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STUDY: 65 PERCENT OF INVESTMENT STRATEGIES HAVE SHORTER INVESTMENT HORIZONS THAN INTENDED

More Turnover Can Create Higher Trading Costs and Indicate Investment Process Issues

New York, NY, 9 February 2010 – Some active equity fund managers have higher portfolio turnover rates than they themselves claim, a new study finds. Nearly two-thirds of institutional investor-focused investment strategies exceeded their expected turnover from June 2006 through June 2009. Of these strategies, the turnover was on average 26 percent higher than anticipated, with some strategies reporting turnover between 150 and 200 percent more than expected.

The new report, [*“Investment Horizons – Do Managers Do What They Say?”*](#) demonstrates that investment managers themselves underestimate turnover and often do not live up to their stated claims when it comes to the holding periods for the stocks in their portfolio. The study, conducted by [Mercer](#) and funded by the not-for-profit [IRRC Institute](#) examines the investment horizon of active equity investment managers, comparing various strategies, different geographies and styles between June 2006 and June 2009.

"Short-term investing is often cited as an issue by the press, policymakers, academics, and many in the business and investing community," noted Jon Lukomnik, program director for the IRRC Institute. "What has not been recognized until now is that this is not only particular to day traders or arbitrage funds or others who may have short time horizons by design. When two-thirds of long only equity institutional investment products have turnover that exceeds what they themselves expect, there is a systemic issue."

"The findings should raise serious questions for investors," Lukomnik continued. "When managers greatly exceed their expected turnover level, the impact can be significant in terms of cost, performance, and risk that the strategy is not being managed in line with its stated investment approach."

"A deviation in actual versus expected turnover can be a possible indicator of deeper problems with investment processes," said Danyelle Guyatt, the head of research for Mercer's responsible investment team and the report co-author. "Clients interested in a strategy that seeks to capitalize on longer-term trends and hold stock in corporations for longer periods need to be aware if that situation is changing and why," she added.

Study: 65 percent of investment strategies have shorter investment horizons than intended

The study deployed two approaches to the data analysis. First a quantitative analysis of portfolio turnover of over 900 strategies examined intended and realized average holding periods for various investment products across different regions and styles. Then Mercer researchers conducted a qualitative case study analysis on eight active equity fund managers.

The key findings of the **quantitative analysis** include:

- Nearly two-thirds of strategies have turnover higher than expected, with some strategies recording more than 150-200 percent higher turnover than anticipated. Of the 822 strategies for which Mercer had expected and actual turnover information, 550 exceeded the turnover during the sample period. The average turnover was 26 percent higher than anticipated.
- Within the entire sample of 991 strategies, the average annual turnover of the sample is 72 percent, with some 20 percent of strategies having turnover of more than 100 percent.
- Value managers tend to have a lower annual turnover figure than the other style types. Large capitalization portfolios have lower turnover rates than small capitalization strategies, and socially responsible investing (SRI) strategies have lower turnover than non-SRI strategies.
- Across regions, UK, Canadian and Australian equity strategies have the lowest average turnover value, while European (including UK), international and US strategies have the highest average turnover levels.

The key insights from the qualitative **case study analysis** from the fund managers include:

- Causes of short-termism¹ include volatile markets and changing macroeconomic conditions; mixed signals from clients; short-term incentive systems; and behavioural biases;
- Fund managers recognize the potential destructive nature of short-termism even while claiming it was unavoidable. The managers indicated that short-termism potentially places short-term pressure on companies; increases market volatility; demonstrates a lack of discipline in fund managers' investment processes; and creates a misalignment of interests between fund managers and their clients.
- The managers also identified potential solutions to short-termism, further details of which can be found in the report.

The complete study, *Investment horizons – do managers do what they say?* is available, free of charge, at www.mercer.com/ri.

¹ For the purpose of this study, in absolute terms short-termism is defined as an average holding period of 12 months or less (equivalent to 100 percent p.a. or higher turnover). In relative terms, it can also be measured as a higher actual level of turnover than expected levels as self-reported/used in promotional material.

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The IRRC Institute is a not-for-profit organization headquartered in New York, NY whose mission is to provide thought leadership at the intersection of corporate responsibility and the informational needs of investors. More information is available at www.irrcinstitute.org.

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