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 there is in- or outflow in a fund.

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
- downwards by a swing factor in the case of outflows

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 on every dealing date on a net deal basis regardless of the size of the net capital activity, except when there is no net flow in a fund, in which case the NAV is not swung.

The benefits

When swing pricing is applied, active traders are paying for the cost their trading activity otherwise impose on the fund. 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.

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