Study reveals reliance on recent performance in picking unit trusts

Past performance is just one of several factors financial advisers in South Africa say they consider when it comes to choosing which unit trusts to invest in on behalf of their clients. Along with relative performance of the unit trust (to its peer group), risk measures, and the investment style of the manager, these four top attributes account for only 50% of their overall decision. Responsible investing is at the bottom of the list.

These were some of the findings of an in-depth research report by Shaheed Mohamed, product development manager at Allan Gray, who surveyed more than 400 financial advisers in South Africa to identify attributes that financial advisers in South Africa consider when selecting unit trusts for their clients' portfolios. Mohamed revealed the results of the report at a media event in Cape Town today.

"There are over 1350 locally registered unit trusts in South Africa," Mohamed said. "Faced with that level of choice, most investors turn to independent financial advisers (IFAs) to make the decisions for them."

An IFA's existence in the industry is dependent on him or her offering regulatory-compliant advice; yet there is no regulatory blueprint to aid them in their product selection for clients. So how do they make their choices?

This was a question Mohamed set out to answer. "We noticed that in different market cycles, the flows into funds differed. It therefore didn't surprise me that performance was an important reported criterion for advisers choosing unit trusts," he said. "Looking at relative performance, I was surprised that advisers were not more cognisant of the benchmarks rather than the peer groups – different benchmarks and funds are managed differently across categories.

"Advisers reported relying on a variety of factors, but when we analysed their clients' actual behaviour using fund flows data relative to performance they tended to allocate money based on recent performance. Worryingly this sub-optimal investor behaviour was more pronounced among investors in our lower risk Stable Fund than in our Balanced or Equity Funds."

While the participants in the study were advisers, its findings are relevant to investors, asset managers and product providers.

Mohamed was pleased to see that advisers reported placing more of an emphasis on longer, meaningful performance periods rather than shorter periods.

The study further revealed that 'growth' is the investment style of choice, followed very closely by 'value'. Most trust was placed in managers with tenure of more than seven years, holding a CFA qualification. South African advisers also prefer medium-sized funds for their clients' portfolios – although it is worth noting that performance is not dependent on size.

"Advisers reported that they consider a variety of factors, including long-term performance and the qualitative aspects of a fund. Examples of this include a consistent investment philosophy, a sound investment process, and an experienced investment team. Yet our research shows that even people who have an adviser tend to rely on short-term performance to pick unit trusts.

“It is important to note though that, like fund managers, not all advisers are created equal. Investors should ask the IFA what process is followed when selecting unit trusts for their clients’ portfolios,” concluded Mohamed.

More about Shaheed Mohamed, manager in product development at Allan Gray

Shaheed is a manager in product development. He joined Allan Gray in 2007 as a business development manager, moving to unit trust distribution as an investment specialist from 2012 to mid-2017. Shaheed completed his B Com (Finance), CFP, and MBA (cum laude) at UCT GSB.), CFP, and MBA (cum laude) at UCT GSB.