

AKG ACTUARIES & CONSULTANTS LIMITED

**Citywire**  
**Funds Insider**  
**UK Ratings and Rankings**  
for  
**Citywire**

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**Produced by:**

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# CONTENTS

1. Introduction	3
2. Background	4
3. Data	5
4. Methodology	7
5. Summary	9
Appendix 1. Information about AKG	10

# 1. INTRODUCTION

## 1.1 Background

This report has been prepared for Citywire.co.uk ('The Client') in respect of its Citywire Funds Insider™ product.

AKG Actuaries & Consultants Ltd (AKG)'s original assignment was as follows:

- To review the methodology inherent in the calculation of individual fund manager rankings.
- To review the methodology inherent in the calculation of individual fund manager ratings.
- To carry out sufficient testing of the system to ensure the methodology is accurately translated into the computer code underpinning the production of rankings and ratings.
- To audit the fund manager data held on the system.

AKG originally reported on the system and methodology supporting UK fund manager rankings in February 2001. Following that report there have been a number of amendments to the methodology, for which AKG has issued updated reports. This report has been produced because of a change to the ranking calculation for Fund Managers, initiated in January 2007. This report should be read in conjunction with previous reports, available on request.

AKG reports separately to the Client with respect to rankings and ratings for markets other than the UK.

## 1.2 The Process

This report is based on information supplied by the Client and supplemented by visits to their offices.

## 1.3 Reliances and Limitations

Much of the information upon which AKG's comments are based was supplied by the Client. AKG have relied upon the accuracy of such information, and cannot accept any responsibility for any inaccuracies or omissions.

AKG personnel are available to discuss this report, if required.

## 1.4 Confidentiality

AKG is happy for the Client to reproduce all or part of this report in any internal or external published material, subject to:

- prior agreement of the content, context, duration and volume of such reproduction and of any reference, explicit or implicit, to AKG's involvement in producing this report
- payment of such additional fees as may be mutually agreed between AKG and the Client.

## 2. BACKGROUND

It is the Client's contention that there is a widely held view that fund performance is variable over time and therefore that past performance statistics offer a poor way for investors to make sensible investment decisions.

Citywire believes one of the core reasons for this lack of persistency is the 'noise' within the performance numbers generated by turnover of fund managers.

The objective of Citywire Funds Insider™ is to identify the personal performance track records of individual unit trust managers, rather than focus on individual funds.

Citywire Funds Insider™ is based on the performance of actively managed funds generally available to the public. Rankings and ratings are currently produced for fund managers in the following 24 IMA unit trust sectors:

Active Managed
Balanced Managed
Cautious Managed
UK All Companies
UK Smaller Companies
UK Equity Income
UK Equity and Bond Income
UK Other Bond
UK Corporate Bond
UK Gilt
Global Bonds
Europe Including UK
Europe Excluding UK
European Smaller Companies
North America
North American Smaller Companies
Japan
Japanese Smaller Companies
Far East Incl. Japan
Far East Excl. Japan
Global Growth
Global Emerging Markets
Specialist
Technology & Telecoms

## 3. DATA

### 3.1 Fund Performance data

The fund performance data is supplied by Lipper, a Reuters company.

Performance data in respect of each fund is supplied each month. The data shows the monthly percentage gain or loss (or Total Return) for the selected unit type in each fund over each of the previous 36 calendar months. Lipper also provides an equivalent gain or loss each month for each sector.

Both the Client and AKG have relied on the accuracy of the data supplied by Lipper in establishing the methodology. The Client is aware, from time to time, of minor differences in successive data feeds following corrections being processed by Lipper. These are outside the control of the Client, but are not important in the calculation.

The Client does not maintain or edit the fund data in any way. Historic data (i.e. previous data feeds) is not used in producing rankings, the latest data feed having effectively overwritten previous data. The system therefore only holds data for the previous 60 months.

### 3.2 Individual Fund Manager data

The database contains reliable career histories of virtually all fund managers who have managed unit trusts within the 24 key unit trust sectors since 31 December 1997. The career histories are gathered directly from the fund management companies, and then checked and updated regularly by a team of dedicated researchers at Citywire.

Details of the career history of a new fund manager(s) (subject to a maximum of three individual managers per fund) for the management of an individual fund may be submitted to Citywire by a fund group. The new fund manager(s) will be eligible for inclusion in the Citywire Funds Insider database when the fund group is able to supply a contemporary fund factsheet or relevant interim or annual fund report highlighting the individual as a manager on the fund. No deputy managers, assistant managers or analysts will be eligible for inclusion.

A fund management group may request a retrospective change to the career history of a fund manager or managers attached to an individual fund. Citywire will require the group to supply current fund factsheets or interim or annual fund reports to support the proposed change(s) before any change to the Citywire Funds Insider database will be made.

In cases where the exact joining date is unknown, dates default to the first of that month.

An integral part of the process is that the data has been confirmed and verified as correct by a named person within the fund management company running each fund. If, at any time, a fund management company is unable to verify the current fund manager of a specific fund, the fund's performance record would be excluded from the calculations.

The data is re-verified (by telephone and e-mail) for each fund, at least once a quarter. Each input has to be approved by a checker and all activity is logged, with a date stamp and the user ID of the individual entering and/or checking the data.

Three types of data are entered:

- 1) Management companies.
- 2) Manager careers for individual funds.
- 3) Manager personal information, the minimum being 'name'. Some managers have more detailed information such as date of birth, career history and biographies which is based on details provided by the fund management groups.

AKG has previously carried out a review of the extensive paper files containing the results of the ongoing telephone-based project. AKG compared a significant proportion of the fund manager records held on system with the paper records and found a high level of agreement. A small number of keying errors were referred for correction. Other queries were dealt with by the individual responsible for the data collection exercise, who displayed an extensive knowledge of both the funds and the fund managers.

Following discussion with the Client it was agreed that an ongoing review of the database is no longer practical. Furthermore the process by which data is gathered and subsequently verified is itself largely self-checking.

### 3.3 Information Ratio

The Information Ratio is defined as the Annualised Average Excess Return divided by the Tracking Error. It reflects how much 'added value' in terms of outperformance against the benchmark the fund delivers for each 'unit' of risk assumed (where risk is defined as *not* tracking the index, i.e. *not* mirroring the index's return).

Citywire assigns appropriate benchmarks to each fund according to the fund's sector and specific investment objective. Each month Citywire screens all funds in the database to identify:

- 1) new funds that were not in the system the month before, along with the benchmarks assigned to these funds by the fund management groups and Lipper
- 2) any changes the fund management groups have made to the benchmarks of their funds
- 3) any changes the fund management groups have made to the investment objectives of the fund.

In the cases listed above Citywire will assign the most appropriate benchmark in its opinion. When a fund management group approaches Citywire to have a benchmark altered, the group will be requested to supply in writing (e-mail acceptable) a "reasons why" statement for the group along with an up to date breakdown of the fund's full portfolio. Citywire will examine whether the proposed benchmark is appropriate compared with what is actually in the portfolio.

The Excess Return is calculated separately for each month of the 36-month period, and is equal to the actual percentage return in any one month less the return on the appropriate index (e.g. if the index rises 1% in one month but the fund generates a 1.5% return, then the Excess Return (i.e. added value) for that month is 0.5%).

The Excess Returns are averaged over the period.

The Standard Deviation of the Excess Returns is also calculated.

Both the Average Excess Return and the Standard Deviation are annualised (for returns the standard approach is to multiply by 12, for standard deviations to multiply by the square root of 12). The Annualised Standard Deviation of the Excess Returns is called the Tracking Error or Tracking Risk (reflecting the extent a fund's return deviates from its benchmark returns).

### 3.4 Citywire Manager Ratio

The Citywire Manager Ratio is based on the Information Ratio.

Where a manager runs only one fund in a sector the Information Ratio is calculated as in 3.3 above. The manager must have a minimum of 30 months for the 36-month ratio (8 months for the 12-month ratio). Where the number of months is less than the maximum the ratio is multiplied by actual months/potential months (e.g. 30/36).

Where a manager runs more than one fund within the same sector and they have the same benchmark the Information Ratio is calculated based on an average monthly return for the two (or more) funds, adjusted as above.

If the funds have different benchmarks then they are treated as totally separate funds, in particular the 30-month rule will apply to each fund rather than overall. The separately calculated weighted Information Ratios are then averaged to give the Manager Ratio for the sector.

The above process is repeated for each sector the manager runs funds in, and the resulting separate Manager Ratios are averaged to give an overall figure.

## 4. METHODOLOGY

### 4.1 Fund selection

The focus of Citywire Funds Insider™ is purely on actively managed funds generally available to the public. Therefore there are a number of unit trust funds in each of the sectors that have been excluded from the analysis.

The principal fund exclusions are:

- 1) Institutional funds (not aimed at private investors).
- 2) Charity or exempt funds (not aimed at private investors).
- 3) Trackers and Quantitative funds (no, or minimal, active management by individual fund managers).
- 4) Funds with a minimum investment higher than £10,000.

Many unit trusts have different classes of units – accumulation, income, standard etc – whilst OEICs have different share classes.

Citywire Funds Insider™ tracks the units/shares highlighted by Lipper as the most popular, or mainstream, option offered by the firm. This does mean that whilst Funds Insider is tracking the products most widely held by investors (the prime intention), it does produce a mix of unit types.

When a fund merges with another fund, the fund management company decides which fund's performance track record goes forward. This performance track record feeds into the Citywire Funds Insider™ database to help create the individual fund manager rankings.

The initial population of eligible funds within any one sector was determined by generating reports from the Lipper Hindsight database. This population was then adjusted by removing any other funds that fail the criteria, e.g. quasi trackers.

### 4.2 Fund Manager Rankings

The career database (see 3.2) is tied to Lipper's fund performance database (see 3.1) and the performance of each manager's funds is combined to form an overall performance record. Performance is measured on a total return basis with gross income reinvested at the ex-dividend date, ignoring the effect of initial charges (i.e. bid-to-bid).

The overall manager's record will take account of both the number of funds each manager has run simultaneously and the different funds they have run over time, as well as highlighting 'career breaks' during the period.

The ranking is based on the total returns of each manager. This is calculated by cumulating the monthly performance of the funds managed. [Note: prior to January 2007, the ranking was based on the 'average monthly personal performance' of each manager. This was calculated as a simple average based on the monthly performance of the funds managed. Comparative examples seen by AKG using the two methods indicate that the effect of the change on individual manager rankings is minimal.]

Citywire Funds Insider™ ranks the individual fund managers on the total returns performance figure – expressed in percentage gains or losses – for each individual fund manager over specified time periods (currently 3 months, 1 year, 2 years, 3 years, 4 years & 5 years) over single or multiple funds within each unit trust sector. No account is taken of fund size, volatility or house style. No adjustment is made for differences in annual management charges between funds.

Where there is more than one manager of a fund, Citywire Funds Insider™ credits each manager with the performance equally, for the period a manager is verified as active. The active period for a manager is defined as including the calendar month in which they start managing a particular fund, but excluding the calendar month in which they cease managing a fund.

When one fund manager runs two or more funds at the same time within the same unit trust sector a simple monthly average is calculated across these funds. This is equivalent to the return an investor would have received had they backed the various funds equally at the start of the period and held their investments for the entire time period.

When a fund manager has a 'career break' there is no monthly return figure to include in the analysis. Consequently, to avoid bias, Citywire substitutes the average performance of all managers who actively run funds within that sector for the missing months. Thus a manager's ranking above or below the peer group average is driven purely by their outperformance or underperformance during the months when they have actively managed funds. The greater the number of missing months the more likely a manager's performance will look average against their peer group.

Citywire Funds Insider™ only ranks individual fund managers who have been active on a fund in the sector under review at the beginning or before the beginning, and at the end of the period under review. The manager does not need to be managing the same fund in the sector under review at the start and end of the period, but only funds which remain in the same sector will count towards the manager's ranking for that sector.

It is AKG's opinion that the methodology adopted is reasonable (given the Client's objectives and the known limitations in available data) for the purpose of producing personal Fund Manager Rankings in the selected sectors.

### **4.3 Fund Manager Ratings**

The Fund Manager Ratings are based on the Manager Ratio (see 3.4 above).

The Citywire Rating is based on rankings of managers based on their Manager Ratios (across all 24 sectors). The database is split into two halves based on those who are above or below the average of the managers' Manager Ratios. The managers that exceed the overall average have their ratios averaged again and are separated into two pools. This procedure is repeated for each of these pools to produce four classes of managers, all of which achieved a higher than average Manager Ratio. Only managers within the top three pools receive a rating, categorised into AAA, AA or A. Those managers in the fourth pool are un-rated, as are those below the average.

## 5. SUMMARY

AKG has carried out extensive discussions with the Client concerning the development and implementation of the Citywire Funds Insider™ product.

AKG is satisfied that the methodology inherent in the calculation of individual fund manager rankings and ratings is appropriate and reasonable, given the Client's objectives and the known limitations in available data.

AKG will continue to work with the Client to improve and refine the methodology underpinning the derivation of rankings and ratings.

Nigel Balchin

**Fellow of the Institute of Actuaries**

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## APPENDIX 1. INFORMATION ABOUT AKG

AKG is an actuarially-based consultancy specialising in the provision of information and market assistance to the financial services industry.

### A wide range of clients

Within a specialist focus on the financial services industry, AKG has developed a broad, complementary range of clients including: Intermediaries (IFAs), Life Companies, Friendly Societies, IFA Networks, Regulators, Fund Managers, Trade Bodies, Service Providers, Banks, and Building Societies.

### Support for product providers

AKG assists providers in:

- Financial strength analysis and presentation.
- Data and information provision.
- Actuarial consultancy.
- Distribution consultancy.

### Assistance to financial intermediaries

AKG assists Intermediaries in:

- Financial strength analysis and ratings of product providers.
- Best advice panel services.
- Data and information provision.
- Actuarial and technical support.

### Regular reports

AKG publishes the following reports to assist providers and intermediaries:

- **AKG Company Profile & Financial Strength Reports**  
(covering UK life assurance companies)
- **AKG Offshore Profile & Financial Strength Reports**  
(covering Offshore life assurance companies)
- **AKG UK Life Office OPEN With Profits Report**
- **AKG UK Life Office CLOSED With Profits Report**

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