FTfm Netherlands

Hedge funds and PE are weak performers after creaming off large fees

Analysis of pension funds in Britain and Netherlands raises new worry over value for money

Chris Flood SEPTEMBER 1, 2018

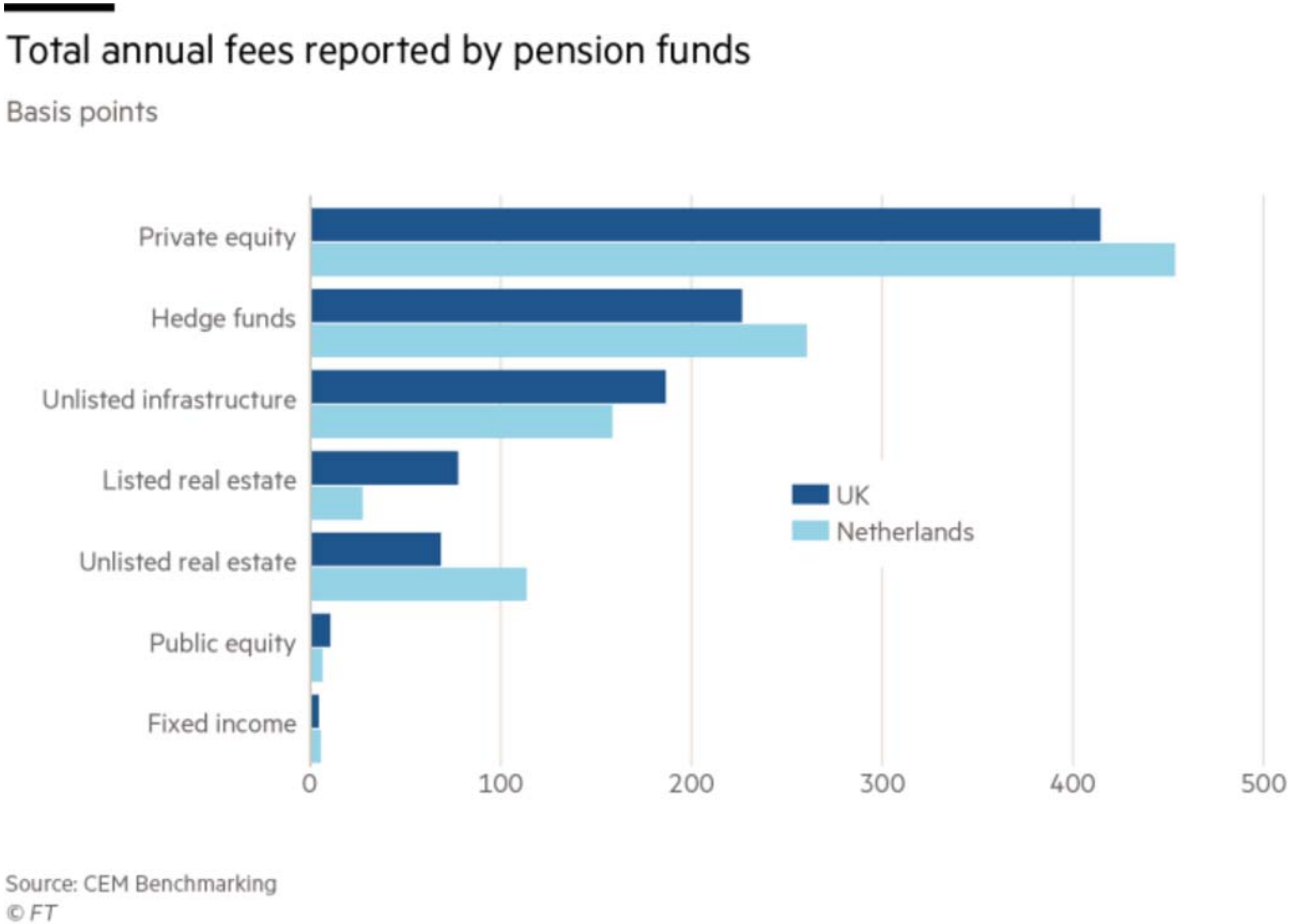
Private equity and hedge fund managers have delivered lower returns after fees than investments in stock markets and property, according to a study that looked at leading pension schemes in the UK and Netherlands since 2010.

The findings by CEM Benchmarking, a Toronto-based investment consultancy, raise more questions about whether lavishly rewarded managers are providing value for money to clients.

CEM, which specialises in providing analysis for institutional investors, examined the returns and fees recorded by 42 UK and 48 Dutch pensions schemes.

UK pension funds registered annualised returns of 9.1 per cent from private equity after fees were taken into account between 2010 and 2016, compared with net returns of 10.3 per cent and 10.4 per cent from their investments in stock markets and listed real estate.

Pension funds in the Netherlands recorded net returns of 9.6 per cent from private equity over the same period, also falling short of the 9.9 per cent and 10.4 per cent net returns delivered by public equities and listed real estate.



The performance shortfall was due entirely to the higher fees charged by private equity managers. UK and Dutch pension funds paid an average of 415 basis points and 454bp in fees respectively to private equity managers.

"Private equity was the best-performing asset class before costs but public equity and listed real estate delivered higher returns after fees are taken into account for UK and Dutch pension funds," said Alex Beath, a senior analyst at CEM.

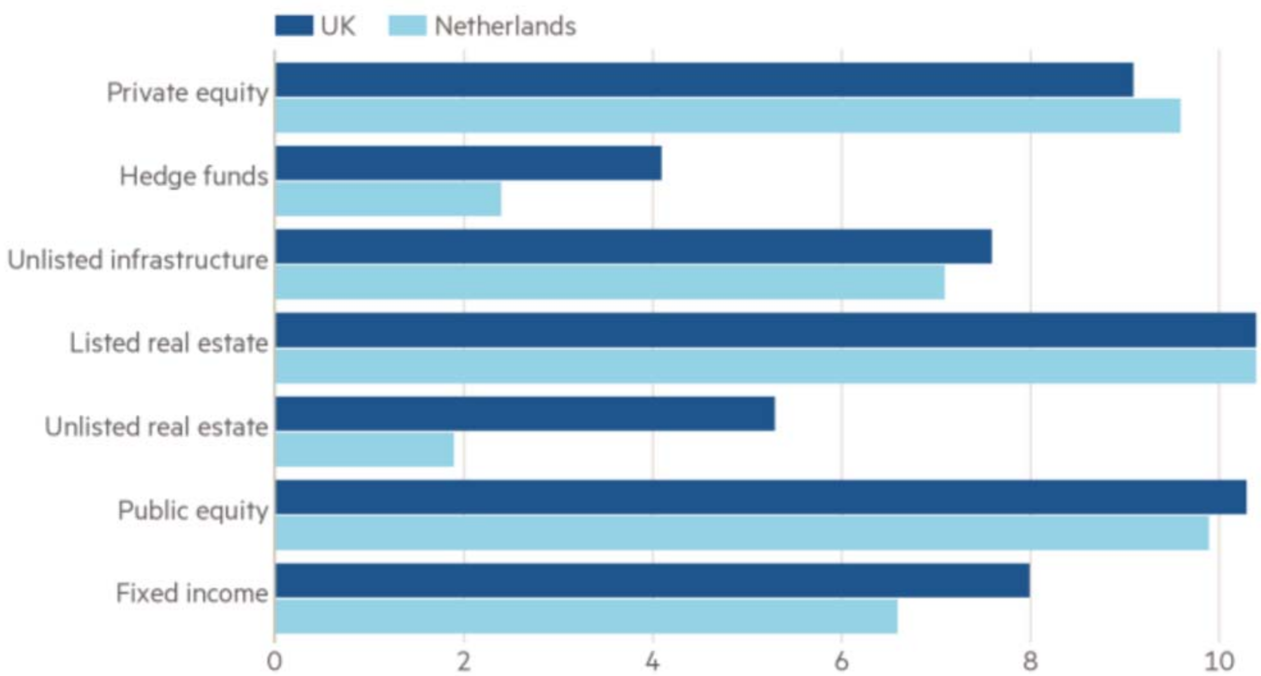
He said there was a "huge disparity" of costs for private equity investments as in-house PE programmes run by pension schemes could operate for as little as 50bp annually while a fund of PE funds could cost up to 700bp a year.

"The highest-cost PE programmes tend to be the worst performers, so it is vital for pension schemes to understand the true costs of their private equity investments," said Mr Beath.

Volatility for returns reported from private equity investments was also significantly higher than any other asset class. Differences in the styles of private equity managers employed by pension schemes can lead to even higher volatility.

Annualised net returns reported by pension funds

2010-16, %



Source: CEM Benchmarking

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UK pension funds held about 5.1 per cent of their assets with private equity in 2016, more than twice the 2.3 per cent holding of their Dutch peers.

Hedge fund managers delivered the worst performance of any major asset class, with net returns of 4.1 per cent and 2.4 per cent respectively for UK and Dutch pension schemes between 2010 and 2016.

UK pension schemes held about 4.6 per cent of their assets with hedge fund managers in 2016, compared with an average holding of 1.1 per cent by their cautious Dutch peers.

Dutch pension schemes, however, paid out more to hedge fund managers with fees averaging 261bp, compared with the 227bp paid by UK retirement funds.

Inigo Fraser-Jenkins, an analyst at Bernstein, the brokerage, said the distinction between traditional actively-managed investments and so-called alternatives, such as private equity, was "fake" and should be abolished.

"It gets in the way of efficient asset allocation and efficient fee allocation. If investors could be persuaded to compare public market and private market modes of investment over the same holding periods, things would be different," said Mr Fraser-Jenkins.