

DIBANISA

RAFI 40 tracker beats majority of peers

WE'VE REPORTED regularly over the past two years of investor frustration with active managers' high fees and poor performance and the consequent swing to indexation-based or passive investing. Investors simply have looked for better returns in relation to costs. That's particularly brought home by the Old Mutual RAFI 40 Tracker Fund, which has done phenomenally well relative to its actively managed peers and just marked its three-year anniversary.

Managed by Dibanisa Fund Managers, a specialist boutique in the Old Mutual Investment Group, it's a general equity unit trust fund that closely tracks the FTSE/JSE RAFI 40 index. Its target market is equity investors who seek long-term capital growth without short-term income requirements from this investment.

Dibanisa MD Craig Chambers says: "It's very retail orientated, in that it has long-term appeal and is good for the guy who wants to rand/cost average every month. It would also appeal to the independent financial adviser who recognises it as a deep value fund and a suitable complement to a well-run actively managed equity unit trust."

Launched in September 2007, the RAFI 40 Fund has returned a cumulative 14,01% after costs compared with the FTSE/JSE All-Share Index's (Alsi) 6,97% and the general equity unit trust mean of 4,96% net of fees. The RAFI 40's annualised one-year return of 20,8% compares with the general equity mean of 17,05%. It's currently ranked 12th of 69 funds over three years.

Also interesting is that on a rolling 12-month return basis in the two years to September 2010, the RAFI 40 outperformed its domestic equity rivals 80% of the time.

So what's the trick? One factor is the fund's lower fees, which are typically half that of conventional unit trusts. Also, underlying other Top 40 indices, is that each company is quantified by its market capitalisation. This means its index weighting is determined by the price of its stock, says Dibanisa research head Kingsley Williams.

The FTSE/JSE RAFI 40 Index is different. It takes a *fundamental approach to determining the size of a constituent company, independent of its stock price*. Four factors used in equal proportions are: book value, cash flows, dividends and sales. Book value is at review date and cash flows, dividends



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and sales are averaged over five years. The overall portfolio is rebalanced every March.

Williams says quantifying each company by market cap can skew the portfolio completely, due to share prices being influenced by sentiment, resulting in either over-exaggeration or undervaluation.

By contrast, the RAFI 40 portfolio of companies isn't easily manipulated by accounting policies, odd ratios or sentiment. The use of fundamental measures averaged over five years provides tangible, long-term measures of a company's importance in the economy.

Also, because of its index construction approach, it removes the emotional side of investing. For example, it's not the case of an active manager getting out of the wrong side of bed that day and deciding to sell a company based on market noise.

Williams emphasises the RAFI 40's top companies aren't necessarily the same as those in the ALSI Top 40. "The reason is that some of the companies at the tail end of the Top 40 from a market cap perspective are large, but from a fundamental perspective aren't large. And some that aren't included in the Top 40 are deemed large from a fundamental perspective."

Because the RAFI 40 Fund is a fully invested equity fund it doesn't try to time markets by moving in and out of cash, says Williams. "That timing is something active managers often get horribly wrong."

Interesting features of the RAFI 40's portfolio show it has overweight positions in Bidvest, Standard Bank, Massmart, Old Mutual and Shoprite, among others, and underweight positions in MTN, AngloGold Ashanti and Clicks.

In Bidvest's case, Williams says its dividend growth roared ahead of the share price growth and for that reason is overweight relative to the market cap index and relative to the active managers. "There was a huge drop in the dividend in 2008, but RAFI measured dividend growth over five years and therefore basically ignored it. A market cap index would have down-weighted Bidvest due to the drop in its share price and active managers would have been tempted to panic and sell. RAFI was therefore perfectly positioned for Bidvest's phenomenal performance from 2009 onwards, ignoring short-term news and following long-term fundamentals." ■

