

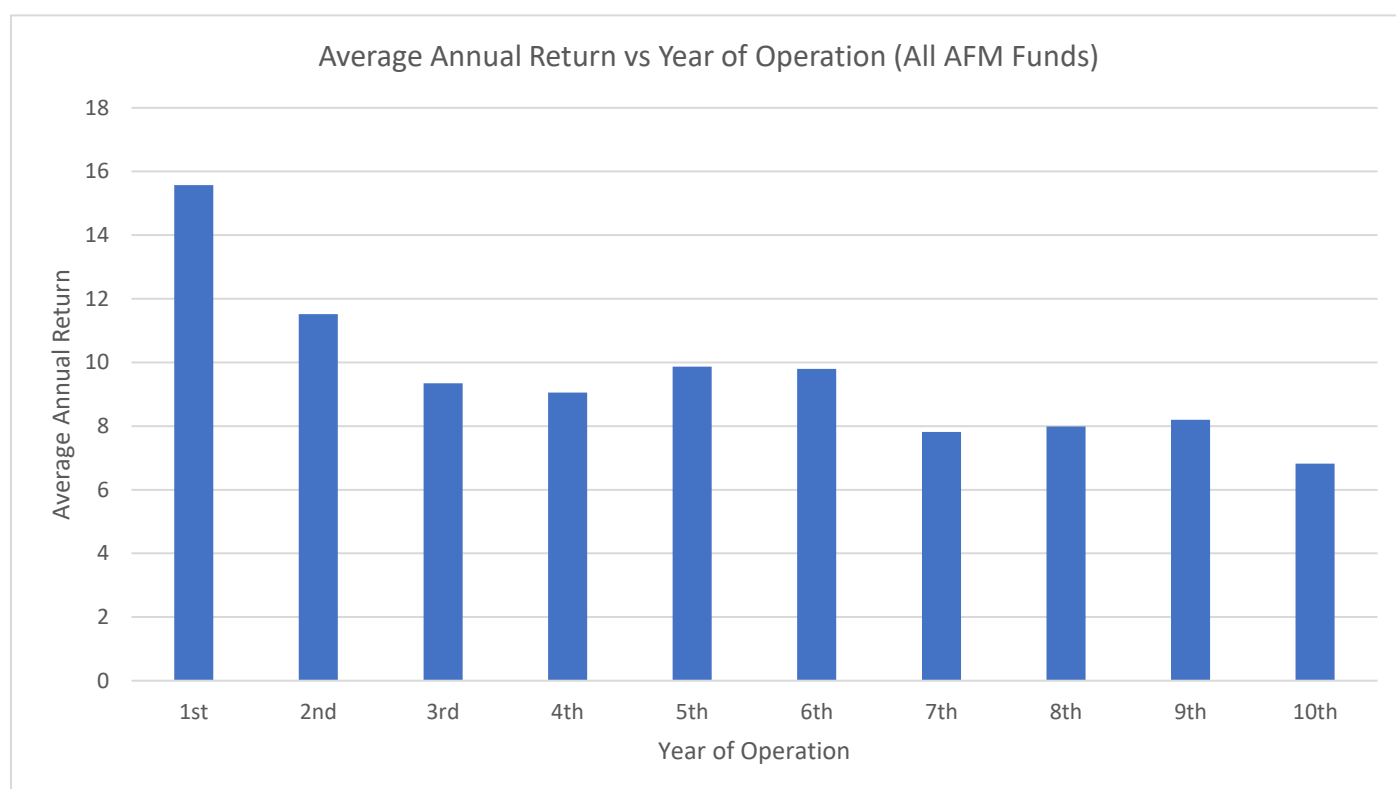
Track Record- The Analyst's Friend or Foe?

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Generally speaking, managed funds are required to have a minimum track record of 3 years, preferably 5, before being able to achieve a recommended rating and thus make it onto the prized Approved Product Lists or APL's of platforms and advisors' dealer groups.

Of course, there is a sound logic for this. Despite the standard risk warning that past performance is no guarantee of being repeated in the future, unless there are sufficient data points (generally monthly performance) across various market conditions, it is difficult to be able build a performance and risk pattern of returns to be able to make an informed decision.

Every fund manager, except the "star portfolio manager" moving from one highly successful or well-respected firm to launch their own fund, is well aware of this requirement. Normally the result is that new or emerging managers take three or more years to build their track record. During this time their profile and presence builds while managing a limited amount of money for a small number of wholesale or sophisticated investors before being able to market and distribute to a wider audience of retail or institutional investors.



However, by avoiding early stage managers, those investors are missing the opportunity of better returns. The data clearly show that in a fund's early years, performance is better than when track record or size increases. As such, while there is less information on which to base quantitative performance and risk analysis, investors are accepting lower returns.

The graph above is not subject to distortion based on market conditions in any particular year. The constituent funds in each “bar” could now have a track record anywhere between 1 and 10 years. The reasons for the early stage out performance can be varied, including an initial focus on the market and the investment portfolio rather than administration, marketing and compliance, or in some cases a propensity to reduce risk as FUM increases.

Equally possible is that with relatively small funds under management, the emerging or early stage manager is able to take opportunities and positions not open to their larger competitors who have to operate under market liquidity constraints.

However, there are always exceptions to the rule. Careful analysis and research will show that there are funds with a long track record, and/or substantial funds under management, that provide attractive risk and return profiles.

The investor is faced with a choice – a large volume of quantitative data by which to analyse performance and risk over a number of years, or a less prescriptive approach focusing on a qualitative analysis of the manager’s credentials and portfolio strategy.

Either way research is essential – and even then as the ASIC caveat suggests, past performance is no guarantee...

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