ETFs Can Seriously Increase Your Wealth

ETFs appear to be despised by the City, many of whom are lobbying profusely to have them restricted or even banned. In our view this is because they are the first major technological change since mutual funds were invented in the 1940s. They cut out whole layers of superfluous City costs and fees, thereby stacking the odds back in the investors' favour. They do not pay commission and are not run by the cosy fund management cartel that has achieved so little for clients over many years; often forgetting whose money they are actually managing. Investors are afforded cheap, efficient, transparent, well spread investments which can also be invested into directly through various low cost share dealing providers.

From an objective perspective, like all investment products, ETFs are not perfect for everyone and some are better than others, but for many they offer the following advantages:

More Performance – An index will over the long term always produce a higher return than the vast majority of traditional funds. Why? Simply because investments managed by fund managers make up the vast majority of the market, it is a zero sum game – after costs the average client will inevitably underperform the index. Research by Morningstar has shown that the funds with higher fees tend to produce lower performance.* Statistically, the chance of an average equity or bond fund manager beating their benchmark three years on the trot is just 4 per cent.**

Less Risk – The risk of investing in a well spread index is often less than a traditional fund as there tends to be a greater level of spread, thereby making the fund less volatile. There is an average of 239 holdings within an average ETF compared to fewer than 100 within an average unit trust. Of course it means you may have much less in the next Apple wonder stock at the start but equally you may have much less in the next Nokia before it becomes unfashionable.

More Transparency – Through ETFs, 100% of the index and its constituents are revealed normally daily. In comparison, the average Investment Management Association (IMA) unit trust has just 40 per cent transparency as they normally only allows investors to see just their top 10 holdings via monthly factsheets which may be up to two months out of date.

More Choice - Investors can assemble their own portfolio directly in an efficient, low cost way, or they can ask a modern discretionary investment professional to assist in portfolio construction. ETFs cover everything, except wine and art, offering investors a much wider choice of assets. There are 869 London listed ETFs available today.

Oh, there is one other thing I forgot. **Less fees**. The average ETF charges just a 1/3rd of the fees of a typical unit trust and all those hidden fees (initial fees, dealing costs, performance fees, fund expenses etc.) either do not exist or are minimised. Once you have included all the hidden, opaque costs of most active funds, especially the hidden dealing costs associated with a typical fund turning over its portfolio at over 100% a year, the real full cost of traditional funds is often 2 to 3 times more than the average 1% headline fees often quoted, a year. This means that over 10 years as much as 20 to 30% of an investor's hard earned savings can disappear in fees by investing via a typical traditional unit trust.

From the negative perspective, some ETFs are better than others, some are more esoteric and they differ in tax efficiencies but at least they all treat investors with respect; providing extensive information so investors can, if they wish, make an informed choice.

At SCM Private we believed that clients deserved an honest, common sense approach to their savings with more transparency, more performance and more diversification but with less cost and less risks. The team conducts robust in-depth due diligence, concentrating on asset allocation through low cost dealing that translates to outperformance. Since launching the SCM Long-Term and Absolute Return Portfolios, they have both significantly outperformed comparable funds. *** Many of our competitors using ETFs have fared less well as whilst they have managed to reduce fees the benefits have been lost by not applying the same fundamental and contrarian investment philosophy as SCM, which then leads to investing in the wrong market at the wrong time.

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*Source: Morningstar *How Expense Ratios and Star Ratings Predict Success* by Russel Kinnel 9th August 2010

**Source: Ishares research on the *Consistency of Active Equity or Bond Performance – Probability of Outperforming the Benchmark* based on 31st December 2010 data from Morningstar, Bloomberg and BlackRock.

***Source: SCM Private – latest performance data and important notes available at http://www.scmprivate.com/performance.php