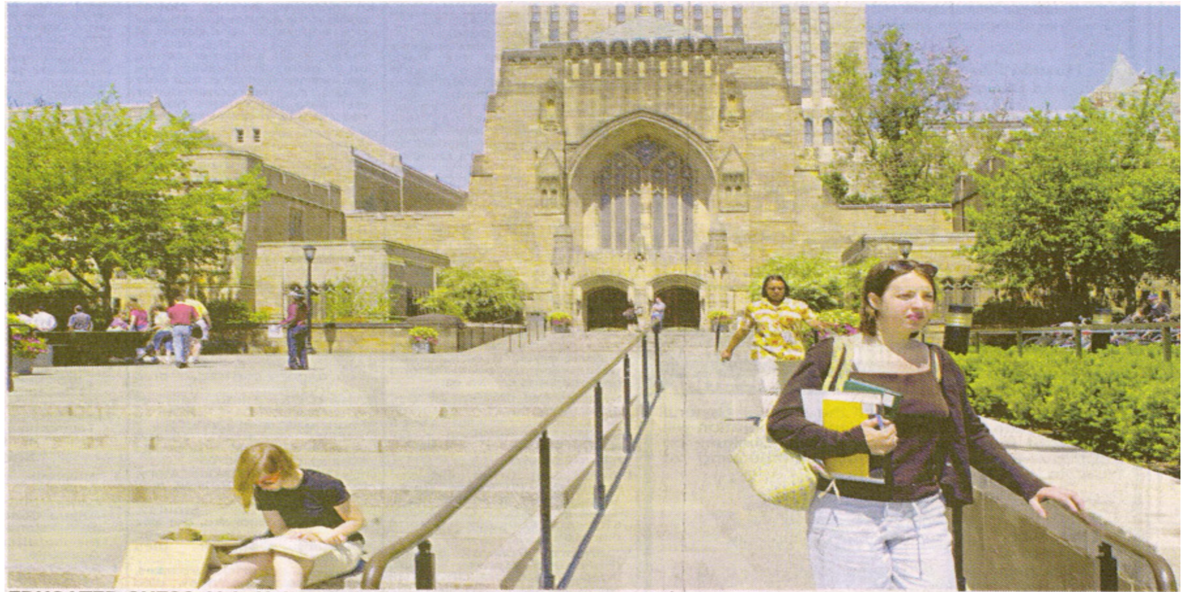
Advice without the strings

COMMENT : A leading fund manager delivers a godsend : investment guidance without hidden agendas



EDUCATED GUESS: Yale University's Endowment Fund is worth US$15 billion. PICTURE / BLOOMBERG

The world may be short of oil, but there is certainly no shortage of experts offering free investment advice.

However, as we all know, much of it is of dubious value as many fund managers and intermediaries have vested interests.

Financial planners often say the road to riches is through high-cost managed funds, stockbrokers inevitably recommend individual stocks conveniently forgetting diversification attractions, and most advocates of real estate secretly believe house prices always go up.

Just about anyone with any specialist knowledge has some sort of hidden agenda, foremost of which is making themselves a dollar. That is why a recent book by a top US fund manager, which highlights the poor economics of the investment industry for retail investors and in the process succeeds in"providing guidance and financial know-how for the private investor", is such a breath of fresh air.

Unconventional Success: A Fundamental Approach to Personal Investment is written by David Swensen, the chief investment officer of Yale University's Endowment Fund, and is designed to show small investors how to manage their assets.

However, unlike Warren Buffett's investment advice of buy good stocks and hold them (which can really only be implemented by a genius like Buffett), Swensen offers a workable solution to the savings conundrum. Swensen manages US$15 billion ($21.9 billion) for the Yale fund.

What makes him special is that he has produced an unparalleled 16.1 per cent return over the past 20 years from a diversified portfolio. For comparison, the much more risky US sharemarket has returned about 13 per cent in the same period.

Growth Portfolio

Bonds	30%
Property	20%
Local shares	30%
Int shares	15%
Emerg mkts	5%

Usually experts like Swensen work for a large fund manager, bank or stockbroker and thus have to watch what they say so as to avoid conflicts with their investment banking division, clients or shareholders not to mention impacting their own remuneration.

At Yale, Swensen is pretty much free of these shackles and thus he strives to minimise costs and maximise returns.

Furthermore, Swensen has realistic expectations of future sharemarket returns and so doesn't buy comments from local fund managers of the year that "fees don't matter".

If you don't have time to read his book (available from Amazon.com), here are some of Swensen's key recommendations:

First, he says fortune favours those who adopt a contrarian alternative. He thus instructs readers to avoid all products from fund managers who are required to make profits for shareholders.

In New Zealand that is virtually everyone, including "fund managers of the year".

They can't work for two masters and, guess what, they don't.

They are working for their annual bonus first and their shareholders second. Small investors in the funds are towards the bottom of the food chain.

Swensen notes that for the fund management industry conflicts of interest abound. Investors desire low fees; shareholders want high fees.

Investors need low portfolio turnover; profit seekers revel in the money and influence that accompany high trading volumes. Investors benefit from smaller, more nimble funds; profit seekers gather assets. Investors search for fair, transparent fee arrangements; profit seekers thrive under complex structures.

Instead, Swensen says, give your money to passively managed funds preferably run by not-for-profit institutions.

Obviously these sorts of institutions are pretty thin on the ground locally, but we can buy not-for-profit fund manager Vanguard's low-cost, exchange traded funds on the New York Stock Exchange.

There are several passively managed exchange traded funds available locally and in Australia. The NZ Stock Exchange's passively managed, NZSE listed funds have low fees compared with most local managed funds, but their fees are still much higher than comparable overseas funds.

Swensen laments that many retail investors spend too much unproductive effort trying to pick which shares to buy instead of constructing well diversified, low-cost share portfolios and persevering through the bad times.

Swensen gives readers an idea of what a growth-oriented portfolio's asset allocation might look like: bonds 30 per cent; property 20 per cent; domestic shares 30 per cent; international shares 15 per cent; emerging markets 5 per cent.

He says this portfolio has 70 per cent of its assets in high-returning growth assets and individuals should use index funds to attain exposure rather than actively managed funds.

"By avoiding asset classes that rely on superior active management to generate returns, investors dramatically reduce the risk of slippage between hoped-for-asset-class performance and actual results."

Despite the Yale portfolio being full of "alternative" asset classes such as hedge funds, private equity and junk bonds, Swensen warns small investors not to venture therein.

"Non-core asset classes command a significant portion of the investment spectrum. Investors require unusual self-confidence to ignore the widely hyped non-core investments and to embrace the quietly effective core investments."

He says hedge funds too are best avoided as the best hedge funds are usually only available to the super rich.

Jeremy Grantham, chairman of contrarian US fund manager Grantham, Mayo, van Otterloo, sums up Unconventional Success rather well when he says: "Unfortunately, at the bottom of our industry, money management, there is a rather thick layer of muck, and Swensen's Unconventional Success rakes through this muck in spectacular fashion and great detail. "It is the truth, the whole truth and the very ugly truth.

"If you want to avoid the snares that lurk in money management, and save yourself lots of money, you must read it."

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