Do expensive funds justify their fees?

Issued by Glacier Invest

With passive funds becoming increasingly easier to access, the fees associated with active fund management have come under increasing scrutiny. The availability of passive investments offering investors low-fee exposure to the market means that active managers are under greater pressure to justify the fees which they charge their clients. As the return that an investor gets on a fund is a return net-of-fees, a fund manager charging a high fee would have to deliver a commensurate return to ensure a net benefit to the investor.

This leads us to the question of whether or not expensive funds generally justify the fees which they charge their clients. Using the ASISA SA Equity General category* for the analysis, we can break down the funds as per their fees (the fee being the Annual Report Net Expense Ratio as per Morningstar). Over the past 10 years, the most expensive 10% of funds in the category delivered an average gross return of 11.66% as compared to 11.49% for the bottom 10%. If we compare this to the market return (FTSE/JSE All Share SWIX) of 11.53% over the same period, we can observe that the funds that beat the market on a gross return basis over this period tended to the more expensive funds.

Does the performance of expensive funds justify their fees?

While it would be easy to thus conclude that more expensive funds are better, the question is not if more expensive funds perform better, but rather it is whether or not their performance justifies their fees. The top 10% of equity funds by fees have an average fee of 2.68%, as compared to 0.38% for the bottom 10%. Thus, in spite of the higher returns of the more expensive funds, the net return that investors would have received would have been higher had they been invested in the cheapest 10% of equity funds.

If we look at the sector over the past five years, the top 10% of most expensive funds delivered a 4.68% gross return on average, while the least expensive 10% of funds delivered 5.09%. Over this shorter period, the more expensive set of funds was unable to outperform the cheaper funds on a gross return. This once again suggests that investors would have been better off investing in the cheaper set of funds.

Fees are an important consideration when deciding on a fund

While this is a fairly simple analysis, it does speak to the idea that fees should be an important consideration when an investor is deciding on a fund or a set of funds to invest in. The ideal situation for investors would be to be able to benefit from the lower costs of the cheaper funds without losing the higher returns that more expensive funds are sometimes able to generate. To this end, there is a clear advantage to investing through a discretionary fund manager such as Glacier Invest, which can leverage its scale to obtain lower fees for its clients, in addition to giving them access to those funds which were less expensive to begin with.

*Zero-fee class funds have been removed from the category for the purposes of this analysis as the fees on these funds are often charged separately.

Data source: Morningstar

Glacier Financial Solutions (Pty) Ltd is a licensed discretionary financial services provider, trading as Glacier Invest FSP 770
Sanlam Multi-Manager International (Pty) Ltd is a licensed discretionary financial services provider, acting as Juristic Representative under Glacier Financial Solutions

Glacier Financial Solutions (Pty) Ltd.

A member of the Sanlam Group
Private Bag X5 | Tyger Valley 7536 | Email client.services@glacier.co.za | Tel +27 21 917 9002 / 0860 452 364 | Fax +27 21 947 9210 | Web www.glacier.co.za | Reg No 1999/025360/07
Licensed Financial Services Provider | Glacier Financial Solutions (Pty) Ltd. is also a Licensed Discretionary Financial Services Provider FSP 770, trading as Glacier Invest | Sanlam Multi-Manager International (Pty) Ltd. | A member of the Sanlam Group

Private Bag X8 | Tyger Valley 7536 | Tel +27 21 950 2600 | Fax +27 21 950 2126 | Web www.smmi.com *|*Reg No 2002/030939/07
Licensed Discretionary Financial Services Provider, acting as Juristic Representative under the Glacier Financial Solutions FSP 770
Glacier International is a division of Sanlam Life Insurance Limited
Sanlam Life Insurance Ltd. | Email life@sanlam.co.za | Tel + 27 21 916 5000 / 0860 726 526 | Fax +27 21 947 9440
Reg No 1998/021121/06 | Licensed Financial Services Provider