Response by Vance Arkinstall, CEO, ISI
to Consumer Article on international equity funds

23 June 2004

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

My overriding feeling is that by attempting to make a simple presentation of the performance of international equity funds the article misrepresents the role of international equities within an investment portfolio. That misrepresentation is increased by a lack of background explanation and caveats in several important areas. In the absence of adequate 'advice and/or warning' you are likely to mislead readers.

It would be most unusual and it would be a very high-risk strategy to invest in an international equity fund as the sole or only asset class and expect that approach to solve future investment concerns. The presentation of your article may lead readers to that conclusion, which is wrong.

International equity funds are one of a range of asset classes available to investors to select as differing economic conditions emerge. At various points over the decade international equities have produced outstanding results. At other times they have performed not so well – this is the nature of investment markets.

Investors who have effectively utilised a range of managed fund options, switching between funds and asset classes and rebalancing at various times, have achieved very good results but your article gives no recognition to that fact or the various options available.

Your concentration on international equities in the manner you have, contains the serious risk that uninformed readers will be adversely influenced regarding the important value of this asset class in a manner that is unrealistic.

Your section "Our Advice" at the end does bring some balance to the article but by the time a reader gets to this, much damage may have been done.

Overall, I feel you are missing a great opportunity to educate and advise existing and potential investors/consumer readers. By 'bagging' international equity funds you may well gain publicity but you will not be assisting investors.

The following are our specific comments:

- It is inappropriate to continue to use emotional catch phrases such as "scandalously-poor performance of balanced savings funds." These funds have followed the investment mandate contained in the marketing material and supporting documentation supplied to investors. The "investment returns" reflect the fluctuations in asset values resulting from market movements. It is simply untrue to use terms such as 'scandal'. The use of such terms has no place in responsible financial reporting - unless there is evidence that investors have been deliberately misled – clearly that is not the case.

- Are you absolutely certain that the funds you are surveying all contain entry, exit and switching fees? I do not have access to the full information but I suspect none of the funds surveyed have these charges. If they do not then you should remove this reference.

- The variation in results of international equities across a number of products and within fund managers is the result of investment markets emerging from what is widely acknowledged as one of the most volatile periods in the history of investment markets. Within the 10 year period measured, equities (especially international equities) which have been particularly affected. The returns provided by international equity funds in the survey cannot avoid being affected by this volatility. Your article contains no recognition of the difficult and unique investment conditions that have existed over this time.

- The article implies that fund managers are at fault for the performance of the markets – they are not. Managed funds reflect the performance of the markets in which they invest.

- The article implies that all current savers in international equity funds have been subject to the results illustrated. This is simply not the case – managed funds have grown steadily over the past decade as new investors have come to appreciate the advantages of using collective investment vehicles for saving. Many current investors would not have been members of these funds 10 years ago. Many will have taken investment advice and switched between funds and other asset classes, recognising changing market conditions. It is impossible to identify how many individual investors would have held the products identified for the full 10 year period.

- As stated in the opening paragraphs, the serious flaw in the article is that international equity is one of a number of separate asset classes. It is unlikely that an informed investor would choose international equity as the sole asset class for the long term. The greater reality is that an investor would choose several asset classes and balance investment between this range of asset classes to suit their personal appetite for risk, their individual circumstances and as economic conditions change. Investors who have adopted this approach are likely to have benefited from satisfactory results. Your article cannot hope to replicate that situation and this is the difficulty you face.

- As a consequence you are unfairly ‘blackening’ the reputation of international equity funds in the eyes of uninformed readers, when many of these funds used effectively will have provided excellent outcomes.

- The performance of international equity managed funds have been affected by complex taxation issues creating gains/losses on unrealised profits/losses. Individual fund managers have responded in ways reflecting the nature of their investors and in a manner to provide equity across different generations of investors. [ISI has prepared guidelines to its members on this subject.] The availability of taxation credits which will emerge over coming periods will provide significant value to investors that the returns quoted in your article will not reflect. [This is a technical issue that is not easily explained in a short and simple manner.]

- The taxation of managed funds is made more complicated for NZ investors by the unusual tax basis that exists in this country. Fund managers cannot be held responsible for this. I am pleased to report that as a consequence of the industry's on-going efforts, Government and Officials now recognise the urgent need for change and are in the process of embarking upon a review.

- Your article gives no recognition to the importance of taking advice and regular monitoring of existing decisions. International equities are a separate sector, the results from which will fluctuate according to the state of the economic cycles as they occur.

You would do readers a service by drawing attention to the importance of good advice and regular monitoring when investing in individual sector funds.

- Your insistence on comparing with 6 month term deposits is disappointing. Historically, diversified portfolios and equities outperformed cash for more than 80% of rolling ten year periods. Whilst it is true that in the period you are measuring 6 month term deposits have outperformed some international equity funds, there is no certainty/guarantee this will occur in the future.

- It is 'wrong' for you to lead your readers to believe that they are better advised to choose term deposits as their preferred investment going forward on the basis of recent history. Perfect hindsight has been shown to be poor when applied as a strategy for investing – selecting prior years winners rarely succeeds.

- Your final comments applied to 'passive funds' creates confusion in your article.

Passive funds have a place within the range of investment options available but it comes down to the importance of matching the requirements and risk profiles of investors with suitable investment sectors and products. Passive funds will mirror their particular index as markets go up and also as they come down.

Passive funds can take many different forms and may be linked to many different indexes. Your comments in the manner they are made are dangerous and risk misleading investors.

Please let me know if I can help further.

Thanks for the chance to comment.

Vance Arkinstall
CHIEF EXECUTIVE