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## **ASK DR MONEY**

Unit trusts and funds:

# **Be careful. Be very careful**

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DO you have money in your CPF account earning 2.5 per cent interest?

Do you want to invest it to earn a higher return?

Be careful. You had better read this first.

Last year, a Singapore bank ran an ad promoting its unit trusts.

It asked: 'Would you want to do your own brain surgery?'

The correct answer, of course, was 'No'.

If you do your own brain surgery, you are likely to end up without a brain.

The brain surgery example is what journalists call 'a misleading metaphor' and others call 'nonsense'.

Investing is not like brain surgery. It's more like learning how to change TV channels using a remote control.

It is easy and doesn't require an expert's advice.

### **Who needs experts?**

Not everyone thinks this way. Most believe investing is complicated and should be left to the experts.

The chief proponents of this view are the experts themselves. Many have written books about how much we need them.

A typical one is *The 5 Keys To Value Investing* by Mr J Dennis Jean-Jacques.

The author walks us through 11 successful stock picks he made in his career in which his employer - Fidelity Funds - invested millions of dollars.

It seems that everything he touched turned to gold.

For example, he advised Fidelity to purchase a company, Varian Associates, then tells us: 'Our assessment of the business and their values paid off.'

'Less than 18 months later, we watched the shares trade up, first meeting then exceeding their fair values.'

### **Prove it**

The only problem is it is impossible to verify these happy outcomes.

Nowhere does the author tell us the date and price at which Fidelity bought and sold the shares.

As we say in Singapore, 'Never mind.'

While the absence of data makes it impossible to evaluate the author's work, we can do something bigger and better.

We can look into the performance of all stock experts. There are thousands of them.

Luckily for me, the work has already been done.

Here is the result: My 8-year old daughter, picking shares at random, will do just as well as highly-paid analysts who have devoted their entire careers to recommending stocks.

It's an amazing finding and dozens of studies come to the same conclusion: Expert analysts do not choose stocks better than someone who picks them at random.

### **The facts**

(1) From 1991 to 2001, all US stocks returned 12.9 per cent per year. Even with their high-priced talent, funds could not match this and returned just 12.4 per cent.

(2) Since 1983, funds beat market averages in only four years: 1990, 1993, 2000 and 2003.

Here is why stock-picking fails:

- First, all available information is already included in the stock's price.

If you read that Company X's profits doubled unexpectedly, the price of Company X's shares will rise very quickly. There won't be time to profit from the news.

- Stock analysts are human and can be bluffed. When briefing analysts, most companies will emphasize positive and not negative points.
- Actively managed funds buy and sell shares frequently. This results in high commissions and taxes. But the biggest costs remain the salaries funds must pay stock analysts.

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### **Difference between passive and active funds**

- PASSIVE management refers to index funds. These manage investments without stock analysts.

Instead of looking for 'the best' stocks to buy, index funds simply duplicate the performance of a market index like the STI (Straits Times Industrial Index).

- Active management is when stock analysts try to out-perform a market index like the STI or the S+P 500. Nearly all funds in Singapore are actively managed.

But it doesn't work. Actively managed funds do not out-perform passively managed index funds and they are much more expensive.

### **PRIVATE PENSION PLAN**

Don't despair. There's hope for the future.

In Singapore, less than 3 per cent of our unit trusts and funds are passively managed index funds.

To keep costs low, the proposed Private Pension Plan (PPP) may be passively managed.

The CPF Board told me, 'We want costs to be kept as low as possible for PPPs.'

'We have deliberately not specified whether funds should be actively or passively managed to give providers the flexibility to propose options that will achieve the objectives of PPPs.'

<b>How much they cost</b>			
<b>Types of funds</b>	<b>Low-cost US index fund*</b>	<b>All US funds</b>	<b>All Singapore funds</b>
<b>Predominately active or passive</b>	<b>Passive</b>	<b>Active</b>	<b>Active</b>
<b>Expenses (% of assets)</b>	<b>0.2</b>	<b>1.6</b>	<b>2.2</b>
*The low-cost index fund selected for this example is the world's largest, the Vanguard S+P 500 Index Fund.			