Moneyweb

Is this the best investment fund in the world?

Hint: it's not an index fund.

Magnus Heystek / 10 July 2017 00:51

The news that Amazon was looking to take over Whole Foods caused the share prices to rocket, while almost every other retailer in the USA and UK — Wall Mart, Target, Tesco — slumped instantaneously. Such is the fear of what Amazon can do to established industries. Picture: Reuters

Travel broadens the mind, is an old saying we well and truly understand.

We come back from faraway countries with new insights into different cultures and customs; often which we repeat in our own private lives.

I still drink green tea after a trip to Thailand many years ago when we couldn't find any decent coffee on one of the islands.

And so it was very much the same after a recent whistle-stop tour of the USA together with 20-odd colleagues in the investment world, which started with visits to Fortune 500 companies in Seattle (Starbucks, Amazon, Microsoft and Boeing), continued to San Francisco (Tesla, Facebook, Wells Fargo and Google) and ended up with investment seminars hosted by Black Rock and Investec in the Big Apple.

If you're an investment roadie, then this was the ultimate tour of them all; facilitated by Investec Asset Management, using all their contacts (and then some more) to get us through the doors of the above listed prestigious companies.

But even Investec couldn't crack us an invite to Facebook at their head office in Palo Alto. Facebook is notoriously security conscious and does not allow anyone into their campus without top security clearance.

No problem: we arranged a talk by a Facebook spokesman outside on the pavement….

When asked on my return what the overriding impression was of this tour in one word, I can safely say: speed.

The speed at which our lives will change over the next couple of years is not being fully discounted by most local investors. Industries will rise and fall much faster than in the past. At Amazon we were given a talk — by a South African 'boykie' from Bedfordview, nogal — how Amazon will disrupt almost every retail industry, first in the USA and then later all over the modern world.

Not a week later the world awoke with the news that Amazon is looking at taking over Whole Foods, a sort of Woolies-equivalent in the US.

Two things happened on the news. Amazon and Whole Foods share prices rocketed, while almost every other retailer in the USA and UK — Wall Mart, Target, Tesco — slumped instantaneously. Such is the fear of what Amazom can do to established industries.

At Tesla, for instance, we had a visit to the Palo Alto factory and a talk about the future of cars. Barely a month later Volvo announced that it will be the first major motor car manufacturer ceasing to produce internal combustion engine vehicles and go totally electric.

I felt real proud to be able to tell our tour guide that Elon Musk, visionary founder of Tesla, grew up in the same suburb where I have been living for 25 years.

At the heart of all this change is technology and the world leader in technology is in Silicon Valley, which by the way, is not in a valley at all. Technology has been the major boost behind stock market returns over the past five to eight years and if you did not have any of the FANG companies in your portfolio, then you have been lagging badly.

(FANG stands for Facebook, Amazon, Netflix, Google).

Vanguard's little secret

But it was the chance encounter with a group of Vanguard executives in New York which also added immensely to my investment repertoire.

At an upmarket venue I bumped into some Vanguard people who were there for a conference and we got talking. I raised the issue of Warren Buffett's oft-repeated advice that most investors should simply buy the S&P 500 Index and be done with the rest.

It's also what Jack Bogle, founder of the Vanguard Group, has been punting for many years. The index lovers and punters have pounced onto this comment by Buffett as the holy grail of investment advice in their promotional endeavours.

My question whether they all followed Buffett's advice with their own money was met with a polite cough and a subtle sideways shift of the eyes. Sensing that there was something afoot, I pressed on, looking for more information.

In the end — after buying a couple of rounds — I finally got to the bottom of this story. Seems that Vanguard is a little bit embarrassed by this free publicity they are getting from the likes of Warren Buffett and their founder but that they mostly invest their own money in a very large global equity fund — the Vanguard US Opportunities Fund (Bloomberg code: VANGUOA).

The reason? This fund has beaten their S&P 500 index fund (and any other comparative index funds) from day one since inception in 2002 by the proverbial mile. But they cannot come out and publicise this fact; it might just slow down the inflow of funds into their index fund.

For a start I didn't know that Vanguard offered actively-managed funds. In fact, as I subsequently found out, more than half their assets under management are still held in active funds.

And secondly, when I did some more work on the Vanguard Opportunities Fund I was blown away by its massive outperformance against, not only the index, but also against its peers. To such an extent I have to ask whether this is not the best investment fund in the world?

Since inception this $2.4 billion fund has returned 15.5% pa (versus 8.2% pa); over ten years the returns were 11.77% pa (6.32%); over five years it returned 21.5% (versus 14.5%), 15.12% (9%) over three and 28.8% (versus 17%) over one year.

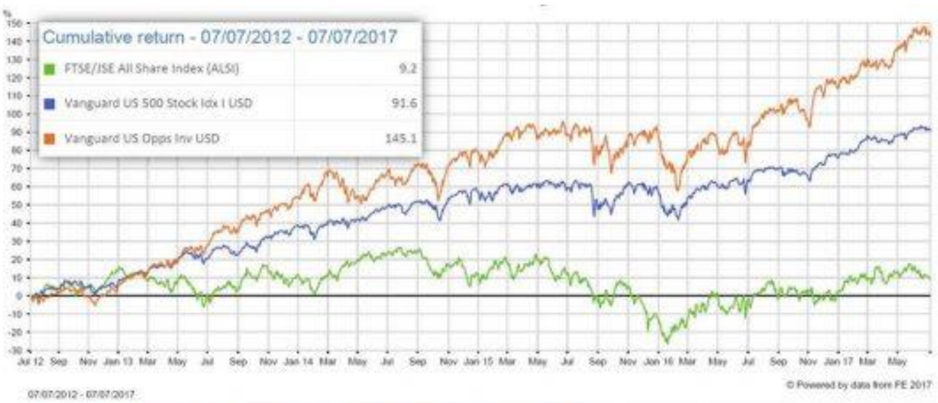
The fund managers look particularly at the future earnings potential of the companies they invest in, especially in so far if that fact is already in the share price. Most of the companies are in the US (currently 94%) but it also searches for qualifying companies in Canada, China, Europe and emerging markets. There is no index fund that replicates such a strategy.

Because it includes offshore companies in its fund, its benchmark is the Russell 3000 Index.

It's also a cheap fund; costs are 0.9% per annum.

Finally, I compared the returns of this fund with the returns (USD and rands) over the last five years against the S&P 500 and also the JSE Top 40 Index (see chart).

Did Warren Buffett choose the wrong Vanguard fund?



Monthly and annual average returns (%) - dates to 07/07/2017

Instrument	1 month	6 months	1 year	3 years annualised	5 years annualised /*Since launch* annualised*
FTSE/JSE All Share Index (ALSI)	-4.1	5.9	15.5	-4.0	1.8
Vanguard US 500 Stock Idx I USD	-0.2	7.2	17.2	8.6	13.9
Vanguard US Opps Inv USD	-0.1	12.2	32.8	13.7	19.6

The chart clearly shows how this fund has beaten the S&P 500 Index substantially. Against the JSE Top 40, it's a brutal massacre.

The Top 40 has not grown much in US dollar terms over the past 5 years.

And even with the stronger rand over the past 18 months the Vanguard fund has still beaten the Top 40 Fund!

A final word about Regulation 28 and the JSE

I have to feel sorry for investors, perhaps not so well informed, who keep on investing (or are advised to invest) in underperforming funds/indices linked to our local stock market. The sad part about this is that Regulation 28 forces pension funds and other institutional funds to invest at least 75% in the local market. That's why the retirement dreams of many pensioners are crashing around their ears. Pension fund returns (together with residential property prices) are not performing and are declining in real terms. And there is nothing the big fund managers can do about it.

They are at mercy of the whims of Treasury who decides what percentage fund managers can invest offshore.

There is no one standing up for the little man/woman and appealing for greater offshore exposure via retirement funds. I am willing to bet that the millions of investors in local pension/provident funds have no idea what Regulation28 is doing to them and how badly it is effecting their retirement.

And then Treasury has the audacity to compile a massive report and point fingers at fees as a major contributor to sub-par investment returns. Fees are important, no doubt, but then Treasury completely ignores their own role in keeping pensioner returns under pressure.

My comments and warnings about Regulation 28 are not new. I have been making them for several years now, and every time I do, I get the usual fallacious arguments about the need for local investments/patriotism/loyalty/blah, blah, blah.

The sad fact that Regulation 28 is part of foreign exchange controls which like under the apartheid regime, keeps capital locked into poorly-performing assets as a result of government's poor handling of the economy.

It also comes as no surprise to me that the JSE itself, is being hit hard by the outflow of money from the local bourse. The JSE over the weekend announced major retrenchments of staff (about 60 people) and cost cutting measures. The JSE did not release any statistics but it no doubt comes as a result of foreign investors and wealthy South Africans fleeing our market. Foreigners have withdrawn an estimated R270 billion from our market over the past 18 months while wealthy local investors have moved an estimated R80–R100 billion out of the country via the Foreign Investment Allowance over the last number of years. This is money now being invested on other bourses were the return outlooks are infinitely better.

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https://www.moneyweb.co.za/moneyweb-opinion/is-this-the-best-investment-fund-in-the-world/