

## **Research into Active Fund Size Bias within the UK All Companies and UK Equity Income Sectors, End June 2010-2015**

**Published September 2015**

### **Summary**

- Over 100% of out-performance of UK equity funds over the last five years to end June 2015, was found to be due entirely to a bias to small and medium sized stocks, within the largest retail fund sector, **the £168 Bn UK All Companies sector**. These funds typically had just 53% invested in the largest UK companies which represent 70% by value of the UK stock market. They typically invested 47% of their funds in smaller/medium sized companies that together represent 30% by value of the UK stock market.
- 85% of out-performance of UK equity income funds over the last five years, was due to the same inherent bias within **the £60 Bn UK Equity Income sector**. These funds had just 59% invested in the largest UK companies which represent 70% of the stock market by value. They typically invested 41% of their funds in smaller/medium sized companies that together represent 30% by value of the UK stock market.
- The performance of the so called 'actively managed' largest fund sector, the £168 Bn UK All Companies sector, closely tracks a simple investment of 55% in a FTSE 100 tracker, and 45% in a FTSE 250 tracker from year to year.
- Only 2% of the funds analysed (4 out of 179 funds) beat the market five years running, once adjusted for the inherent size bias of each fund.
- Following the outperformance of small and mid-cap stocks, many of these stocks now command a premium valuation, compared to their larger peers. This may negatively impact the future returns of many active funds in £168 Bn UK All Companies sector and the £60 Bn UK Equity Income sector.

### **Conclusion**

Whether a typical 'active' UK fund performs well or badly in the future is mostly dependent on an investors view as to which will do better in the future, the largest companies or the smaller/medium sized companies.

## Background

When the UK equity market is segmented by size, it is evident that the real gains have been in the smallest 30% of the stock market by size; with the larger firms having performed much worse.

The average UK smaller company beating the larger peer by 8.9% pa, and the average medium UK beating the larger peer by 5.7% pa.

### Total Ret Annualised 5 Yrs to end June 2015

<b>UK Equities Overall (FTSE All-Share)</b>	<b>+10.7% pa</b>
UK Large Cap (top 70% of market by value)	+9.2% pa
UK Mid Cap (next 20% of market by value)	+14.9% pa
UK Small Cap (bottom 10% of market by value)	+18.1% pa

## Research Aim

Many fund groups market their performance as being the result of stock picking skills. SCM Direct's research aim was to test whether it was simply a result of the inherent bias of active funds to have less in large companies and more in smaller/medium sized companies.

## Methodology

SCM Direct analysed all funds within the two principal sectors of UK equity funds - UK All Companies and UK Equity Income, analysing monthly data regarding the percentages invested in large caps, mid-caps and small caps.

The large-cap companies were defined as those that account for the top 70% of the value of the UK stock market, the mid-cap stocks those in the next 20% and the small-cap stocks the remainder. The data was then analysed to calculate the average exposure yearly based on monthly data, to calculate the return that would have been achieved had their exposures to small cap, mid cap and large cap simply performed in line with the market.

SCM Direct.com conducted a further **in-depth study of 179 active UK equity funds in these two popular sectors with combined assets of £122 Bn**. All funds analysed possessed a five year track record from June 2010 to June 2015, were part of the Investment Association UK All Companies or UK Equity income sectors, had monthly market cap data available and aimed to beat the FTSE All-Share Index.

## Findings

As the tables below illustrate, there is an inherent bias to smaller and mid-sized companies that changes very little from year to year.

### UK All Companies Funds exposure by size of UK stocks held

	<b>Average over 5 years to end June 2015</b>	Year to end June 2011	Year to end June 2012	Year to end June 2013	Year to end June 2014	Year to end June 2015
<b>Largest 70% of market</b>	<b>53.2 %</b> (vs 70% index)	53.3 %	55.3 %	53.1 %	52.8 %	51.5 %
<b>Mid-cap – next 20% of market by size</b>	<b>28.0 %</b> (vs 20% index)	26.4 %	26.1 %	29.0 %	29.4 %	28.8 %
<b>Small-cap – next 10% of market by size</b>	<b>18.9 %</b> (vs 10% index)	20.3 %	18.6 %	17.9 %	17.9 %	19.6 %
	<b>100 %</b>	100 %	100 %	100 %	100 %	100 %

### UK Equity Income Funds exposure by size of UK stocks held

	<b>Average over 5 years to end June 2015</b>	Year to end June 2011	Year to end June 2012	Year to end June 2013	Year to end June 2014	Year to end June 2015
<b>Largest 70% of market</b>	<b>59.2%</b> (vs 70% index)	60.6 %	61.0 %	58.7 %	58.7 %	57.2 %
<b>Mid-cap – next 20% of market by size</b>	<b>24.5%</b> (vs 20% index)	22.8 %	21.8 %	24.5 %	26.2 %	27.1 %
<b>Small-cap – next 10% of market by size</b>	<b>16.3%</b> (vs 10% index)	16.6 %	17.2 %	16.7 %	15.2 %	15.7 %
	<b>100 %</b>	100 %	100 %	100 %	100 %	100 %

## Comparison

**When you strip out the effects of this inherent bias to small and medium sized companies, the out-performance for UK All Companies Funds disappears and nearly disappears for UK Income funds.**

If an investor had invested via a simple combination of a FTSE 100 tracker with a FTSE 250 tracker (SCM used the HSBC FTSE 100 and FTSE 250 index funds within this analysis), the results were astonishingly similar to the so called '*actively managed*' IA UK All Companies sector funds, again demonstrating that performance is largely dependent on the size bias of each fund.

	5 Yr Return to End June 2015	12m to End June 2011	12m to End June 2012	12m to End June 2013	12m to End June 2014	12m to End June 2015
<b>IA UK All Companies Sector</b>	12.1% pa	+24.4%	-4.5%	22.2%	14.1%	6.8%
<b>55% FTSE 100 tracker, 45% FTSE 250 tracker</b>	12.2% pa	+25.1%	-3.8%	22.1%	13.6%	6.8%
<b>Difference</b>	-0.1% pa	-0.7%	-0.7%	+0.1%	+0.5%	0.0%

## UK All Companies Funds

	Average over 5 years to end June 2015	Year to end June 2011	Year to end June 2012	Year to end June 2013	Year to end June 2014	Year to end June 2015
IA UK All Companies	12.1% pa	24.4	-4.5	22.2	14.1	6.8
FTSE All-Share Index	10.7% pa	25.6	-3.1	17.9	13.1	2.6
UK Index weighted by size of companies invested	12.6% pa	26.9	-2.3	21.8	14.4	4.8
<b>Outperformance Vs Mkt Cap Invested Benchmark</b>	<b>-0.6% pa</b>	<b>-2.5</b>	<b>-2.2</b>	<b>+0.4</b>	<b>-0.3</b>	<b>+2.0</b>

## UK Equity Income Funds

	Average over 5 years to end June 2015	Year to end June 2011	Year to end June 2012	Year to end June 2013	Year to end June 2014	Year to end June 2015
IA UK Equity Income	12.4% pa	22.2	-1.1	21.4	14.3	7.0
FTSE All-Share Index	10.7% pa	25.6	-3.1	17.9	13.1	2.6
UK Index weighted by size of companies invested	12.2% pa	26.6	-2.2	20.9	14.1	4.1
<b>Outperformance Vs Mkt Cap Invested Benchmark</b>	<b>+0.2% pa</b>	<b>-4.4</b>	<b>-1.1</b>	<b>+0.5</b>	<b>+0.2</b>	<b>+2.9</b>

## Analysis of Funds with a Five Year track record

SCM Direct then analysed a sample of 179 UK funds with combined assets of £122 Bn. All these active funds possessed a five year track record, were part of the Investment Association UK All Companies or UK Equity income sectors, had monthly market cap data available and aimed to beat the FTSE All-Share Index.

Only four of the funds within the sample - Lindsell Train UK Equity Inc, JOHCM UK Equity income, Lazard Multicap UK Income, and Royal London UK Equity Income - beat the market cap adjusted returns of their fund, in each of the five twelve month periods to end June 2015 analysed.

***There are very few funds that consistently out-perform the returns of their market-cap weighted investments.***

	Mkt cap adj outperformance Yr to end June 2011	Mkt cap adj outperformance Yr to end June 2012	Mkt cap adj outperformance Yr to end June 2013	Mkt cap adj outperformance Yr to end June 2014	Mkt cap adj outperformance Yr to end June 2015
CF Lindsell Train UK Equity	+2.2%	+6.0%	+10.1%	+1.6%	+11.0%
JOHCM UK Equity income	+1.1%	+0.6%	+8.3%	+2.0%	+2.3%
Lazard Multicap UK Income	+0.7%	+0.8%	+1.8%	+1.6%	+3.1%
Royal London UK Equity Income	+1.6%	+4.3%	+4.0%	+5.4%	+0.6%

***In the sample, the funds below consistently under-performed the returns of their market-cap weighted investments:***

	Mkt cap adj outperformance Yr to end June 2011	Mkt cap adj outperformance Yr to end June 2012	Mkt cap adj outperformance Yr to end June 2013	Mkt cap adj outperformance Yr to end June 2014	Mkt cap adj outperformance Yr to end June 2015
F&C UK Equity Income	-0.3%	-1.5%	-3.5%	-5.6%	-1.2%
M&G Recovery	-0.3%	-2.5%	-12.1%	-7.3%	-8.6%
MFM UK Primary Opportunities	-9.3%	-13.5%	-3.7%	-2.6%	-0.4%
Scottish Widows UK Select Gr	-2.0%	-13.3%	-1.5%	-12.3%	-4.9%

Interestingly, the top and bottom 10 funds in the sample ranked by reported outperformance, varies significantly to the top 10 and bottom funds within the sample ranked by outperformance adjusted by each funds inherent size bias.

	Performance vs FTSE ALL-Share		Performance vs Index adjusted for size bias of each fund
	5 years to end June 2015		5 years to end June 2015
Unicorn UK Income	<b>+80.1%</b>	Lindsell Train UK Equity	<b>+55.6%</b>
EdenTree UK Equity Growth	<b>+70.3%</b>	Jupiter UK Growth fund	<b>+50.2%</b>
FP Miton Undervalued Assets	<b>+69.6%</b>	EdenTree UK Equity Growth	<b>+46.2%</b>
Lindsell Train UK Equity Inc	<b>+67.0%</b>	FP Miton Undervalued Assets	<b>+38.7%</b>
PFS Chelverton UK Equity Income	<b>+66.5%</b>	Majedie UK Focus	<b>+36.7%</b>
GVQ UK Focus	<b>+60.6%</b>	IP UK Growth	<b>+33.4%</b>
Jupiter UK Growth fund	<b>+58.9%</b>	GVQ UK Focus	<b>+30.3%</b>
Liontrust Special Situations	<b>+56.0%</b>	IP Children's	<b>+29.4%</b>
River & Mercantile UK Eq L/T	<b>+53.0%</b>	Threadneedle UK Eq Alpha	<b>+29.2%</b>
Unicorn Outstanding British Co	<b>+46.9%</b>	IP UK Strategic Income	<b>+28.4%</b>

	Performance vs FTSE ALL-Share		Performance vs Index adjusted for size bias of each fund
	5 years to end June 2015		5 years to end June 2015
Scottish Widows UK Select Gr	<b>-42.7%</b>	MFM Bowland	<b>-54.9%</b>
MFM UK Primary Opportunities	<b>-32.5%</b>	SLI UK Opportunities	<b>-54.1%</b>
M&G Recovery	<b>-27.9%</b>	AXA Framlington Monthly Income	<b>-52.4%</b>
F&C UK Alpha	<b>-27.8%</b>	Scottish Widows UK Select	<b>-49.9%</b>
AXA Framlington Monthly Income	<b>-24.0%</b>	M&G Recovery	<b>-45.3%</b>
L&G Growth	<b>-22.0%</b>	MFM UK Primary Opportunities	<b>-43.6%</b>
Henderson UK Alpha	<b>-18.9%</b>	F&C UK Alpha	<b>-43.2%</b>
Scottish Widows UK Equity Income	<b>-18.4%</b>	Henderson UK Alpha	<b>-41.8%</b>
Scottish Widows UK Growth	<b>-18.4%</b>	L&G Growth	<b>-35.7%</b>
Santander N&P UK Growth	<b>-15.9%</b>	L&G UK Special Situations	<b>-23.7%</b>

The value of investments can go down as well as up and investors may not recover the amount of their original investment.

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