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Demands for high fees on funds to come down

By Alice Ross

Financial advisers and investors are demanding that high fees on unit trusts come down, as fresh evidence surfaces about the impact of charges on returns.

This week, Standard Life Investments came under fire from financial advisers for raising the fees on seven of its funds, including the flagship UK Smaller Companies fund, run by Harry Nimmo. From November this year, annual charges on the fund will rise from 1.5 to 1.6 per cent.

The move angered some financial advisers, who said that pressure was on fund managers to lower fees, not raise them. Philippa Gee, head of Philippa Gee Wealth Management, said she was considering withdrawing her clients' money from Standard Life Investments as a result.

Figures compiled for the Financial Times by Lipper show that funds with lower fees outperform those with higher fees over all time periods studied, even when the funds have the same manager.

Over time, the difference in outperformance became larger, the research found, in an indication that charges eat into performance over the long-term.

Investment trusts, which have cheaper costs as they do not pay commission to financial advisers, returned 7.8 per cent more than unit trusts run by the same managers over three years. This differential rose to 9.3 per cent over five years, and 11.1 per cent over 10 years.

However, fund managers argue that another reason for the outperformance of their investment trusts could be gearing – whereby investment trusts are allowed to borrow money to invest in a rising market.

Harry Nimmo at Standard Life Investments, who runs both an investment and a unit trust, says that some of the outperformance of his investment trust over the past two years was due to this effect.

Managers also say that the need to justify themselves to an investment trust board can be restrictive.

“I’ve rarely been asked by a board to be more aggressive,” says James Henderson, who runs both the Lowland Investment Company and the Henderson UK Equity Income fund.

“In 2008, I found it easier buying at the bottom of the market in the open-ended space – I didn’t have to justify it, I could get on and do it.”

One fund manager says that his investment trust suffered going into the downturn in 2008 as the board insisted that he keep a level of gearing, against his better judgment. He moved part of his open-ended fund into cash, however, and outperformed the investment trust during that time.

Hugh Young at Aberdeen, who runs the Aberdeen New Dawn investment trust and Aberdeen Asia Pacific fund, argues that discounts on investment trusts can be confusing for investors. But he says that, while the price of a unit trust is more transparent than that of an investment trust, it is often harder for investors to understand the full breakdown of charges in a unit trust, as different amounts are paid out as commission or to distributors of the fund.

Ed Moisson at Lipper, who conducted the research, points out that when performance figures are adjusted for charges, unit trusts actually performed better over 10 years.

“The difference of charges is so important that if you add back in the effect of the total expense ratio (TER), unit trusts perform better over 10 years,” he says.