

Interview with Wilfred Hahn, September 4, 2003

Interview by Donna Guzik

IC: Welcome to InvestorCanada.com. I'm Donna Guzik.

After the \$1.4 billion US settlement from US brokerages last year, New York Attorney General, Elliot Spitzer has now set his sights on cleaning up the mutual fund industry.

He started with a \$40 million settlement from a hedge fund that allegedly reaped huge profits from after-hours trading in several mutual funds.

The Securities and Exchange Commission has an ongoing review of both hedge funds and mutual funds and is working up some recommendations that would improve and increase disclosure requirements for both. So how are we doing in this country?

Wilfred Hahn is head of Hahn Investment Stewards in Grimsby, Ontario. He joins me now.

Wilf, help us understand, first of all, what's going on in the States. What does after-hours trading mean in mutual funds? What are they talking about?

Hahn: What Mr. Spitzer is referring to is a practice that's only possible in those funds that have different closing times than the daily valuation. Let me that explain that very briefly.

Four o'clock every day, mutual funds place their values on the unit values and on the instances of some funds that are traded primarily, or at least have assets that are traded primarily in foreign environments, different time zones, there's a huge gap.

For example, an Asian fund, let's say it's listed in Hong Kong or based out of Hong Kong, the trading will have closed in that market 12 hours before. So during that 12-hour interval, there is room to do some trading before the final valuation date, that day at four o'clock.

IC: How do you get around that? I mean, if funds are traded in different

time zones.

Hahn: I'm not familiar with all the exact details of how they are doing it, but apparently Mr. Spitzer alleges that there are some fund companies that open their funds for trading, at least to some hedge fund managers, during that interim, allowing them to take advantage of any price movement that may have occurred during that time.

Some of these stocks that are in some of those mutual funds, even though they may be closed of trading during the earlier part of the day, for example, are inter-listed and continue trading around the clock, around the world.

IC: This shines a spotlight once again on the fund industry in North America and when we look at Canada, as investors, are we right to wonder about the fund industry here and whether or not it's serving our needs?

Hahn: Well, I think that's always a good question. Is the mutual fund industry serving our needs? The issue that Mr. Spitzer has highlighted is only one issue and it's kind of a sideline issue.

I think there's much greater questions to ask and that is, is the mutual fund, as you put it, serving clients? Are there practices that could be better? What is the record? And how can things change to serve clients' investment needs and retirement needs better?

IC: One of the things that the US is also looking at, of course, are the disclosure requirements for mutual funds and fees. Do you think in Canada, the disclosure requirements are good enough and are the fees good enough?

Hahn: I think the disclosure side of things isn't too bad in Canada, at all. It's a matter of understanding what those things are once they're disclosed.

There are definitional things and so

on and so forth and one has to be up on the technical definitions in other words to really understand what all the disclosure are required. But I'm not so certain there's a great deficiency in that side of things.

There is maybe one point, and that is that sometimes it's difficult to get an up-to-date picture as to what actually is in a mutual fund. Sometimes fund companies only will reveal what their top-ten holdings are and they probably have some good reasons for that, competitive reasons; but by and large, it's sometimes hard to get an up-to-date picture.

IC: There's been a lot of criticism here about the fees, management expense ratios. And the fund industry says that you get what you pay for. You're getting some top notch management, you're getting good advice, you're getting the expertise and, as well, there's a distribution network to deal with, so that's fair.

Hahn: You get what you pay for, but what is one getting and what was one hoping one was getting? It's fine to pay high fees for high-value services, but what is the result? What's the fruit of those high-value services?

And I think the research shows conclusively that overall, the fund management industry does not offer the services that they pretend to charge for.

For example, just looking at performance, that's only one issue. There's lots of research around that says that mutual fund managers, as high paid as they may be and as expert as they may be, have not out-performed over a long periods of time. In fact, the industry overall, once fees are deducted, is under-performing the indices.

IC: But can Canadian fund companies lower fees and still make a good profit?

Hahn: My contention is yes. We

...continued from other side

expect higher productivity from many industries. I mean, that's one of the underlying premises of finding a good company to invest in, if one is a stock investor.

We're always looking for companies that can boost profits by doing things cheaper, more intelligently and so on, so forth. And the mutual fund industry I think has, the investment industry overall I think has those opportunities but hasn't been taking them. There are new ways.

There are new approaches and I don't see that really being taken advantage of.

IC: What kind of new approaches?

Hahn: Well a number. We haven't really talked about the whole advice component and I think that's another important problem that needs to be addressed with the wealth management industry overall. But sticking to the question, there are new kinds of vehicles. I'll mention one in particular. There's a new class of investment called exchange traded funds.

Just to explain what those are very briefly, they're kind of like index funds. Only they're listed and you can get exposure to the various groups of asset classes and different types of investments here in North America abroad and so forth.

And the MERs, in other words, the expense ratios that are embedded in those are very, very inexpensive and, in fact, lots of good research early in the game for these ETFs showed that they're very, very competitive vehicles. That's one thing.

I only illustrated one example, but then there's new technological platforms. I think there are new ways and new portfolio management systems, for example, just to issue one, that allow fund management companies and wealth management companies to reduce fees and costs.

IC: You mentioned the advice component. What are we missing here?

Hahn: Well, when I say advice

component, what I'm really referring to there is the responsibility of wealth management advisors. I mean, after all, as they say, we're worth what we're paid for. So what are we supposed to be worth? And I think one of those components is offering good advice.

I mean, you look at the evidence.

I'll just cite some here, some very reputable organizations have come up with these. For example, John Bogle's Foundation, just a quick example, since 1990 – I'll take the stock market example only, not diversified investments, but stock markets only – the index, the S&P 500, for example, and then index of the US stock market has gone up an average 11.2 percent between 1990 and 2002.

The average mutual fund, equity mutual fund has done somewhere around 9 percent. So there you can see that disparity. That's already two percent under performance.

But the average investor – and this is key, this is criminal, almost – has only performed 2.6 percent. And why is that? And that is, I believe, for two reasons.

The industry is very much oriented to selling product, selling mutual funds – that's the whole focus – as opposed to recommending funds when they are appropriate. And the second reason why, we're all human beings. We sometimes get dragged into trends too late and we tend to buy high and sometimes not buy low.

IC: But if the fund industry is offering the consumer, the investor only what they're asking for, then who's at fault?

Hahn: That's a valid contention, Donna. But I question the abilities of the average individual to do that. I'm sure good common sense helps. I think everybody with a good measure of common sense can not do too badly investing. But I don't think most people are.

There are some do-it-yourselfers, but the rest of us, we need some help.

When's a good time to invest in

stocks and bonds? When should one shift that around a little bit? How can I best diversify my portfolio for the retirement needs that I have?

Most of us I think don't have the time to do that.

IC: And so we need that advice?

Hahn: That's right.

IC: Is the price of that advice fair right now?

Hahn: I think getting good advice is worth a good fee, there's no question about that, and I think there's always room for the wealth management industry to offer that service and charge a good fee for it. But we don't see the evidence.

The research does not show it. There is no evidence that that advice has been worth very much. In fact, as the statistics have revealed, as I've shown, that's not been the case. The average investor out there, whether he's been advised or not, has not done very well.

And I sometimes use the analogy of the money management business being like the pharmaceutical business. You know, we're dealing with drugs in a sense.

Money needs to be dealt with advisedly and there's a duty of prescription. It's not just about selling something over the counter just because the client wants it.

We have professionals that we expect to give us some good advice as to what kind of product we should be buying, and I think the same applies to the wealth management industry.

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