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The long run

Funds put to the endurance test

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Top of the class

John Collett compares the share funds that have done best for investors over five years

The tremors on world stockmarkets should remind investors that the best fund managers tend to be those who do a good job of preserving capital during tough times. They do not necessarily produce dazzling short-term performances during the good times.

Money asked Morningstar to list the five top-performing funds over five years in each of four share fund categories. However, selecting a fund on the basis of past performance is almost always a recipe for disappointment. Sure, the five-year performance numbers are more meaningful than those over shorter time periods, but the performance numbers tell investors nothing about how well managers have performed during those periods when sharemarkets fall.

The performance numbers also say nothing about how much risk the managers are taking to achieve those returns, nor do they say how the manager will perform in the future.

Anthony Serhan, the head of research at Morningstar, says just looking at tables and picking the best performer is to put the cart before the horse. Before even thinking about individual funds, investors must decide on asset allocation, he says. Serhan says investors must be clear on what assets they already have in their portfolios and what could be better diversified.

A fund's performance can change for all sorts of reasons. Serhan says key investment staff jump ship and managers change their investment processes. Market conditions favouring one style of investment management can change.

Given that most fund researchers say share funds should be regarded as a seven-year or more investment, you'll do best with funds that manage well in all market conditions.

Some of the most highly rated Australian share fund managers – Perennial Value, Investors Mutual and Maple-Brown Abbott – do not feature in the performance tables. That doesn't mean they are bad managers. They are "value" managers who hold companies paying reliable and growing dividends, which helps support their share prices during downturns.

Unfortunately for them, the market boom has favoured more growth-oriented funds. But if history holds true, their time will come again.

GLOBAL SHARES

There is no better example of managing with an eye on limiting risk than Platinum Asset Management. It invests in sharemarkets all over the world from Sydney. It is a "contrarian" investor. It short-sells stocks, which is a way of making money when share prices fall. Platinum will also short-sell stockmarket indices, or hold high levels of cash, if it believes markets are overvalued.

Since the bull market in global shares started in early 2003, Platinum's flagship International Fund has struggled a bit. Over the past three years to January 31, the International Fund returned 12.34 per cent against the index return of 13.59 per cent. That performance, relative to the index, should improve given the current volatility and the defensive characteristics of the portfolio.

Another Platinum fund, the International Brands Fund, tops the global shares category with an average annual return of 17.35 per cent over the five years to January 31, 2007.

Simon Trevett, who has been managing the fund for five years, says the fund can invest in companies listed anywhere in the world that have well-recognised consumer brands within the markets in which they do business.

The fund has benefited from growing consumer demand in China, India and the rest of Asia and by buying companies that have been neglected by the market.

Trevett was an early investor in Indian-listed companies such as Asian Paints and United Spirits. The fund retains holdings in these companies but has decreased its Indian exposure to a "core" holding because of Trevett's belief that the Indian market is overvalued. That has turned out to be a smart move. Since the correction in global markets started two weeks ago the Indian sharemarket dropped 16 per cent before recovering somewhat to be down about 10 per cent. The fund also holds shares in European companies with substantial businesses in Asia, such as the French wines and spirits producer Pernod Ricard and cosmetics company Clarins.

AUSTRALIAN SHARES

In Australian shares, Melbourne boutique manager Prime Value Asset Management continues to demonstrate savvy market sense with an eye to minimising risk. Its two (and only) funds sit in first and second place in the Australian share fund category.

The Prime Value Imputation Fund returned an average annual 33.09 per cent for the five years to January 31, while the Prime Value Growth Fund produced 26.3 per cent over the same period. The Imputation fund aims to provide a higher level of tax-effective income than the growth fund.

"To be frank, a return of 30 or 35 per cent-plus frightens me a little bit," says Prime's founder, Han Lee, who, together with Leanne Pan, manages the two funds.

Lee has been telling investors returns like these should be regarded as "bonus" returns. Prime aims for returns of 10 and 15 per cent a year, on average, over the long term. The funds have indirectly benefited from the mining boom through investing in companies that are providing the "picks and shovels" to the miners.

Mining services provider Monadelphous Group has proved to be an outstanding investment. Lee bought shares in the company when it was small and unknown. Prime has also reaped rich pickings in other sectors of the sharemarket. Tasmanian forestry company Gunns has proved a big winner for the funds, as has women's clothing retailer Noni B.

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AUSTRALIAN SMALL COMPANIES

It is among the Australian sharemarket's smaller companies that a manager's skill can really pay off for investors. Dozens of analysts follow each of the market's big companies but the smaller fry can be overlooked.

Macquarie's Small Companies Fund, which returned 26.55 per cent over the five years, takes top spot in Australian small companies. Over the year to January 31, the fund returned just over 74 per cent, more than double that of second place-getter BT. Macquarie's good performance over the long term has been sustained, despite a high level of turnover in the small companies team. John Bugg was hired in 2005 and co-portfolio manager Neil Carter joined Macquarie last year. Macquarie has structured its small companies investment capability as a separate boutique business, with Bugg's and Carter's rewards tied to the profitability of the business.

Much of the fund's success has come from holdings in companies providing services to the booming mining sector, such as Transfield Services, earthmoving equipment provider Emeco Holdings and engineering services company VDM Group. Over the five years, the best performers have included gold producer Saracen Minerals and AED Oil. Information service companies such as Oakton and SMS Management and Technology have also been good long-term performers.

Leanne Pan. Photo: James Davies

Sticking to its proven investment process has been the key to the long-term performance of BT's Smaller Companies Fund. Its annual average return, over five years, of almost 26 per cent is only just behind that of Macquarie's fund.

Small companies are inherently riskier than large companies. The good performance of the BT fund has come with relatively low volatility. Morningstar says BT has been "adept at preserving capital in falling markets".

Portfolio manager Paul Hannan is the sole survivor of the original four-member team which came across to BT in 2002 from Rothschild. Like other top-performing funds over five years, this fund has done well from companies supplying resources companies such as United Group. Other long-term holdings of the fund include Ramsay Heath Care, David Jones and Macquarie Leisure.

AUSTRALIAN PROPERTY

Australian listed property has outperformed even the stellar returns of the Australian market, with an annual average return over five years to January 31 of more than 20 per cent.

The Australian Unity Property Securities Growth Fund, with an annual average return of 29.49 per cent over five years, takes the top spot in Australian listed property.

Money is still pouring into the Australian listed property sector from domestic investors through their compulsory super. And, as Australian listed property makes up about 10 per cent of the global market, foreigners are investing heavily in the local market to get their international exposure.

Vincent Stranges, the head of equities and listed securities at Australian Unity, does not manage the money himself. Australian Unity is a multi-manager. It selects the underlying managers and puts them into a single fund for investors. The three underlying managers are Legg Mason, Credit Suisse and Invesco.

But a warning. This fund is one of three that feeds from an underlying pool. Most of the capital gains from the underlying pool is apportioned to the "growth" fund.

That means investors receive little income, as most of the return is by capital movements (up or down). The fund is not suitable for income investors and if the property sector experiences a downturn, the fund is expected to underperform the market. Many analysts believe listed property, which has been the best-performing sector of the Australian sharemarket for many years, is overvalued.

Investors wanting income as a larger component of their total

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returns and more stable returns could consider the UBS Properties Securities Fund.

Over five years, the fund has produced an annual average return of 21.49 per cent. The UBS fund's total return (change in unit price plus distributions) is almost a third less than the Australian Unity fund but the UBS fund has paid more income and its returns should be more stable in the event of continuing market volatility.

Piers Bolger, the director of research and investments at UBS Global Asset Management, believes the listed property sector is overvalued. But he says that value can still be found among the smaller listed property trusts, where UBS does most of its best buying. The listed property sector illustrates the importance of alway seeking to understand the reasons behind a fund's performance.


Winners are grinners ... John Bugg and Neil Carter. Photo: Louie Douvis

SMALL AUSTRALIAN SHARES

Institution	Start date	Return 1yr (%)	Return 3yr (%)	Return 5yr (%)
Macquarie Master - small companies	4/6/98	74.04	43.63	26.55
BT PPSI - wholesale smaller companies	1/8/00	35.76	34.62	25.98
Credit Suisse Pri Inv - Aust small comp.	21/3/01	34.51	26.59	25.32
AMP FLI - small companies#	21/2/89	39.80	35.88	24.93
EQT small companies	22/6/01	25.59	15.49	24.64
S&P/ASX Small Ordinaries Accum Index		31.76	27.42	19.16

CLOSED RANKED BY FIVE-YEAR RETURNS TO 31/1/07

AUSTRALIAN SHARES

Institution	Start date	Return 1yr (%)	Return 3yr (%)	Return 5yr (%)
Prime Value Imputation	20/12/01	24.81	25.37	33.09
Prime Value Growth	10/4/98	20.79	30.42	26.39
EQT SGH Absolute Return Trust	12/11/01	18.66	21.83	19.15
Challenger Select Aust Share	1/2/83	26.90	27.78	18.07
BT Investment - BT Imputation	1/11/98	26.31	28.99	18
S&P/ASX 200 Accumulation Index		22.22	26.10	15.48

RANKED BY FIVE-YEAR RETURNS TO 31/1/07

INTERNATIONAL SHARES

Institution	Start date	Return 1yr (%)	Return 3yr (%)	Return 5yr (%)
Platinum International Brands Fund	18/5/00	13.94	22.85	17.35
MLC MKey Unit Trust - Platinum Global	29/6/94	9.40	14.43	11.12
Platinum International Fund	4/4/95	7.23	12.34	9.93
Vanguard - Index Hedged Int Share	3/1/01	15.29	16.42	9.86
BT Investment - Core Hedged Global Sh	1/11/01	18.13	16.59	9.57
MSCI World ex-Aust Net Dividends Reinv $A Index		13.41	13.59	1.64

RANKED BY FIVE-YEAR RETURNS TO 31/1/07

AUSTRALIAN LISTED PROPERTY

Institution	Start date	Return 1yr (%)	Return 3yr (%)	Return 5yr (%)
Aust Unity Property Securities Growth	17/5/85	57.35	42.81	29.46
UBS - Property Securities	1/2/93	35.07	27.75	21.49
Commonwealth - Property Securities#	21/10/96	42.97	31.46	20.75
RREEF Paladin Property Securities	1/5/95	38.67	27.43	20.22
Col First State MIF - Prop Securities	10/5/91	36.53	27.99	19.89
S&P/ASX300 Property Trusts Accumulation Index		38.86	26.78	20.32

CLOSED RANKED BY FIVE-YEAR RETURNS TO 31/1/07 SOURCE: MORNINGSTAR