

The Australian

'Big Squeeze' hits managed funds industry as market pessimism continues to spread

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Managed funds

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BRIAN Thomas at Perennial Investment Partners calls it "the Big Squeeze", and it's separating the outperformers from the also-rans in the nation's \$1.4 trillion managed funds industry.

A deep-seated fear of equities, still evident after the global financial crisis, was combining with the irresistible forces of regulatory change and industry consolidation to produce an exceptional set of challenges for the industry, according to Thomas, head of retail funds management at Perennial.

The Australian sharemarket this week recorded its seventh weekly fall out of nine, not only depressing investors but prompting talk about fund manager redemptions and loss of mandates as investors seek to maximise returns on their investment funds.

"We've had the GFC, which hit investor confidence and fund flows, but rather than bouncing back we've had the big squeeze over the last couple of years," Thomas says.

At Wilson Asset Management, chairman Geoff Wilson consoles himself with the counter-intuitive theory that a short-term rally is likely because the pessimism is so pervasive.

Thomas, for his part, says that the big squeeze can't last forever. Regulatory issues will be sorted out and the fear will dissipate, highlighting instead the industry's long-term growth prospects, he says.

In the meantime, both fundies say their business models are equipped for the tough times ahead.

Wilson relies on flows from rich clients and is not exposed to flighty wholesale mandates, while Thomas stresses the importance of the boutique owner/manager model and its ability to quickly adapt to difficult markets.

The managers under most pressure, according to industry observers, are those with large legacy books, where investors are moving into the drawdown phase.

In the December half year, for example, Perpetual suffered a 6 per cent fall in funds under management from \$29.3 billion to \$27.5bn.

Smaller players in the start-up phase were also finding the environment very tough, as were funds that offered little more than index returns, or worse.

Mercer principal David Carruthers says the average return from an active fund manager in the 12 months to May was 10.9 per cent (before fees in the range of 0.5-0.6 per cent), which was less than the 11.1 per cent improvement in the market.

"When the market was falling through the GFC, active managers did pretty well relative to the market," Carruthers says.

"But in the last year, it's been tougher to outperform.

"It's a real struggle to know where the market's going," Carruthers says.

Taking a longer term perspective, Rainmaker director of research Alex Dunnin says wholesale balanced funds have typically earned a rolling 4-5 per cent return.

Three-year returns incorporating the GFC were only 0-1 per cent, he says.

"Investors are asking: 'If all you guys can deliver is 5-6 per cent and I can get a 6 per cent cash deposit down the road with no risk, why bother with a managed fund?'" Dunnin says.

This is exemplified in the Westpac-Melbourne Institute survey, released on Wednesday, which shows only 8.4 per cent of Australians feel that the safest place to put their savings is in shares, compared with 32 per cent favouring bank deposits.

A decade ago, the situation was reversed, with 27 per cent nominating shares and only 14 per cent saying deposits.

In a note to clients yesterday, Goldman Sachs says tougher conditions mean active managers have to be more aggressive to achieve the kind of outperformance, or alpha, to which they have become accustomed.

Over a 15-year period until September 2009, the median active manager achieved an alpha of 170 basis points, Goldman says.

Since late 2009, however, the market has traded in a thin range of plus or minus 5 per cent for more than 90 per cent of the time. This has contributed to the median manager only delivering "benchmark-like" returns.

"Simply put, it appears active managers have continued to hold portfolios with similar levels of active positions, but that these positions are currently insufficient to deliver target levels of alpha," Goldman says.

"We believe that in periods like the current one, active managers need to be more aggressive in positioning and rebalancing portfolios."

Wave Stone Capital principal Ian Harding, formerly head of Australian equities at Colonial First State, says a lot of stocks he looks at appear to be cheap over short and medium-term horizons.

"But retail investors are picky about where they're putting their risk dollars," Harding says. "You might need a strong market to jolt them out of this.

"But that means double-digit returns and it's a tough ask when we have one of the tightest interest rate policies in the world and there's an austerity program in place."

Harding is wondering when the next rate adjustment will be down, instead of up, even though the only sign of inflation is cost blowouts at Woodside Petroleum.

But it's all relative, he says, with 2008 clearly a tough year with the near collapse of the financial system.

"Stocks will eventually right themselves and people will get out of their deep funk," he says.

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2

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