

It's chest-beating time for index beaters



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The highest achievement of a mutual fund is to consistently beat the stock or bond index against which its performance is measured.

The reason: Most mutual funds fail to match the returns of their benchmark indexes. This explains why some people prefer index investing, where you simply buy a mutual fund or exchange-traded fund offering the return of any one of dozens of different North American and global stock and bond indexes.

Still, the fact remains that some funds do manage to beat the index over long periods of time. As we head into the home stretch of registered retirement savings plan season, it's an opportune time to recognize them.

To that end, this week's Portfolio Strategy column presents a list of index beaters in four fund categories: Canadian equity, U.S. equity, global equity and Canadian bond. Funds on the list meet two tough criteria, the first being that their compound average annual 10-year return to Jan. 31 was greater than the stock or bond index used to gauge its performance.

Right away, a lot of the chaff was blown away in the various fund categories. Among Canadian equity funds, for example, just 36 per cent of funds beat the index over the 10 years. Just 8.3 per cent of bond funds beat the index, 16 per cent of U.S. equity funds did so and 46.5 per cent of global equity funds managed the feat.

A fund that beats its benchmark index over 10 years certainly has some managerial expertise behind it, but that doesn't mean you necessarily want to be a client. The vagaries of fund performance data mean that a fund can intersperse a few superb years among a larger number of dismal ones and still come up with an impressive 10-year number through the impact of averaging.

The question is, do you like the idea of a highly volatile fund that wins big for you now and again but kills you in other years? For the purposes of this exercise, let's say no. Accordingly, the second criterion used to build the list of index beaters was that a fund must not have endured severe and extended slumps during the 10 years, or showed a pattern of being hot one year and stone-cold dead the next.

Do not be so naive as to think a fund that beat the index over the past 10 years will necessarily do so over the next 10. A whole world of eventualities can derail a fund -- maybe the manager leaves, or he or she falls victim to the investing version of Steve Blass syndrome, named after a Major League Baseball pitcher who posted some top years and then suddenly and irrevocably lost his mojo. Still, what better place to look for index beaters than among funds that have already managed the feat over 10 years?

If you're looking for RRSP buys, don't make that most elementary of errors and focus on the best 10-year performers on the list. Instead, give some thought to looking at the worst one-year performers in the group. The point here is to use a buy-low approach. All the funds in the group are proven performers, so why not look at the ones with the weakest recent results?

In the Canadian equity category, weak is a relative term. Fidelity Canadian Growth Company has returned about half what the S&P/TSX composite made in the 12 months to Jan. 31 at 15.6 per cent, but that's still a solid gain in the grand scheme of things. More importantly, the fund has been a five- and 10-year index beater with an average level of volatility.

Other blue-chip Canadian equity funds that have lagged the index recently while trouncing it in the long term include Saxon Stock, GBC Canadian Growth, IA Canadian Conservative Equity and Leith Wheeler Canadian Equity. All of these funds have stable, smart management teams that have been in place a long time.

An example of a 10-year index beater that you'd be buying high right now if you invested in it is Sceptre Equity Growth. This is an impressive fund in that it's the third-best performer on the Canadian equity fund list over both the past year and second best over the previous 10 years.

There are far fewer index-beating U.S. equity funds to choose from, a result of the fact fund managers have had a tough time beating the S&P 500 index over a long period. Of the 43 U.S. equity funds that have been around for a decade, just seven beat the 7.01-per-cent compound average annual return of the S&P 500 index in Canadian-dollar terms (four were selected for the list of index beaters).

The beaten-down index beaters in the U.S. equity category are Investors U.S. Large Cap Value and McLean Budden American Equity, both of which have been disappointing over the past five years. Note that the Investors Group fund has the overstuffed management expense ratio that is typical of this fund family, while McLean Budden is one of the lowest-MER funds in the category.

Dynamic American Value is a tough fund to call because its manager has been in place only since September, 2004. So far, so good, however. The final choice, Chou Associates, offers great returns and a much better-than-average safety profile.

The list of index beaters in the global equity category is full of funds that seem to be coasting on numbers built on strong performances of yesteryear and not anything that has happened recently.

Your willingness to buy funds like these should depend on how much faith you have in the ability of management. Ivy Foreign Equity is an interesting case study in this regard. Its five- and 10-year numbers beat the index cleanly, but the past few years have been a wasteland. Manager Jerry Javasky is a widely respected, conservative money manager who knows how to preserve client money in a down market -- if this resonates with you, then this index-beating fund might be of interest.

Index beaters are rare in the Canadian bond fund category for a simple reason -- with interest rates as low as they are and MERs in the category averaging 1.84 per cent, it's tough to outperform.

Still, one fund manager stands out for doing this. His name is Satish Rai and he runs a team of people that has achieved consistently excellent returns for unitholders of TD Canadian Bond and TD Real Return Bond. Altamira Bond is another top-performing bond fund, but it's quite a bit more volatile than some because it focuses on long-term bonds.

Consistent quality

Only a minority of mutual funds manage to beat their benchmark stock or bond indexes over the long term. Here is a selection of funds that have managed this feat over the past 10 years.

CANADIAN EQUITY	ONE-YEAR RETURN	10-YEAR RETURN	MER	MINIMUM INVEST- MENT
Northwest Specialty Growth	+26.37%	+17.49%	2.30%	\$500
Sceptre Equity Growth A	+2.77	+15.62	1.67	5,000
ABC Fundamental Value	24.21	+15.31	2	150,000
IA Canadian Conservative Equity	+23.95	+14.94	2.43	500
Leith Wheeler Canadian Equity B	+23.73	+14.15	1.5	25,000
CI Canadian Investment	+28.12	+14.05	2.38	500
Saxon Stock	+23.58	+13.65	1.87	5,000
GBC Canadian Growth	+20.37	+13.53	1.98	100,000
Northwest Specialty Equity	+28.08	+13.01	2.68	500
Fidelity Canadian Growth Company	+15.59	+12.76	2.51	500

A				
Renaissance Canadian Core Value	+22.6	+12.07	2.36	500
GGOF Canadian Growth Fund	+28.79	+12.03	2.54	500
PH&N Canadian Equity A	+24.43	+11.82	1.16	25,000
Dynamic Value Fund of Canada	+33.18	+11.52	2.66	500
Ferique Equity	+26.68	+11.48	0.63	500
MD Equity	+22.4	+11.34	1.44	3,000
AGF Canadian Stock	+27.14	+11.31	2.45	1,000
S&P/TSX composite total return index	+32.18%	+11.03%	-	-

U.S. EQUITY

Dynamic American Value	+18.10%	+7.73%	2.70%	\$500
Chou Associates	+12.57	+15.45	1.74	10,000
McLean Budden American Equity	+1.59	+8.71	1.25	10,000
Investors U.S. Large Cap Value C	- 0.07	+8.21	2.92	1,000
S&P 500 composite index (\$Cdn.)	+1.97%	+7.01%	-	-

GLOBAL EQUITY

MacKenzie Cundill Value A	+13.53%	+10.35%	2.14%	\$2,500
CI Global Small Companies	+11.02	+9.1	2.5	500
Templeton Global Smaller Co.	+0.87	+9.06	2.71	500
Dynamic International Value	+25.45	+8.9	2.88	500
Saxon World Growth	+9.67	+8.71	1.87	5,000
AGF International Value	- 0.58	+8.62	2.87	1,000
Trimark Fund SC	+5.21	+8.29	1.62	500
Orbit World	+14.67	+7.94	2.82	500
Trimark Global Endeavour	+6.9	+7.75	2.46	500
Renaissance Global Opportunities	+16.76	+7.73	2.45	500
MacKenzie Ivy Foreign Equity	- 0.05	+7.44	2.51	500
Trimark Select Growth	+5.29	+7.43	2.35	500
MD Growth	+8.53	+7.16	1.45	3,000
Bissett Multinational Growth F	- 1.79	+6.39	1.51	500
CI Global	+8.35	+6.19	2.5	500
Fidelity International Portfolio B	+12.02	+6.09	2.44	500
Fidelity International Portfolio A	+11.74	+6.06	2.64	500
Investors Global C	+14.39	+5.94	2.95	1,000
Investors Growth Portfolio C	+13.42	+5.82	3.08	1,000
FMOQ International Equity	+8.13	+5.81	0.95	500
MSCI World index (\$Cdn.)	+8.65%	+5.79%	-	-

CANADIAN BOND

TD Real Return Bond	+8.27%	+8.88%	1.62%	\$1,000
Altamira Bond	+7.33	+8.03	1.58	1,000
TD Canadian Bond	+4.5	+7.69	1.07	1,000
Scotia Capital Universe total return index	+4.79%	+7.49%	-	-

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