

How to choose a unit trust: Factors that matter most to financial advisers

By Shaheed Mohamed

The number of locally registered unit trusts on offer in South Africa has grown to approximately 1350. The excessive choice has become a burden for investors, especially considering that the typical investor in unit trusts struggle to make the appropriate comparisons. Data from the Association for Savings and Investments SA (2015) shows that most investors in unit trusts seek the aid of financial advisers. This does not mean that financial advisers necessarily find it much easier to make comparisons. A financial adviser's existence in the industry is dependent on him or her offering regulatory-compliant advice; yet there is no regulatory blueprint to aid them in their product selection for clients.

Faced with an extensive range of unit trusts, how does a financial adviser make his or her choice? What are the attributes of unit trusts that financial advisers consider and how much emphasis is placed on each of them?

A survey of more than 400 financial advisers conducted by Allan Gray in South Africa aimed to answer the above questions by better understanding which attributes and attribute levels of unit trusts drive the decision-making process for financial advisers; and to rank the relative importance of these attributes. The findings are outlined below and the research approach is explained in the Annexures at the end.

Survey findings

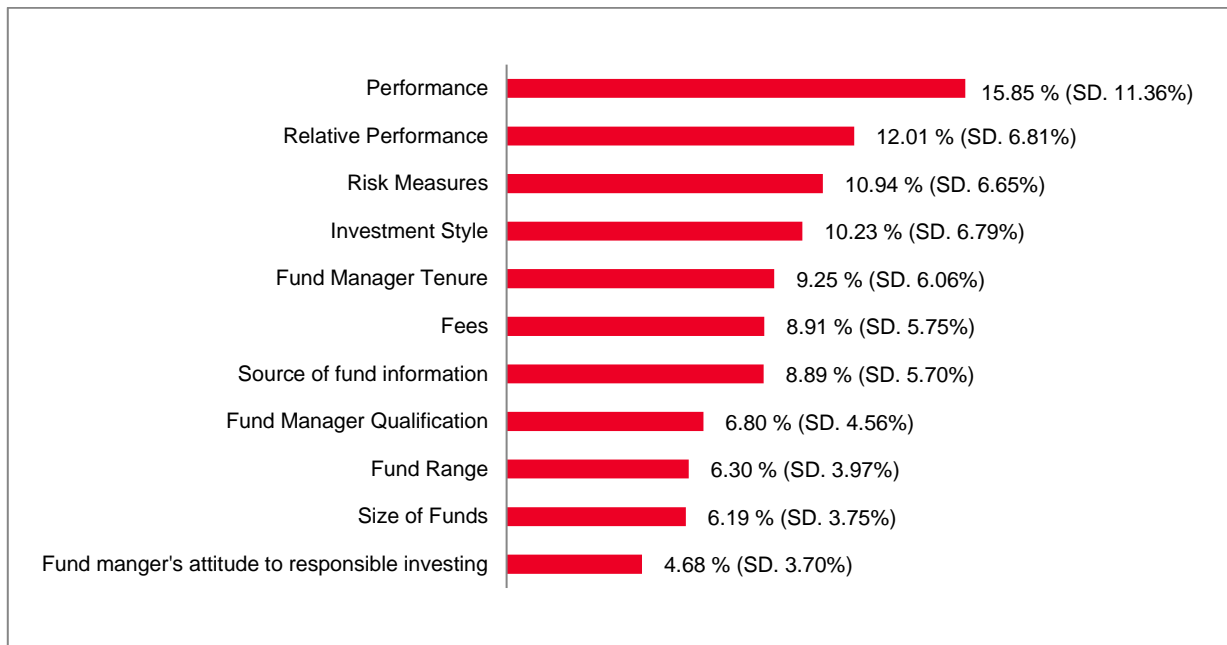
Q1. Which unit trust attributes are most important to South African financial advisers for the inclusion of these funds in client portfolios? How are they ranked?

Table 1 lists the attributes in order of importance, as ranked by the financial advisers surveyed, showing both the average ranking, as well as the standard deviation (SD)¹. Past performance is considered to be the most important attribute relative to the other attributes for financial advisers when they recommend specific unit trusts for client portfolios. Even though historic performance is not a guarantee of future performance, the respondents continue to place the most emphasis on this attribute.

The second most valued attribute is the relative performance of unit trusts. Advisers measure the performance of a unit trust relative to either a benchmark or the fund's peer group. Both performance and relative performance collectively account for 28% of the overall decision by advisers.

¹ Standard deviation is a measure of dispersion in statistics. "Dispersion" tells you how much your data is spread out. Specifically, it shows you how much your data is spread out around the mean or average. For example, are all the scores close to the average? Or are lots of scores way above (or way below) the average score.

Table 1: What drives the decision to include a specific unit trust in a client’s portfolio?



The third highest ranked attribute amongst the sample of advisers is risk measures, accounting for 10.94% of the overall decision. The financial planning best-practice process in South Africa entails the adviser conducting a risk-profile analysis on his or her client before determining which risk-category of unit trust to include; so it is understandable that the risk measure attribute is ranked in the top three attributes.

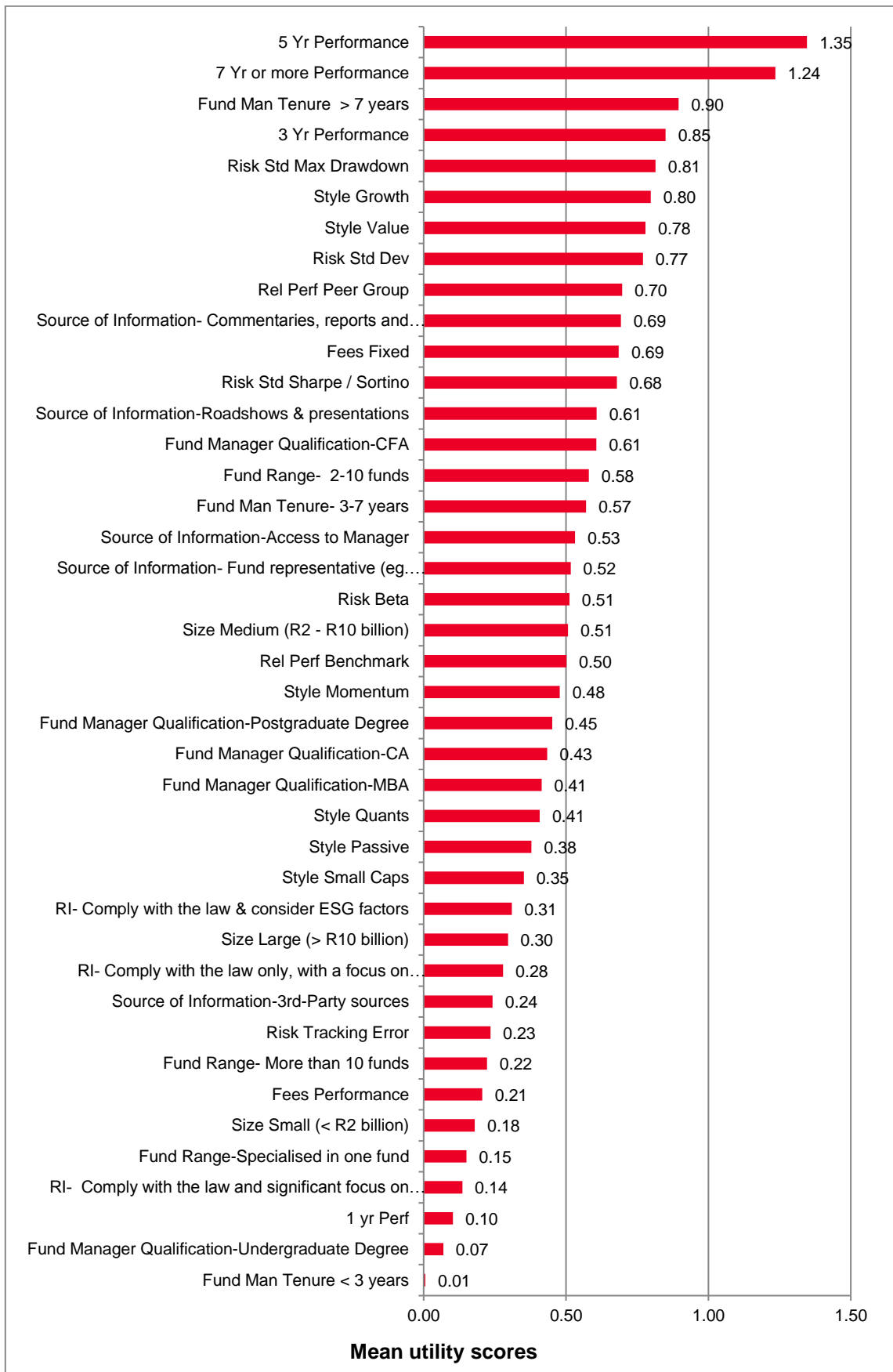
The least important attribute for financial advisers is the fund manager’s attitude to responsible investing. Responsible investing (RI) encompasses fund managers allocating capital not only to maximise profits but also to ensure that environmental, social and governance (ESG) factors are considered in the process.

Q2. What is the relative importance of the attribute levels and how are these ranked by South African financial advisers?

It is evident that when expanding the attributes to include the underlying levels or sub-categories (Annexure A) the decision-making process can become more complex and cumbersome, which is one of the main reasons why investors often seek the services of advisers in the first place. The ranking at attribute sub-category level further confirms the advisers’ value on past performance for their overall decision. Of the entire list of 41 sub-categories, past performance accounts for three of the top four positions. The last of the performance measurement periods, however, of one-year performance, is ranked 39th/41.

Ranked third overall is “fund manager tenure exceeding seven years”. This is interesting considering that fund manager tenure ranked only fifth in the attributes ranks, which highlights the fact that a fund that has a manager with tenure of anything less than seven years would hardly be considered by an adviser.

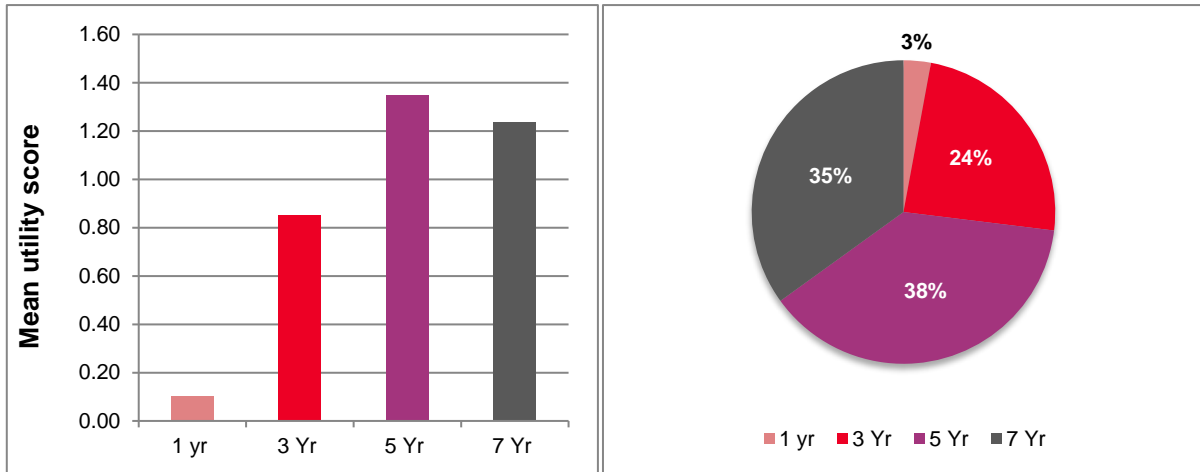
Table 2: Relative importance of each of the underlying attribute levels



Q3. What is the relative importance of the attribute level within each attribute category?

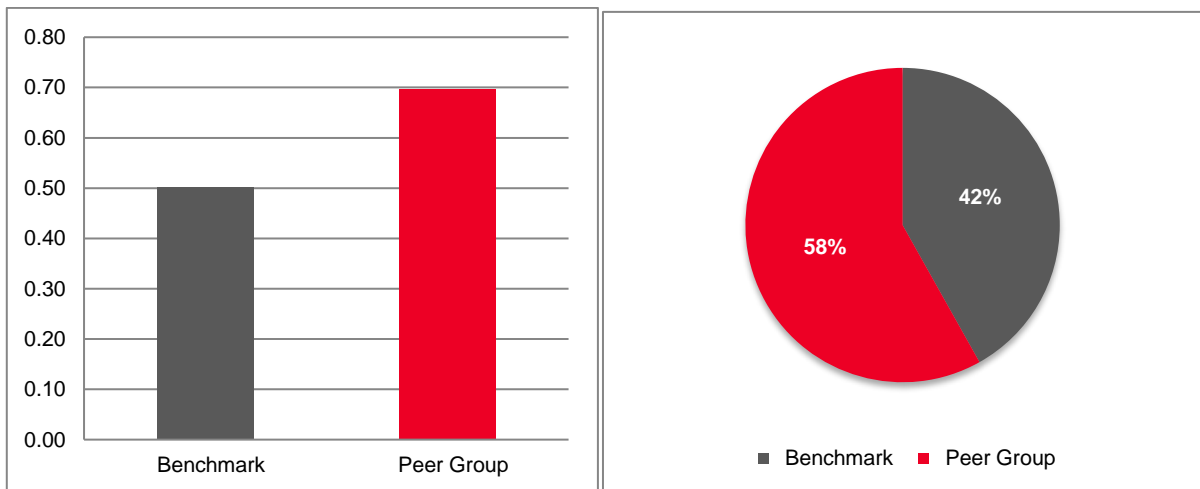
The graphs below reflect the constituents of each attribute category. The mean utility scores for the bar-charts on the left (L) were re-weighted to 100% and are reflected in the pie-charts on the right hand side (R).

Graph 1: Performance



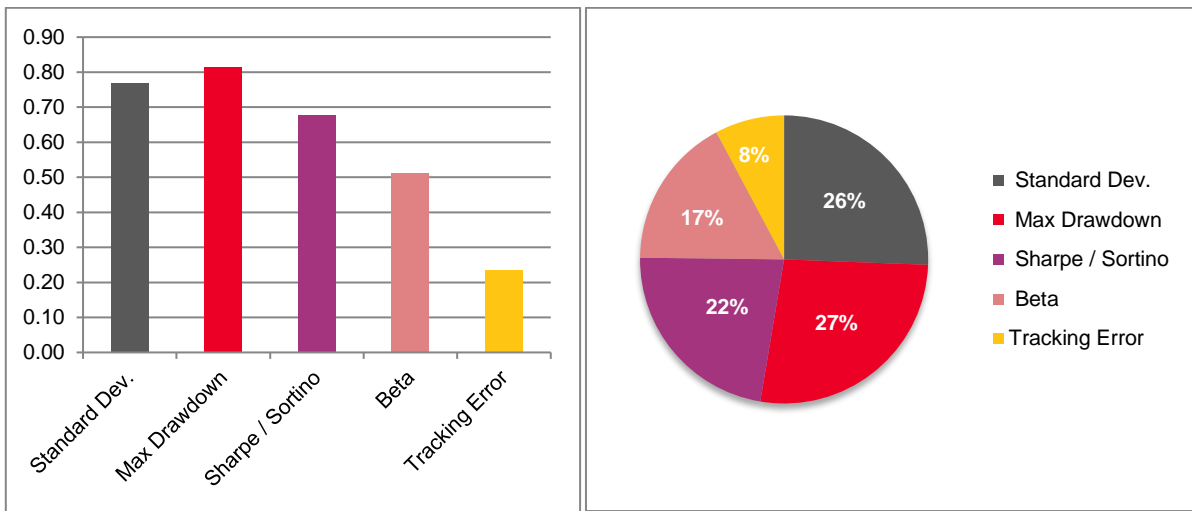
Mean utility for performance attribute levels (L) and weighted to 100% (R)

Graph 2: Relative performance



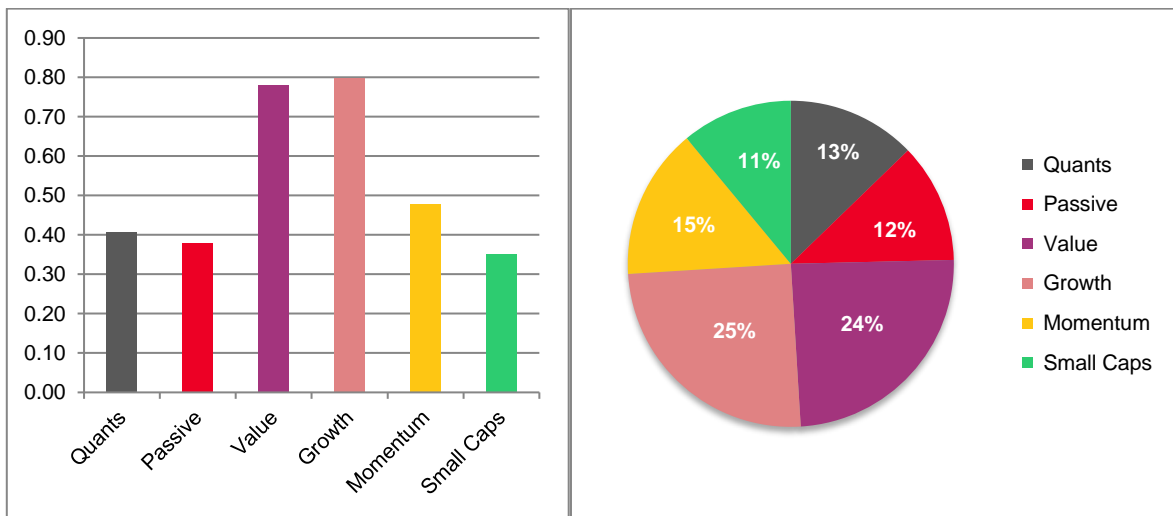
Mean utility for relative performance attribute levels (L) and weighted to 100% (R)

Graph 3: Risk measures



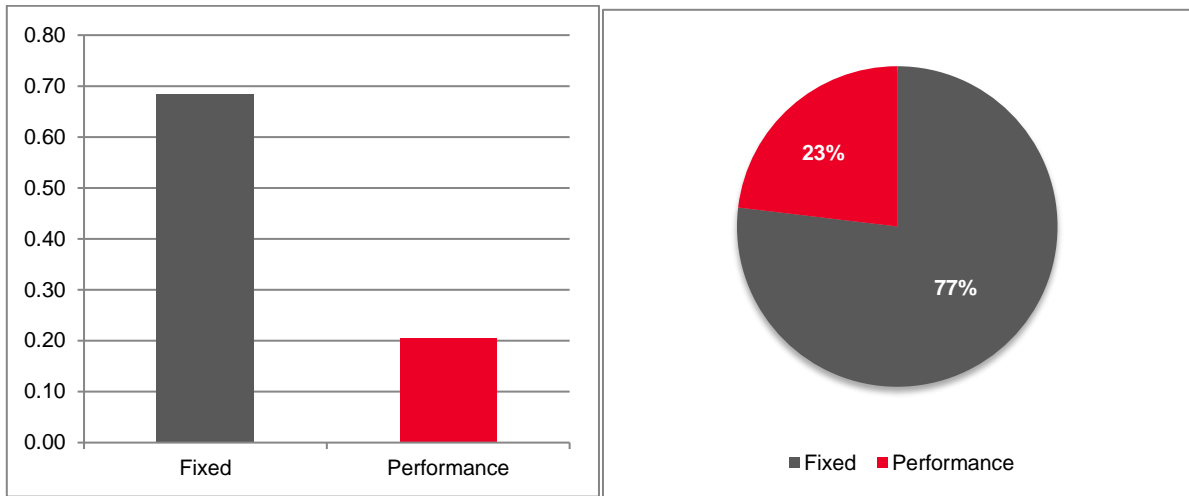
Mean utility for risk measure attribute levels (L) and weighted to 100% (R)

Graph 4: Investment Style



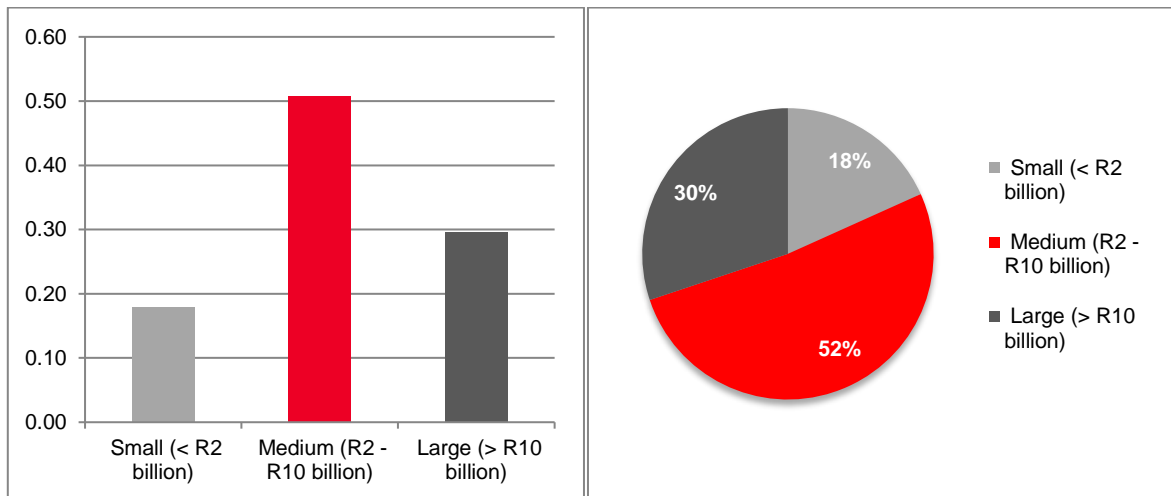
Mean utility for investment style attribute levels (L) and weighted to 100% (R)

Graph 5: Fees



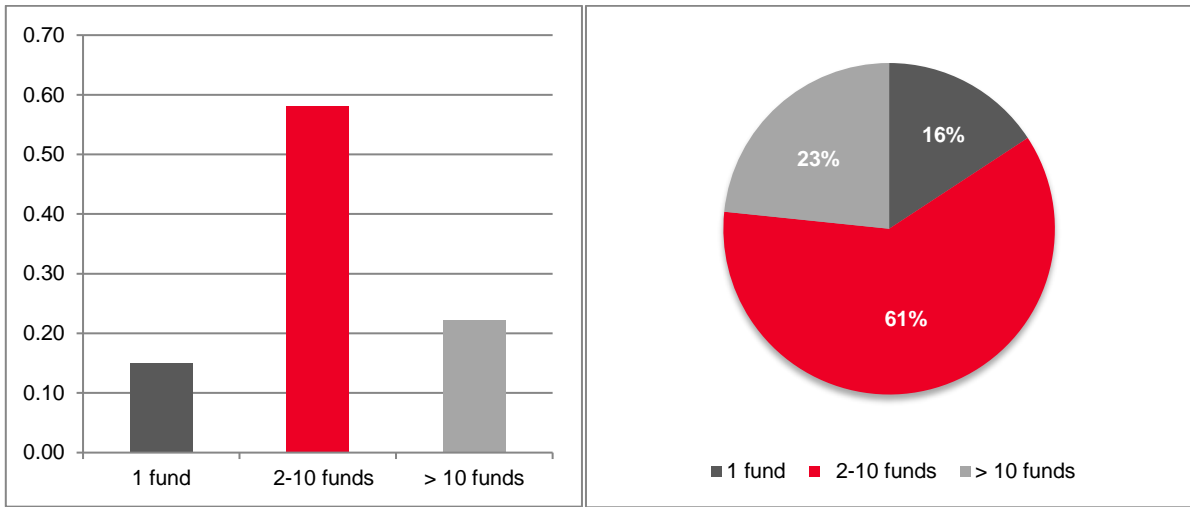
Mean utility for fee attribute levels (L) and weighted to 100% (R)

Graph 6: Size of fund



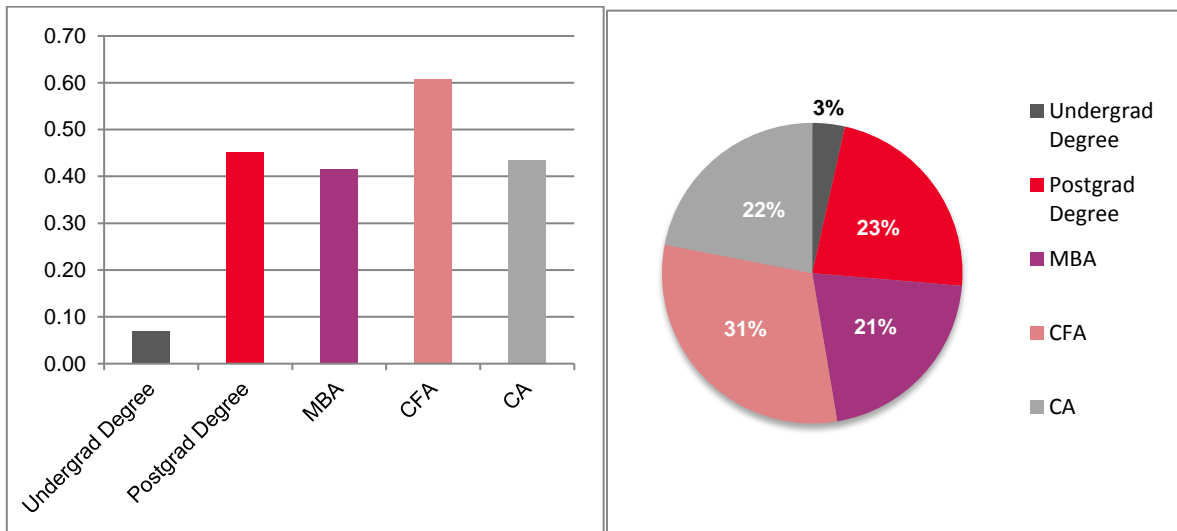
Mean utility for size of fund attribute levels (L) and weighted to 100% (R)

Graph 7: Number of funds in range



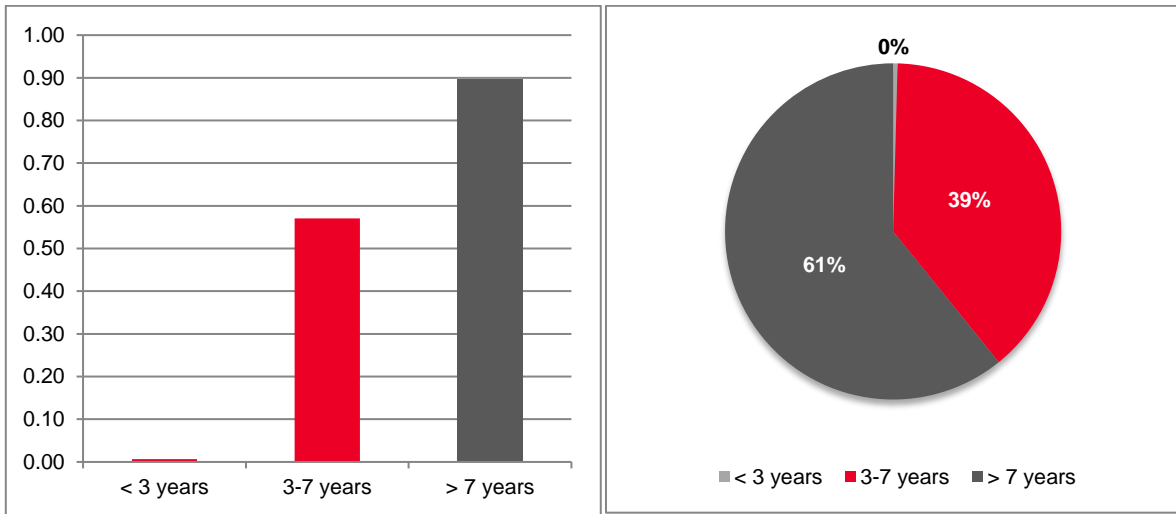
Mean utility for number of funds in range attribute levels (L) and weighted to 100% (R)

Graph 8: Fund manager qualification



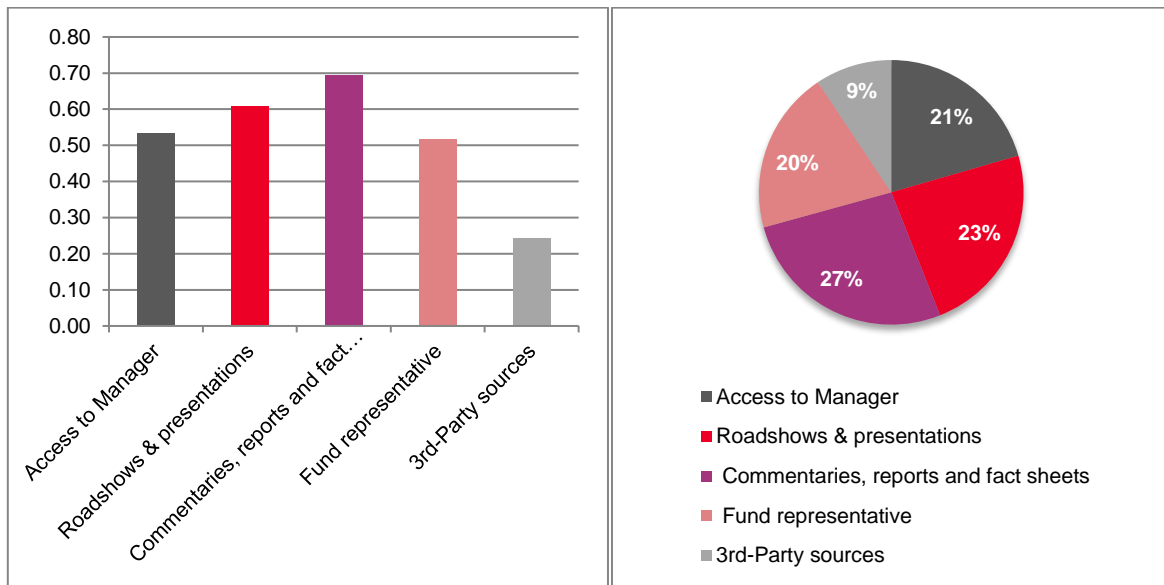
Mean utility for fund manager education attribute levels (L) and weighted to 100% (R)

Graph 9: Fund manager tenure



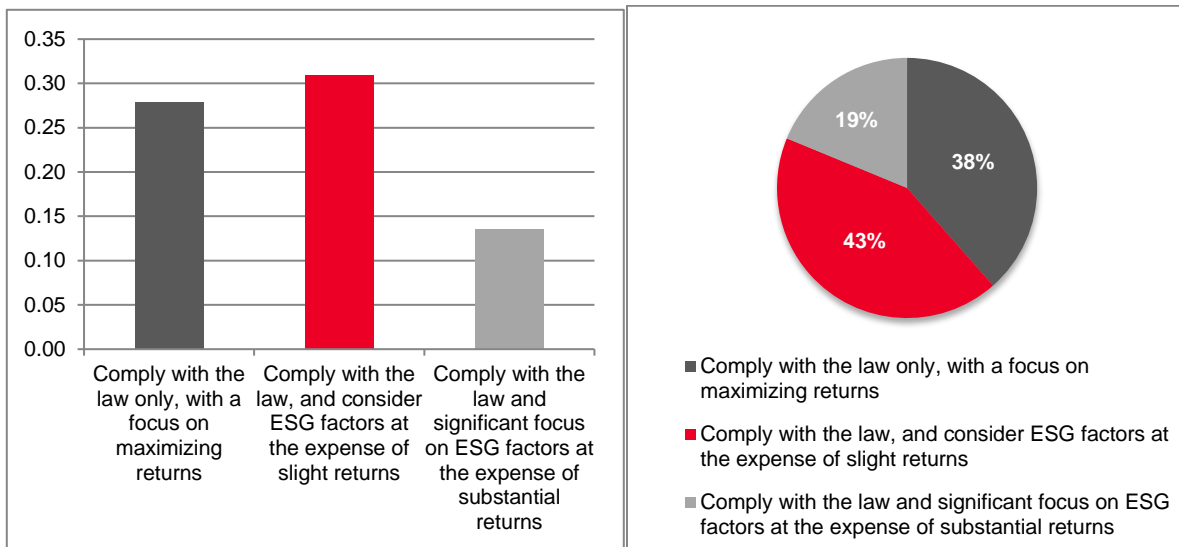
Mean utility for fund manager tenure attribute levels (L) and weighted to 100% (R)

Graph 10: Source of fund information



Mean utility for source of information attribute levels (L) and weighted to 100% (R)

Graph 11: Fund manager’s attitude to responsible investing



Mean utility for attitude to responsible investing attribute levels (L) and weighted to 100% (R)

Conclusion

The results of the study reveal that past performance ranked as the highest attribute considered by financial advisers in South Africa. Past performance was followed closely by the relative performance of the fund, the risk measures, and the investment style of the manager. These four attributes can be considered the most important to financial advisers in South Africa and account for 50% of their overall decision. Fund manager tenure, fees, and the source of fund information were ranked 5th, 6th, and 7th respectively and can be considered to be of moderate importance to financial advisers. Collectively they account for 30% of the overall decision. Of lesser importance to advisers in SA are the attributes of fund manager qualification (8th), fund range (9th), and size of funds (10th).

It is interesting to note that South African advisers place very little importance to the fund manager’s attitude to responsible investing. This attribute was ranked last at 4.68% of the overall importance of mutual fund selection. South African investors and investment professionals may need to be more cognisant of responsible investing practices. In the US responsible investing has grown by 76%, according to the Forum for Sustainable and Responsible Investing, and research by Morningstar shows strong evidence of responsible investing reaping larger inflows.

To gain a deeper understanding of South African advisers’ unit trust selection criteria, the attributes were deconstructed into underlying levels – also known as utilities – and further analysed. When analysing the utilities, it is evident that advisers in South Africa typically judge performance over a long-term time frame (five to seven years) and prefer to measure the actual performance relative to the fund’s peer group and not its benchmark. When analysing risk, the maximum drawdown measure is preferred amongst advisers, most likely because it is the easiest to compute of all of the presented risk measures.

The investment style of choice is “growth” followed very closely by “value” and these need to be managed by managers with tenure of more than 7 years, holding a CFA qualification. South African advisers prefer medium-sized funds for their clients’ portfolios which account for 52% of the weighted “size” decision.

Annexures

Attribute categories and sub-categories which formed part of the survey

Annexure A: List of attribute categories with attribute levels

Attribute category	Attribute sub-category
1. Performance - Actual	1 year or less
	3 years
	5 years
	7 years or more
2. Performance - Relative	Compare to a benchmark
	Compare to peer / category
3. Risk measures	Volatility (standard deviation)
	Maximum drawdown
	Sharpe or Sortino ratio
	Beta
	Tracking error
4. Investment style	Quants
	Passive (index tracking)
	Value
	Growth
	Momentum
	Small caps
5. Fees and expenses (TER)	Fixed fees
	Performance fees
6. Size of funds	Small (< R2 billion)
	Medium (R2 bill-R10 bill)
	Large (> R10 billion)
7. Fund range	Specialised in one fund
	2-10 funds
	More than 10 funds
8. Fund manager qualification	Undergraduate degree
	Postgraduate degree
	MBA
	CFA
	CA
9. Fund manager experience	< 3 years
	3 - 7 years
	> 7 years
10. Source of information	Must have access to the fund manager
	Roadshows and presentations
	Manager's commentaries, reports and fact sheets
	Fund manager's representative (e.g. consultant or BDM)
11. Fund manager's attitude to responsible investing (Environment, Social, Governance - ESG)	Third-party information sources
	Comply with the law only, with a focus on maximizing returns
	Comply with the law, and consider ESG factors at the expense of slight returns
	Comply with the law and significant focus on ESG factors at the expense of substantial returns

Research approach

This study aimed to identify attributes that financial advisers in South Africa consider when selecting unit trusts for clients' portfolios. The attributes were identified by examining existing literature, as well as through the experience of the researcher in the unit trust industry in South Africa. This study further sought to establish the relative importance and rank of these attributes. Unlike this study, most of the existing academic literature analyses the unit trust selection criteria from the viewpoint of the investor, and overlooks the role that the financial adviser played in aiding their selection. The two most relevant studies which influenced this research paper were respectively conducted in 2003 in Malaysia (Ramasamy & Yeung, 2003) and in 2010 in Turkey (Gözbacsi & Çltak, 2010).

To the best of the researcher's knowledge these respective studies are the only attempts to utilise the conjoint analysis to determine the importance of attributes and attribute levels or sub-categories in the selection of unit trusts by financial advisers.

Conjoint analysis is a method which is popular amongst marketers to determine which attributes of a particular product or service creates demand (Curry, 1996). Conjoint analysis is usually conducted to aid product design by determining the order of importance for the attributes that consumers consider as significant when purchasing a product (Gözbacsi & Çltak, 2010).

Once the 11 attributes and 41 attribute levels of unit trusts were identified, data was collected from a sample of the target population through a web-based structured-survey. The survey incorporated a self-explicated conjoint-analysis methodology and was completed in full by 419 respondents, the majority of which were degreed males older than 46. The data was tested for internal consistency and further analysed through statistical procedures in order to robustly determine the findings of this study.

In order to gain a deeper understanding of South African advisers' unit trust selection criteria, the attributes were deconstructed into underlying levels – also known as utilities – and further analysed. All-in-all there were 41 utilities in the entire construct. Even though performance was categorised into four measurement periods, three of these measurement periods were ranked in the top four of all of the 41 utilities. The performance measurement period of five-years was ranked as the highest utility of the entire construct, which is consistent with the utility level findings of Ramasamy & Yeung (2003) in Malaysia and Gözbacsi & Çltak (2010) in Turkey. Interestingly, this five-year performance measure did not tie-up with the preferred investment style of "growth" which requires a three-year performance measurement period (Naidoo et al., 2014)

Sources

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