AJ Bell Growth Funds – three years on

On 18 April 2020, the AJ Bell Growth Funds turned three. This represents an important milestone, given many advisers use the three-year track record as part of their due diligence; for example, quantitative rating systems such as the FE crown ratings and the Morningstar star ratings are both based on three-year track records. It's a period of time that strikes a balance: short enough to be representative of the current management team and process, but long enough that the return is a reflection of skill rather than just luck.

The AJ Bell Funds are multi-asset, with the objective of each to maximise long-term returns within a set of risk parameters. Therefore a common way of assessing the performance of this style of fund is to compare its performance to a peer set of funds with a similar level of investments in equities, which is used as a proxy for measuring risk. The most common way this is done within the industry is to use the Investment Association's (IA) mixed investment sectors – a classification system for multi-asset funds. The four sectors in which our funds fall are as follows:

- IA Mixed Investment 0–35% Shares
- IA Mixed Investment 20–-60% Shares
- IA Mixed Investment 40–85% Shares
- IA Flexible Investment

The first three are self-explanatory, with the flexible sector allowing between 0 and 100% in equities.

Performance is often assessed using quartile rankings – with funds in the first two quartiles performing better than average, and those in the first quartile within the top 25% of performing funds over that timeframe. A summary of the rankings of the funds within our 'growth' range over a one-, two- and three-year horizon to 18 April 2020 is as follows:

Fund	Sector	1 year Quartile	2 year Quartile	3 year Quartile
VT AJ Bell Cautious	Mixed Investment 0-35% Shares	1	1	1
VT AJ Bell Moderately Cautious	Mixed Investment 20-60% Shares	1	1	1
VT AJ Bell Balanced	Mixed Investment 40-85% Shares	1	1	1
VT AJ Bell Moderately Adventurous	Mixed Investment 40-85% Shares	1	1	1
VT AJ Bell Adventurous	Flexible Investment	2	1	1

Source: FE Analytics, April 18 2020

We are proud to see our 'growth' range within the top quartile across all discrete years (with the exception of 'Adventurous' over the last twelve months, which instead falls in the second quartile). We will now aim to explain what has helped differentiate our funds and deliver this outcome.

Costs

As the last three months have shown, investment performance is unpredictable and the overall performance of the market is uncontrollable. However, one element of the funds we can control is cost.

The AJ Bell Growth Funds operate with on overall OCF (Ongoing Charge Figure) cap of 0.35%. Of this fee, up to 0.15% is paid to AJ Bell as a management fee, with the remaining distributed to third parties, such as the costs of our underlying investments, and third-party fund running costs. This compares to an average OCF for the IA Mixed Investment 40–85% Shares sector of 1.07%. If AJ Bell charged the industry average rather than 0.35%, the performance of our balanced fund would fall by 2% over the last three years, highlighting the power of low fees, and the effects of compounding.

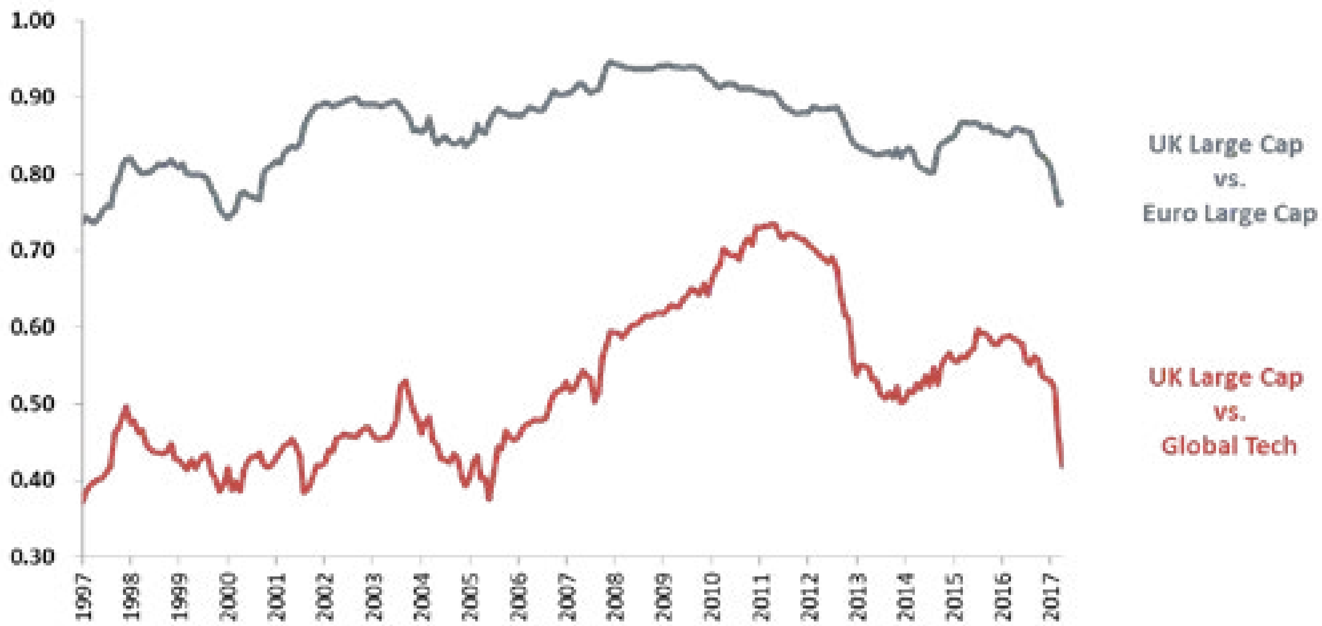
Asset allocation

The supermarket industry in the UK has transformed over the last decade, as consumers have realised that lower cost does not necessarily mean lower quality – leading to the growth of Aldi and Lidl. This is analogous to the growth of passive investment within the investment industry. Producing high-quality, rules-based strategies that pass the benefits of scale back to investors has led to significant growth of both ETFs and tracker funds – lowering the cost of the investments we make.

However, we still retain full control of the asset allocation process. Over 90% of long-term returns are driven by asset allocation, with less than 10% driven by security selection. We have therefore placed emphasis within the funds on getting the asset allocation right, whilst implementing our strategy using low-cost trackers.

We have taken a different approach to asset allocation compared to many other fund ranges. Rather than just allocating our equity holdings across different regions (such as the US and the UK), we also have a separate allocation to different sectors such as technology, healthcare and consumer staples.

It is important to stress that we take this sector approach to improve diversification, rather than due to a short-term view on each sector. In a globalised economy, regional allocation only has limited diversification benefits, whereas a technology company such as Netflix has very different characteristics to a consumer staples company such as Tesco. By blending higher- and lower-risk sectors together in this way, it should smooth the volatility in the portfolios, allowing us to achieve higher returns without higher volatility. For example, the below shows the 20-year correlation of UK equities with European equities and compares this to the correlation of UK equities and global technology equities. The lower correlation between technology and UK equities dampens the falls without necessarily limiting return potential.



Source: Bloomberg LP

The drawdowns we experienced in the first quarter of 2020 are a great example of this in action. The three sectors we use all performed better than the general equity markets.

- **Technology** stocks performed relatively well as people transitioned to working from home and shopping online, benefitting software companies
- **Healthcare** companies did see falls, but less than the market as global governments scrambled to develop a vaccine to and treatment for COVID-19
- **Consumer staples** benefitted from two effects – firstly the price of these companies is closely linked to bonds due to the predictable cash stream and secondly the global demand for basic goods protected revenues for many of these companies

On the other hand, we saw large falls for the European, UK and Asian equity markets, which offered little protection as the markets plummeted.

We take a similar approach within our bond allocation: we employ a more granular strategy than many of our peers, using different bond maturity buckets, and have a long-term allocation to emerging market debt.

Independence

At AJ Bell, we are a multi-manager investor – we do not run single-strategy funds such as UK equities, international bonds and so on. We instead invest across a number of different fund managers, such as Blackrock, Vanguard and Invesco. Although this approach does add in a layer of cost, we believe it is one worth paying. Many fund groups are presented with a conflict of interest of using their own products within their multi-asset funds, even if it is not necessarily the best product in the market. As an unfettered provider, we are genuinely independent in our choice of funds, allowing us to focus on maximising returns for investors – be that through our asset allocation process or by encouraging price competition in the index-tracking marketplace. At the heart of our philosophy is to never forget whose money it is. Our goal is to grow the assets we manage, and we will only do that by delivering a solid performance for you and your clients.

Benefits of scale

At AJ Bell, we run our funds using an AMC+ model. This means we fix our management charge at 0.15%, with other costs passed onto investors (with a total charge cap of 0.35%). A lot of these fund running costs are fixed, so as the funds grow, the relative percentage charge these represent of each fund falls. This benefit of scale passes straight back to the investor under our model. In addition, any cost negotiations we undertake with our suppliers such as custodian, depositary and auditor are for the benefit of the investors, not us. This is different to many other fund groups, which will use an all-in AMC model, where they absorb these running charges within the AMC – allowing the fund manager rather than the investor to benefit from the funds scaling up.

The AJ Bell Growth Funds have seen significant inflows over the last three years. This allowed us to cut our OCF cap from 0.50% to 0.35%. As the funds continue to grow, we would expect the OCF to fall even further. This happens automatically. We operate with a single share class structure and we do not offer rebates. This means a fair deal for all investors in the funds.

So we would like to take the time to say thank you for your continued support. We believe our proposition offers something different to many of our competitors and blends well with other multi-asset funds given our differentiated approach to asset allocation. Although it has been a tough three months, we hope the benefits of diversification, which have dampened some of the recent falls, have highlighted the virtues of a multi-asset approach, and we hope in three years' time we are still delivering a market-leading performance. If you haven't used our funds before, we are more than happy to provide further details. Please contact your Business Development Team.