

# Fund Manager Efficiency: Picking Winners

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When I select mutual funds, I filter them in several ways. My article about the REEF Line (Canadian MoneySaver, November 1996 and December 1996) touched on one of these filters, the consistency of the returns for a given risk level.

Another measure that I use is how much of the total return I pay to the fund manager. When I studied this topic last year, I was shocked to find that many of the mutual funds kept more of the investment return than the investor. Subsequently, my study became the subject of an article by Ellen Roseman, in the Globe & Mail, on April 10<sup>th</sup>, 1996. Recently, I revisited the subject. I was not surprised to see that not much has changed.

The management fees and expenses you pay are normally expressed as a ratio of a fund's assets. This is known as the management expense ratio or the MER. To find out what portion of total profits you are paying to the fund management, divide the MER by MER plus the fund's return.

For example if the MER is 3% and the published return is 6%, then 33.3% of the total return is kept by the fund as MER, calculated as  $3\% / (3\% + 6\%) \times 100\% = 33.3\%$ . I call this the *Pay-Away Ratio*, or PAR for short.

I generally include in my "favorite funds" list only those mutual funds with *Pay-Away Ratios* lower than 15%. In my view, a high *Pay-Away Ratio* is an indication of a poorly performing fund.

(If I were to tell my clients "I'll manage your money, but keep half of *your* return *each* year!", they would laugh their way out the door. However, there are many mutual fund managers who, in effect, do exactly that. Uninformed investors continue putting money into their funds. This is very difficult for me to understand.)

This time, I ranked the funds in a way that includes both the Sharpe Measure (consistency of high performance) and the Pay-Away Ratio. For lack of creativity, I call this the *Otar Efficiency Measure*, or OEM for short. OEM is calculated by dividing the Sharpe Measure by the Pay-Away

Ratio.

OEM combines all these factors into one single number. By definition, the funds with a high OEM indicate an optimum point in:

1. overall performance,
2. consistency of performance with respect to fund's volatility or risk,
3. lower expense ratio with respect to its performance,
4. indicating indirectly, sufficient assets under management to allow proportionately lower fund expenses.

Following is my list of mutual funds<sup>1</sup> with the lowest and the highest OEM's. It's another tool you may want use to evaluate your holdings. A portfolio with an overall<sup>2</sup> OEM of less than 0.25 may need some rearranging and improving.

To be fair, keep in mind that resource funds and specialty funds have high volatility, by definition. They may rank at the top or at the bottom at different times. Also, in the US equity category, several index funds appear to be winners. Over the long term, when (and if) some sense of tranquillity prevails, I expect more of the good managers to outperform the indexes.

It is also interesting to note that no matter what criteria I use, there are some funds that always show up in my "favorite funds" list, and there are others that show up on the bottom consistently. Just like thoroughbred horses, some win all the races on any terrain. Some others lose no matter what. Are some fund managers genetically better than others? We will look at this in future articles.

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<sup>1</sup> All data is based on a 3-year return, ending March 1997 (courtesy of Pal-Trak mutual fund data base).

<sup>2</sup> dollar weighted average OEM of all mutual funds in the portfolio

### Funds with Highest OEM<sup>3</sup>

Fund Name	MER	3 Yr CAR	PAR	OEM
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Sceptre Equity Growth	1.5	25.7	5.5	0.92
PH & N Dividend Income	1.2	17.1	6.5	0.68
BPI Dividend Income	1.0	13.8	6.8	0.67
Bissett Dividend Income	1.5	17.3	8.0	0.63
AIC Advantage	2.5	28.4	7.9	0.62
Bissett Canadian Equity	1.4	17.0	7.4	0.50
Guardian Enterprise A	2.0	21.2	8.7	0.45
Tradex Equity	1.4	17.1	7.3	0.44
PH & N Vintage	1.8	18.8	8.5	0.42
Cundill Security	2.1	15.3	11.9	0.42
Ivy Canadian	2.4	15.6	13.2	0.40
Saxon Stock	1.8	17.2	9.8	0.40

### Funds with Lowest OEM

Fund Name	MER	3 Yr CAR	PAR	OEM
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BPI Cdn. Resource Fund	2.9	0.7	80.6	-0.01
Cambridge Resource	2.9	0.3	90.7	-0.01
Dynamic Precious Metals	2.5	1.9	56.7	-0.01
First Heritage	4.2	4.0	51.5	-0.01
Industrial Equity	2.4	0.2	92.3	-0.01
CIBC Capital Appreciation	2.4	3.9	38.1	-0.02
University Avenue Cdn	2.6	2.5	51.0	-0.02
CT Special Equity	2.2	2.4	47.6	-0.02
All-Cdn. Resources Corp.	2.0	-2.5	NM	NM
Cambridge Growth	2.9	-8.4	NM	NM
Cambridge Special Equity	2.9	-1.8	NM	NM
Goldtrust	2.3	-6.4	NM	NM

### Canadian Equity

### Canadian Bond

Optima Strat-Cdn Fx Inc	0.4	10.8	3.6	0.64
PH & N Bond	0.6	10.4	5.5	0.51
Bissett Bond	0.8	10.6	6.6	0.41
O.I.Q. Ferique Obl.	0.6	9.5	6.0	0.40
Dynamic Gov. Income	0.9	9.3	8.4	0.37
Green Line Cdn Bond	1.0	11.0	8.0	0.35

GrowSafe Canadian Bond	2.1	5.9	26.3	0.00
Manulife VistaFund 2 Bond	2.4	5.8	29.1	0.00
Manulife Cabot Divers Bond	2.0	5.2	27.8	-0.02
BPI Canadian Bond	1.5	4.7	24.2	-0.02
Scotia Canam Income	1.6	5.1	23.9	-0.03
Pursuit Canadian Bond	0.8	3.8	17.4	-0.06

### US Equity

Green Line US Index	0.72	20.8	3.3	1.61
Scotia Canam Growth	1.34	19.5	6.4	0.75
CT AmeriGrowth	1.48	19.8	7.0	0.70
Mawer US Equity	1.23	17	6.7	0.70
PH & N US Equity	1.12	17.9	5.9	0.70
Fonds de Croissance Sel.	1.00	17.6	5.4	0.67
Formula Growth	0.95	16.1	5.6	0.45
Cassels Blaikie American	1.24	16.8	6.9	0.44
Elliott & Page Amer Grth	1.16	14.7	7.3	0.42
Mclean Budden Am Grth	1.75	18.6	8.6	0.42

GBC North American Gr	1.8	8.2	18.2	0.03
General Trust US Equity	2.2	6.6	25.2	0.01
Caldwell Securities Intl.	2.7	6.4	29.4	0.01
ADMAX American Growth	2.9	6.6	30.4	0.01
InvesNat Blue Chip Am. Eq	2.4	5.5	30.1	0.00
AGF Intl Grp-Special U.S.	2.8	4.7	37.4	-0.01
Jones Heward American	2.5	4.5	35.7	-0.01
University Avenue Growth	3.0	4.2	41.6	-0.01
Century DJ	1.8	4.1	30.5	-0.26
Cambridge American Growth	2.9	-7.3	NM	NM

### International Equity

Chou Associates	2.0	19.3	9.2	0.51
AIC Value	2.6	22.0	10.4	0.46
Trimark Fund	1.5	14.9	9.3	0.36
Fonds Prof. Int. Eq	0.8	10.1	6.9	0.35
Saxon World Growth	1.8	15.0	11.1	0.31
MD Growth Investments	1.3	12.5	9.4	0.30
Cundill Value	2.0	11.1	15.4	0.29
Green Line N.A. Growth A	2.3	16.3	12.6	0.25
Vision Europe	2.1	14.6	12.6	0.25
Ivy Foreign Equity	2.4	13.5	15.1	0.25

Sceptre Asian Growth	2.4	0.5	82.8	-0.02
Spectrum Utd Asian Dynasty	2.6	0.6	81.1	-0.02
Universal World Emerg Grth	2.6	2.1	54.9	-0.02
First Canadian Intl. Growth	2.1	3.4	38.4	-0.02
Green Line Intl. Equity	2.4	3.0	43.9	-0.02
General Trust Intl.	2.5	1.4	64.2	-0.03
Orbit World	2.5	1.1	69.4	-0.03
O.I.Q. Ferique International	1.0	3.3	23.3	-0.04
Mackenzie Sentinel Global	0.5	4.5	10.2	-0.04
First American	2.8	0.5	84.8	-0.04

<sup>3</sup> PAR - Pay Away Ratio, OEM- Otar's Efficiency Measure, 3 yr CAR - 3 year compound annual return, MER - Management Expense Ratio, NM- not meaningful. All data for 3 year period ending March 31<sup>st</sup>, 1997.