



## Finding the right funds

As covered elsewhere, we are in tough investing times and the consensus view is that we will stay here for some time.

I return to one of my favourite subjects – the returns actually delivered to investors (as opposed to the past performance graphs).

Morningstar recently analysed data from the US market. The average annual return of a technology fund over the last 10 years was 3.25%; however the average returns achieved by investors was – 5.04%. Average investors in Latin American funds “enjoyed” returns that were 6% less per annum than the average Latin American fund. How can this be? There are two principal reasons – fees and timing.

Retail investors generally pay material fees when they switch investments and this drags down net performance. On top of this retail investors’ timing is on average very poor – buying at peaks selling in troughs. I must say how pleasing it is to be acting for clients who very rarely pressurise us to sell at a loss.



Further interesting data is published in the following academic paper:

*Dumb money: mutual fund flows and the cross section of stock returns by Andrea Frazzini and Owen A Lamont from the University of Chicago.*

Frazzini and Lamont conclude that high net flows into mutual funds are an indicator of poor future returns. Popular mutual funds tended to underperform the average by about 3% per annum. There are many reasons for these puzzling statistics but what should investors do?

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Backing fund managers with high net outflows and poor performance would seem to be a possible strategy, but the data suggests that if past performance does persist anywhere, it is in this group of funds.

Another tactic could be to look for funds with reasonable performance numbers but without big net inflows. Sadly however this strategy is now in print and so will only work briefly, or only work for the first few to act upon it.

I will leave other possible tactics (including following star fund managers and buying the worst performing market) for another note.

We remain of the opinion that the best chance investors have of enjoying the market returns to which they are entitled is to purchase asset class (or index tracking) funds and to take profits occasionally.

**If you would like further information on any of the issues discussed please contact Ben Sherwood on 01442 220713 or email [ben.sherwood@hhllp.co.uk](mailto:ben.sherwood@hhllp.co.uk).**

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