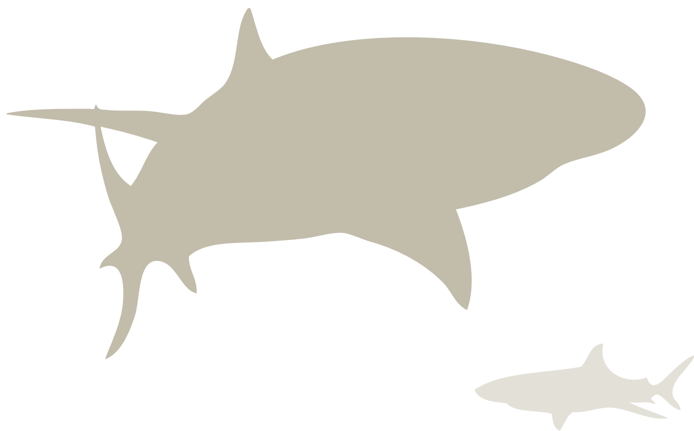
SPEED READ

- Why are we being charged double for the same thing?
- Why does it cost more to buy a fund online?
- Why do performance tables tell only half the story?
- Is the customer really at the centre of our industry?

Curtains for the 'cost monsters'

'People ask me why we have a shark on the front of our brochure,' muses TCF Investment founder DAVID 'DAN' NORMAN. 'It's actually a cost monster. Beware of these cost monsters, they hunt in packs and they're what will destroy your wealth in retirement.'



In fund management, so long as you remember you're looking after the customer's money, then innovating to challenge the status quo is actually very simple. That's because the industry has habitually been looking after its own interests more than that of the customer.

When we founded TCF Investment in 2009, we chose the name to recognise what we stand for:

- Transparency: we disclose all the costs of running our funds.
- Consistency: the funds will deliver in line with their long term expectations based on simple investment truths.
- Fairness: our interests are truly aligned with our customers.

There are so many examples of things that are simply not transparent or consistent or fair, it makes me think the mantra of our industry really ought to be more like 'Shafting Customers Properly'. Consider this:

Diseconomies of scale: When you buy more of something, you'd normally think it should get less expensive per unit. But, if you examine the total expense ratio for retail funds across four of the biggest jurisdictions in the world by fund size, you'll notice something very interesting: everywhere else on the planet, as funds grow and more money goes in, they get cheaper – except in the UK.

One for the price of two

In the last ten years, the total expense ratio of funds in the UK has risen, yet this has happened while assets in the industry have doubled. People are effectively being charged twice as much for the same thing, and bizarrely profitability of asset managers in aggregate has actually declined. It does seem more than a little odd that the people you're trusting to increase your money by investing in well-run businesses don't seem able to run a bath, let alone their own business. Its surely no surprise that people have just given up on this industry and have said: "My house is my pension."

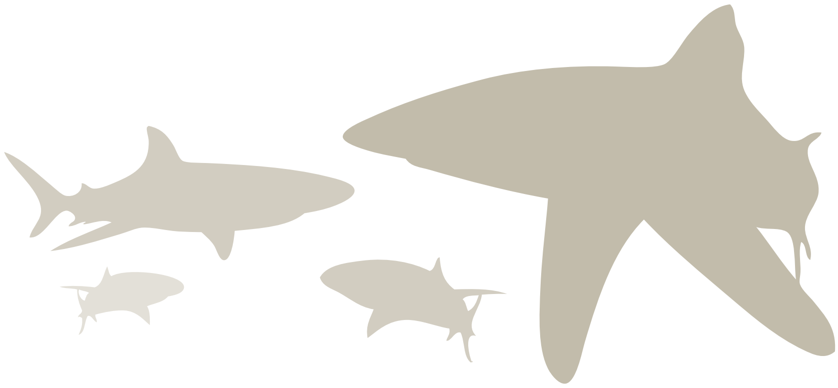
Innovation

This asset management industry congratulates itself that it's "great at innovation". But, if you shop online – at Amazon, Tesco, Waitrose or wherever – you don't expect to pay more than doing it offline. But, buying a fund on a fund supermarket/wrap platform now, you are indeed paying more than you used to pay offline. The total management fee has gone up to pay for the fact that you're now buying it online. It might be innovation but it is not for the customer's benefit.

Survivorship bias: Would you consider it fair, say, for a school to remove all the D and E grades from its league tables and base its comparisons only on the A, B and Cs? Yet, here's the outrageous truth about survivorship bias in our UK industry: in 1999, there were 2,437 retail funds available in the UK. At the end of 2009 there were 2,524. And over that ten year period, 2,500 funds were launched and 2,400 were closed/merged.

This means that on average over every five-year period, half the funds you're looking at in a league table have disappeared. And it doesn't take a rocket scientist to figure out that it tends to be the poor performers rather than good performers that have been merged away! The upshot is that the past performance table tells you only half the story – the good half that's left. Even past performance tables are not a guide to past performance!

Economies of truth: How do you turn 60% growth over 15 years into nought? This was a real question posed by a real investor who wrote to *The Guardian*: "I paid £70k of contributions into my pension scheme over



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15 years. In that period, the FTSE All-Share Index went from 3,000 to 5,000 – that's about 60% growth. When I finally cashed in my policy after 15 years, it was worth just under £70k. How has this industry managed to turn £70k into just under £70k in a period when the market is up 60%?"

Here is the scary truth of how it works. The typical costs of an Equity fund in the UK are 1.65% pa TER plus another 1.45% pa trading costs (the costs of buying and selling the stocks and shares inside the fund). This creates a total drag of just over 3% pa, which compounded up over 15 years equates to almost exactly 60%. And that is where the poor investor's money went.

The worrying thing for all of us is that over the very long run (100 years), equities outperformed cash and inflation by about 4% a year. So, if the typical costs a UK fund manager charges for an equity fund comes out at 3.1% pa, that doesn't leave much of the 4% for the investor. Now I will confess that a good manager may have enough skill to beat those costs… but it does strike me as a very big headwind to overcome every single year.

Of course, you could spread your bets – instead of buying one manager you could buy a fund-of-funds. But that could easily cost you 4.7% pa or more… to try to get 4% a year! It's like walking up the escalator the wrong way. It takes a very long time to not get anywhere. It's complete and utter madness. This is all just too damned expensive in the current environment.

Eyes wide open

So how do you find details of these trading or 'running costs', the 'miles per gallon' or the 'energy efficiency' of a fund? Well, typically you don't. You might find the rate at which a manager trades (on page 25 of the prospectus) but not the actual impact or estimate of these costs. It just isn't transparent. And that's before we get into stock lending revenue, soft commissions, fund rebates, the 'manager/fund fee shuffle' and ridiculous custody fees. No wonder people are asking: "Why should I trust a fund manager, especially with my money?" RDR will make very little difference to this, and UCITS IV actually makes it less transparent.

Who is on look out?

The FSA has overseen the doubling of total expense ratios over ten years, advice fees on the rise, platform fees introduced for what is basic custody, and overall costs become less transparent. Many customers would have perhaps cheered the demise of the FSA, hoping that the new Consumer Protection and Markets Authority (CPMA) might really put the customer at the heart of the industry… but even before its birth the CPMA has been renamed the much less friendly sounding Financial Conduct Authority.

Same old, same old…

TCF Investment was challenged at the recent FS Forum conference to outline how it is challenging the status quo. My response is: we don't have any initial charges, which is unusual. We don't pay commission – there's no point because the RDR is getting rid of it. Our total expense ratios start low and go down as the funds get bigger – that's unique in the UK (and much fairer). And we disclose our turnover rates on our Fact Sheets rather than hiding them on page 25.

We keep our trading costs very, very low and trade infrequently. We also show potential investors what the worst 12 months for any of the funds would have looked like over the last 20 years. That is designed to help one understand the risks of investing.

The cost monsters really can eat a big hole in your wealth. We are doing everything we can to make sure our investors collect as much as possible of the 4% pa that markets deliver. Oh yes, and just to make sure the funds stay true to their promise, the founders (including me) have the majority of their own savings in the funds…just to make sure no-one gets shafted.

DAVID 'DAN' NORMAN is co-founder with Gary Mairs of TCF Investment: www.tcfinvestment.com

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