BE YOUR OWN FUND MANAGER

Trying to determine whether the JSE is expensive, what is happening to resources, where the rand is going and what further damage politicians will do to our markets is an impossible task. Many investors (and their financial advisors) choose to outsource control of their investments to fund managers of flexible or balanced funds. The belief (or hope) is that the fund manager has a better insight into the future than the rest of us. Frankly, I think these investors (and their advisors) are making a big mistake. Private individuals who control their own asset allocation in a rational and structured way will do much better in the next few years than flexible or balanced funds.

Fund managers make structural errors

Many credible fund managers (not all unit trust managers are credible) make two structural mistakes with their balanced or flexible funds over the long term. Firstly, they are usually under-invested in equities over longer periods of time and secondly, they are almost always under-invested in listed property. The usual explanation from balanced fund managers about their under-investment in shares is that they are protecting investors from potential losses if the stock market drops. A fund manager who remains conservative with equities in a balanced fund over the long term is more likely to keep his job because he won't have a blow up in a 12 month period. This does not necessarily mean he is doing a good job for his investors.

Listed property is more interesting, it is very rare to find balanced funds with a large exposure to property companies. This is partly because the property sector is quite small in comparison to the rest of the stock market. However this is not the only reason. I have a view (not scientifically proven) that most balanced fund managers are equity managers at heart and are not fundamentally comfortable with listed property. They will take small positions at certain stages in a market cycle but for the rest of the time will avoid property. As you can see from the table below, an underinvestment in property (as shown by property unit trusts) was a very poor decision over the last five years.

Asset Class	Index/Fund Name	5 year annualised returns
Shares	All Share Total Return	8.14% per year
Property	Average of all property unit trusts	12.21% per year
Property	Best Property Unit Trust	16.18% per year
Balanced Funds	Average Balanced Funds	7.14% per year
Balanced Funds	Best Balanced Fund	10.08% per year

Source: Morningstar

One could also infer from the table that the average balanced fund manager was very risk averse over the last five years, in a time when interest rates were declining, which was great for local bonds and listed property.

Take control

For a private investor, there are few limitations on the portion of capital that you can allocate to any asset class. It is unlikely that a very large balanced unit trust will invest 15% or 30% of its capital in listed property because the property sector is too small. This would not be a problem for an individual and so it does not make sense to allocate the bulk of your capital to a balanced fund where you will be limited from investing in quality listed properties. Having said all that, I am not advocating that you place all your money in listed property – far from it. I feel you should create a structural asset allocation for yourself that is not determined by external factors. To start with, if you adopted a really simple approach to asset allocation, you could do the following:

Asset class	**Percentage Allocation**
Shares	50%
Bonds	25%
Listed Property	25%
TOTAL	**100%**

The real benefit of this approach is that you determine your allocation to growth assets based on your own situation. It is only by investing in growth assets (equities and listed property) on a sustained basis, that investors will make the maximum possible return without taking excessive risk. If the stock market continues to rise, fund managers are likely to reduce their exposure to shares and listed property even further. This is because they are worried that the market might dip in the short term but a short term dip might not be relevant to you. If you bought quality growth assets at a great price, the fact that they fall for a year or two might be irrelevant if you are investing for 20 years. You might have bought the investments 8 years ago and so a 15% drop from current levels would be small in the context of your overall investment performance.

My preference would be to allocate portions of your capital directly to an equity fund, property fund and bond fund. You can then determine when to rotate asset classes based on your own goals rather than the fund manager's.