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THE FEES VERSUS PERFORMANCE CONUNDRUM

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How would you like to engage a fund manager who ***will not receive a single dollar, as long as the portfolio is not profitable?*** This is exactly what you will get, when you invest with Unicorn Financial Solutions.

Offering such a fee structure is almost unheard of in the financial industry today. It should be of comfort to you that such a fund manager exists in Singapore. It is also a set-up which investors locally – and globally – have been yearning for. Most fund managers scoff at the hint of such an idea.

Unicorn currently avails this **performance-based** service to clients via two platforms – **Unicorn Discretionary Management Service (UDMS) and Unicorn Securities Advisory Service (USAS).** The differences between the platforms are in the minimum investment sum required (S$500,000 for UDMS compared with S$200,000 for USAS) and that USAS has a ***one-time only*** set-up fee.

Unicorn is also exploring the possibility of reducing fixed fees in favour of performance fees for our managed-funds clients. This is ***if and when*** we have the licence to manage their portfolios, rather than the current practice of providing advice only. This idea though, is still in its infancy, and it could be a while before it comes to fruition.

Investors' Problem With Fund Managers

US$100 billion! That's the amount investment guru Warren Buffett poignantly estimated that pension funds, endowments and wealthy individuals have lost in the last decade to hedge funds and other money managers that charge sky-high fees.[1]

At first glance, it seems that Buffett is not a fan of an investor's use of fund managers. But upon closer inspection, you will realise that he is actually misquoted and misinterpreted. **In essence, Buffett's beef with fund managers is that they charge high fees *while* frequently falling short of their promise to outperform indices such as the S&P 500.**[2]

Being a fund manager himself (Berkshire Hathaway essentially operates like a hedge fund, although it is structured as a holding company) – and a highly successful one – it would be ludicrous for Buffett to imply that the use of a fund manager is a death knell for all investors.

Having wrongfully misunderstood Buffett's real contention with fund managers, many investors were quick to seize this 'opportunity' and lament about the high fees that they suddenly believed were levied by their fund managers. Comments in social media such as 'gross' and 'unjustified' were prevalent after Buffett's comments above. **And it was not just about high fees.** ***It's <u>any</u> fees.***

In many aspects of life, indeed, paying top dollar does command top-grade products or services. However, we have all known that this is not always the case. This is especially so in the realm of investing.

For example, should you ask a shareholder of Berkshire Hathaway if he or she would have any issues with paying Buffett high fees, given the well-documented and impressive returns he has been generating over the last few decades, I will find it hard to believe that the answer is yes. (A US$1,000 investment into Berkshire Hathaway in 1964, when Buffett took charge, is worth about US$18 million today!)[3]

What Should An Investor Do?

For a start, forget about the amount of fees a fund manager is charging. We suggest that you look at his **fee structure** instead. We believe that this can reveal a great deal about his motivations and intent. I will use the following example to illustrate my point.

Let's say you are a shareholder of an ailing company that is looking for a new Chief Executive Officer (CEO) to turn your company around. A candidate offers the following pay (fee) structure to you: he **<u>will not</u>** receive a single dollar as long as the company is not profitable. But when he has turned things around, he should be rewarded with a 20-25% cut of the profits.

What does this say about this candidate's motivation and intent?

Firstly, he or she has his interest aligned with you, the shareholder. Both of you sink or swim together. You are paying only when there is performance. It is akin to an emperor asking his chef to taste the food that has been prepared to ensure that the quality of the food is what the chef will accept himself. What more can an investor ask for? It is easy to believe that the angst and agony that many investors feel today about fund managers probably stems from the fact that they do not think the fund managers are in the same boat as them.

Secondly, he or she is confident of his ability. Only someone who knows full well that he has what it takes to deliver results will throw down such a gauntlet. I will be surprised to find any fund manager today who will take on the idea of 'pay-me-only-when-I-have-delivered'.

Thirdly, he or she has the desire to succeed. As Napoleon Hill once said, 'I had learned, from years of experience with men, that when a man really desires a thing so deeply that he is willing to stake his entire fortune (or income, in this candidate's case) on a single turn of the wheel in order to get it, he is sure to win.'

The late Steve Jobs of Apple was such a CEO. In 1997, he returned to Apple as CEO and revitalised the company into the innovative tech giant that is the envy of many today. And Jobs' remuneration as CEO? A self-imposed annual salary of only US$1 a year – with stock options.[4]

Conclusion

Finding a good fund manager or financial consultant to take care of your portfolio is critical. Shareholders of Berkshire Hathaway will attest to that.

You should turn the way a fund manager structures his charges and fees in your favour. Use it like a microscope to magnify who the fund manager is and to scrutinise what he stands for. What is a bane to others becomes a boon to you. You now possess a tool to unearth one of the most important factors to a successful investing journey – finding a good shepherd who is really looking out for you, knows what he is doing, and is focused on growing your flock.

And when you do find it, it is worthwhile to note that quality comes with a price. But the reverse is not always true.

Source

[1] – Warren Buffett on Why Big Money is Losing Big Sums to Managers Who Charge Big Fees
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[2] – Buffett: The Hedge Fund's Biggest Profits Are Going to Managers, Not Their Clients
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[3] - Stocks Your Parents Should Have Bought The Year You Were Born
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[4] - Steve Jobs Still Makes a $1 Salary
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