

Tracker Fund vs Active Management

Huge bonuses to fund managers have been in the headlines recently. Chris Budd analyses whether the money is well spent.

One of the fundamental decisions to be made when choosing an investment is whether to go for a tracker fund, or to choose a fund which is actively managed by a fund manager.

A tracker fund is typically run by computer programme, and seeks to replicate the holdings of a given index. For example, a FTSE 100 tracker will aim to hold the same portfolio of shares as makes up the FTSE 100 index. In theory, the performance should therefore be identical to the index (although there is typically a small tracking error).

In comparison, active funds are run by a manager, who is able to take a decision as to which companies to invest in, which are likely to rise, which are likely to fall. He should also, therefore, be able to be more aggressive when markets are rising and more defensive when they are falling.

Performance

Of course, such active management comes at a cost. So, are the additional charges of an active fund worth paying?

Let us consider the performance of funds over the last five years. The table below shows the relative figures for two different UK indices, the FTSE 100 and the FTSE All Share. For the FTSE 100, the average active managed fund (which may include shares outside the FTSE 100) has considerably out performed the average tracker fund, and also out performed the index itself.

For the All Share, the active managed funds also beat tracker funds, however under performed the index. These figures are after charges (i.e. offer to bid), with income reinvested net of basic rate tax, and show annual compound growth rate over a five year period.

	FTSE 100	FTSE All share
Average Tracker	6.40%	8.00%
Average Tracker (all share)	8.30%	8.30%
	7.90%	9.20%
<i>Source: Money Management, Feb 2007</i>		

Of course, this is only one example. For example, a similar comparison when markets are falling may well show a different story. However, this is not the end of the story.

There should be little difference between the best and worst performing tracker funds. This is because, by definition, they are tracking the index.

For active funds, however, there can be an enormous difference. For example, one of the best performing UK all company funds over the five year period with a Saracen Growth fund, which provided annual returns of 16.8% - over double that of the average tracker fund.

To give another example, the best performing fund in all sectors over five years, the JPM Natural Resources fund, turned £1,000 into £4,581. However, the worst performing fund over the same period, Close Finsbury Uni Life, turned £1,000 into £484! (source: Money Management, February 2007).

We can therefore see the importance of careful selection of the funds, and of keeping an eye on them. Equally as important is the asset allocation – the spreading of investments over a range of sectors. The first stage of an investment plan, before any funds are chosen, is to decide on the spread of investments to reduce risk.

So, the message is clear. First, reduce risk by deciding on your spread. Secondly, choose active funds if you (or your IFA) are going to review and monitor your investments. Use trackers if you are not intending to keep an eye on your investments.

This article is for general information only. Remember past performance is not a guide to future performance and investments can go up as well as down. If you have any doubts in respect of your own personal circumstances you should request a full review with an independent financial adviser to get their help.

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