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Why the vast majority of pension funds fail investors

By [Matthew Morris](#) | 14:31:15 | 13 August 2009

Matthew Morris, director of [howmuchdoineedtoetire.co.uk](#), explains how 86% of pension funds fail investors.

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 (ie 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 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 fairly depressing to see that if one applies some very basic criteria to funds, then a heavy majority fall down. Our research identifies that poor performance is, in effect, endemic, with only 14% of the 778 funds we examined meeting the base standards set. This means about 670 funds fall down – 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 this isn't even new.

To quote a good fund manager, Mr Warren Buffett, the tide has gone out and we can see who has been swimming naked. 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 to come out of the troubles of the past 18 months is to see how so many funds were, in effect, closet trackers, offering no serious management function whatsoever. 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 five-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.




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3. The funds had to have volatility equal to or less than the average.

The fact is that the '86% of pension funds fail investors' 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.

The eagle-eyed might say that this comparison is only against peer performance and that general fund performance is not accounted for. The reason for this is simple: general fund performance is poor and funds *generally* on average do not provide any great added value.

It really doesn't matter what sector or benchmark one wishes to apply, the same principle is generally established: funds underperform, at the average, the market.

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

My conclusion

The research shows that not only do funds generally underperform, but that most funds then fail even to meet 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.

What should pension investors do?

Well firstly, not let their money wallow in such funds. Secondly, they should constantly review their positions and sack any fund manager or fund that fails to produce results.

Thirdly, and most crucially, they should apply a process which includes having a strategy that applies certain basic requirements and standards.

Fourthly, in mainstream areas it is clear that index tracking makes most sense, and in this regard investors should seek out very low-cost and effective index trackers, probably using a self-investment process and allocating their money to [LEIFs \(Exchange Traded Funds\)](#), which are often 1% per year cheaper and better-performing.

Matthew Morris is director of consumer information and advice site www.howmuchdoineedtoire.co.uk

