

Why 86% of pension funds fail investors

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1. Introduction

When a pension investor hands their hard earned money to a fund manager to get them a return they must have an expectation that the manager will produce something more than they could achieve by doing the investing themselves (i.e. paying for the expertise) and hopefully that the manager will stack up well when they are compared to their peers and competitors, otherwise why bother?

“one may as well throw some darts at a the dartboard”

One may as well throw some darts at the dartboard and pick investments on that basis (incidentally many pieces of research have identified this as more successful than relying on “professional” managers).

It is on this premise that we state that is fairly depressing to see that if one applies some very basic criteria to funds then a heavy majority fall down, the research identifies that poor performance is in effect endemic with only 14% of the 778 funds we examined meeting the base standards set, that means about 670 funds fall down – please bear in mind the bar we set was not very high when we report these figures!

The industry is failing (with some very notable and laudable exceptions) and do you know what? This isn't new! What's happened is (to quote a good fund manager, Mr Buffet) the tide's gone out and we can see whose been swimming naked.

“managers were able to produce some form of positive performance even if it was relatively bad”

The years 1987-2007 masked the shortfalls in performance that have now become apparent, the boom years meant that most managers were able to produce some form of positive performance even if it was relatively bad and investors either didn't notice or didn't care.

However one of the best things that have come out of the troubles over the past 18 months is to see how so many funds were in effect closet trackers - and “under-trackers” at that because their returns seemed to have lagged the benchmark - offering no serious management function whatsoever.

In other words in virtually every sector from equities in the UK and Overseas through to Property and then to Bonds funds are failing to meet certain basic standards:

In undertaking our research we looked at every mainstream pension fund available to private/personal investors in the UK, we then filtered this down by excluding any fund below £10 million and/or any fund that did not have at least a 5 year track record.

This was for the purpose of excluding very small boutique funds where performance can be skewed by a small variation in an underlying asset and then having a decent time period (5 years +) to exclude a spectacular year disproportionately affecting the results.

Having done this we found 778 funds to be analysed.

We then applied some performance criteria:

1. **The fund had to have achieved 1st or 2nd quartile rankings in at least 3 out of 5 years.**
2. **Over 5 years and 10 years it had to have above average returns.**
3. **The funds had to have volatility equal to or less than the average, to ensure that the fund was not taking above average risks.**

The fact is that the “86%” figure actually only applies to the first and second criteria, if the third figure is factored in then only 12% of funds pass the test, raising the failure rate to 88%.

The eagle eyed might say that this comparison is only against peer performance and that general funds performance is not accounted for.

Correct! The reason for this is simple: general fund performance is poor and funds *generally* on the average do not provide any great added value.

This can be demonstrated by taking very simple benchmarks. One example is the pension fund sector “UK All Companies” which has a total of 361 funds in it. The average performance over 5 years is +13.5% (2.5%) and over 10 years -3.5% (-0.5%); the figures in brackets are the annualised returns. Compare this to the FTSE All Share returns which are +22.92% (4.21%) over 5 years and +9.25% (0.89%) over 10 years. So in both cases (5 and 10 years) the average performance is about 1.5% below the market return and guess what? This is roughly the same as the charge on the average fund, so funds are dragging performance down, in this example, by their charges.

It really doesn't matter what sector or benchmark one applies - the same principle is generally established: funds under perform, at the average, the market.

Our research then applies another level: those funds which under perform in their category or sector against their peers on a consistent basis and this is where the 86% figure comes from.

2. Conclusion

The research shows that not only do funds generally underperform but that most funds then fail even to meet up to a basic standard of performance against their peer group. This means that investors would undoubtedly be better following a strategy of NOT using funds. Arguably they would be better throwing their money at randomly selected assets or more variably at index trackers of one sort or another.

Critically the research identifies that fund managers are failing (in 86% of cases) to add any value at all. Investors are being charged for consistent and in many cases very real failure by fund managers who are “getting away with” appalling performance by any measurement.

3. What should investors do?

Ok so we have established that funds are failing, so what should investors do? We believe anyone who has a personal pension fund should follow these basic steps in getting their plan or plans charged up and performing:

1. Get a strategy in place.

Please think about this: do you have a cohesive pensions/retirement strategy? If the answer is no then get one! You are on your way towards retirement and ensuring you get there to best effect you need to adopt a strategic approach. We suggest that to do this you need to:

2. Work with the best advisers.

Ok so advisers have not always enjoyed the best reputation: but the fact is that independent advisers who have survived through the turmoil are generally now highly professional and extremely competent. They will be geared to helping with a strategic approach to retirement planning and instigating the necessary processes.

3. Get a written plan of action, including targets and benchmarks.

The strategy should lead to a written plan, which should include targets and benchmarks. This is a classic case of if you don't know where you are going you are probably not going to get there! The fact is that a decent run business will have a business plan, budgets, targets and check points. Investors/savers should have exactly the same approach: set out your stall in precise terms and get it all down in writing (which is where your adviser can help).

4. But take personal control of the investment management.

Although we suggest working with an adviser, make sure you effectively take personal control of the investment management: don't allow fund managers to hold your money and produce terrible returns. Ensure that you are entirely happy with the strategy, the plan and then the implementation, make sure the money you have invested is in the areas you want and critically that you are using all types of investment holding (e.g. direct shareholdings, ETFs, private equity): in other words don't get stymied by funds, they are not the be all and end all.

5. Use filters to find the best funds.

When you are using funds of any description (and this will be right for some of your money some of the time) then make sure that you have applied filters to sort out which funds to use. Filters should include checking to make sure the fund passes certain standards of past performance and has in place the requisite framework for achieving future performance.

6. Don't just rely on funds.

Your plan should embrace all possible investment options to suit your asset requirements and risk profile. It is unlikely that managed style funds will be the right answer in all cases, direct

ownership of shares and gilts may be better than funds in these areas. Also Private Equity and Hedge funds may be applicable, as may some form of alternative asset holdings, such as futures and/or derivatives. We live in a modern world where many different methods of investing can apply: investors should use them if they can and if they are appropriate.

7. Review, rebalance, reject.

What is important is that an investment should always be fluid. Whatever mix you use within your pension plan, make sure you keep this constantly under review and rebalanced. If things change (which they will) then you will need to adapt your plan to this and your strategy should reflect this: and make sure that if something isn't working out (again which will happen) then get rid of it and replace it with something that will work.

4. How to get further help

In order to take any of this further: [whether you have existing funds or wish to start from scratch please complete our enquiry form.](#) This will enable us to help you get in place the strategy and plan of action that will transform your retirement planning.

5. Full Details of research

Full details of the research are held off line and can be viewed on request. If you would like to access the research document please submit your details below and click on the “submit button” located at the top of this screen highlighted in purple. Please note that all fields marked with a “*” are required.

Name*: -

Address: -

Postcode: -

Telephone Number*: -

Are you a?

Pensions Investor / Saver

Professional Adviser

Fund Manager