ARVEST
FUNDS AG

Monthly Report for August 2009

Fund manager's strategy report

Inefficient markets

In the efficient market theory, it is assumed that capital markets are efficient as long as all relevant information is reflected in securities prices relatively quickly and all market participants act completely rationally.

In the current economic crisis, it is being increasingly discussed and disputed whether or not this theory remains tenable based on the experience of the last several years. Questioning the validity of this theory is critically important for every investor, as it impacts virtually every investment decision. It appears that market participants are becoming increasingly more convinced of the validity of this theory, although its weaknesses have become ever more apparent in the current crisis. This is primarily evidenced by the continued brisk and steadily growing demand for ETFs. The shift by many investors toward passively managed funds is a result of the failure by many fund managers to provide evidence of higher returns for their investors through active management.

ETF providers argue that their products perform better over a longer period of observation than the average actively managed fund. Their better performance versus actively managed funds, they claim, is the result of lower cost structure, as active fund management is more costly than passively replicating an index.

Quit my job?

Were I convinced by the efficient market theory, my position as a fund manager would be completely unnecessary, as my job essentially consists of actively managing assets entrusted to me in order to generate at least a higher yield than the market.

But because, as you may already suspect, I am not fully convinced of the validity of the efficient market theory, I will dare to discredit this theory, both at a theoretical level and through a practical example, and show how active fund management can be superior to a passive investment strategy.

Theoretical argument

Let's take a look at the oft-cited, primary argument against active fund management: performance. Various studies do in fact show that very few actively managed funds perform better over the long term than their underlying benchmarks. This is the basis for allegedly conclusive proof of the capital market efficiency theory. In an inefficient market, informed fund managers would manage to perform better than less-rational market participants and thus better than the overall market or ETFs. Because this is not the case, the market must not be inefficient but, rather, efficient. However, this type of argument is not permissible. The fact that many fund managers do not manage to beat the market could easily be due to the fact that many of them are just as irrational as the market itself. The fact that these circumstances do not allow an outperformance of the market and that relative underperformance is very likely due to often downright high management fees is not surprising based on these assumptions. If, therefore, the average fund manager is equally as irrational as the market, this would indeed be disappointing. However, to say that this is proof of the accuracy of the efficient market theory is a rather bold, gap-filled argument.

Practical example

Our ARVEST GLOBAL STARS stock fund was established in 2000 and has since been actively managed. Despite several market crashes since its inception, the fund has thus far managed to grow by 16%. In contrast, its comparison index, the S&P Global 1200, fell by 49.6% in the same period. This equals a relative outperformance of +65.6%. Expressed in monetary units, if you had invested, say, CHF 1 million in our fund at the beginning, you would now have CHF 1.16 million. If, instead, you had invested in an ETF, your assets would have been cut in half. This outperformance by ARVEST GLOBAL STARS has not been the result of greater risk-taking. To the contrary, risks have increasingly been temporarily reduced through active management decisions aimed at protecting against investor capital losses.

This striking outperformance despite deep risks should be reason enough to be virtually overwhelmed by a deluge of new funds. The fact that this is not the case shows me that markets don't always process available information efficiently, at least in the short to medium term. Perhaps, however, this report will help bolster the efficiency of the market in the long-term.

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