

## **CAN EXCHANGE TRADED FUNDS (ETFs) CONSISTENTLY OUTPERFORM ALL UNIT TRUSTS?**

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In theory, **actively managed** investment products, such as unit trusts, should outperform **passively managed** products, such as ETFs.

The mandate of the active manager is to outperform the benchmark and the benchmark is the index. The passive investment manager, i.e. ETF asset manager, will faithfully replicate the index, by holding the constituent shares of the index, in exactly the weightings and numbers stipulated by the index providers. The mandate of the passive manager is merely to replicate the index and not to outperform it.

As the index provides the average return of the market, 50% of the active management industry should theoretically outperform the index and 50% should underperform the benchmark. After costs, the ratio of outperformance by active managers will decline.

### **Average Performance**

A number of recent studies have indicated that, on balance, some 75% to 80% of all active managers of South Africa unit trusts, fail to beat a common index benchmark and this illustrates, inter alia, that:

- The costs of active management could be too high in South Africa;
- The “narrowness” of the South African market, i.e. all the liquid shares are represented in the main indices, makes it hard to beat benchmarks which embrace most of the realistic stock choices in any event; or
- The “skills” of the active asset management industry might be less proficient than often made out to be.

### **Top Performance**

**Perhaps even more surprising is that the active asset managers also cannot provide the very top performing funds over time.** It would be expected that in a straight-line first-past-the-post performance race, the active managers should typically get the first prize, and at least, fill all the podium positions. After all, the active manager has infinite choice of shares to include in a portfolio, with the mandate to outperform the index. The passive manager only replicates the performance of the index.

Examination of the latest Quarterly Unit Trust Survey, which despite its name, also includes ETFs in its performance data, **indicates that ETFs, either provided the best performing fund, or at least the runner-up in all periods from 1 year to 7 years, for the period ended December 2012.** The table below summarises the medal winners in the straight performance stakes.

<b>Best Performing Collective Investment Schemes</b> <b>% total returns (with dividends reinvested, where applicable)</b>				
	<b>Top Performing Fund</b>	<b>Runner Up</b>	<b>Highest Placed ETF</b>	<b>Place</b>
<b>1 Year</b>	Prescient Africa Equity (UT)	<b>Satrix INDI 25 (ETF)</b>	Satrix INDI 25 ETF	2
<b>2 Years</b>	NedGroup Investments Entrepreneur (UT)	<b>Satrix INDI 25 (ETF)</b>	Satrix INDI 25 ETF	2
<b>3 Years</b>	<b>Satrix INDI 25 (ETF)</b>	NedGroup Investments Entrepreneur (UT)	Satrix INDI 25 ETF	1
<b>5 Years</b>	<b>NewGold (ETF)</b>	Discovery Flexible Property (UT)	NewGold ETF	1
<b>7 Years</b>	<b>NewGold (ETF)</b>	<b>Satrix INDI 25 (ETF)</b>	NewGold ETF	1
<b>10 Years</b>	Momentum Small Mid-Cap (UT)	NedGroup Investments Entrepreneur (UT)	Satrix INDI 25 ETF	6
Source: Unit Trust Survey (Profile Data) 31/12/2012.				

ETFs fill in the top two places in all the time periods examined, other than 10 years. As more ETFs and ETNs enter the South African market, giving exposure to an ever greater choice of asset classes and investment types, it seems likely that the potential for index trackers to beat the great majority of active strategists would be enhanced.

The answer to the question in the heading "Can ETFs Outperform Unit Trusts" appears to be yes.

Appendix: Top Performing Unit Trusts / ETFs Over 1 to 10 Years

For more information or detail, please contact Mike Brown, contact details below.

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<b>Top Performing Funds (1 – 10 Years)</b> <b>Exchange Traded Product (ETP) Ranking Amongst All Collective Investment Schemes</b> (includes Unit Trusts (UT), Exchange Traded Funds (ETFs), Exchange Traded Notes (ETNs), Fund of Funds, Multi-Class Portfolios, etc)					
10 YEARS	Type	% Total Return	7 YEARS	Type	% Total Return
Momentum Small Mid-Cap	UT	25,34%	<b>NewGold</b>	<b>ETF</b>	<b>21,07%</b>
NedGroup Investments Entrepreneur	UT	25,31%	<b>Satrix INDI 25</b>	<b>ETF</b>	<b>19,95%</b>
STANLIB Property Income	UT	24,98%	36 One Met Flexible Opportunity	UT	19,69%
STANLIB Industrial	UT	24,71%	Momentum Small Cap	UT	19,27%
Coronation Industrial	UT	24,40%	STANLIB Industrial	UT	19,25%
<b>Satrix INDI 25</b>	<b>ETF</b>	<b>23,63%</b>	STANLIB Property Income	UT	18,74%
5 YEARS	Type	% Total Return	3 YEARS	Type	% Total Return
<b>NewGold</b>	<b>ETF</b>	<b>19,17%</b>	<b>Satrix INDI 25</b>	<b>ETF</b>	<b>25,77%</b>
Discovery Flexible Property	UT	17,33%	NedGroup Investments Entrepreneur	UT	25,75%
<b>Satrix INDI 25</b>	<b>ETF</b>	<b>16,76%</b>	36 ONE MET Flexible Opportunity	UT	24,62%
BJM Multi-Manager Property	UT	16,01%	Coronation Industrial	UT	23,59%
STANLIB Property Income	UT	15,85%	Prudential Enhanced SA Property Tracker	UT	23,56%
<b>Satrix DIVI Plus</b>	<b>ETF</b>	<b>15,83%</b>			
2 YEARS	Type	% Total Return	1 YEAR	Type	% Total Return
NedGroup Investments Entrepreneur	UT	25,76%	Prescient Africa Equity	UT	48,46%
<b>Satrix INDI 25</b>	<b>ETF</b>	<b>25,63%</b>	<b>Satrix INDI 25</b>	<b>ETF</b>	<b>43,51%</b>
STANLIB Global Property	UT	25,50%	<b>NewFunds eRAFI FINI 15</b>	<b>ETF</b>	<b>43,22%</b>
Catalysts Global Real Estate	UT	23,77%	<b>DBX Africa Equity</b>	<b>ETN</b>	<b>42,54%</b>
36 ONE MET Flexible Opportunity	UT	23,59%	Investec Emerging Companies	UT	40,34%
Source: ASISA/Profile Data Unit Trust Survey (December 2012). Calculations done on NAV to NAV basis. Total returns, with dividends reinvested.					

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