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BUILDING VALUE FOR PRIVATE CLIENTS

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Murray Sherwin
Chair - NZ Productivity Commission
PO Box 8036
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Dear Murray

SUBMISSION – Kiwisaver initiative

Private Asset Management wishes to make a submission on the first interim report of the services sector enquiry and in particular on the Kiwisaver initiative. I think the PC is on the right track here with the proposed Kiwisaver cost/switching website.

The sad fact is that it is virtually impossible to consistently pick outperforming fund managers so investors need to focus on that information which you can be sure of and chief amongst those is …. fees. Whilst the data in NZ does not yet confirm that low fees equal higher returns and it is remotely possible that NZ fund managers may be able to add value in the local stock market this isn't really relevant because NZ shares typically represent less than 15% of a balanced portfolio versus 3-4 times that weighting in international stocks and there the evidence is clear – that low fees do translate to high returns.

Many unbiased experts around the world are of the view that fees are the single most important factor in determining which fund an investor should buy, after consideration of asset allocation. So let's see what those experts have had to say on the fees/performance issue of late.

1. Writing in the Financial Times last year a senior visiting fellow of the Pensions Institute at the Cass Business School said "there is little academic evidence to support the argument that asset management and a potential for outperformance is more important than cost".

2. In "Why Do Retail Investors Make Costly Mistakes – An Experiment On Mutual Fund Choice" two law professors at the University of Pennsylvania write that there is "mounting evidence that retail investors make predictable, costly investment mistakes including the payment of excessive fund fees". The professors cite "the fact that high fee funds underperform".

3. In February of this year the US National Bureau of Economic Research based in Massachusetts under took a mystery shopping exercise and defined good advice "as advice that moves the investor toward a low cost, diversified, index approach" and acknowledged that this approach is the strategy that many text book analyses of investment suggest is the best approach. The NBER study further added that the market for financial advice "leans against those products which do not generate high fees".

4. Financial advisers and fund managers are fond of saying that investors "get what they pay for" but the truth is that you don't get what you pay for because, duh, what you pay goes to

> somebody else! We covered the “you get what you pay for” nonsense back in 2009 and highlighted two articles from the Journal of Finance. The first study concluded that funds with high fees underperform even before the deduction of fees! The other study, by Mark Cahart, in the March 1997 Journal of Finance concluded that “expenses have at least a 1 for 1 negative impact on performance”.

My understanding of the reality of the Kiwisaver market is that many financial advisers outside the banks who advise on Kiwisaver tend to limit their recommendations to providers which pay commissions and those providers, nine times out of ten, have much higher fees than the default providers so the PC initiative is a direct threat to those advisers’ business models. If mum and dad switch the trailing fees stop.

My view is that PC should go ahead and ignore the protests from people/organisations with obviously conflicted interests.

Yours faithfully

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