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Investors should not just limit themselves to unit trusts.

By Craig Gradidge, as published in Business Day on 4 February 2020

When I joined the unit trust industry in 1998 there was roughly R70bn invested in 190 funds. Today there is roughly R2.5tr invested across 1,240 funds. The largest fund in the industry today is the Allan Gray Balanced with over R145bn invested in that fund. It's been an incredible journey to be part of and to watch in various roles over the years. However, since becoming a financial planning practitioner in 2008 I have noticed that unit trust investments tend to dominate client balance sheets from a retail investments perspective. This makes sense when you consider that unit trust funds are the underlying investments in financial products such as endowments, retirement annuities, preservation and living annuity funds.

The recent Raging Bull awards evening was a reminder that the marketing machinery behind the industry is pretty jacked up. Tired, boring, unimaginative but very efficient and effective. The largest unit trust funds are bigger than the entire hedge fund, S12J and public BBBEE scheme sectors combined.

Several questions arise: Why do unit trusts dominate like this? Are investors missing opportunities as a result? Where are the other opportunities?

There are several reasons why unit trusts dominate. They are easy to understand. They are easy to understand and are widely available. Investors are well protected (from a regulatory perspective). The marketing machinery works. Lends itself to effective selling by traditional brokers who have little to no market knowledge. The long-term track record has been largely good to investors. Of late they have been getting cheaper courtesy of competition from passive investments.

However, it seems that investors are missing out on other investment opportunities. The hedge fund industry has produced a few shining stars of late. However, their growth seems to be stifled by the fact that investors have largely been sensitised to costs. The TERs of hedge funds can make your eyes water, especially after a period of outperformance of easy hurdle rates. We have approved only one hedge fund for our clients so far as it ticked most of the boxes on the checklist. Managers with long and credible track records, a performance fee hurdle of CPI +3% p.a., and an attitude of wanting to protect investors' capital. The fund has delivered almost 1% p.a. better than the best performing unit trust fund which has a CPI + 3% benchmark, and 2.5% p.a. better than the relevant sector average but manages around R100m versus the sector average of R1.8bn.

A key issue for investors is their choice of adviser. Many advisers have become risk averse as a result of FAIS and other legislation. The standard defence offered by advisers is that there are not enough alternative investment options available for retail investors, and that they require high minimum investments. This is not entirely true. Consider the following list of alternative investments available to clients:

- Structured Products (minimums from R250,000)
- S12J (minimums from R100,000)
- Retail Hedge funds (minimums from R100,000)
- Private Equity (minimums from R100,000)
- Public BBBEE share investments (minimums from R10,000)

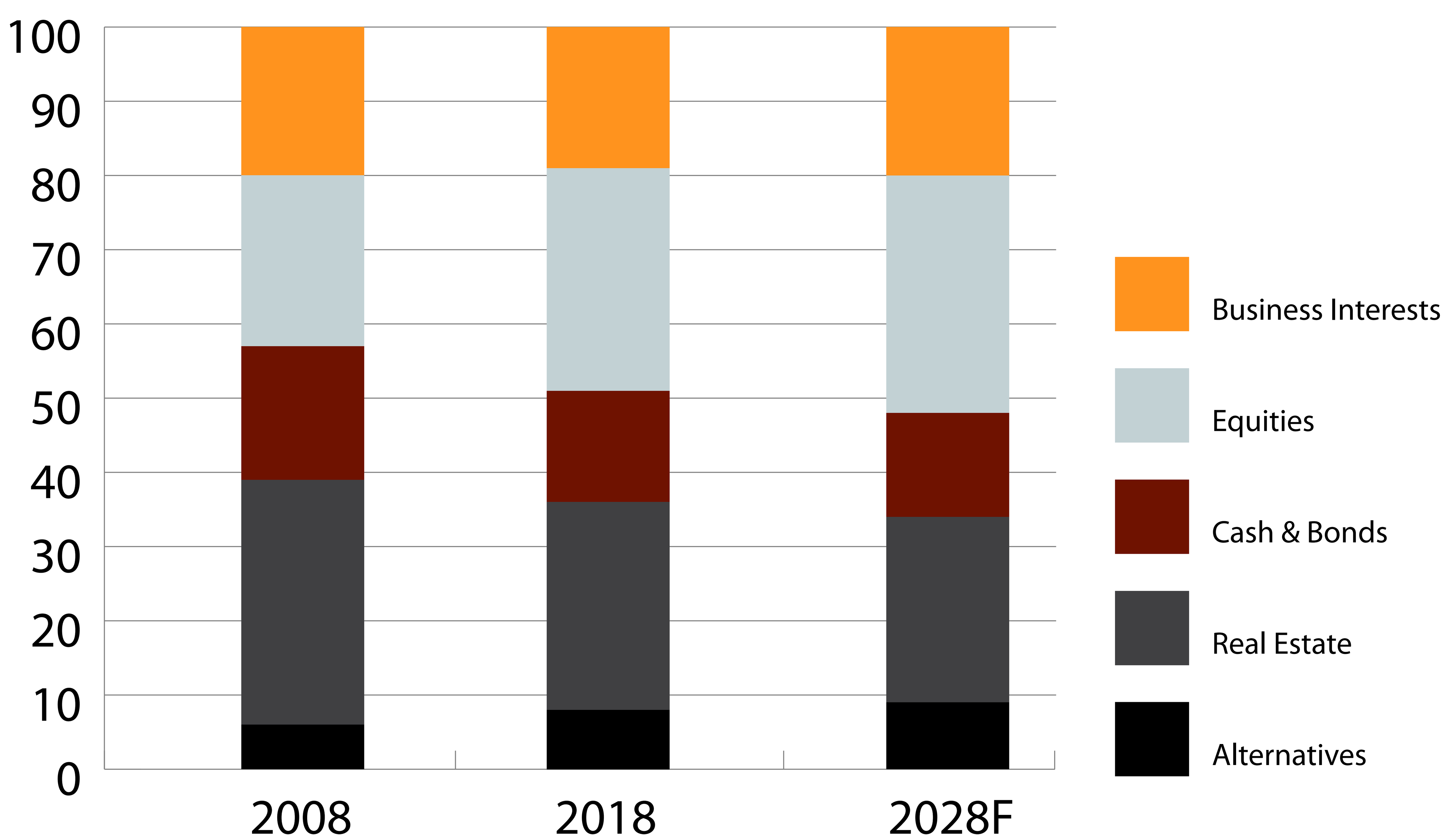
Even retired investors can access alternative investment options with forward thinking platforms allowing retirees to blend insurance into living annuity investments.

The wider variety of investment options should be a boon to advisers as they will be able to refine the investment strategies they put together for their clients. They would be able to build in capital protection, reduce fees, combine uncorrelated investments, and even achieve some tax efficiency. S12J for example allows investors to tap into the power of the deduction to enhance return without being stuck in the investment till age 55. Structured products provide investors with an opportunity to build in defined short to medium term returns.

Investors would do well to invest some time and energy to get to understand these alternative investments. Some ideas for investors wanting to diversify away from unit trusts:

- - Limit exposure to alternative investments to 15% - 20% their portfolio
- - Initially enter via a product provider in the top 2 or 3 in that market.
- - Favour managers or providers with long and verifiable track records

The AfriAsia Wealth Report of 2019 found that there has been an increased allocation to alternative investments by wealthy South African investors. This trend is expected to continue over the coming decade which is a good thing.



There are good reasons why unit trusts dominate the retail investment landscape, and we expect that this should continue. However, investors and advisers should keep an open mind and consider investment opportunities outside of their comfort zone. No investment presentation or article is complete without a Warren Buffett quote. The most relevant one in this context would be "never test the depth of the river with both feet"

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