INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**

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Who let the dogs out?

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Sometimes we read an investment article that makes our blood boil. One regular such item is Bestinvest's 'Spot the dog – the guide fund managers would love to ban' report. This report would be laughable if it did not have such a potentially serious impact on investors' wealth. It is often quoted in the Sunday papers and can influence many DIY investors (those who do not seek advice) in their fund buy and sell decisions, despite the caveats that Bestinvest provide. It can also unsettle sensible long-term investors if they see a fund on the list that their adviser has recommended. While we have no problem calling out poor value for money in funds – which is far too common - the methodology used to identify 'dogs' is blunt to the point of being unhelpful.

In essence, a 'dog' fund is one that has underperformed a Bestinvest nominated market benchmark by a cumulative 5% over the past three years. From an investment perspective, three-year performance is riddled with market noise and is too short a timeframe to make any decision based on performance. In fact, you need around 16 years of data to be able to distinguish skill from luck[1]. Most investors have long investment time horizons of 20-30 years or more. This provides the luxury of being able to take evidenced-based, strategic decisions around which to build portfolios. In the case of systematic investors, this may well be the decision to own overweight positions to value stocks, smaller companies and more profitable companies, as the empirical evidence points to higher expected returns that may be captured over the sorts of horizon investors hold.

In its 2021 report (data to December 2020), Bestinvest had the Dimensional Emerging Market Core Equity Fund as one of the 'Biggest beasts in the Spot the Dog by fund size' category. It may have met their three-year criteria, but this fund does not simply try to track the emerging market index, but holds long-term, strategic overweights to value, size and profitability. For the longer-term investor that can be exceptionally valuable. The chart below shows this fund's performance against its peer group to the end of June 2022, 18 months after the report was published (fund = red diamond, blue pentagon = benchmark index, grey diamond = peer group average).

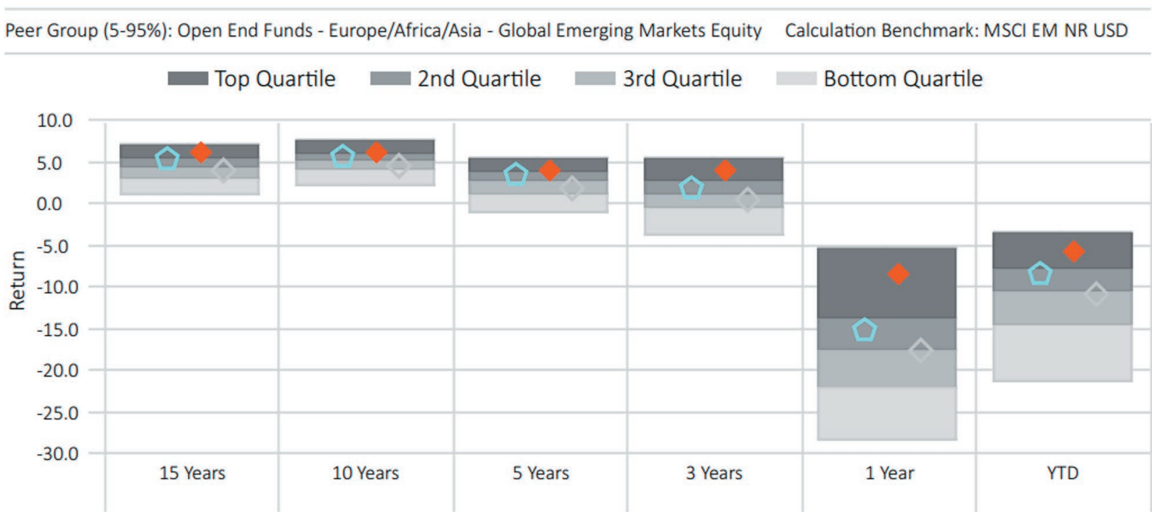

Figure 1: Not too shabby – it would have been costly not to remain invested

Source: Morningstar Direct © All rights reserved. Returns are annualised.

The fund sits in the top quartile of its peer group across all periods and beats the market index and the peer group average[2]. The SPIVA Report 2022[3] reveals that 93% of all actively managed emerging market funds in the US failed to beat the emerging market benchmark over 20 years to the end of 2021. Not bad for a 'dog' fund!

Perhaps ironically, the highly concentrated, growth stock-oriented active investment trust that heads the 'pedigree' list for best global equity performers in the 2022 report (data to December 2021) has fallen almost 50% from its high in November 2021. Remember that going up 100% followed by going down 50% puts you back where you started! This fund has fallen almost 40% since the report was published. The global market is down around 11% in comparison to the end of June 2022. Beware of short-term performance.

Fund ranking and 'dog' lists can be injurious to your wealth. Ignore the barking.

End notes

1.
Assuming a 95% confidence level and an information ratio of 0.5.

2.
This is not a recommendation to invest in this or any other fund, simply an educative illustration of the dangers of using naïve, blunt tools and short-term performance to make fund selection decisions.

3.
https://www.spglobal.com/spdji/en/documents/spiva/spiva-us-year-end-2021.pdf

Other notes and risk warnings

Use of Morningstar Direct© data

Risk warnings

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