

The equity investment fund button

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Last Saturday 14 April, the Chief Executive of Abante, Santiago Satrustegui, politely criticised one of my articles on investment funds which appeared on 28 March, saying he disagreed completely with it: "my objection is to all of it." In my article of 28 March I gave several figures on domestic equity investment funds. One piece of data was that in the past 10 years (1997-2006), only one of the 43 existing funds gave investors returns higher than that of the Madrid Stock Exchange Total Index (ITBM). Another was the fact that in the past five years (2002-2006) only five of 83 funds provided returns above the ITBM. Commissions charged by the 83 funds amounted to more than 700 million euros. In light of these figures, I concluded that "not all fund managers deserve the commissions they charge for their work." I do not understand why Santiago disagrees with this claim, because he provides no data in his article. I am not saying that no manager deserves the commission he charges: obviously, the manager of the only fund in the past 10 years to have shown returns above that of the ITBM deserves a commission. The manager of that fund has an MBA from IESE.

Does active management generate value?

Santiago suggests, "I also disagree with the claim that active management is incapable of generating value." Active management may be defined as that in which a manager buys and sells frequently to change the makeup of a fund's portfolio. With the data provided by the majority of funds it is impossible to tell whether active management generated value for investors, though it certainly generated value for the trading departments that bought and sold shares (they charged commissions investors then paid for). It seems reasonable and appropriate for funds to inform their investors of how many trades they carried out and of the commissions investors paid (the majority of funds do not do this). It would likewise be interesting if funds provided data on the return they would have posted if the portfolio had not been changed: we would then know exactly what value was added by active management. What we do know from the data provided is that the initial investment decision plus active management in the past 10 years has failed to create value for investors in 42 of the 43 domestic equity investment funds in existence in the past decade.

In light of the above information, I cannot agree with the claim that "investment funds, along with pension funds, are the most efficient form of access to financial markets for individual investors." In another article we will discuss pension funds, which have an even more painful history than investment funds. Part of the financial press also contributes to a false perception of "efficiency." As an example, the following news item: "domestic equity funds rose 32.44% in 2006, while the Spanish stock market gained 31.79%." At first glance the phrase seems to suggest that 2006 was a good year –on average– for domestic equity funds. However, the Ibex 35's return (including dividends) was 36%, and that of the ITBM was 40.5%. Where did the figure of 31.79% come from? It was the Ibex 35's return excluding dividends paid by the companies listed on it.

Santiago ends his column with a very good joke, which inspired the title of his article: "A repairman, to whom a client complained after he charged him a thousand euros to push a button to fix a machine, decided to send the client a bill broken down in the following manner: one euro to press the button and 999 euros to decide which button to press." The problem with domestic equity investment funds is that –judging by data from the past 10 years– only one repairman (manager) out of 43 pressed the right button, though all of them sent a similar bill.