Swing pricing

The mechanism used to keep prices fair for all shareholders

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Swing pricing – an overview

Swing pricing is a mechanism used to protect the interests of long-term investors in fund vehicles against the trading activities of short-term investors – especially during times of extreme market volatility.

To counter the dilution effect on the fund's assets of trading activity by the few, and protect the interests of the majority of ongoing investors, industry regulations exist which permit these costs to be recovered from those investors joining or leaving a fund rather than from the fund's assets. This is achieved by swing pricing – a mechanism which adjusts the fund price to recover trading costs from those who are doing the trading rather than penalising long-term holders by paying these costs from the fund's assets.

Diluting the costs of trading activity

Where a fund is valued every day using a single NAV per share – as is the case with all sub-funds in the Sparinvest SICAV – this price reflects the valuation price of all the fund's assets. It does not take into account the dealing costs, taxes and spreads that occur when a portfolio manager is required to trade as a result of investors buying or selling holdings. Without swing pricing, these costs are routinely charged to the fund and, although the impact at times may be negligible, it has the potential to amount to an unjust dilution of the fund return – in particular when there are one-way flows over an extended time period or large subscriptions/
redemptions.

In addition, during times of extreme market reaction, when costs are impacted by e.g. higher bid/offer spreads and market impact/liquidity, trading costs can be high.

The Board of a SICAV may act to ensure that the fund's assets are not significantly impacted by the dilution effect of high trading costs, i.e. by employing swing pricing.

How swing pricing works

The implementation of swing pricing is done in a clear and systematic fashion. It kicks into effect when flows in or out of a fund reach a certain threshold (the 'swing threshold'). This threshold is dependent on the market situation and tends to be higher when markets are calm and liquid and lower when the opposite is the case. The swing threshold is calculated as a percentage of the fund's NAV or a specific amount.

In the case of large inflows or outflows, swing-pricing adjusts a fund's NAV:

- upwards by a swing factor in the case of inflows which exceed the swing threshold
- downwards by a swing factor in the case of outflows which exceed the swing threshold.

The swing factor reflects the trading costs under the prevailing market conditions. This is done to recover trading costs from those who are investing or redeeming and with the intention of protecting the overall performance of funds to the benefit of the remaining investors.

When is swing pricing applied?

The decision to apply swing pricing to the sub-funds of Sparinvest SICAV is taken on the basis of overall net flows into or out of the fund from all investors – not per client or per share class (eg R or I) within the fund. Thus, under swing conditions, the NAV per share will move for all share classes of a fund on a given day.

Sparinvest applies swing pricing when the swing threshold for a fund is exceeded. Currently an individual swing threshold (a fixed percentage of NAV or an amount) and swing factor apply for each of the sub-funds within Sparinvest SICAV. The threshold and the swing factor per fund is determined by the board of Sparinvest SICAV and is regularly reviewed. It is standard market practice not to publish thresholds in order to prevent investors from trading against the fund.

The benefits

When swing pricing is applied, it is a penalty for active traders. The money raised is paid to the fund, not to the management company. Thus those remaining in the fund – or investing in it - will ultimately be compensated by better returns. In brief swing pricing:

- Protects the fund's assets against elevated trading costs
- Protects the interests of the long-term investors
- Provides an opportunity for contrarian investors to buy at discounted prices – although they will not know with certainty when the swing is applied and in what direction
- Studies have shown that there is a long-term performance benefit for funds where swing pricing is introduced.

The drawbacks

- Swing pricing is likely to increase a fund's tracking error because market practice is to calculate performance on the basis of the 'swung' price rather than the more representative 'unswung' price.
- It can also introduce volatility into a fund's daily prices, amplifying the effect of market movements. This should not be misinterpreted as an increase in the inherent level of portfolio risk.

Further information

If you have any questions about Sparinvest's swing pricing policy, please do not hesitate to get in touch with a member of our Client Management department as shown below, or your usual Sparinvest contact.

InternationalClientServices@sparinvest.eu
+352 26 27 47-1