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SMAs Beat Funds In 2008

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Last year some rich investors finished richer – or, at least a little less poor – than other investors did.

The well-to-do in so-called separately managed accounts, or SMAs, did better on average in 2008 than typically less-well-off mutual fund holders, bolstering some of the brokerage industry's marketing claims about these products' superiority.

Separately managed accounts outperformed mutual funds in 25 of 36 stock- and bond-market categories tracked by fund researcher Morningstar Inc. This may reflect differences in the way the accounts are run, expenses or different reporting requirements, says Morningstar Analyst Rachael Olson.

Last year doesn't seem to be an exception. Over the past three years, SMAs outperformed in 22 of 26 categories. (Morningstar looked only at categories that included at least 20 of each type of investment.)

SMAs are a type of fee-based account where the brokerage firm hires an outside money manager to pick a basket of stocks or bonds on behalf of an investor. Unlike a mutual fund, where investors own shares in a single pool of assets, SMA investors own their stocks directly.

Because of the added complexity, SMAs have much higher investment minimums. They usually work best for investors with at least $1 million or $2 million to spread among several different SMA strategies.

For 2008, SMAs that held large-company stocks were down 34.8%, according to Morningstar's data - not great, but about 3 percentage points better than the average mutual fund return. Top SMA performers were Robinson Value Management Ltd.'s Market Opportunity Composite Strategy, which involves making some bets against the market, down 3.7%, and PTI Securities & Futures L.P.'s Protected Index Program, which uses options to limit risk, down about 5%.

SMAs that target small- and medium-sized companies also outperformed similar mutual funds. So did intermediate-term bond SMAs, but that may reflect a different mix of holdings among corporate and government bonds rather than a result of their investment structure.

One reason SMAs may be outperforming mutual funds is that individual SMA strategies tend to have smaller amounts of assets than popular mutual funds, allowing them to trade more nimbly. Meanwhile, high investment minimums often translate into lower fees, which will drag less on performance.

Morningstar cautions that comparative data may not be perfect. Mutual funds are required to publish their returns in annual reports filed with the U.S. Securities and Exchange Commission, while SMA managers report voluntarily. So it's likely that some struggling SMA managers have decided to keep mum, thus tilting the statistics for SMAs.

Here are average returns for SMAs and mutual funds in some of the broadest categories. We also included a popular ETF for each category to give investors an idea of how they might have done in an index fund. Because SMA investors own stocks directly - and can make alterations to the strategies - individual returns don't always match what is reported by managers.

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