Response by Vance Arkinstall, CEO, ISI
to Consumer Article "*Savings Scandal: Where has your money gone?*"

17 May 2004

Susan Guthrie
Consumers Institute

Dear Susan

Response to Consumer Article

Thank you for the opportunity to comment on the draft of the Consumer article.

I will respond to your article under three sectors:

1. Overview

- The article is very sensational in the style of its presentation. The subject matter is important but by the nature of your presentation you risk panicking readers. We acknowledge your comment towards the end of the article "Whatever you do don't give up saving and investing." – However, by this point the damage in some minds will have been done.

- Your article has a strong implication that the fund managers are to blame for the performance of investment markets over the past 10 years. Clearly, they aren't – I will comment further on this below.

- Nowhere in your article do you draw the readers' attention to the fact that investment markets are volatile and change is a characteristic of global investment conditions. You would do your readers a greater service by including the importance of seeking professional advice and regular monitoring of investments to ensure they remain appropriate for investors individual needs and risk profile. I comment further on changes that have taken place in product and fee design.

- A key thrust of your article is the impact of fees. The article confuses the impact of global investment returns and fees and further, you commit a serious error by comparing investment returns and the impact of fees over different periods in a manner that may distort the true picture.

- I will attempt to comment only from an overview of the total market. I understand you have contacted some of the individual managers who will comment on their specific product.

2. General Comments

- The article focuses on 13 funds and uses terms which imply that the overall market of managed investment products, which totals in excess of 700 products, has produced similar outcomes – it hasn't. Many funds especially those that are sector specific, have produced excellent results in testing market conditions.

- Your article will unreasonably lead readers to believe that the 13 funds are representative of the total available market of 700 plus managed investments – they are not.

- The article fails to acknowledge that the period under review includes what is widely acknowledged (globally) as one of the most volatile periods in the history of investment markets.

- The article fails to recognise that the industry, recognising the volatile conditions prevailing, has introduced products designed to maximise the returns available through specific sectors which have particular advantages through various stages of the investment cycle. A prime example has been the launch of mortgage and cash management products.

- Wise investors who have sought good advice have diversified out of products that may have been appropriate in the late 1980s into products that were suitable for the changed and volatile conditions existing through the 1990s.

- Your survey concentrates on balanced fund products which operate under a mandate (generally incorporated in the Trust Deed) governing the investment policy that the fund manager is required to follow. The decisions of the fund manager in these circumstances are limited by the nature of the fund and the investment mandate. The exceptional investment markets over the past 3 years specifically and the volatility of the past decade means that sector specific funds will in many cases have outperformed balanced funds.

- Timing is a major factor when comparing returns. You have elected to measure the performance of a small selection of products over a decade ending in 3 years of negative returns – a situation that has not prevailed since the 1930s. You have quoted the median return for the 10 year period 1993 to 2003 at 3.39% for the 13 funds in your survey. The median return for all balanced funds in the Morningstar survey for the total product range with a 10 year performance history (54 funds) was 3.51%. Had you selected the period of 1993 to 2000, the weighted average return for the same 54 funds rises to 5.40%. The effect of timing is significant.

3. Specific Issues with the Article

- Your reference to the example of "Monica began saving for retirement in 1986" might be considered mischievous – in this example you have timed the inclusion of both the 1987 equities crash and the last 3 year period of negative returns. You risk being criticised as having deliberately sought the worst sequence of events.

- The table entitled "Your Returns" does not define "average 6 month term deposit." Term deposits commonly attract different rates depending on the sum of the investment. Are the averages you have used based on the basic minimum (generally $5,000 but often $10,000) or is it based on the interest rate that larger sums such as $250,000 attract, or is it the average across all categories?

[I comment below about the risk that you will be drawing readers into comparing lump sum investments with the returns from regular monthly contributions.]

- Many of the products in your survey are designed to accommodate regular monthly contributions often as low as $100 per month. Your presentation risks that some readers will compare the returns from a monthly ‘drip feed’ product with those of term deposits that generally require a minimum lump-sum of $5000 often $10,000. This will be a misleading picture for many investors.

- As stated in my General Comments (4th point), your article has a relatively narrow focus, ie comparing the 13 balanced funds surveyed against 6 month term deposits. It fails to recognise the returns that many investors have achieved through specific sector funds regularly managed and adjusted to suit the rapidly changing conditions of the 1990s, eg property, international equity, mortgage trust, NZ equity.

- I am especially concerned that the various pie-charts comparing the distribution of gross earnings are misleading. You have used the period 1997-2003 for Tower and 1994-2003 for BNZ. The reasons you have selected these periods are not clear, but they do unreasonably distort the outcomes. Once again, timing produces significant differences in results. In the Tower example quoted over 6 years the effect of the negative equity results through 2001 to 2003 will have a much greater impact and distort the result compared with taking the 10 year picture. In this example the fees will be a higher percentage as negative international equity yields exist for a greater portion of the period of review.

- Your article fails to recognise that the fee structure for managed funds continues to react to market/investor requirements. Managed funds operate in the most competitive of markets and fees have become more transparent and flexible. Over the past decade there has been a move to greater discounting of fees by advisers who charge separately for service. Entry and exist fees no longer exist in many products. The fee examples you provide give no recognition of the greater flexibility and discounting available that are now commonly applied by fund managers.

- On page 2 you confuse by using ‘median’ return for funds and ‘average after tax’ returns for term deposits. You should clarify this.

- On page 6 under 1 Fees, you make a comment "If fund managers are not prepared to take a more realistic approach in predicting what returns might be …." One thing is clear, predicting the future is not possible. A fact that you do acknowledge in other parts of your article.

- By comparison with a number of direct investment opportunities managed fund investors have benefited from superior returns.

I hope these comments are helpful and would be happy to expand where necessary.

Yours sincerely

Vance Arkinstall
CHIEF EXECUTIVE