

HIGH-TURNOVER FUNDS DEFY CONVENTIONAL WISDOM

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When Noah Blackstein buys and sells stocks for his \$395-million Dynamic Power American Growth Fund, he pulls the trigger with gusto.

Regulatory filings indicate his annual portfolio turnover over five years ended June 30, 2007, ranged from a low of 743 per cent in fiscal 2006 to a high of 1,265 per cent in 2003. In calendar 2000, it was as high as 2,121 per cent.

"I certainly have high turnover," said the 38-year-old manager with Goldman Investment Counsel Ltd. "But a large part of that is trading around core positions."

Active trading in his U.S. stock fund hasn't hurt performance. He has beaten the S&P 500 total return index in Canadian dollars terms over the long haul without currency hedging. Over the five years ended March 31, his fund posted an annualized return of 12.7 per cent compared with 3.6 per cent for his benchmark.

Mr. Blackstein is among the portfolio managers who are bucking conventional wisdom, which suggests that funds with high turnover tend to have inferior performance longer term because they rack up trading costs that eat into returns.

Portfolio turnover is a measure of how many times a fund manager flips his securities every year. If the turnover ratio is 100 per cent, it may mean that all of a fund's securities were bought and sold in a year.

It's worth paying attention to high turnover because this trend can increase a fund's brokerage costs calculated as the trading expense ratio (TRE). (You can find the ratio and TRE for a fund in its Management Report of Fund Performance filed on sedar.com.)

TRE is a hidden cost that is not part of the management expense ratio (MER), which includes fees for managers, advisers and operating costs. For example, a fund with an MER of 2.55 per cent and TRE of 1.3 per cent would have 3.85-per-cent deducted from its return.

Turnover can affect returns, said Legg Mason Capital Management strategist Michael Mauboussin. He found that low-turnover funds performed better than their high-turnover peers over three, five and 15 years after analyzing U.S. stock fund data until 2006.

Funds with turnover of 100 per cent or more posted an average annual return of 6.6 per cent over 10 years and 8.8 per cent over 15 years. However, its peers with a turnover of 20 per cent or less garnered an annualized return of 9.5 per cent over 10 years and 11.2 per cent over 15 years.

Dan Culloton, fund analyst at Chicago-based Morningstar Inc., echoed that **"additional transaction costs, plus the risk of picking the wrong times to get back in and out of securities ... erodes returns over time."**

Dan Hallett, a Windsor, Ont.-based independent fund analyst, said low turnover is advantageous because it means investors are less likely to incur capital gains from a manager selling a stock if a fund is held outside a tax-sheltered registered retirement savings plan.

Some managers, however, will increase turnover in funds to reduce taxes - crystallizing losses from certain stocks to offset capital gains, Mr. Hallett added. "High turnover is not necessarily a

bad thing ... If the manager has done very well, then their trading has added value ... At the end of the day, it depends on the skills of the manager."

Mr. Blackstein attributes the high turnover in Dynamic Power American Growth partly to running a portfolio of about 20 stocks. "If I bought and sold 20 stocks, it would be a 100-per-cent turnover," whereas it would be a 20-per-cent turnover for another manager with 100 stocks, he said.

His fund includes names such as Apple and Google. If some of those stocks climb to about 10 per cent of his fund, he may sell their shares to reduce their weightings down to 3 or 4 per cent to manage risk in the portfolio. "Buying and selling those shares count as turnover," he added.

Peter Hodson, who runs Sprott Growth Fund at Sprott Asset Management Ltd., is another top-performing manager who is an active trader.

His fund's turnover was 335 per cent in 2007, and 341 per cent in 2006. But his fund also has posted a robust 16.6-per-cent annualized return for the two years ended March 31, compared with 3.8 per cent for the S&P/TSX completion total return index.

He actively trades about 25 out of his 61 names. Because it is not uncommon for a stock like Kinross Gold Corp. to jump \$1.50 on a day, Mr. Hodson might sell a small portion - say 150,000 out of his 950,000 shares - and then buy back that holding again when the price drops.

"I do opportunistic trades in volatile liquid stocks," he said, adding that he might only sell out six to eight stocks annually. "It also depends on the year. In 2006, I had 13 takeovers in the portfolio."

Mr. Hodson, whose fund has had no distributions since inception, also attributed higher turnover to selling stocks that might be in the red to reduce any potential capital gains.

Peter Loach, managing director of fund research at BMO Nesbitt Burns Inc., is not concerned with high turnover in funds as long as a manager can still outperform.

"Value managers tend to have low turnover. Growth investors tend to have high turnover. The alpha from high turnover has to justify the cost. If it does, then it's worth it."

An active trader

Dynamic Power American Growth Fund Series A

Fiscal year ends June 30th	2007	2006	2004	2003
Management expense ratio*	2.55%	4.34%	3.90%	2.70%
Trading expense ratio	1.30%	1.03%	1.71%	3.63%
Portfolio turnover rate	827.94%	742.76%	761.56%	1265.39%
One-year return to June 30	19.74%	2.81%	33.18%	11.46%

*Includes performance fee

MAGGIE WONG/THE GLOBE AND MAIL; SOURCE: MANAGEMENT REPORT OF FUND PERFORMANCE

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