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Tales of heroism and gambles weighed with princely results

The odds of success for an active fund management approach to saving are too long and not worth the risk, says Barry O'Neill, investment director at Carbon Financial Partners in Aberdeen

ACTIVE FUND MANAGERS: Are they heroes or just plain lucky?

Professor Richard Taffler from Warwick Business School conducted a series of interviews with active fund managers from Europe, the US and Asia about their investment successes and failures.

The findings are illuminating and help to explain the deep-rooted, fundamental problems with active fund management; namely the frailties of human nature.

Managers explained their successes as if they were the all-conquering hero in an epic battle.

They described their failures as "hard luck stories", where they were the poor victim deserving of sympathy because the management of companies they chose to invest in failed to deliver on the promises they made.

> "These odds are also often down to luck, but fund managers are all too happy to take any credit"

The first part of this may have some truth in it as the odds of active managers outperforming is so low that such successes are indeed rare.

These odds are also often down to luck rather than skill, but fund managers are all too happy to take any credit.

Barry O'Neill

The evidence for this comes in the form of the regular Persistence Reports published by ratings agency Standard and Poor's (S&P's).

They expose how many of the active fund managers who manage to finish in the top half of their peer group in any year manage to repeat this feat over the next few years.

The findings of S&P's latest study into the US active fund management industry are damning.

Over the three years from March 2012, only 16.67% of fund managers of large company equity funds who finished in the top half in 2012 maintained their top half position in each of the next three years.

Managers of smaller company funds fared slightly better, with 22.67% persisting. This is even less impressive when you factor in that random chance would suggest that 25% of managers should persist. Perhaps this makes the luck or skill question clearer?

The situation worsens as longer terms are considered. The five-year numbers are even worse, with the random chance statistic of 6.26% only marginally beaten by small company managers.

When you consider that most sensible investors have their money invested over much longer periods, the chances of an active manager delivering above average performance are too small to base an investment strategy on.

Some reasonable conclusions can be drawn from these studies, which time after time show the same results – that your odds of being rewarded with superior returns by selecting active fund managers is next to nil over an investment lifetime of 20-30 years.

A much more robust approach is to structure your investment portfolio by carefully selecting the asset classes you want exposure to – for example, UK, international or emerging market equities, government or corporate bonds and property – and regularly re-balancing your exposure, while minimising costs.