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current practice of largely removing front-end fees or initial charges and escalating the ongoing service fees through performance-based fees and layering of structures. The effect of that practice is to link profitability exclusively to assets under management."

Pearse adds the breakeven point for an asset manager is currently around R1bn and for a financial adviser about R100m,

making it very difficult for new entrants to enter the market.

"Another interesting barrier to entry seems to be created complexity," Pearse says. "Investment management – like so many disciplines – is shrouded in complexity and kept that way for so many expedient reasons. Consider the unnecessary complexity paraded on a daily basis in public forums," says Pearse, pointing out there are more than 900 unit trusts now operating in SA, all seeking to outperform their peers in order to attract new subscriptions. That process is largely endorsed by industry commentators and analysts, who tend to promote past returns as the best indication of future returns and focus on short-term returns to spin drive this process.

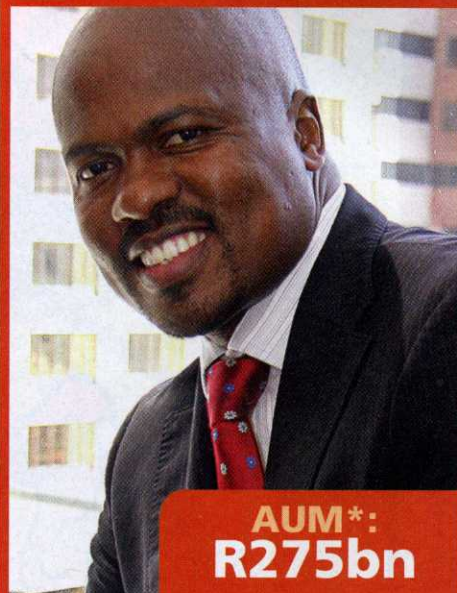
It's been a bumper few years for the asset management sector, with a number of major players seeing large inflows as markets have been kind to them up until 2008. However, investors are wising up to underperformance and the "asset gathering" mentality. And with new, low-cost passive investment products coming online in SA there's likely to be a shift in thinking from investors – and that may well force a rethink from the money men. ■

\* The quote is from Williams-Scott's contribution to Franco Busetti's book *The Effective Investor* released in 2009.

ASSET MANAGEMENT COMPANIES

# What the

## INVESTEC



AUM\*:  
**R275bn**

**Thabo Khojane**  
MD for SA

**It's not possible** to manage assets if you haven't gathered any. Like most investors worldwide, South African investors still look at past performance when choosing a fund. For a large portfolio, size can begin to impact performance negatively. At that point it makes sense to close the portfolio.

"We were the first South African manager to close a portfolio, when we soft closed our Value Fund six years ago. A soft close means we only accept a large inflow if there's a matching outflow. We've soft closed two other portfolios since then. "So we've totally aligned our business with clients' needs. In order to do that we had to build a business that focuses on client-specific solutions as opposed to a single philosophy. We also keep the investment team away from sales activity. Portfolio managers need to be totally focused on managing client money, not sales or client services."



# 'Big Guns' say

\*AUM: Assets under management

## OLD MUTUAL (OMIGSA)



**AUM:**  
**R484bn**

**Kerrin Smith**  
Head of boutique management

“The asset management industry in SA encompasses quite a number of different players focused on a variety of things. Lisps and other kinds of distribution platforms are highly focused on asset gathering: they make their margin through volume and administrative efficiency. That in itself isn't contrary to adding value to clients, as they're providing ease of access, choice, flexibility and ultimately investing the assets gathered across a wide array of investment firms and funds.

“Within a focused direct investment firm, large AUM can impede the ability to deliver active performance, particularly in the equity market, given the illiquidity of some of our counters and relatively small share universe. That's one of the major reasons we believe in owning multiple separate, autonomous investment businesses at Omigsa: they each run completely independent investment strategies and have very different ways of viewing the market and adding alpha.

“None of our active equity businesses has more than R40bn under management and each of them can operate as a small business and close their doors to new assets when they hit the maximum amount they believe they can run effectively.”

## CORONATION

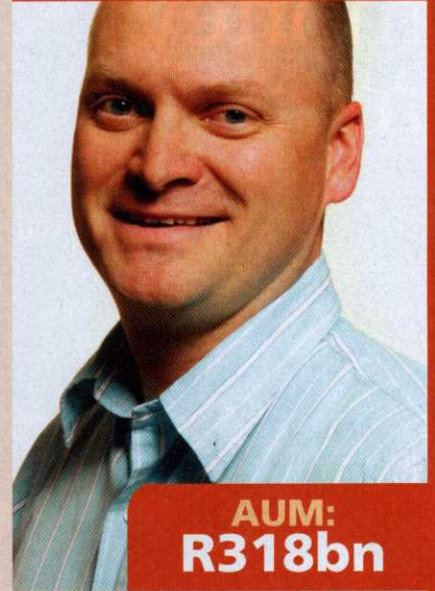


**AUM:**  
**R176bn**

**Karl Leinberger**  
Chief investment officer

“I think this is a very fair criticism of the industry: most asset managers will put the business before the industry. At Coronation we've shown clients we're prepared to close funds and that we won't fall into the trap of asset gathering. We closed the absolute return funds for four years and we think we lost between R10bn and 15bn in flows.”

## STANLIB



**AUM:**  
**R318bn**

**Stewart Rider**  
Chief investment officer

“There's something like 900 unit trusts registered in SA. If you compare that to the number of shares funds can invest in I think that answers the question about whether there's a proliferation of products in the market. However, I think it's more important to look at how managers are managing the assets they have. A perfect case for us is our property propositions, which we've closed to new institutional mandates.

“This [managing of large funds] is going to become an increasingly important issue for the larger asset managers who are dominant in certain classes: there's no unlimited environment where you can manage risk and ultimately it's your reputation that will suffer if the investment performance suffers from having too many assets under management.”