PRUDENTIAL
INVESTMENT MANAGERS

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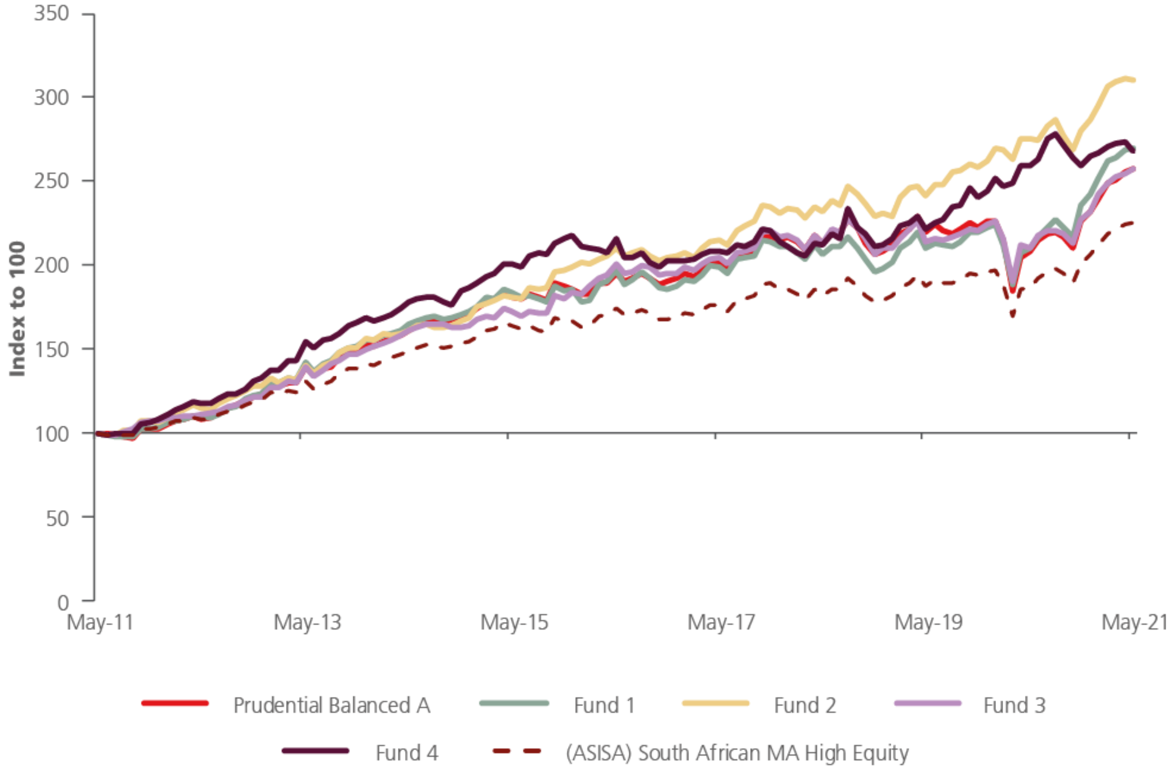
# Why investing in the latest top performers doesn't work

It's obvious from the data that South African investors are constantly choosing their investments based on a fund manager's latest (1-3 year) fund returns (or outperformance), often switching into last year's top performers. The higher the better, they think, and extrapolate these past results into the future. But what they don't realise is that manager outperformance is only temporary and never constant, due to the unpredictability of future market moves. There may be investment trends that continue for some time, but there is never one strategy that outperforms all the time. In fact, it is often the case that last year's winners are this year's losers.

This is easily shown by comparing the outperformance (or alpha) of five of South Africa's largest fund managers (and the most successful) over rolling one-year periods versus their 10-year performance. Looking at the ASISA SA Multi-Asset High Equity category (typical Balanced funds) in Graph 1, we can see that over the 10-year period all of these managers, including Prudential (the solid red line), comfortably outperformed the category average (the dashed red line).

**Graph 1: SA's 5 largest Balanced funds comfortably beat average over 10 years**

**(ASISA SA Multi-Asset High Equity fund category)**

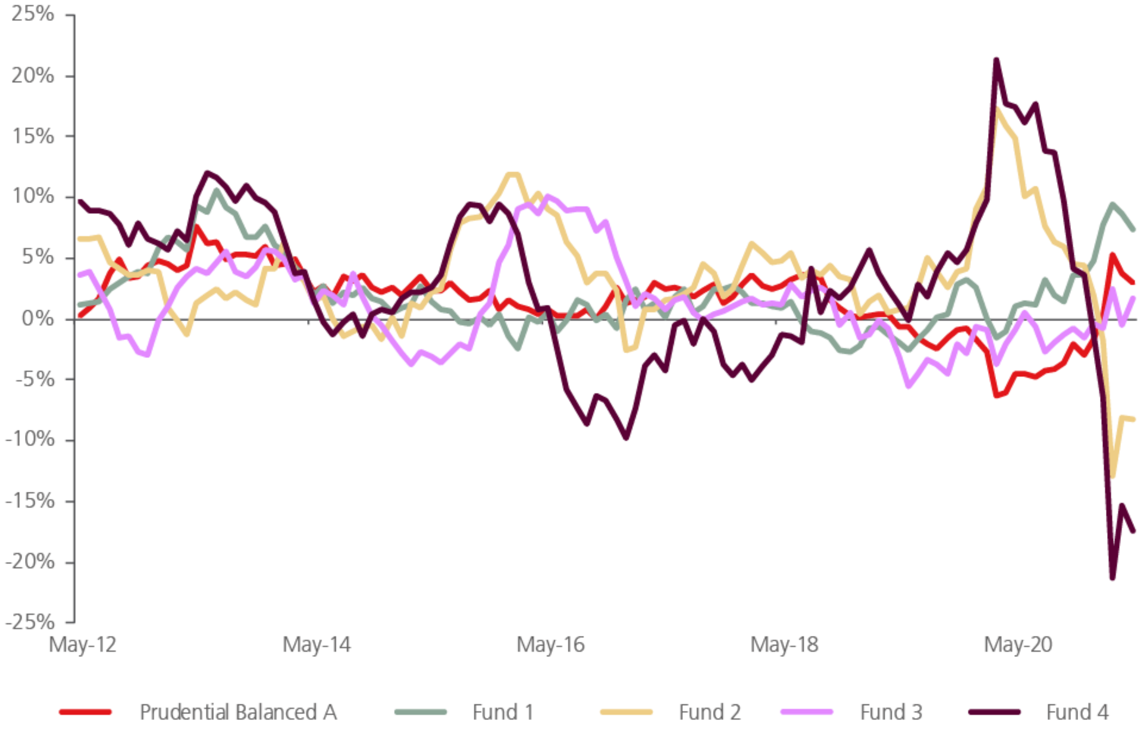



Source: ASISA, Morningstar

But how was this outperformance achieved? What was it built on over the shorter-term? Graph 2 shows the managers' rolling one-year Balanced fund outperformance versus the category average (represented by the grey 0% line). What is clear is that **not one of these managers delivered outperformance over every 12-month period.** The experience of the manager shown in purple is particularly volatile – investors would likely have been very tempted to sell out of the fund in 2016-17. Yet over 10 years they succeeded in achieving one of the strongest performances in the category, because their total outperformance over time exceeded their total underperformance.

**Graph 2: No asset manager outperforms over all periods**

**ASISA SA Multi-Asset Fund category (1-year rolling outperformance/alpha)**




Source: ASISA, Morningstar

This history tells us that, in fact, it is not beneficial to keep investing into the previous year's top-returning funds every year. Rather, using this type of approach can have a very detrimental impact on longer-term returns. Yet during 2020, ASISA data again clearly highlighted that many investors persisted in moving to the best-performing managers at that time, and that again many failed to deliver going forward, as Graph 2 illustrates. For example, those who switched into the two high-flying dark purple and yellow funds would have been disappointed by their subsequent well-below-average performance. Yet the three other funds that were lagging at the time have gone on to beat the two high-fliers so far in 2021. In an earlier 2015 example, those who switched out of the red fund when it lagged, and into the green or purple funds, would have missed out on its subsequent strong outperformance in 2016-17.

As such, we can see that a buy-and-hold strategy over the past 10 years would have been preferable to a switching strategy. Not only would investors have been better off in monetary terms, but they also would have been spared the stress of continually worrying about missing out on better returns elsewhere. Individual investors should be sure they pick an investment manager with a successful long-term track record up front, and an appropriate fund to meet their investing needs (with help from a financial adviser if necessary), and then stick to their plan over time with well-considered adjustments along the way according to their changing requirements. They should expect their fund to underperform periodically, but then regain ground and likely outperform again over time.

For more information, please feel free to call our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.