Patience in Investing – The Exception

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My colleague Tom Bradley (president of Steadyhand Investment Funds) wrote a column in *The Globe and Mail* in September 2009 on the topic of mutual fund mergers and manager changes. In the piece, Tom opined that individual investors are far too patient when it comes to dealing with changes in their mutual funds. He noted, "They're (investors) quick to make moves based on short-term trends and performance, but slow to recognize the impact of fundamental shifts in personnel or investment approach."

At the time, Trimark had just changed managers on a few of its major funds, Ethical and Northwest mutual funds were proceeding with 18 fund mergers, and Bank of Nova Scotia was making organizational changes throughout its asset management platform. Anyone who follows this industry can attest that change is a constant.

Perhaps the biggest warning sign of pending change is when an acquisiton occurs. Prominent transactions over the past decade include: Investors Group-Mackenzie, Franklin Templeton-Bissett, Bank of Montreal-Guardian Group, Manulife-AIC, IGM Financial-Saxon, National Bank-Altamira, IGM Financial-Cundill, and Royal Bank-PH&N.

More recently, we've seen AGF purchase Acuity, CI acquire Hartford's Canadian arm, and Bank of Nova Scotia buy DundeeWealth (the parent of Dynamic funds). Further, with many large corporations and banks flush with cash, there is speculation that the consolidation wave will continue to roll.

Consolidation can be beneficial to both parties involved. There are often cost savings and synergies to be recognized (economies of scale) and bilateral access to intellectual capital, research, vendors, etc.

Investors, however, should focus more on people and philosophy than economies of scale – which are seldom passed on to unitholders in the form of lower fees. To quote my colleague, "a fund's performance will ebb and flow, but its principles and people should not." A solid long-term track record is built through the combination of a focused philosophy and process, and a smart trigger puller (lead manager). These are the valuable intangibles in any acquisition.

Yet, as is often the case, people leave and the philosophy and process gets watered down following the acquisition. Change may occur immediately or it may be phased in gradually (particularly during periods of underperformance). As well, the corporate culture can change, which may be demotivational to employees. Further, when two companies amalgamate, there are the requisite fund mergers that follow (small out-of-favour funds are often merged into larger funds). It is when there are changes to personnel and philosophy that investors are too patient.

Part of the reason for the complacency is that assessing any changes in process and people isn't easy. After a merger takes place, it's difficult to see what's happening through the closed doors. Which managers' responsibilities are being shifted? Which fund is being re-positioned or assigned a different mandate? How is the new team getting along? Not surprisingly, the fund companies will put a positive spin on any acquisition or fund merger and can be convincing in their communications. After the "new car smell" has worn off, however, there may be little communication on important behind-the-scene changes.

The impact of a fund merger can be substantial. Tom provides a good example:

You receive notice that your international equity fund is being merged into a global dividend fund. You're told the new fund has performed better and has the same fee. (Note: this is not an extreme example – over the past five years a slew of conventional equity funds became "dividend" funds.) So what has changed? Well first, the mandate of the fund has been altered by expanding the geography (global includes the U.S., international doesn't) and restricting the investment approach. The fund is now constrained to dividend-paying stocks, so it's unlikely that technology, resources or emerging markets will be included. And you have a new portfolio manager.

What looks like a simple name change on your statement represents a dramatic change of personnel, approach and the role the fund will play in your portfolio. And in some cases, by merging a poor performer into one that is in a hotter category, the fund company is doing exactly what it doesn't want you to do – chase performance.

There are circumstances where an acquisition will have little impact on investors and they will be well served to do nothing. For example, a fund company may purchase a competitor and keep it as a separate, unique entity without making personnel and/or operating changes (e.g. fees, distribution, marketing, etc). This tends to be the exception rather than the norm, however.

Further, there are instances where the replacement of a manager may benefit investors. A perennially underperforming fund, for example, may need a new trigger puller. Nonetheless, investors need to keep in mind that a new manager may bring a strategy and direction to the fund that doesn't fit with their original reasons for buying it.

The bottom line: if you own a fund that has undergone a change in ownership, personnel, or approach, it's not the time to be patient. You need to re-assess your reasons for owning it. If the people and process have moved on, it may be time for you to follow.

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