Managed Fund Advertising

– Progress Report

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March 2002

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Preface

The authors are conducting a detailed study of advertising for managed funds.[1]

The first part of the study (covered by this progress report) examines the content of advertisements from a qualitative perspective. A later statistical analysis will compare the performance of funds before advertising and after advertising. The final report is expected to be completed in December 2002.

Project Rationale

Advertising is a key potential factor influencing investment decisions in managed funds. Some of this advertising is targeted at consumers, some at advisers and some at both. Fund advertisements often include past performance information as a selling point. The use of past performance in advertising is of both policy and academic interest.

Jain and Wu (2000) examined the use of advertising by US mutual funds. They found funds advertised when they were performing well and generated significant fund inflows . However, the advertised funds did not subsequently perform any better than comparable non-advertised funds (if anything they performed worse). They concluded that "the emphasis on past performance in advertisements is misplaced" and further "it is possible that the mutual fund operators are well aware of the possibility that past performance is indeed not a good predictor of future performance … .Yet the fund operators choose to advertise funds with superior performance." (Jain & Wu, 2000, p.957). No such research has been conducted in Australia and the primary objective of this project is to remedy this.

This first report examines the content of advertisements from a qualitative perspective. A later statistical analysis will compare the performance of funds before and after advertising.

[1] After learning that the research project was underway, the Australian Securities and Investment Commission provided modest sponsorship assistance to aid its progress.

Advertisements Database - Magazines and Time Periods Covered

The first step of the project requires the compilation of advertisements used to advertise managed fund products. Advertisements from five magazines have been chosen to include in a database. The first four - Money Magazine, Shares, Business Review Weekly and Personal Investor represent, in order, the most widely read personal investment magazines (Roy Morgan Research, 2001). The Business Review Weekly has a distinct business/corporate focus and complements the retail individual investor focus of the other magazines.

The fifth magazine, Investor's Advisor, is an industry publication with a primary market of financial planners. Financial planners represent the most likely source of financial advice when sought by individual investors (Roy Morgan Research, 2000). Managed fund investments represent the majority of investments made by financial planners.

The periods covered vary between the publications, and range in total between January 1997 to September 2001. All advertisements were published before 11 September 2001.

Database summary and criteria

A summary of the magazine coverage is presented in Table One. A total of 507 advertisements have been collected. The criterion for inclusion in the database was that a specific managed fund product (MFP) must have been referred to in the advertisement. This excludes advertisements that advertise master trusts of a fund manager or those advertisements that advertise the fund manager only.

The 507 advertisements include references to 709 MFPs. A number of managed fund products were advertised more than once and a number of advertisements were used more than once. Allowing for this, the database includes 270 unique MFPs. The range of MFPs is representative of a wide range of categories and is summarised in Table Two.

In this paper the unit of analysis is the 'event' of a managed fund product advertisement (MFPA). Therefore statistics in this paper predominantly reflect those of the advertisements, rather than focussing on unique products or unique advertisements. Some MFPs that are extensively advertised will therefore have a greater weight in some percentage figures. For an investor at any point in time who accesses MFP advertisements however, this overweighting will not bias results as long as they are spread over the time period of the analysis. This is the case for the majority of MFPs and therefore the statistics provide a useful means of analysing what the investor faces at a point in time.

Table One: Magazine Coverage

	Time Period Included	Number of advertisements	Number of MFPs
Personal Investor	5/1999 - 4/2001	132	175
Investor’s Advisor	11/1999 – 9/2001	155	270
Shares	3/1997 - 7/2001	128	148
Money Magazine	8/1999 - 7/2001	65	85
Business Review Weekly	1/1997 – 7/2001	27	31
Total		**507**	**709**

Table Two: MFP Broad Category[2]

	Number	Percent
Australian Equity	136	23.9%
International Equity	201	35.3%
Multisector	98	17.2%
Cash, Fixed Interest	62	10.9%
Mortgage, Property	38	6.7%
Australian Equity - Small Equity	31	5.4%
Other	4	0.5%
Total	570	100.0%

Categories based on Morningtsar classification. Not all funds advertised matched to Morningstar and hence the number in this table does not correspond to the number of MFPs in Table One.

[2] All classification and historical return calculations used in this report are sourced from Morningstar Total Access.

Performance Measures

Approximately seven in every ten MFPAs include at least one performance measure, with one in every five including two separate performance measures. Table Three also indicates that the dominant reported means of advertising performance is with an average annual percentage return. In the main these return calculations were clearly stated, though where a MFPA included a performance measure, the reporting basis was unclear in five percent of advertisements. Most frequently this lack of clarity concerned whether the returns were stated as per annum or whole of life returns.

Table Three: Reporting of Returns - All Advertisements

	Measure One		Measure Two		Measure Three	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Annual returns	399	56%	118	17%	7	1%
Accumulated dollar value	45	6%	5	1%	7	1%
Unclear	24	3%	8	1%	2	0.3%
Monthly returns	8	1%	0	0%	72	10%
Total returns	8	1%	11	2%	4	0.6%
Sub-total	484	68%	144	20%	92	13%
None	225	32%	565	80%	617	87%
Total	709	100%	709	100%	709	100%

The typical period employed when reporting performance for a MFP, summarised in Table Four, was the previous year. Whilst the previous twelve month period was the most often employed as indicated by the mode and median, the mean period was 2.6 years. The distribution of periods has a number of outliers due to advertisements where the whole of life of funds were employed, with a maximum period of 26 years. In instances where second and third performance periods were used, these were invariably longer time periods.

Of the ads where only one historical measure was used, 57% had figures for the past year only.

The 46 Cash Management Trust MFPA represent a distinct group in terms of the performance period they employ in their advertisements. The mean period for this category of funds is 0.25 years, with more than half of the MFPAs using annualised projections based on a one week period. If Cash Management Trusts are excluded from the sample, the mode and median performance period remains one year, with a mean of 3.1 years. The focus on short term performance periods is perhaps more pronounced than the averages suggest as 65 percent of advertisements which include a performance measure use the last twelve months and 72 percent use the last two years.

Given that more than one MFP can be included in each advertisement and that each MFP may appear in a number of advertisements, each of the above measures were recalculated examining both unique advertisements or unique MFPs. The mean period is marginally larger in both cases suggesting that when advertisements are frequent or when multiple products are advertised they tend to use shorter time periods. This could be suggestive of advertising when recent performance has been favourable.

The focus on relatively short term historical performance does not appear to be due to a lack of MFP history. In those instances where a MFPA includes a performance measure, the MFP had been in operation for a mean period of 7.9 years, with 50 percent of MFPs having a history of 6.6 years.

Table Four: Performance Time Periods - All Advertisements

	Time Period (years)		
	Measure 1 (n=446)	Measure 2 (n=122)	Measure 3 (n=77)
Mean	2.81	3.35	4.25
Median	1.00	2.00	3.01
Mode	1.00	2.00	3.00
Minimum	0.00	0.25	0.00
Maximum	26.26	26.51	15.01

Risk

The use of the term performance generally implies return as well as risk. The most apparent feature of the MFPAs is however the almost total absence of risk measures. If risk is referred to it is invariably in the fine print, and in the general terms in the perfunctory "past performance is not indicative of future performance" disclaimer.

The advertisements in this respect are very one-sided, using historical measures to highlight potential return upsides, but choosing not to identify the potential risk downside.

In some instances risk is presented in almost a positive light. For example in AD275[3] "Unfortunately, we cannot guarantee *high returns* every year" (emphasis added). This can have the implication that the potential risk is of not enjoying high returns, not of negative returns. The subtle difference in terminology allows a more positive focus. In AD264[4] the product is advertised highlighting the declines that a number of specific companies enjoyed in 1999. Later in the advertisement there is an almost goading warning that those "not shy of high risk and volatility" may wish to invest in it.

There are some exceptions to the exclusion of risk, which notably appear in the practitioner publication, Investor's Adviser. For example in AD488[5] the standard deviation of the product's historical return is included. AD369[6] specifically includes the standard deviation of returns and a traditional return and risk graph space, however it appears technically incorrect. Such graphs are generally used to identify the various combinations of return and risk that would result from the proportions in each of the assets/portfolios which are in this case 100% International Shares and 100% Australian Industrial Shares.

The use of the graph implies a 60/40 combination of the nominated 100% international shares and 100% Australian Industrial Shares produces the nominated risk and returns as on the graph. The nominated 60/40 split return is not a true 60/40 split of the two nominated funds as these graphs are normally used. If by re-weighting the ad suggests that they deviate from a 60/40 split regularly then the graph is not showing a true 60/40 split of the two assets. AD389[7] provides another rare example

[3] AD275, Jun-00
[4] AD264, Apr-00
[5] AD488, Aug-01
[6] AD369, Nov-99
[7] AD389, Feb-00

of the same risk-return graph. AD393[8] includes the tracking error volatility of the MFP compared with another product offered by the fund.

Benchmarks

A range of benchmarks was employed which have been grouped into broad types in Table Five. In total approximately 40 percent of advertisements included a benchmark measure and the benchmarks ranged in their degree of specification. Of these advertisements, 16.7 percent had a secondary benchmark and 2.1 percent had a third benchmark.

Approximately equal proportions of advertisements used other MFPs (46.4 percent) as the benchmark as used various sharemarket indices (43.4 percent). In the instances where other MFPs were used as the benchmark, comparable MFPs, that is in the same category of funds, was most common. In the cases where a secondary benchmark was used, it was generally of another type. For example, for the 19 advertisements that included other MFPs as the secondary benchmark, 16 had a Share Index as their first. Of the 19 advertisements that used a Share Index as the secondary benchmark, 10 had Dissimilar MFPs as their first. For example, when discussing returns from a property trust, average returns for share funds would be a 'dissimilar' benchmark.

Table Five: Performance Benchmarks – All Advertisements

	Main Benchmark		Second Benchmark		Third benchmark	
	Number	Percent	Number	Percent	Number	Percent
Comparable MFPs	89	32%	5	11%	0	0%
Australian Subsidiary Indices	50	18%	5	11%	2	33%
Australian Sharemarket Index - All Ordinaries	45	16%	16	36%	0	0%
Dissimilar MFPs	41	15%	14	31%	0	0%
Overseas Sharemarket Indices – World & Country	26	9%	0	0%	2	33%
Cash, Bank Deposit, Fixed Interest	23	8%	2	4%	1	17%
Other	6	2%	3	7%	1	17%
Total	**280** (39.5%)	**100%**	**45** (6.3%)	**100%**	**6** (1.0%)	**100%**

n=280 (39.5%) of advertisements

[8] AD393, Apr-00

Ratings and Awards

Ratings and awards are increasing phenomena in MFPAs. Table Six identifies that over ten percent of advertisements in the sample included a rating. These numbers perhaps understate the growing role of ratings. For example, if the advertisements from 2001 only are considered, of the 175 advertisements over thirty percent have reference to rating. Table Six also identifies that product ratings were most often used though companies also utilised either other fund product ratings within the fund or overall fund manager ratings.

Table Six: Ratings in Advertisements

	Assirt	Morning star	vanEyk	Investor Web	Intech	Total (% of all advertisements)
Product Rating	25	10	15	4	4	58
Other Product Rating	5	1	3	0	0	9
General Fund Manager Rating	5	12	0	0	1	18
	35	23	18	4	5	85 (12.0%)

n=709

The use of awards has also increased in prevalence though not to the same degree. Of the 175 advertisements in 2001, 20 percent referenced an award. The Money Management awards were the most prevalent as summarised in Table Seven.

Table Seven: Awards nominated in advertisements

	Number	**Percent**
Money Management Fund Manager of the Year	65	71.4%
Money Management Product of the Year	1	1.1%
Morningstar Fund Manager of the Year	6	6.6%
Top Performer by Personal Investor Magazine	18	19.8%
Inaugural national Banksia Award for SRI	1	1.1%
Total (% of all advertisements)	91 (12.8%)	100.0%

n=709

Preliminary Issues Arising From Advertisements

The preliminary analysis of the advertisements has identified a range of issues, which will be further investigated but are discussed briefly below. Where particular advertisements are mentioned, these are used as examples and do not necessarily imply that they are the only advertisements with that feature. For each example, footnotes show the fund name and the date of the advertisement. This information is often necessary to interpret the comments. It also shows whether issues relate to minor or major players.

Benchmark clarification

- It is not readily clear in all advertisements, where a share index has been used, whether it is an accumulation index or a share price index, eg. AD10[9] and to a lesser degree AD22[10].
- AD10[11] claims that the MFP has had higher returns than the Australian stock, bond and property markets. It is unclear as to what index or Australian stock(s) they are comparing it to, this is also unclear in the diagram.
- In AD98[12] there is mention that on average the long-term performance of "international shares" had been better than Australian shares, property and fixed interest investments. There is no specific supporting evidence and neither is there any specific description of the benchmarks or of "international shares".
- AD482[13] presents historical returns for 4 of the fund's products over a 5-year period alongside returns over the same 5-year period of an *unknown* benchmark.

Benchmark Choice

The use of a benchmark can be used for two broad reasons. The first is to highlight a manager's performance relative to others in the asset class as a whole. The second is to highlight the relative performance of respective asset classes. There is potential in both cases for relative out performance to be attributable to different risk exposures

[9] AD10, Sep-99
[10] AD22, Jan-00
[11] AD10, Sep-99
[12] AD98, Mar-97
[13] AD482, Jul-01

rather than the skill or ability of the manager. The implicit attribution of performance to the MFP needs clarification to avoid confusion. The following are examples of possible sources of confusion.

- AD448[14] is a High Growth Shares Trust yet they have chosen the S&PASX200 index as the benchmark in the advertisement. In another advertisement for the MFP (AD485[15]) it states that the MFP is a high growth shares trust which takes short and long positions in shares. Its risk is therefore quite different to the nominated benchmark and it is therefor not surprising that its performance in returns is different.
- In AD37[16] the choice of benchmark obviously portrays the MFP in a favourable light. Quite rightly the advertisement points out that it has outperformed the Small Ordinaries Index and that the fund was less volatile than "other funds of its kind because it avoids speculative stocks and focuses on companies with established earnings". What is not included in the advertisement is that over the same time period, the fund had achieved a lower return relative to the index of other MFPs in the same category of funds, using the Morningstar sub-category classification.
- AD83[17], AD440[18], which is for an Australian Share Fund, compares returns of the product against a set of funds including Imputation and Industrial products which are possibly not directly comparable. AD309[19] is a similar example.
- In AD443[20] one year returns of the All Ordinaries Index are used to promote a Property fund. This is a good example of a MFPA which is primarily using a sector versus sector argument to advocate their product. The argument that investing in property is better than investing in the broad sharemarket should however be based on an understanding of the risk of the two and longer term comparisons, which are not included in the advertisement. Curiously, the advertisement was placed in the Investor's Advisor. Do they think that this is the basis that financial advisers will choose a MFP?

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[14] 448, Feb-01
[15] AD485, Aug-01
[16] AD37, Jun-00
[17] AD83, Dec-98
[18] AD440, Jan-00
[19] AD309, Jan-01
[20] AD443, Feb-01

- A similar sector versus sector approach can be found in AD75[21], which is for an International Fund. Instead of representing the MFP's actual return, the advertisement uses other world indices compared with the All Ordinaries Index. Such relative performances are not necessarily long term. For example using 2001/2002 data the performances would be reversed. These advertisements of course say nothing of the performance of the actual MFPs managers.

Choice of Time Period

The choice of relatively short time periods for performance measures, as discussed previously, is questionable in a number of instances given a MFPs longer term performance. It certainly means recent performance is not put into context.

- In AD480[22] for example the advertisement provides information that emphasises the previous 12 month period where the fund outperformed the nominated benchmark. In the next sentence the advertisement provides the return the fund has achieved over a five year period but it doesn't provide the benchmarks as well. Information from outside the advertisement shows it had outperformed the benchmark, though by nowhere near the margin enjoyed over the previous twelve months. Exploring this fund's performance a little more reveals that over the previous five-year period the accumulated value of the nominated benchmark was greater than the fund for certain time periods. It is questionable what information the five-year annualised figure by itself actually provides.

No mention of competitors' name

- In AD25, 245, 364, 380, 355, 24[23], the benchmark quoted is an interest rate of the funds "largest competitor's" cash management account. The advertisement does not state who this competitor is. It is understandable that the fund would not want to advertise its competitor, however there is no accountability.

Past returns from other sources

There are a number of examples where backfilling is used that is, using either hypothetical or actual data not of the MFP.

[21] AD75, Jul-98
[22] AD480, Jul-01
[23] AD25 etc, Feb-00 onward

- AD10[24] clearly states the fund commenced on 1 July 1999, however the return is calculated from October 1993 to December 1998. The diagram shows backfilled past returns while the text refers to "a unique opportunity to reap consistent high returns with less volatility than the Australian stock market". This provides a potentially misleading representation of the fund's possible future return, As it is a major leap to suggest that comparable figures could be produced by the fund into the future.
- AD216[25] contains identical information as AD10, however omits the important piece of information of when the MFP commenced trading. The advertisement poorly informs readers about the use of backfilling, which is only inferred in the fine print "As at the issue date of the Prospectus the Fund has not actually traded" and the sentence within the main body of the advertisement "*would have* achieved……..". (emphasis added)
- In AD439[26] long- term performance data was not available for this new fund and therefore backfilling over a period of one, three and five years. The advertisement discloses this but by way of the fine print. The table in the advertisement prominently associates high returns with the product using the representative returns. It is not clear from the fund what portfolio the returns are representative of.
- A similar case can be found in AD459[27] where the fund was quite new (inception date: April 2000) at the time the advertisement was published in the March 2001 edition of Investor's Advisor. The advertisement backfills performance over one year to October 2000. Again this is disclosed only in the fine print but the dominant feature of the advertisement is the return measure and the name of the MFP.
- Not exactly backfilling but in AD144[28] the MFP is new and without a record and thus an Infrastructure Index is used to reflect the potential performance of the MFP against the All Ordinaries. It is not clear what market the Infrastructure Index is from and how this relates to the fund. The fund also does not appear to be an Index fund of the Infrastructure sector.

[24] AD10, Sep-99
[25] AD216, Jul-99
[26] AD439, Jan-00
[27] AD459, Mar-01
[28] AD144, Mar-01

Return Clarification

- In AD494[29] it is claimed that with a return of 22%, the MFP outperformed the benchmark MSCI World Accumulation Index by 27.82%. It is not readily clear whether the outperformance is in relative or absolute percentage terms. This is not a problem peculiar to MFPs however as it is common across the financial press.
- In AD216[30] backfilled returns come from other trading results of the investment manager. These trading results were reduced by 30%, but it is unclear why.

Return and Risk Balance

The absence of specific measures of risk from the majority of advertisements has been discussed. In some instances advertisements suggest that there need not be a trade-off between risk and return.

- In AD318[31] the MFP is recommended as one which combines high performance with "lower risk". Lower risk is a vague term, which is not defined, akin to food advertisements, which use the term "lite". The return of the product of 55.16% over one year is impressive, though its sustainability and the actual longer term risk involved should be included to balance this out.
- In AD347[32] it is claimed that the MFP provides "the optimal balance of risk and return". However the risk and return graph used in the advertisement suggests that the MFP does yield a higher gross return than the other selective competing funds, however when risk is involved the "optimal balance of risk and return" really depends on the individual's risk aversion. It could be the MFP advertised but it could also be one of the other funds as well.

[29] AD494, Aug-01
[30] AD216, Jul-99
[31] AD318, Mar-01
[32] AD347, Nov-98

Currency of performance quotes

- In AD244[33] the finishing performance date for the MFP was 9 months prior to when the advertisement was published in the Personal Investor's November 1999 magazine.
- In AD338, 340, 341[34] the historical returns end 5-6 months prior to the advertisement dates.

Omission of performance dates

- In AD254, 260, 269, 271, 277, 281[35], and unlike most other advertisements in the database, the MFPA fails to provide specific start and finish performance dates for the returns quoted. The MFPA does state that the return was achieved over the last 12 months, however the time elapsed between the advertisement being produced and published and the reader viewing it, the return may not accurately reflect the last 12 months.
- In AD474[36] returns over a number of time periods for three products and four benchmarks are presented with no reference to the performance beginning and closing dates.

Performance type unclear

There are several advertisements, which give no indication as to whether the returns are, for example, an average monthly figure, an average annualised figure or a total return.

- In AD3[37], 29[38], 204[39] for example MFPs quote returns for period less than 12 months. It does not reveal whether this is an average annualized return, a total return or an effective return.

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[33] AD244, Nov-99
[34] AD338 etc, Dec-97, Jan-98, Mar-98
[35] AD254 etc, Mar-00 - Aug-00
[36] AD474, May-01
[37] AD3, Jun-99
[38] AD29, Mar-00
[39] AD204, May-99

Minimum performance period

Most of the MFPs, excluding cash management funds, display a performance period of one year or longer.

- In AD3[40], 204[41] the performance period is 10 months and in AD1[42] the performance period is for 11 months.
- The norm for cash management trusts of annualising from short term results. This is evident in Macquarie CMT advertisements for example (AD530[43]) which present an annualized simple rate of return for the period 9/7/99 - 15/7/99. It is not clear that this approach is appropriate.

Implications of future performance

- The choice of words in AD490[44] could give a false sense of the risk of the fund. The headline is "You're in *absolutely* safe hands". It is unclear how a fund can make such a claim when considering future returns and indeed in the fine print it states that the "capital value of and performance of an investment in the Fund is not in any way guaranteed". Further "the investment is subject to investment risk, including possible delays in repayment and loss of income and principle invested.". Examining the past returns of the fund reveals that there have been a number of months where the fund suffered negative returns in the period before the advertisement was placed.
- In AD384[45] it is stated that "a clear and disciplined investment process delivers predictable out-performance over the medium and longer terms". No disclaimers are provided regarding future performance. The returns in the diagram used suggest very high returns.
- There is no performance disclaimer in AD482[46].

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[40] AD3, Jun-99
[41] AD204, May-99
[42] AD1, May-99
[43] AD530, Nov-99
[44] AD490, Aug-01
[45] AD384, Feb-00
[46] AD482, Jul-01

Summary of Preliminary Analysis

This report has reviewed the managed fund product advertisements placed in five leading investment publications over the period 1997 to 2001. The analysis has focussed on specific product advertisements as distinct from general fund managed advertisements.

A dominant feature of these advertisements is the product's historical return and is featured in more than 70 percent of all of the advertisements examined. This emphasis on returns is not balanced in two major respects. Firstly, the focus is very short term with more than 65 percent of these advertisements using only the past year's return. This is not due to lack of data as more than 50 percent of these products had histories of over six years. Secondly, there is not a corresponding focus on the risk attached to these returns; the exception being a small proportion of products advertised in a practitioner publication. A changing feature of these advertisements over the time period has been the increased usage of ratings and awards. The endorsements offered by ratings in particular are taking an important role in these advertisements.

There is a general lack of consistency across the advertisements in the choice of benchmark to which a product's performance is compared. This is not surprising given that the promotion of a product can be greatly enhanced by showing good relative performance. However, the choice of benchmark does not always reflect a comparable risk investment, which can render the comparison of limited value. In a similar vein the use of indicative performance, where advertisements have used other funds or hypothetical portfolios, is also of limited value.

References

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