

To manage or multi-manage - that is the question

A multi-manager approach could provide property investors with the additional diversity they crave

This has been an interesting year for property fund performance, and not for all the right reasons. As an investment medium, property is a useful asset class and many clients still have a proportion of their assets held in this sector. It offers an excellent diversification to equities, cash and bonds and tends to have relatively low correlation with other asset classes.

However, it is the issue of diversification within the property market itself that needs to be considered when it comes to the introduction of multi-manager funds focusing on the property sector, as well as other developments such as the introduction of Reits. Is the multi-manager approach just another marketing spin to attract money to the market? Probably not.

A tough market

It is clear the commercial property market is complicated and diverse. It is potentially more difficult for a financial planner to pick stocks and almost impossible to make a direct holding recommendation because of the required knowledge base and usual investment sums required.

To put this into context, the office sector of the commercial property market currently dominates returns, just as it did in 2006. What was noticeable in the year-to-date was the gulf between the returns from the office, retail and industrial sectors. Retail property units have delivered just 2.5 per cent return so far this year, according to the Investment Property Databank measure, compared with 8.1 per cent from offices and 4.2 per cent from industrial units. There is a real contrast between the present retail return and the return of almost 16 per cent from the same sector in 2006.

According to the Royal Institute of Chartered Surveyors, a geographical split is emerging in the retail sector, with London the front runner, as the City economy booms. Elsewhere, the picture is not so bright with investor and occupier demand for retail spaces declining as the latest round of monetary tightening takes effect. However, the credit crunch in global debt markets may yet see London retail demand, which to date has defied rising interest rates, finally and dramatically fall in to line with broader conditions across the country.

Meanwhile business demand for office and industrial space remains firm and recent reports, again from RICS, suggest demand continues to rise at a fast pace on the back of a strong global economy.

Negative comments of late have centred on low yields and they could have triggered investors to flee to other asset classes. Consider the moves taken by Norwich and New Star, for example, to try to discourage large outflows. But in truth the low yields seen in the commercial property market have not stifled demand to the extent some feared.

RICS commercial property spokesperson Ian McRae, speaking in August, suggested "record rental expectations offer investors some comfort that continued growth will support returns. The global economy is supporting the commercial property sector and investor appetite for the asset class has not dried up." Of course two months is a long time and we have seen tremendous volatility in the equity and debt markets since August which will undoubtedly have an effect on the demand for office space in time.

IFAs should not, however, simply recommend multi-manager funds as a matter of course. With correct asset allocation, the need for another manager to pick another manager's funds seems to be a 'manager too far'.

However, a new facet in the multi-manager sector is the use of property funds with both direct and indirect holdings. This is potentially a much more interesting concept for IFAs to take into consideration, especially with some good fund launches on the cards.

For example, HSBC is due to launch a fund of funds in November 2007. This is proposed to be an

arrangement with approximately 10-15 holdings, both direct and indirect with the objective of lower volatility.

As the capital amounts required to purchase commercial property are high and there have recently been difficulties securing high quality property for fund purchase, it has been difficult to maintain returns without diluting funds with cash inflows. This has been evidenced recently with restrictions placed by some fund managers on the levels of contributions allowed. This can mean that some funds are not as internally diversified as some would want, with large holdings in single buildings or areas.

This is where the multi-manager approach could work. The first point to highlight is the ability of a multi-manager to have direct holdings as well as indirect holdings. This in itself is a further diversification that a single fund manager may not achieve. Added to this the ability to move quickly in what is a diverse market could mean that the multi-manager approach is the one to take in the future when allocating a section of clients' funds.

Some people may not agree, but if funds are allocated to the property sector, one additional thought is to split the holdings between the multi-manager approach and single manager funds. Would this give the best of both worlds? Only time will tell.

Offering diversification

IFAs will watch with interest how the multi-manager property sector performs. Generically, the property sector is in for a bumpy ride over the coming months and managers will have to be bold in their investment choices, but good returns are achievable and the property multi-manager approach adds some excellent additional diversity that could work.

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