DECISION TIME: Barry O'Neill . . . knowing the inherent costs will help

'Less is more' when making fund choices

Investment: Providers have too many virtually identical products

BY BARRY O'NEILL

The number of new investment funds brought to market by the European fund sector was outstripped by fund mergers and closures last year.

A contraction in the number of funds is good news because it's a bit like the banks constantly launching new types of account and conveniently forgetting about the old uncompetitive ones they brought out a few years ago.

Simply devoting resources to the old funds or accounts would serve investors and savers much better as it would cost a fraction of the marketing budget required to develop and promote new products.

The only other occasion in the past decade that the number of funds available contracted was 2009.

Although the reduction last year was modest at 43 funds, the rate of decline in the second half of 2011 was more marked than in the first. Could this be a sign that product manufacturers have realised investors have more than enough choice already and are frankly underwhelmed by yet more shiny brochures hitting their doormats?

Europe-wide, investors have a bewildering 35,000 funds to choose from. By comparison, US investors have 8,000 funds from which to select. This plethora of fund choice has led to only one thing; an abundance of mediocrity.

"Investors have a bewildering 35,000 funds to choose from"

Quite simply, fund mergers should be more common. Fund-management groups have far too many virtually identical funds, some of which have failed to achieve "critical mass" and are costing investors dearly because of the fixed costs being spread over too small an asset base.

The link between costs and fund size can be better understood when you consider that 19 of the top 30 most expensive funds available to individual investors are smaller than £10million and all have a published total expense ratio (TER – the most transparent measure of costs available) of more than 2.8% per annum, with the most expensive having a TER of 5.88% a year.

Fund rating and research company Morningstar said in a recent article that, although fund performance was shown net of costs, "the problem is rather in predicting which funds have the best opportunity of outperforming their benchmark or peers in the future. The higher the overall cost hurdle becomes, the harder it is for managers to keep beating a benchmark over the long term".

So the message is clear – regardless of how old a fund is, knowing the inherent costs will help you to make the best investment decisions.

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