



## FITZROVIA

### 5. Definition

Portfolio turnover is a measure of how much buying and selling of its underlying investments a fund has undertaken. A portfolio turnover of 100% does not, however, necessarily indicate that all stocks within the portfolio were turned over during the year, although this may be the case. It may actually mean that only a small portion of assets were transacted intensely. Therefore the portfolio turnover figure is a reflection of the value of total fund assets transacted upon during the year.

With the above definition in mind, as a general guide, a portfolio turnover level of 25% indicates a holding period of 4 years, a portfolio turnover level of 33% indicates a holding period of 3 years, a portfolio turnover level of 75% indicates an average holding period of 16 months, and a portfolio turnover level of 150% indicates an average holding period of 8 months.

### 6. Calculation

For the purpose of this report, we have used the most commonly accepted method of calculation: the lesser of purchases or sales for the year divided by the average total net assets of the fund during that year. This is also the most straightforward method that may be replicated by a retail investor, which is in line with our approach to calculating Total Expense Ratios (TERs).

The use of this calculation means that the effect of any extraordinary inflows or outflows, which may serve to distort the resulting portfolio turnover level, is negated as the lesser of the purchases or sales for the period has been used.

This methodology is also the one required in the US, where the SEC's form N1-A requires funds to disclose portfolio turnover as follows: "Divide the lesser of amounts of purchases or sales of portfolio securities for the fiscal year by the monthly average of the value of the portfolio securities owned by the Fund during the fiscal year."

While Fitzrovia calculates an average net assets figure that is based on management fee data (percentages and absolute amounts collected from fund report and accounts) and thus more accurate than a simple monthly average, the principle remains the same.

### 7. European Commission

The methodology for calculating portfolio turnover is defined in the European Commission paper 2004/384/EC (and replicated in the FSA's consultation paper 04/18) as:

$$\frac{[\text{Purchases} + \text{Sales}] - [\text{Subscriptions} + \text{Redemptions}]}{\text{Average Net Assets}}$$

This methodology tries to strip out the 'natural' purchases and sales that one would expect as a result of subscriptions and redemptions, with portfolio turnover as the excess. However, if subscriptions and redemptions are reasonable and offset one another, a cash balance is likely to be sufficient for the fund not to need to keep investing (and therefore subscriptions and redemptions could exceed purchases and sales). In such a situation, this methodology may result in a negative portfolio turnover figure.

In addition, it appears instinctively wrong that a fund which buys and sells its entire portfolio should have a turnover of 200%, rather than 100%. At the very least, this cannot be helpful for investors.



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This methodology also contrasts with that of the US regulator, as highlighted in two example funds shown below, using actual data from fund report and accounts.

### Methodology Comparison: SEC and EC

Fund	A fund	Z fund
Average Total Net Assets	1,773,933,333	129,036,800
Purchases	1,443,151,000	70,966,966
Sales	1,311,012,000	82,300,543
Lesser Purchases/Sales	1,311,012,000	70,966,966
<b>SEC Portfolio Turnover</b>	<b>73.9%</b>	<b>55.0%</b>
Subscriptions	155,472,000	2,532,660
Redemptions	63,816,000	11,123,341
Subscriptions+Redemptions	219,288,000	13,656,001
Purchases+Sales	2,754,163,000	153,267,509
[P+S] - [S+R]	2,534,875,000	139,611,508
<b>EC Portfolio Turnover</b>	<b>142.9%</b>	<b>108.2%</b>

One can see that, not surprisingly, adding purchases and sales has the effect of roughly doubling the portfolio turnover figures compared to the SEC's methodology. Even if one were to divide  $([Purchases + Sales] - [Subscriptions + Redemptions])$  by 2, the methodology seems overly complex for no distinct advantage.

Fitzrovia uses the SEC methodology as this is an accurate and simple way to measure the degree of active fund management, and to create a ratio based on voluntary rather than forced trading, because only voluntary trading is the more meaningful measure of the degree of active management.

Fitzrovia's concerns are not only that UCITS funds might be placed at a competitive disadvantage with US mutual funds as a result of dramatically different methodologies, but also that UCITS investors will not be better served as a result.