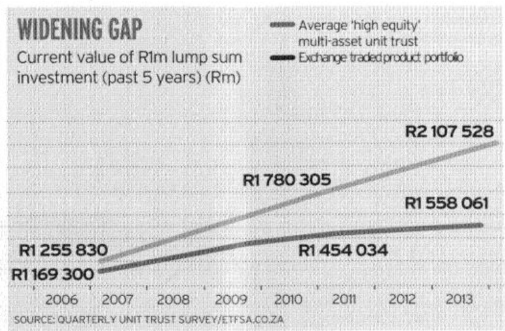
EXCHANGE TRADED FUNDS

Time to think unit trusts

Exchange traded funds (ETFs) are the way to go if you are disillusioned with active fund management. That's the conventional wisdom — but passively managed unit trusts can be a better alternative in terms of costs and accessibility.

It is a reality Sanlam has taken to heart in a move aimed at boosting the visibility of its index-tracking unit trusts by harnessing the power of its Satrix ETF brand.

A process to rebrand six Sanlam Investment Management (SIM) index-tracker unit trusts as Satrix funds is being set in motion, says Satrix CE Thomas van Heerden. As a first step Satrix is launching six unit trusts identical to the SIM funds with which they will merge. SIM's seventh tracker fund, SIM Index, is to be closed.



SOURCE: QUARTERLY UNIT TRUST SURVEY/ETFSA.CO.ZA

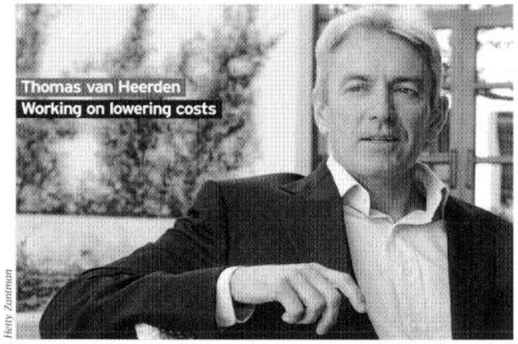
Van Heerden says six more Satrix unit trusts will be launched during October and November and will track MSCI's World (developed market), North America, UK, Europe ex-UK and Emerging Market indices. Parallel ETFs will follow.

Choosing between a broad index ETF or tracker unit trust comes down to costs. Unit trusts generally have the edge.

Taking the direct route into an ETF through a stock broker incurs brokerage, JSE fees and Vat. While brokerage varies, total costs can amount to as much as 2,5% on a R10 000 investment.

Placing most tracker unit trusts at an advantage is the absence of upfront fees if no financial adviser is involved. Stanlib Index and Stanlib Alsi 40 funds, which charge a 2,28% upfront fee, are exceptions.

Initial costs make a big difference over time. For example, R10 000 growing at 15%/year will amount to R40 455 in 10 years. Had 2% been deducted upfront the final amount would be R809 less.



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Management fees also make a big difference to returns. A fund charging a 0,5%/year fee growing at 15%/year will deliver a net R38 477 after 10 years. At a fee of 1% the outcome will be R36 587, a R1 890 (4,9%) shortfall. Over 30 years the shortfall is a staggering R82 900 (14,5%) — R569 670 compared with R486 770.

For investors targeting the JSE Top 40 index, the Satrix 40 ETF comes at a fee of 0,45%/year. Its closest unit trust rivals are Stanlib Alsi 40 Fund at a fee of 0,48% and SIM Equally Weighted Top 40 Fund at 0,51%. The odds are swung in the SIM fund's favour by initial costs on the Satrix 40 and Stanlib fund. For example, assuming the same annual growth rates, the SIM fund's net total return will after 10 years be 1,4% ahead of the ETF's and 2% ahead of Stanlib's fund.

The JSE all share index (Alsi) presents another tracking opportunity. Leading the field is the Gryphon All Share Tracker unit trust, which comes at a low 0,35% management fee. "We intend reducing the fee to 0,2%," says Gryphon Asset Management CEO Abri du Plessis.

Thanks to its low fee and astute management, Gryphon's fund has excelled, producing a return of 19,82%/year after costs in the 36 months to August. This was the best net return of any unit trust or ETF tracking the Alsi or Top 40.

Du Plessis explains that unlike an ETF, a unit trust is not required to hold all the shares in an index in its portfolio. "We do not hold shares that have no influence on returns and only add costs," he says. This has enabled Gryphon to offset most costs including fees and produce a net return in line with or slightly ahead of the Alsi's.

Another key cost consideration is the use of investment platforms, an unavoidable extra cost when ETFs or unit trusts are linked to a retirement annuity or preservation fund. It is an area in which ETFs fall down.

"With unit trusts you can negotiate fees as low as 0,15% with some linked investment service providers [Lisps]," says Du Plessis. With ETFs there is no room to negotiate with the only service provider, AOS, on whose platform investor programmes such as Satrix's and etfSA's run. "No Lisp has the technology needed to handle ETFs," says Van Heerden.

AOS's fees are stiff. Annual fees are 0,65% on investments up to R500 000, 0,5% on investments of R500 000-R1m and 0,35% on investments over R1m.

On the Satrix 40 this leaves investors paying at best a total fee of 0,8% and at worst 1,1%. In all cases it seriously harms one of the key rationales for ETF investment: low costs.

Satrix is well aware of this. "We are working to lower AOS platform costs and ETF fees," says Van Heerden. "We feel ETF fees of 0,2% are ultimately attainable."

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