FTfm Mifid

Popular absolute return funds notch up high trading costs

Mifid II disclosures show funds incurred transaction costs almost equal to headline charges

Transaction charges represent the costs incurred when a fund manager buys or sells underlying investments (Evgeny Ivanov/Dreamstime)

Siobhan Riding 5 HOURS AGO

Popular alternative and absolute return funds run by JPMorgan Asset Management and Aviva Investors notched up high trading costs in 2018, according to new disclosures that will sit badly with investors bruised by the funds' one-year underperformance.

Transaction charges represent the costs incurred when a fund manager buys or sells underlying investments. They involve the explicit cost of trading as well as implicit costs, which reflect the difference in the price at which a transaction is executed with the price when the transaction order was entered.

These costs are not included in the industry's standard measure of running costs, the so-called ongoing charge figure. However, rules that came into effect last year under Mifid II, the second Markets in Financial Instruments Directive, oblige investment managers to provide a breakdown of the hidden charges borne by investors.

Final disclosures for the first year of Mifid II show that at least two of the UK's previously best-selling funds incurred transaction costs above their headline charges in 2018.

The £1.2bn Aviva Investors Multi-Strategy Target Income fund, part of the group's flagship absolute return range, recorded transaction costs of 1.03 per cent — higher than its management charge of 0.85 per cent. This means that the total cost of investing in the fund last year was 1.88 per cent when all costs are included per cent when all costs are included.

JPMorgan AM's £5.3bn Global Macro Opportunities fund, an alternatives strategy, disclosed transaction costs of 1.16 per cent last year, more than its 0.75 per cent management fee.

The high costs represent a drag on performance and will probably trigger investors' ire following the challenging year for absolute return and alternative funds.

The Aviva Investors' fund recorded a loss of 7.58 per cent last year, while the JPMorgan fund, which has the same flexible approach as an absolute return fund but takes more risk, was down 1.34 per cent.

Investors will see this spelt out over the next few weeks when they receive their first annual fund cost breakdown from their investment providers.

"If investors realise they didn't get good returns, then they see how much they've been paying to get those returns, that's not a good place to be in," said Mike Barrett from the Lang Cat consultancy. The disclosures are likely to provoke "uncomfortable conversations" between investors and fund managers, he added.

Absolute return funds conduct more trading and hedging than other types of funds, meaning they are likely to incur higher dealing costs. The amount of trading also varies according to market conditions. Hugues Gillibert, director at fund fee consultancy Fitz Partners, said: "During a year like 2018, one would expect to see portfolio managers trying to chase superior performance through a higher level of investment activity, which could translate into higher transaction costs."

But Guillaume Prache, managing director of consumer group Better Finance, said: "It is concerning that some absolute return funds generate very high transaction costs while not delivering at all on overall returns."

The absolute return funds analysed by FTfm generally recorded higher transaction costs than those incurred by other strategies included in the analysis. Janus Henderson's UK Absolute Return fund had costs of 0.52 per cent, Invesco's Global Targeted Returns fund disclosed costs of 0.37 per cent, while the Merian Global Equity Absolute Return fund said it had notched up 0.27 per cent.

Meanwhile, the trading costs for a popular money market fund run by BlackRock were just 0.02 per cent. Those racked up by Lindsell Train's Global Equity product, which has a highly concentrated portfolio, were 0.01 per cent.

Mr Gillibert said the methodology for calculating transaction costs meant it was difficult to make comparisons. Asset managers have criticised the calculation methodology stipulated in Mifid II, saying that it produces inconsistent results.

JPMorgan AM said that its 2019 transaction cost disclosure was "a snapshot that will vary across time". It said that the Global Macro Opportunities fund may incur higher transaction costs on account of its "flexible approach that helps enable it to deliver positive returns in up and down markets for equity and fixed income".

The US fund group added that transaction costs should be considered in the context of a fund's strategy and the return net of fees being achieved, noting that its fund had gained 6.7 per cent on an annualised basis.

Janus Henderson said that portfolio turnover was "a key part" of its UK Absolute Return fund's strategy, as its managers repositioned the portfolio to adapt to market changes on an ongoing basis.

Aviva Investors said it made "significant changes" to its fund's holdings late last year following the shift in policy direction by the US Federal Reserve. The transaction costs that this incurred subsequently led to strong performance, said the company, adding that the Multi-Strategy Target Income fund has returned almost 8 per cent so far in 2019. Aviva Investors said it did not expect transaction costs to have a material impact on returns in the long term.

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