

Over the last 10 years the unit trust industry in South Africa has enjoyed substantial growth both in assets under management and in the number of funds available. At the end of June 2003, the industry managed R192 billion in assets and had a total of 475 funds. By the end of June this year investors could choose from a staggering total of 1 021 funds and assets under management totalled R1 506 billion. To put this in context, our stock market consists only of some 460 shares. How are investors and advisers supposed to make sense of this vast universe of funds?

Fund selection is one of the toughest decisions

We perpetually encourage investors to do their homework and to try to be certain of their choices. After all, if you are convicted in your choice, you are more likely to remain invested for the long term, giving you the opportunity to benefit from your chosen fund manager's skill.

Past performance is easy to research but it is no guarantee of future performance. Remember that while performance is often an indicator of investment management skill, it is historic skill, and almost always also includes an element of good or bad luck. Short-term good performance by a fund has even been shown in some studies to be a predictor of future short-term underperformance, and vice versa. The dilemma is that past performance is the one piece of very readily accessible comparable information, so investors are often tempted to use it as their sole judging criterion. Like the proverbial drunk looking for his car keys, they are looking under the street light because that is where they can see, not because it is the best place to look.

The best predictors of future performance are harder to analyse because they involve qualitative judgements, and they are harder to access because they require insight into what happens inside a fund manager's investment office. For example, it is very important to spend time checking whether a fund manager has a clear, well-defined investment philosophy and process, with the right people on board to implement these, and whether they follow their process and philosophy with discipline when making investment decisions. These factors are logical indicators of future performance and they are therefore factors that investors should research, judge and compare between funds. But they are hard to get to for one fund. Moreover, how is the average investor to undertake such a due diligence on the 1 021 funds available in South Africa, let alone the many thousands available in the world?

Independent, qualitative ratings shed some extra light on fund choices

Of course most investors do not have the time, appetite or access to information to thoroughly research all funds or fund managers. To get around this problem, it helps to consult independent fund ratings. These are available readily internationally, and in fact, in countries such as Australia, a fund cannot be listed on a retail platform, nor made available through a superannuation (retirement) fund, without an independent rating.

We have therefore recently engaged independent ratings' agency Fundhouse to rate the funds on our platforms. In June this year we added ratings to the offshore platform, and we are pleased to announce that local fund ratings have recently become available. This means that there are now ratings available for most* of the funds on our fund lists, including those from the Allan Gray and Orbis group of companies. We hope that these ratings add an extra layer of assurance in the decision-making process and go some way to assisting investors and their advisers to make the right long-term choices. From an offshore perspective, the addition of fund ratings will hopefully help investors and advisers to compare lesser-known global managers, and make the offshore investment process less daunting.

Fundhouse's ratings methodology

Fundhouse is an independent, owner-managed financial services group, with a global research team and an extensive evidence-gathering process. They apply a bespoke, qualitative approach to fund ratings. The team analyses each fund manager, looking at the business and shareholders, the investment edge and process, the experience of the team, their decision-making skills and past investment actions. They gather detailed evidence by engaging in face-to-face interviews with investment teams and conducting due diligences. Analysts collate as much information as possible to ensure that the evidence is relevant to future outcomes and not based on past returns. At the end of this process a rating is assigned to each fund. Tier 1 is Fundhouse's highest rating and indicates that Fundhouse is satisfied that the offering is managed according to a well-considered, consistently applied process. Tier 2 reflects that there is a well-considered process, but Fundhouse is uncomfortable with certain aspects of how the process is applied - these may be people or business related. Tier 3 signals that Fundhouse is concerned about numerous aspects that underpin the investment proposition. Ratings are reviewed annually.

Benefits of fund ratings

Evaluating and comparing investment options takes time and brainpower. This is true for all aspects of the investment process. Fund managers spend much of their time on rigorous research of companies to include in their portfolios; it makes sense for investors to apply the same kind of rigour when researching potential funds for investment. Investment decisions of any nature may be compromised when decisions are not backed up by thorough research. Fund ratings, performed by an independent party, should give investors and advisers some comfort that their investment decisions are based on a properly researched process.

Our [local](#) and [offshore](#) fund lists have been updated with an additional column, reflecting the funds' respective ratings. To access the fund lists visit www.allangray.co.za, click on 'Our unit trust funds', followed by 'Other investment options'. You can find the link to the fund lists underneath the 'Downloads' section, which is located on the right hand side of the page. Alternatively, please contact your Business Development Manager or our Client Service Centre on 0860 000 654.

*Fundhouse is only able to rate funds with prior manager consent. While Fundhouse approached all the fund managers on our local and offshore platforms to assess their processes and produce fund ratings, some funds are not rated for various reasons described on our fund lists.