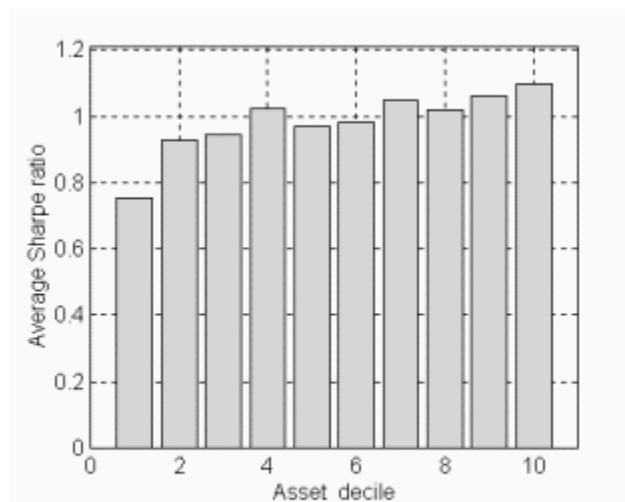


(dollarDEX, [www.dollarDEX.com](http://www.dollarDEX.com), March 2003)

## Size isn't everything

Since many funds have shrunk because of redemptions and the downturn in market prices, should we all flock to those remaining giants? On the surface we would expect the biggest funds to have better economies of scale, and therefore lower expense ratios, the luxury of attracting better fund managers, and the ability to build superior investment processes. Put plainly: big funds should be the stars.

Indeed, a study by William F. Sharpe, winner of a Nobel Prize in Economic Sciences and one of the originators of the Capital Asset Pricing Model, showed that bigger funds have historically enjoyed better risk-adjusted returns as measured by Sharpe ratios. But significantly he concluded this was probably due to their tendency to have lower expenses and turnover, not just because they were big.



**Bid funds seem to do better**  
Average Sharpe ratios for ten deciles based on total assets.  
Source: wsharpe.com

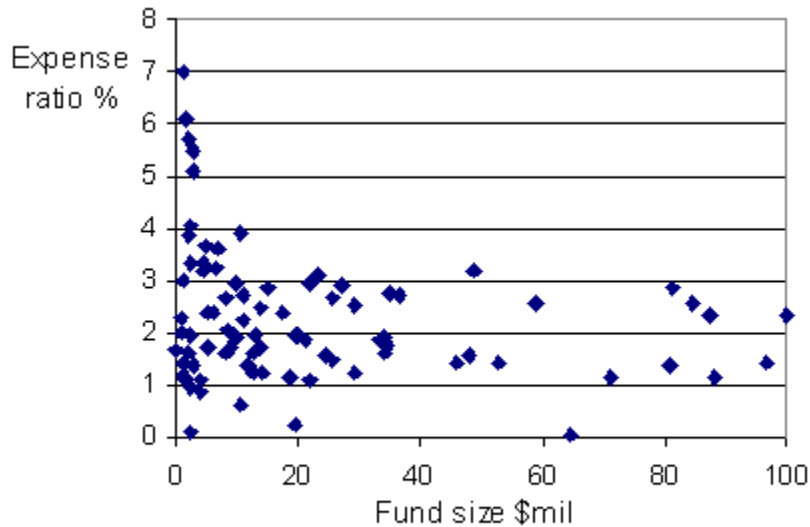
What about funds sold in Singapore? A recent study by dollarDEX looked at all 48 unit trusts and ILPs bigger than S\$100 million. Of these, the average ranking of the big funds is only middle-of-the-road but the 10 biggest of the big have actually done worse. Their three-year average is 65/100, and their one-year average a dismal 67/100 (1 being best and 50 being average).

In fact, three of the biggest ten ranked last within their peer groups over the past three years. In the worst case, one fund lost 24% compared with the 16% loss in the “Asset Allocation Global Neutral” peer group, about 50% worse than the average. Fortunately some giants do live up to their stature (see table).

<i>Fund</i>	<i>Peer rank</i>
<b><i>ACM IF-Global Growth Trends</i></b>	3 <sup>rd</sup> out of 19
<b><i>FTF-Templeton Global Balanced</i></b>	1 <sup>st</sup> out of 9
<b><i>United International Growth</i></b>	2 <sup>nd</sup> out of 29

**Three giant funds living up to their stature**  
Source: dollarDEX, Lipper, S&P

So what is going on? First, scale is important to get the expense ratios down, but once a threshold size is met, other factors, such as manager skill or investment process, become more important. In Singapore it seems the minimum size is \$10-20 million. If a sector requires copious research and active management, the higher the minimum needed to spread costs. For feeder funds (where no research is done locally) the minimum of the local fund is likely to be \$10 million.



**Bigger doesn't always mean cheaper**  
Global and US equity unit trusts. Source: dollarDEX, Lipper, S&P

What about looking at it the other round: how big are the top performers?

<i>Fund</i>	<i>5-year return</i>	<i>Fund size (\$ mil)</i>
<i>Schroder Singapore Trust</i>	76%	181.5
<i>Aberdeen Thailand Equity</i>	60%	8.5
<i>Aberdeen Singapore Equity</i>	53%	11.6
<i>Aberdeen Pacific Equity</i>	41%	33.0
<i>Deutsche Premier Asia Bond</i>	38%	16.3

**The small size of top five funds on five-year returns.**  
To February 6, 2003. Source: dollarDEX, S&P

It seems size doesn't really play a part, at least for these sectors. Only one, Schroder Singapore Trust, is larger than \$100 million. All the others are tiddlers by comparison, yet significantly, above a threshold of around \$10 million.

Another explanation might be investment style. Some managers thrive with small funds (the "opportunistic"), while others are relatively size-independent, or may even benefit from scale (the "steadfast").

The "opportunistic" manager could be generating good returns through aggressive trading of thinly traded issues or by identifying brief market mis-pricing. Such tactics could work well for small funds, since each opportunity is relatively small in dollars, but significant relative to the portfolio size.

Yet this same approach might not work as the size of the portfolio grows. What used to be a big deal now becomes insignificant, or worse, impossible to execute. Taking this logic to the extreme, a fund can actually get too big, and its initial success can never be repeated without modifying the investment approach. In practice, some funds might choose to close when they reach a certain size.

On the other hand, a “steadfast” manager is more likely to emphasise the “buy-and-hold” of broadly traded securities, and depend more on process than skill. For these kinds of funds it would be hard to grow so big that a position change affected the market (and started to impact performance).

So in theory if the fund grows and the expense ratios keep going down, the unit holders all benefit by better performance. The determining factor on whether funds can achieve this is their having a scalable investment process. For example, a successful large fund must be able to expand its team easily, and not be dependent on finding a few outstanding individuals.

When does a fund really get too big? It depends on the fund’s strategy and the liquidity of the target market. Some funds have grown huge without much impact. The Vanguard 500 Index fund, which tracks the performance of the S&P 500, was at one point over US\$110 billion. To put that in context, it’s bigger than the market capitalization of the entire Singapore stock market, currently around US\$105 billion!

But if a fund becomes a significant percentage of a market (let’s say bigger than 2%), its trading could start to affect market prices. That’s about \$3 billion for the Singapore stock market. So the biggest local-market unit trust, Schroder Singapore Trust, still has plenty of room to grow at \$181 million, a mere 0.12% of the market. Likewise, the \$300 million exchange traded fund, streetTRACKS STI, represents a tiny 0.20%.

	<i>Fund Size (\$m)</i>	<i>Percent of market</i>
<i>streetTRACKS STI*</i>	306.7	0.204
<i>Schroder Singapore Trust</i>	181.5	0.121
<i>Singapore Index Fund</i>	94.2	0.063
<i>UOB United Growth</i>	83.3	0.056
<i>Horizon Singapore Equity</i>	81.0	0.054
<i>DBS Shenton Thrift</i>	36.7	0.024
<i>OCBC Savers Singapore Trust</i>	18.1	0.012
<i>Aberdeen Singapore Equity</i>	11.6	0.008
<i>UOB United Foreign Equity</i>	3.4	0.002
<i>UOB Optimix Singapore Equity</i>	1.7	0.001
<b>Total</b>	818.1	0.544

**A drop in the ocean**

Singapore equity funds relative to Singapore stock market  
Fund sizes as at 31/1/03 source S&P Fund Services, except \* from semi-annual report, 31/12/2002

What does this tell the average investor? It doesn’t simply mean look for the biggest funds. And conversely it doesn’t imply that big funds are lumbering giants. The only thing it might warn you about is funds smaller than \$5 million; these are probably too small to outperform their peers. Once this threshold has been reached the best funds depend mainly on the people and processes behind them.