# Passive Investment Strategies

UOFS MBA – Investments
Guest Lecture
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# Nerina Visser, CFA

- Consulting & Advisory Work
  - World Bank / IFC
  - Financial Services Board (FSB)
  - Johannesburg Stock Exchange (JSE)
  - Outsurance Insurance Co
  - Satrix Managers
  - Momentum SP Reid
  - Cloud Atlas Investing
  - Rwanda Stock Exchange
  - S&P Dow Jones
  - Nigerian Stock Exchange
  - Nedbank Private Wealth
- Academic & other Qualifications
  - BSc Applied Mathematics & Mathematical Statistics
  - MBA (Financial Management specialisation)
  - CFA Charter holder
  - FAIS Key Individual

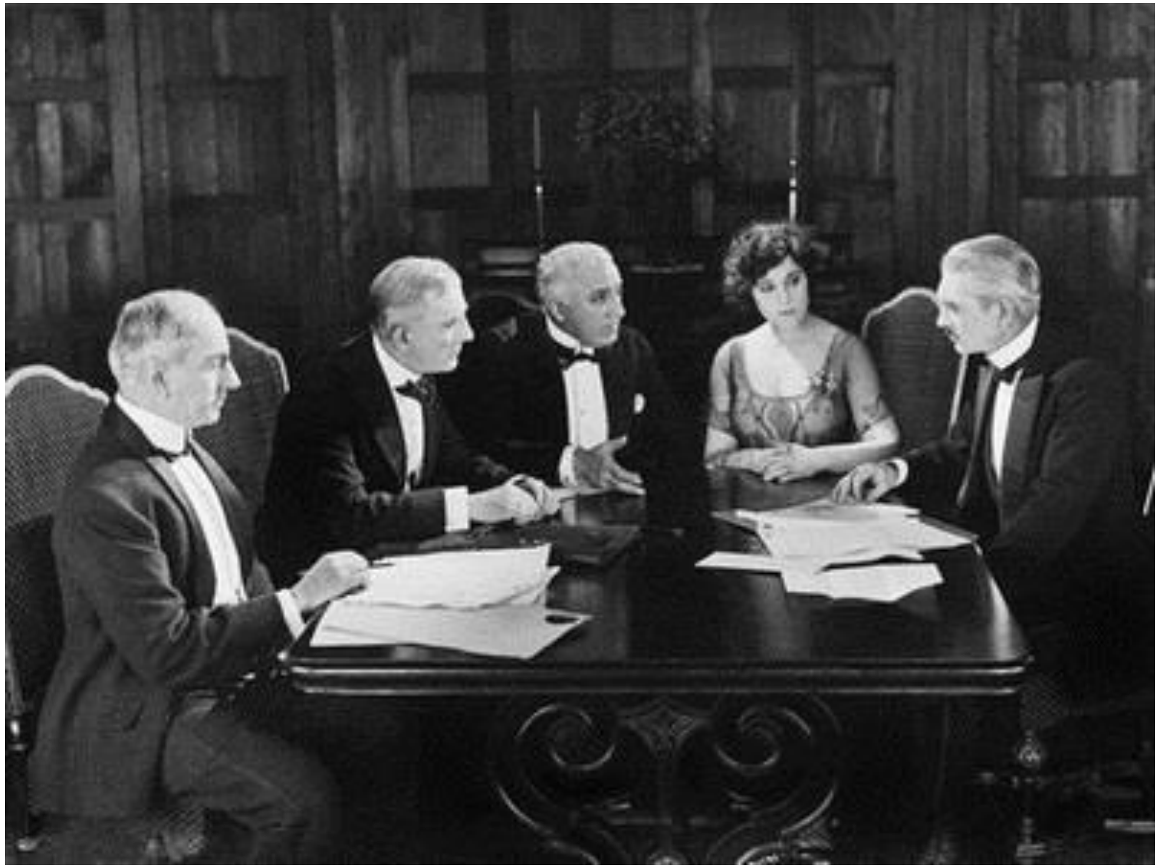
- Training and Education Initiatives
  - ASISA Academy: CIS Short Course
  - ASISA Academy and University of Johannesburg: CIS@UJ
  - Financial Services Board (FSB): Exchange Traded Products (ETPs) training workshop
  - Passive Investment Management Mastery School (PIMMS): online course
  - Journalist Training Academy (JTA) for FinWrite – Wits Journalism
  - Nigerian Stock Exchange (NSE): ETF Workshop
- Industry Volunteer Involvement
  - CFA Institute – Vice President of the South Africa Society
  - ASISA Investments Board Committee – ETF Standing Committee – chairperson
  - JSE Issuer Regulation Advisory Committee – member
  - JSE Product Advisory Committee – member
  - SWIFT African Advisory Group – member
  - Collective Insight publication Editorial Advisory Committee – member
  - NSE – ETF Product Advisory Committee – member
  - Women in ETFs – South Africa chapter co-head

# How did we manage investments in the previous century?

- Law firms – trustees – fiduciary responsibility
- Establish cash flow first, invest surplus in "special interest shares"

*"Don't worry your pretty little head young lady….*

*we'll take care of you"*



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# Investments products and processes from the previous century

- Insurance companies were the first "asset managers"
- Introduction of specialist asset managers
- Occupational pension funds – move from defined benefit to defined contribution shifted responsibility to member
- Direct stock broking portfolios for wealthy investors
- Unit trusts opened up investment opportunities to a broader client base
- "Democratisation of capital" requires new investment opportunities for the 21st century

# How do you make investment decisions?

- Fund / manager selection
  - Unit trusts

- Stock / share selection
  - Company-specific analysis
- ETF / index selection
  - ETF = Exchange Traded Fund
  - Not to be confused with EFT
    - Electronic Fund Transfer

# What is the basis for these investment decisions?

- Fund / manager selection
  - Based on observed past performance
  - What looks / sounds good from the outside
  - What your friend has or what will make you feel comfortable
- Stock / share selection
  - Fundamental / Technical analysis
  - “Hot tips”
  - A good story
- ETF / index selection
  - Selecting the required index / asset exposure
  - So-called “passive” investing

# Who makes the decisions?

- Fund / manager selection
  - Multi-manager
  - Financial adviser
- Stock / share selection
  - Portfolio manager
  - Stock broker
- ETF / index selection
  - Investment strategist
  - Portfolio "assembler"

# What skills are needed to make these investment decisions?

- Fund / manager selection
  - Understanding the investment style / approach
  - Trust? Faith? Hope?
- Stock / share selection
  - Financial statement analysis
  - Industry / sector insights
  - Price trend analysis, technical analysis
- ETF / index selection
  - Macro-economics
  - Matching return drivers to liability profile
  - Investment “recipe”

# Introduction

*"My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and the rest in a* ***very low-cost S&P 500 index fund*** *(I suggest Vanguard's). I believe the trust's long-term results from this policy will be superior to those attained by most investors – whether pension funds, institutions or individuals – who employ high-fee managers"*

# A bit of history …1

**John Bogle**, Found of Vanguard

- World's biggest Mutual Fund manager
- "Father of index funds"
- "World's 100 most powerful and influential people" by Time Magazine in 2004

- 1951: John Bogle graduated from Princeton

  Thesis: "Mutual Funds can make no claims to superiority over the Market Averages"

- 1974: Bogle founded Vanguard Group and launched the First Index Investment Trust in 1975, drawing much criticism
  - It was derided as "un-American", the fund referred to as "Bogle's folly"
  - The chairman of Fidelity Investments said he couldn't believe that investors would be satisfied with receiving just average returns

# A bit of history …2

- Eugene Fama and Kenneth French (of Fama-French fame): their key premise, the Efficient Market Hypothesis (EMH)

  *No active investor has the ability to **consistently** beat the market through smart timing or shrewd stock picking*

- Passive management (also called passive investing) is an investment strategy in which
  - the fund manager makes very few portfolio decisions
  - in order to minimise transaction costs
  - including the incidence of capital gains tax
- Index Funds: most popular method – mimics the performance of an externally specified index

# A bit of history …3

- Bogle's fund was later renamed the Vanguard 500 Index Fund, which tracks the S&P500
  - It started with relatively meagre assets of $11 million but crossed the $100 billion milestone in November 1999
  - This astonishing increase was funded by the market's increasing willingness to invest in such a product
- Bull market of the 1990s helped spur phenomenal growth in indexing
  - Investors were able to achieve desired absolute returns simply by investing in portfolios benchmarked to broad-based market indices, e.g. S&P500, Top40
  - Indexed funds have outperformed the majority of active managers, especially on an after-cost and after-tax basis

# Simplicity of Bogle & Buffett

*"Relentless Rules of Humble Arithmetics"* *(Bogle)*

- Gross return in the financial markets, minus the costs of financial intermediation, equals the net return that we as investors share
- Successful investing is understanding that markets don't give you returns – the underlying investments do
- The 'market' represents the 'level of the ocean' – all investments are made into the same prevailing market conditions

# Simplicity of Alpha-Beta Separation

*"The Trader is dead, Long Live The Trader"* *(IBM Consulting)*

- The separation of Alpha from Beta is expected to shift profit away from traditional long only active funds toward the extremes of unconstrained Alpha-generating investing (more volatile pools, such as certain types of hedge funds and private equity) and passive investing (index funds, exchange-traded funds and certain types of derivatives)
- Firms that understand how to best match assets to liabilities – and, over time, can execute on that understanding – will attract and retain the most assets, from both institutional and retail investors

# The Current Context

- Investors are increasingly growing resistant to paying fees for Alpha and receiving Beta performance
- The scalability of Alpha strategies is limited – large Alpha funds tend to a Beta performance profile
- Funds are using their limited tracking error / risk budget allowance to achieve Beta performance when the bulk of this allowance should be reserved for Alpha

# Simplicity of Passive Investing

*Why the reluctance to change?* *(Buffett)*

- "most people either seem to have difficulty recognising what lies in plain sight, right before their eyes, or, perhaps even more pervasively, refuse to recognise the reality because it flies in the face of their deep-seated beliefs, their biases, and their own self-interest"
- "it's amazing how difficult it is for a man to understand something if he's paid a small fortune not to understand it"

# Part I

## What is ‘passive’ investing?

# Passive investment = Index tracking

- ‘Index tracking’ means ‘following a recipe’
- To bake a cake, your recipe specifies the ingredients and quantities


# Index measures ‘average’ performance

- An index reflects the aggregate performance (capital growth and dividends) of a basket of securities, e.g.
  - SA equity market as a whole (FTSE/JSE All Share or Top 40)
  - Component of the equity market (Financial or Industrial)
  - Global equity market (MSCI World, FTSE All World)
- Can measure different types of assets:
  - Equities
  - Bonds
  - Listed Property
  - Commodities
  - Currencies
  - Cash (money market)

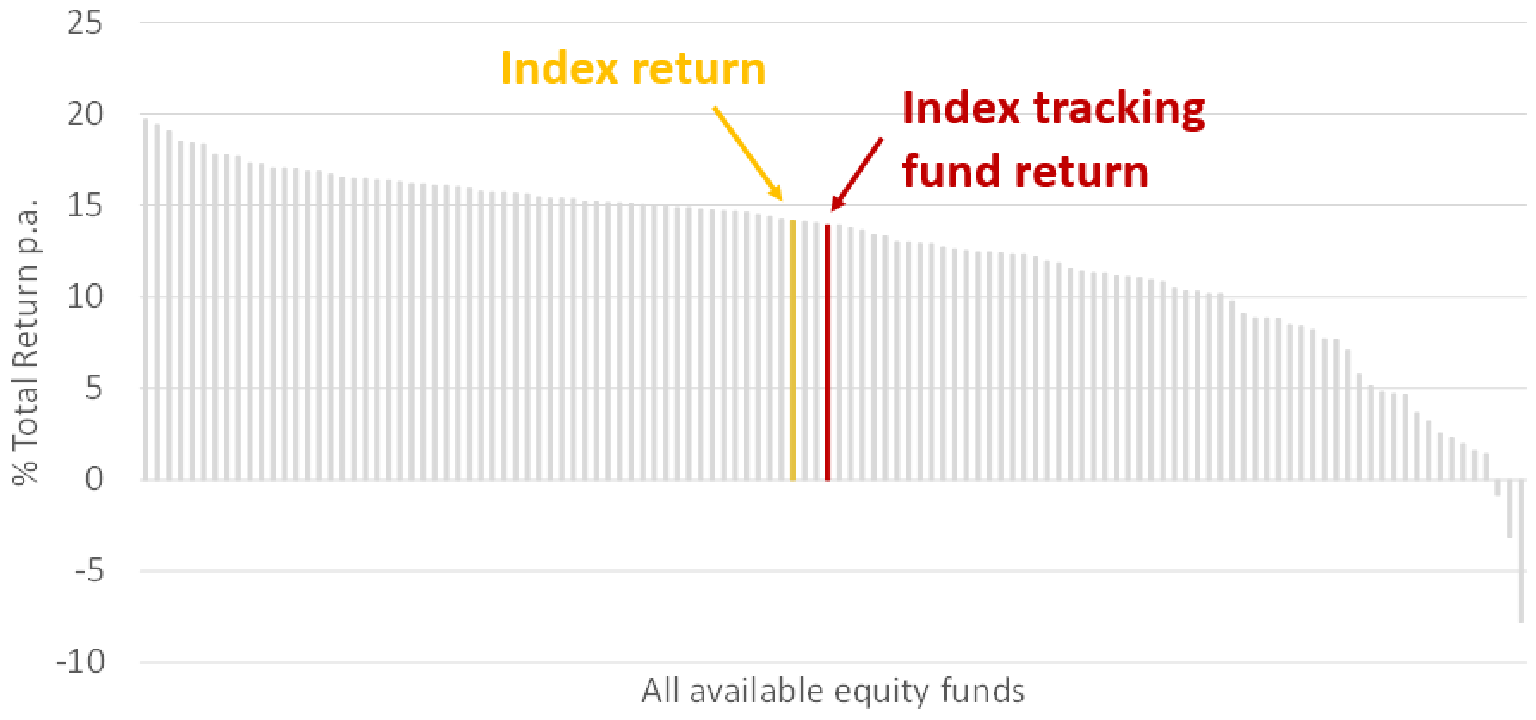
# What is average?

- Index performance
  - (Weighted) average performance of all shares
  - Mathematical calculation – costless
- Fund / portfolio performance
  - Rand value of all investment holdings + cash distributions compared to initial investment amount

    after all costs incurred to make those investments
    - Transaction costs
    - Administration costs
    - Management costs
    - Tax implications

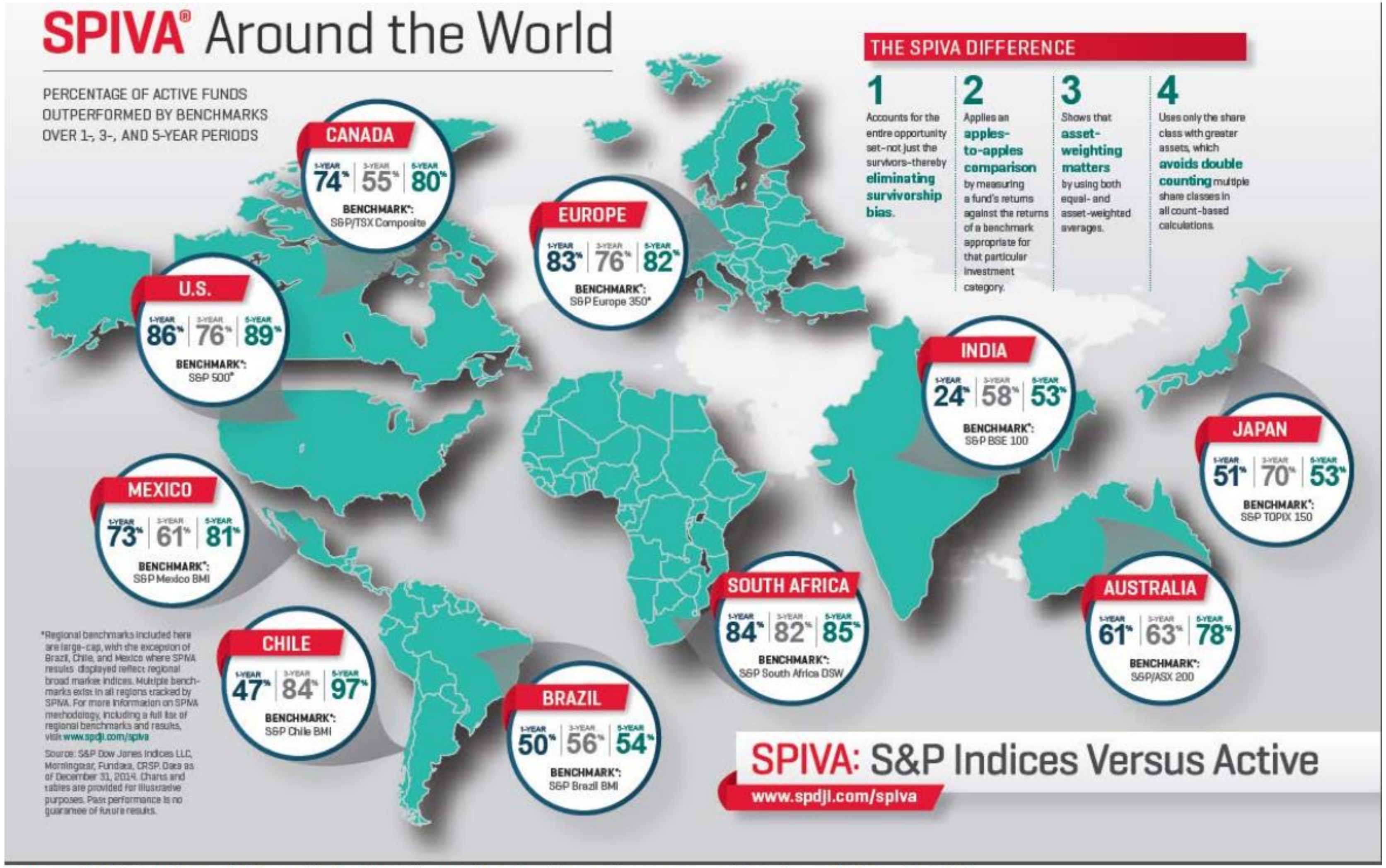
# What we know to be true

## Perception of “average”




All index-tracking funds underperform the index it tracks 100% of the time

# What we know to be true




±80% of active managers under-perform the general equity index

Source: S&P Dow Jones Indices, LLC. Chart is provided for illustrative purposes. Data is as of Dec. 31, 2014.

# How Well Do Actively Managed Funds Perform?

% of active managers who failed to outperform their benchmarks (broad-based market index)

| | 1 year | 3 years | 5 years |
|---|---|---|---|
| USA | 61% | 93% | 86% |
| Europe | 80% | 74% | 74% |
| South Africa | 73% | 80% | 77% |

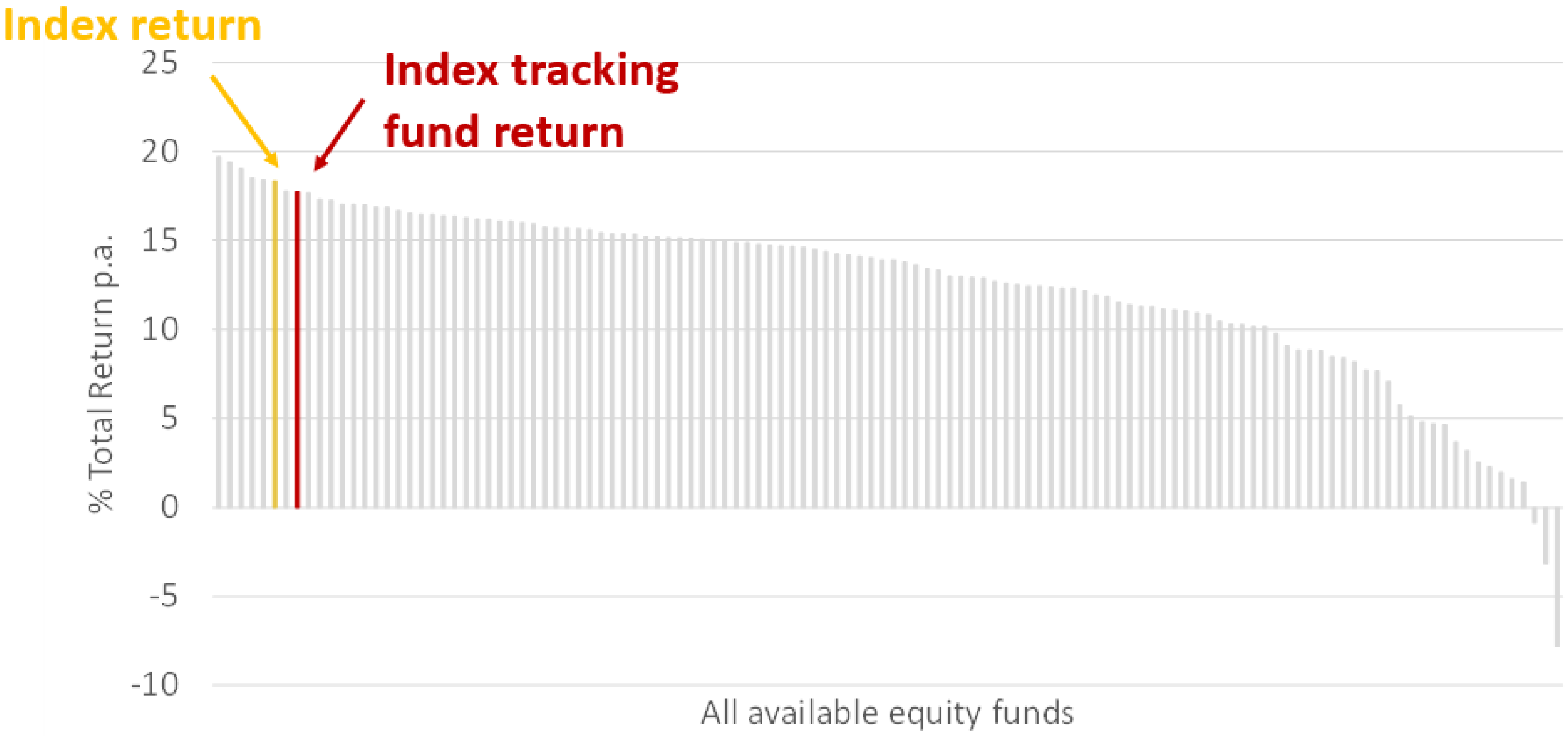
*Source: S&P Dow Jones Indices (SPIVA Scorecard) (December 2016)*

# What causes this underperformance? (other than costs)

- Size matters!
- Investable share universe decreases as fund size increases
- If you invest 5% of your fund in 1 company and do not want that own more than 5% of that company:
  - Fund size R 100 m – 170+ shares to choose from
  - Fund size R 1 bn – <160 shares to choose from
  - Fund size R 10 bn – 80 shares to choose from
  - Fund size R 40 bn – 35 shares to choose from

# What we know to be true

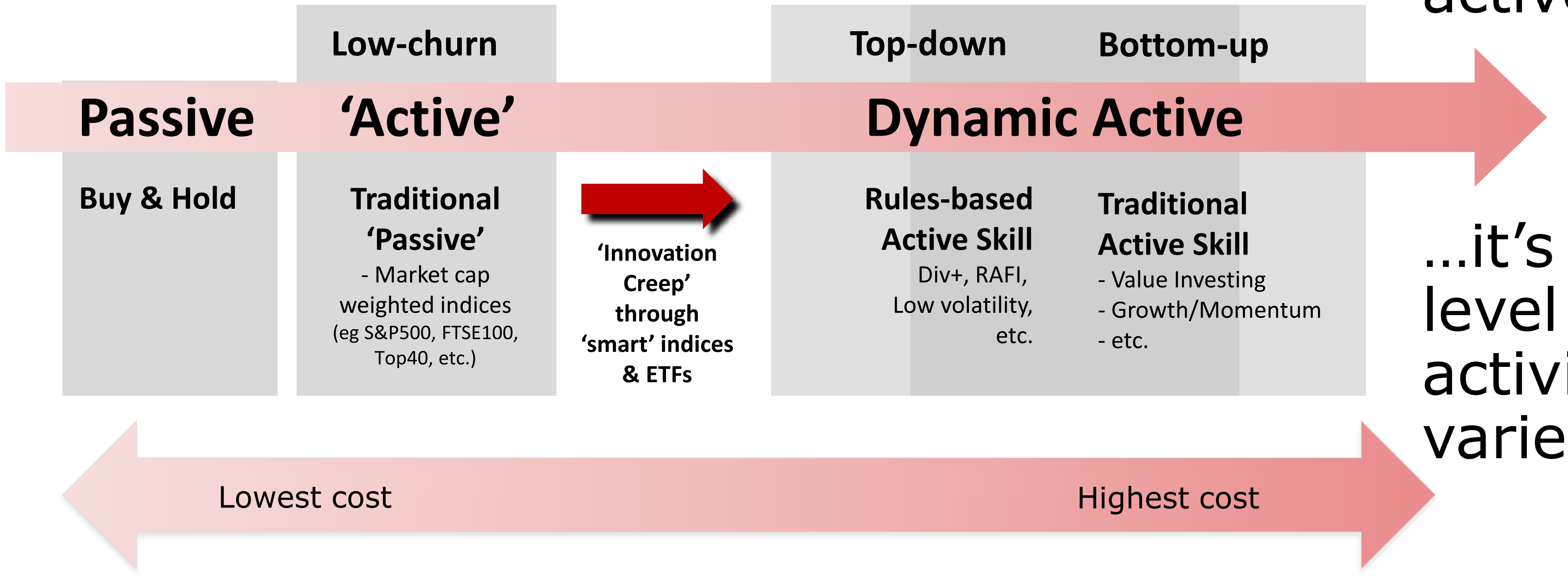
## Reality of “average”




All index-tracking funds underperform the index it tracks 100% of the time

But that does not make it ‘below average’

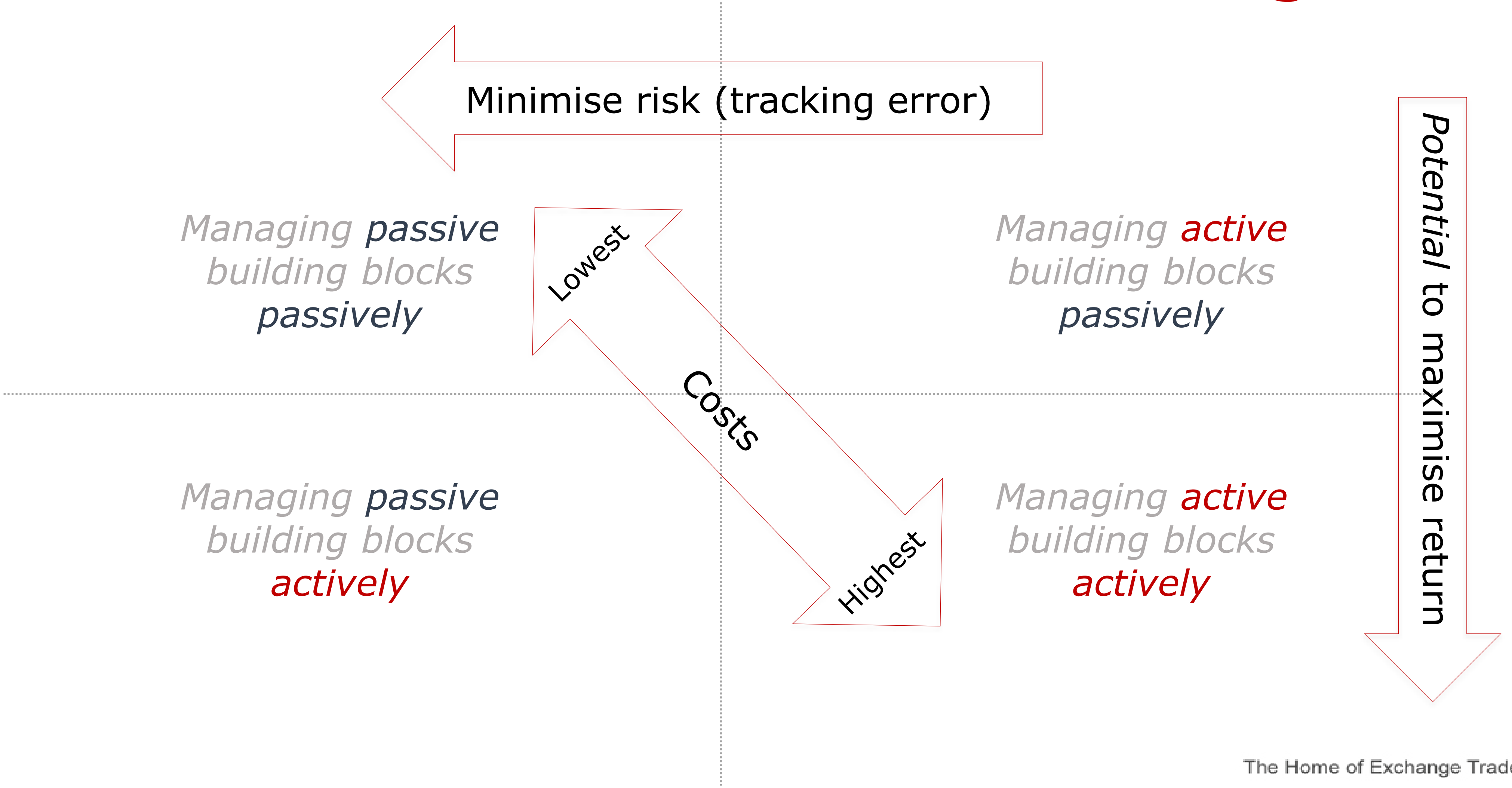
# What we know to be true




All investing is active…

…it's just the level of activity that varies

# What constitutes 'passive' investment for multi-assets / multi-managers?



# Evolution of ‘passive’ investment strategies

- Exposure to broad-based equity market indices
  - Traditional ‘passive’ investing
  - Efficient exposure to (market) beta
  - *Benefit*: low cost, transparency, operational and tax efficiency
- Expansion of ‘passive’ to other asset classes
  - Application of indexation beyond equities
  - ETFs with non-equity underlyings allow for multi-asset class exposure via stock exchange
  - *Benefit* : ease of transaction; security of custody, clearing, settlement
- Rise of ‘smart beta’ and alternative investment strategies
  - Rules-based investment decisions, commoditisation of active decision making
  - Index construction evolves from ‘performance benchmarks’ to ‘allocation guidelines’
  - *Benefit* : multi-factor performance drivers; exposure consistency & style purity

# Part II

## What is an ETF?

# Exchange Traded Funds 101

- What is an ETF?
  - A package deal
  - A box of chocolates
  - A hamper of goodies
- What is in the 'hamper'?
  - Different types– Christmas, Valentine's Day, Back-to-School etc.
  - Every ETF has a 'theme', e.g. Resource stocks, High dividend stocks, Inflation-linked bonds, 'Green' companies, Physical gold, etc.
  - Theme is defined by the index that the ETF follows / tracks

# Exchange Traded Fund (ETF) Defined

- Listed (necessarily) index-tracking (usually) collective investment scheme (sometimes)
- Listed: Securities listed and traded like normal shares on the stock exchange
- Index-tracking: Fund replicates the make up of the reference index
- Collective Investment Scheme (CIS): Also called a Unit Trust or Mutual Fund

# What does an ETF represent?

- Open-ended fund backed by a basket of physical securities
- Allow investment exposure to equity, fixed income, property, commodity indices via a single listed share / unit
- Most ETFs are registered as CISs (unit trusts)
  - But not all ETFs are CISs (and there are also ETNs)
- A market maker ensures that there is always a buyer and seller in the market at the live fair value (NAV) of the ETF

*Investor is **guaranteed** to be able to **buy or sell** at the **NAV** price **on demand**!*
*(bid-offer spread)*

# What performance can I expect from an ETF / index investment?

- An investment in a physically-replicated index-tracking ETF gives you the assurance that you will receive the same return as the underlying asset, which usually means an index such as the Top40 or S&P500, after costs
- Although you do not know in advance what absolute return you will receive, you do know that you will receive the same return as the index
  - This means that an ETF has very low relative risk when compared to the benchmark index
- However, one could still have absolute risk in your investment
  - If the index declines by 10%, your ETF / index investment will also decline by 10%
- Your ETF investment will have the same return and risk characteristics as the index it tracks

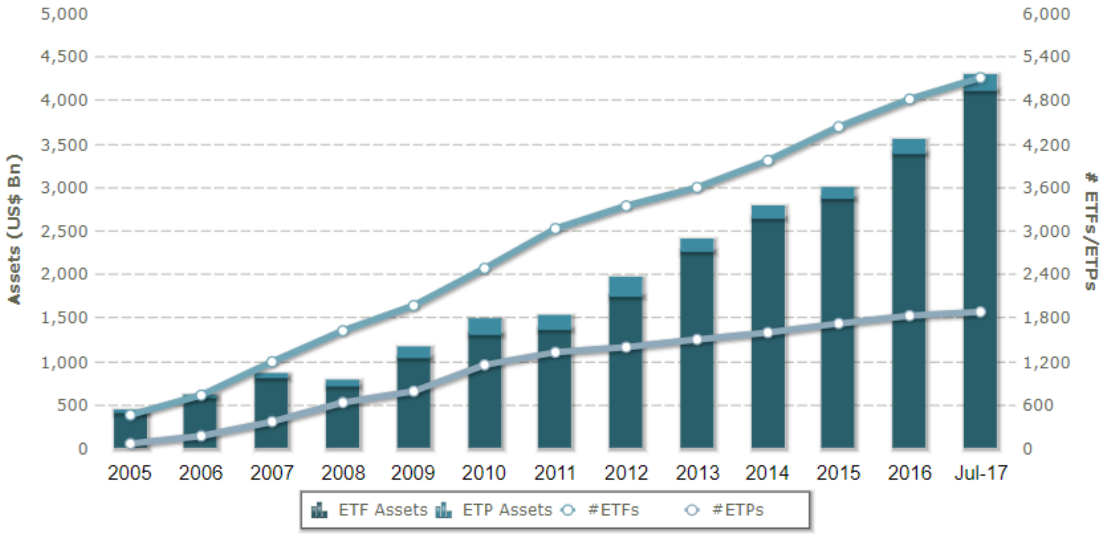
**Make sure you know what that is!**

# "ETFs are Low Risk Investments"

- Absolute Risk
  - An ETF carries just as much *absolute* risk as its underlying investments – can be very high, or very low
  - It's the same as a unit trust in the same category
- Relative Risk
  - An ETF has negligible *relative* risk – SA regulations require full physical backing
  - The level of underperformance ≡ Cost to manage the fund (TER)
- Regulatory Risk
  - An ETF has the lowest *regulatory* risk – governed by FSB & JSE
  - An ETN has additional credit risk

# Global history

- ETFs first launched in Canada in 1990 – US followed in 1993. Net flows into ETFs surpassed those of mutual funds (unit trusts) for first time in 2008
- Global assets of over $1 trillion in 2009 (20 years), in next eight years, it has quadrupled – now over $4trillion




- Global ETP industry is now bigger than the hedge fund industry

*Source: ETFGI*

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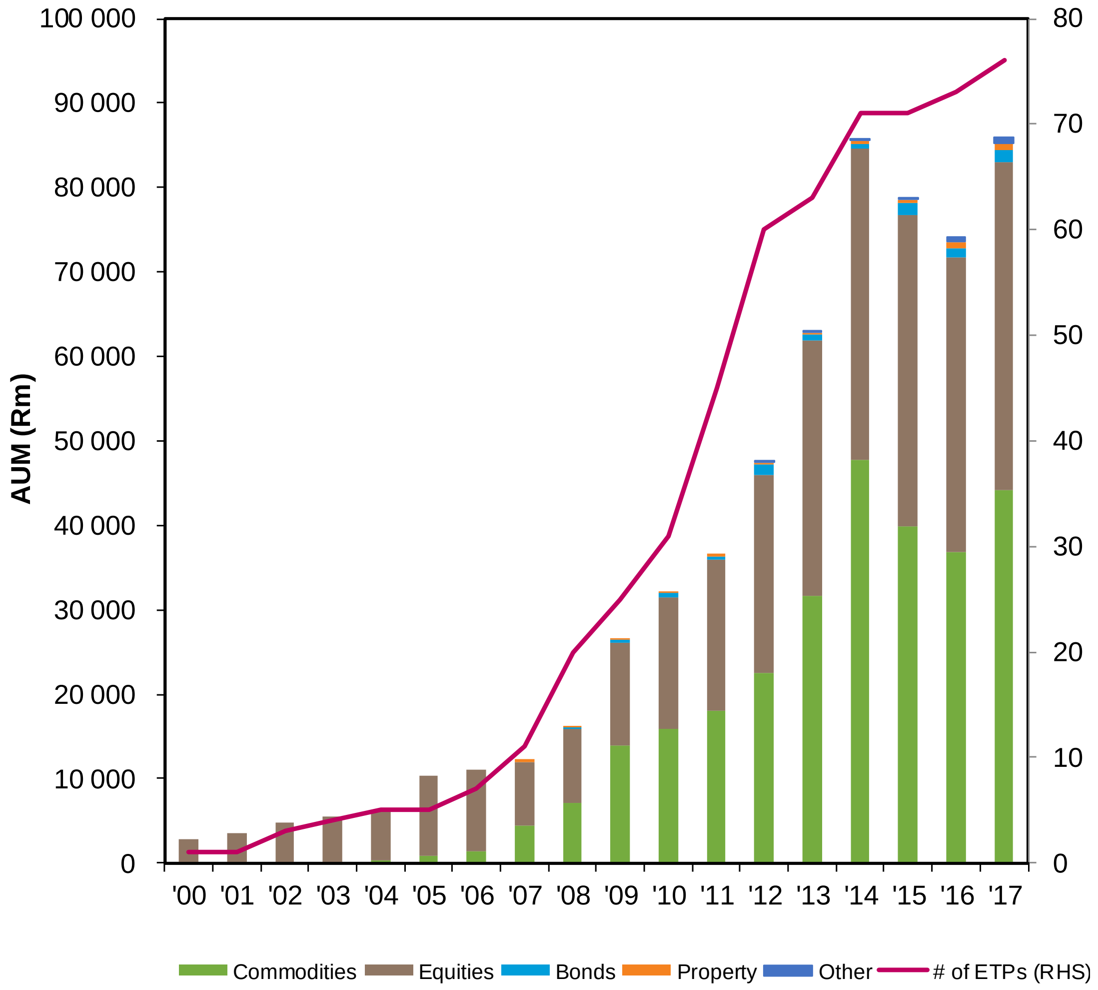
# SA history




- ETFs launched in SA in 2000 (Satrix40); currently 76 ETPs listed on JSE
- Assets of ±R86 billion, tripled since 2009
- National Treasury has identified ETFs as key in achieving reduction in costs and increase in transparency in their quest to reform the retirement and savings industry*

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*Source: JSE, ProfileMedia*  ** Strengthening retirement savings – National Treasury 14-May-12*

# ETFs compared to Unit Trusts

- Most ETFs are 'listed unit trusts' – listing offers
  - Live and fair value pricing (guaranteed liquidity)
  - Electronic transfer, registration, custodianship on a single central register in the investors' names
  - Additional investor protection and regulation of the JSE
- ETFs are NOT:
  - Futures, options or derivatives
  - Synthetic replication (not allowed in SA)
  - Geared, levered instruments (not allowed in SA)

# ETFs vs. ETNs

- Exchange traded note (ETN) sounds a lot like an Exchange traded fund (ETF), but it's a very different type of investment
  - Only thing they have in common is that they are both listed on the JSE
- An ETN carries the credit risk of the issuing bank, and is not necessarily backed by physical assets
  - The issuer promises the investor to pay him a return based on the reference asset, but the investor runs the risk that the issuer will not be able to fulfil this promise
  - The issuing bank may choose to hedge his own risk by holding physical assets, but is not obliged to do so
- Examples of ETNs on the JSE:
  - International index-tracking equity funds (i.e. very similar to ETFs)
  - Commodities; Currencies

# Part III

## What is an index?

# What is an index?

- A single number that represents the combined value of a group of things
  - e.g. Consumer prices; Manufacturing activity; Share prices, etc.
- A stock market index is a statistic reflecting the composite value of its components
  - If "most" of the stocks increase in price, the stock market index will also rise, even if some prices fall
  - It represents the characteristics of its component stocks, all of which bear some commonality:
    - trading on the same stock market, e.g. JSE
    - belonging to the same industry, e.g. Financials
    - having similar size / market capitalisations, e.g. Top40

# How are indices used?

- Indices are often used to benchmark / measure the performance of portfolios such as collective investment schemes (CISs) / unit trusts / actively managed investment funds

- In the case of an index-tracking investment the index is used as an allocation guideline / mandate – full replication

# How do you construct an index?

| UNIVERSE | SHARES IN ISSUE | PRICE | MARKET CAP | J200 WEIGHT | J2EQ WEIGHT |
|---|---|---|---|---|---|
| BIL | 100 | 21 | 2100 | 20.4% | 10.0% |
| AGL | 60 | 28 | 1680 | 16.3% | 10.0% |
| SAB | 60 | 22 | 1320 | 12.8% | 10.0% |
| MTN | 80 | 12 | 960 | 9.3% | 10.0% |
| SOL | 30 | 30 | 900 | 8.8% | 10.0% |
| SBK | 70 | 11 | 770 | 7.5% | 10.0% |
| CFR | 240 | 3 | 720 | 7.0% | 10.0% |
| NPN | 20 | 31 | 620 | 6.0% | 10.0% |
| IMP | 30 | 19 | 570 | 5.5% | 10.0% |
| ANG | 20 | 32 | 640 | 6.2% | 10.0% |
| | | | 10280 | | |

*Source: Satrix*

# How do you construct an index?

| UNIVERSE | PRICE | J200 WEIGHT | J2EQ WEIGHT |
|---|---|---|---|
| BIL | 25 | 23.4% | 11.7% |
| AGL | 28 | 15.7% | 9.8% |
| SAB | 22 | 12.4% | 9.8% |
| MTN | 12 | 9.0% | 9.8% |
| SOL | 30 | 8.4% | 9.8% |
| SBK | 11 | 7.2% | 9.8% |
| CFR | 3 | 6.7% | 9.8% |
| NPN | 31 | 5.8% | 9.8% |
| IMP | 19 | 5.3% | 9.8% |
| ANG | 32 | 6.0% | 9.8% |

*Source: Satrix*

# How do you construct an index?

| UNIVERSE | PRICE | J200 WEIGHT | J2EQ WEIGHT |
|---|---|---|---|
| BIL | 25 | 23.7% | 11.8% |
| AGL | 26 | 14.8% | 9.2% |
| SAB | 22 | 12.5% | 9.9% |
| MTN | 12 | 9.1% | 9.9% |
| SOL | 30 | 8.5% | 9.9% |
| SBK | 11 | 7.3% | 9.9% |
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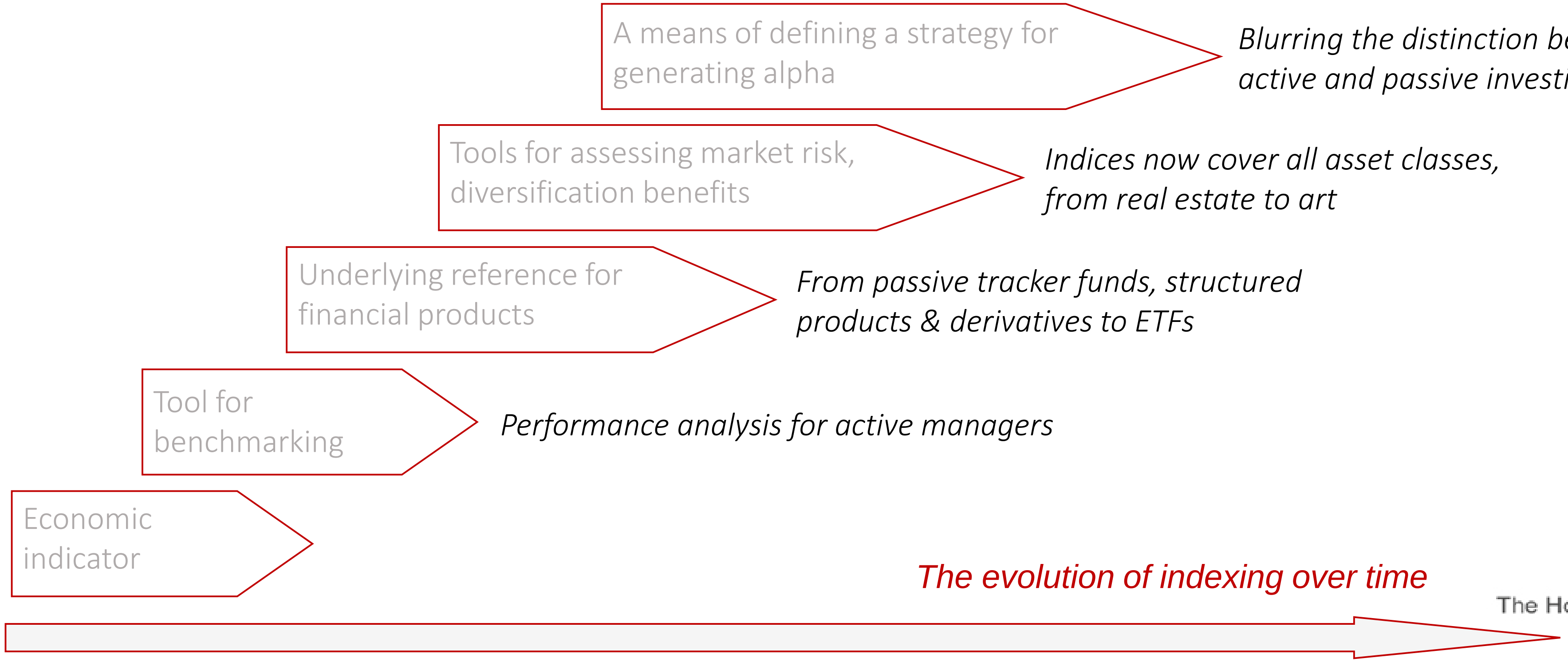
| IMP | 19 | 5.4% | 9.9% |
| ANG | 32 | 6.1% | 9.9% |

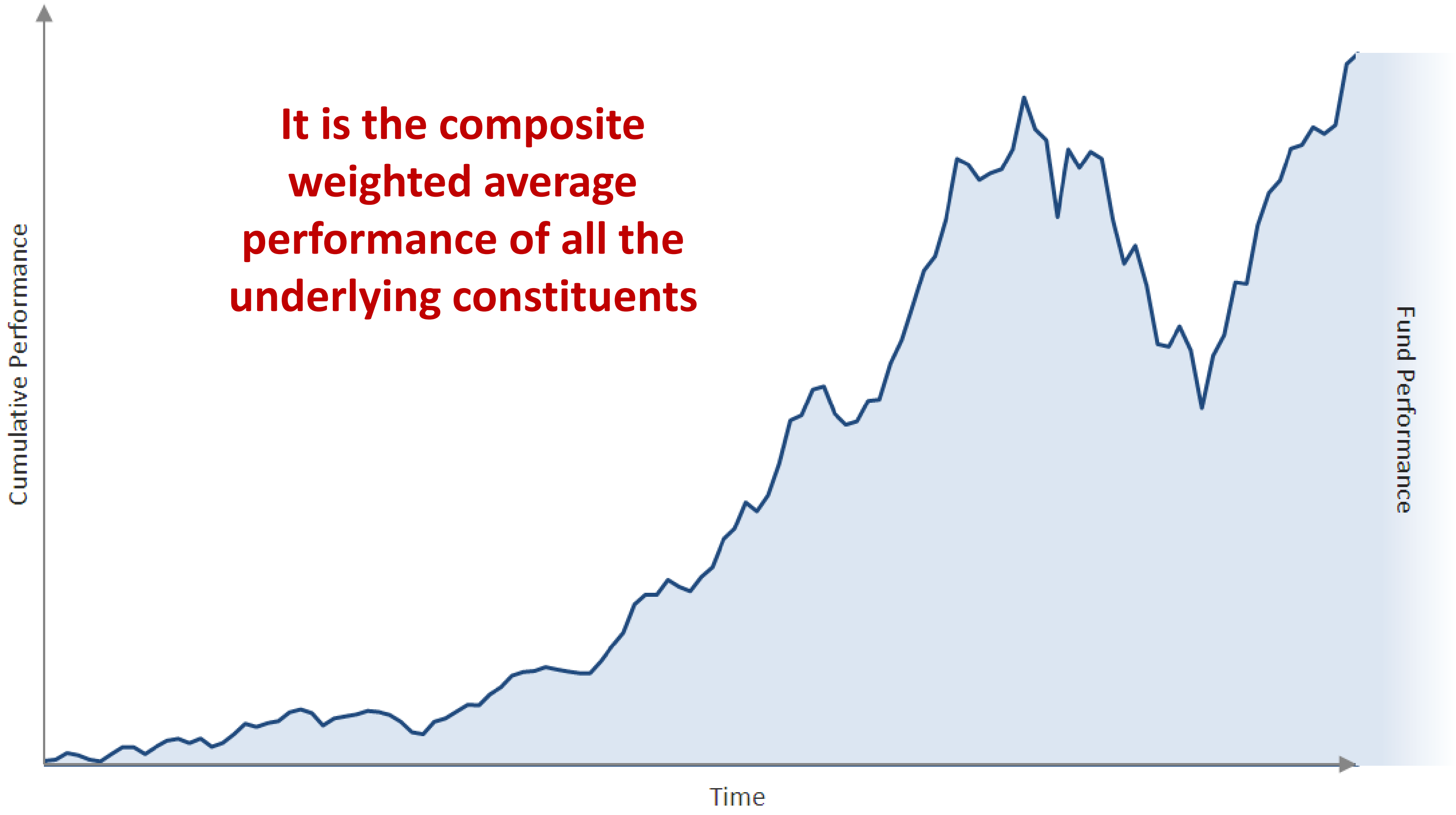
*Source: Satrix*

# Evolution of Indexing

- As the design and application of indices evolve, the introduction of new indexation concepts creates new investment opportunities and choice

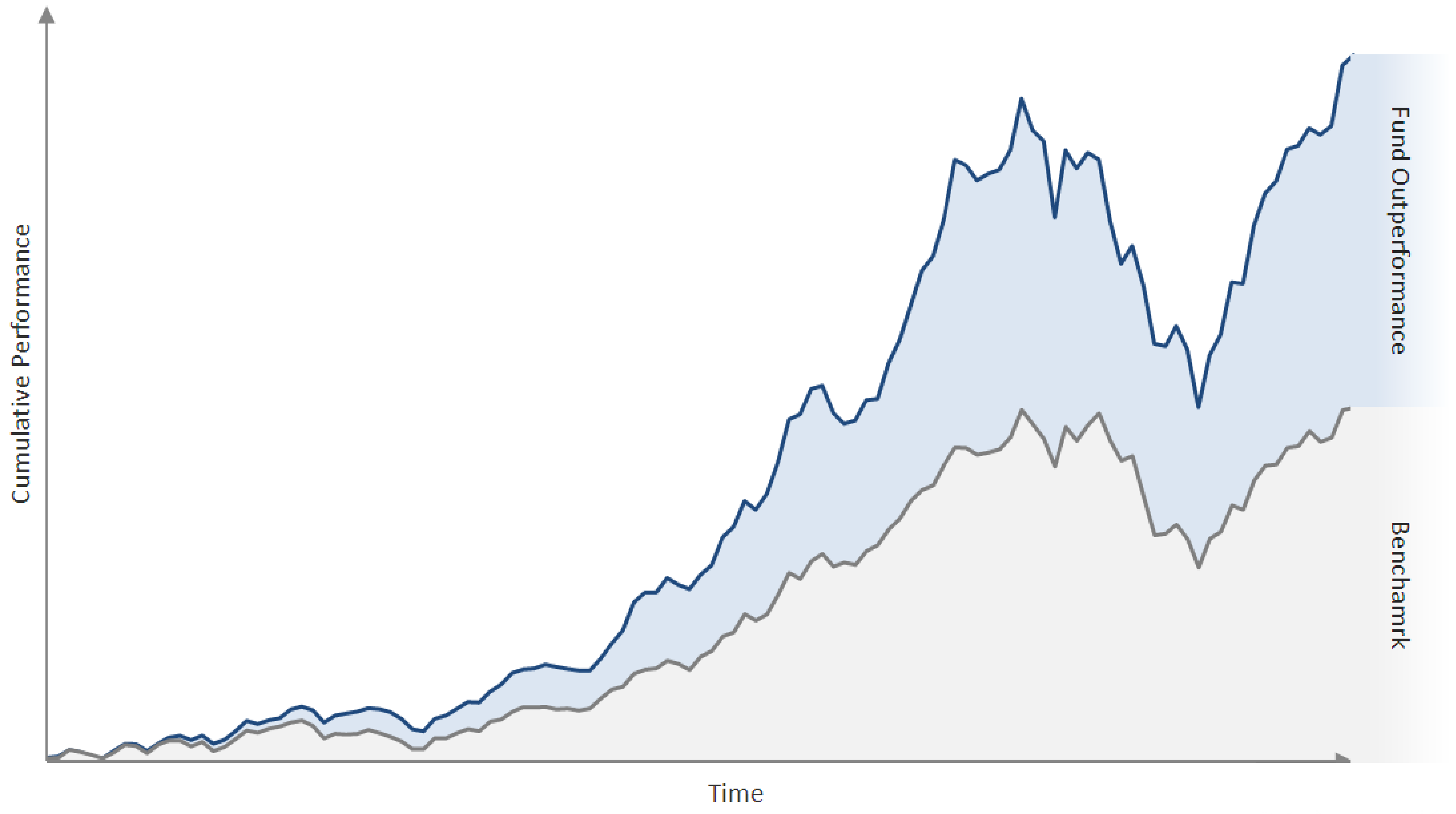


# Where does performance come from?



# Traditionally, Beta refers to the market performance…

…alpha refers to out- or under-performance of a fund to this market benchmark

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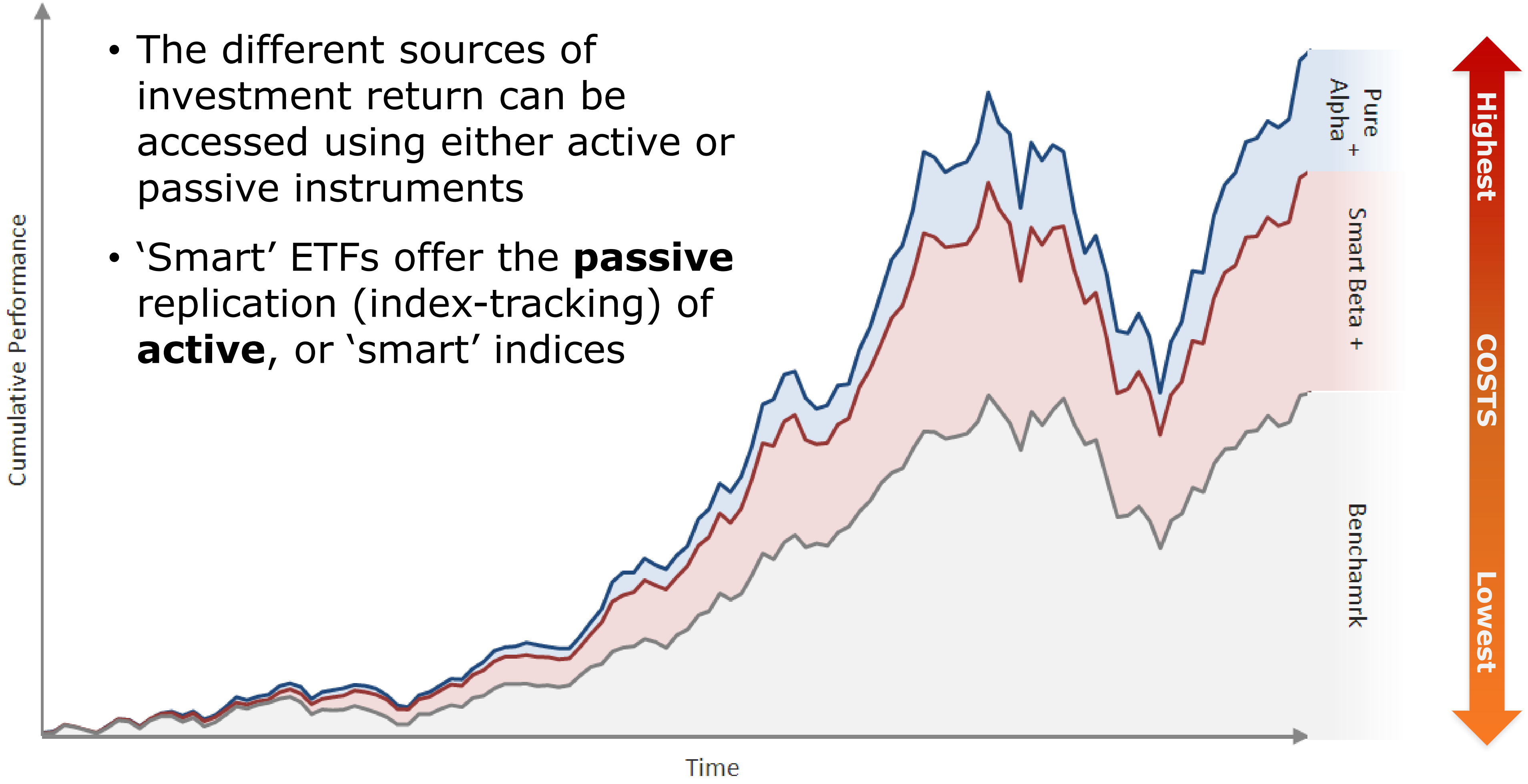
# Beyond Market Cap Weighting

- Risks associated with “traditional” indexation
  - Full participation in price “bubbles” and crashes
  - Behind the curve: inclusion after price increases and exclusion after price falls
  - Assumption that size is the only driver of return
- Rise of smart / factor / strategy indices
  - Alternative selection criteria
  - Alternative weighting methodologies

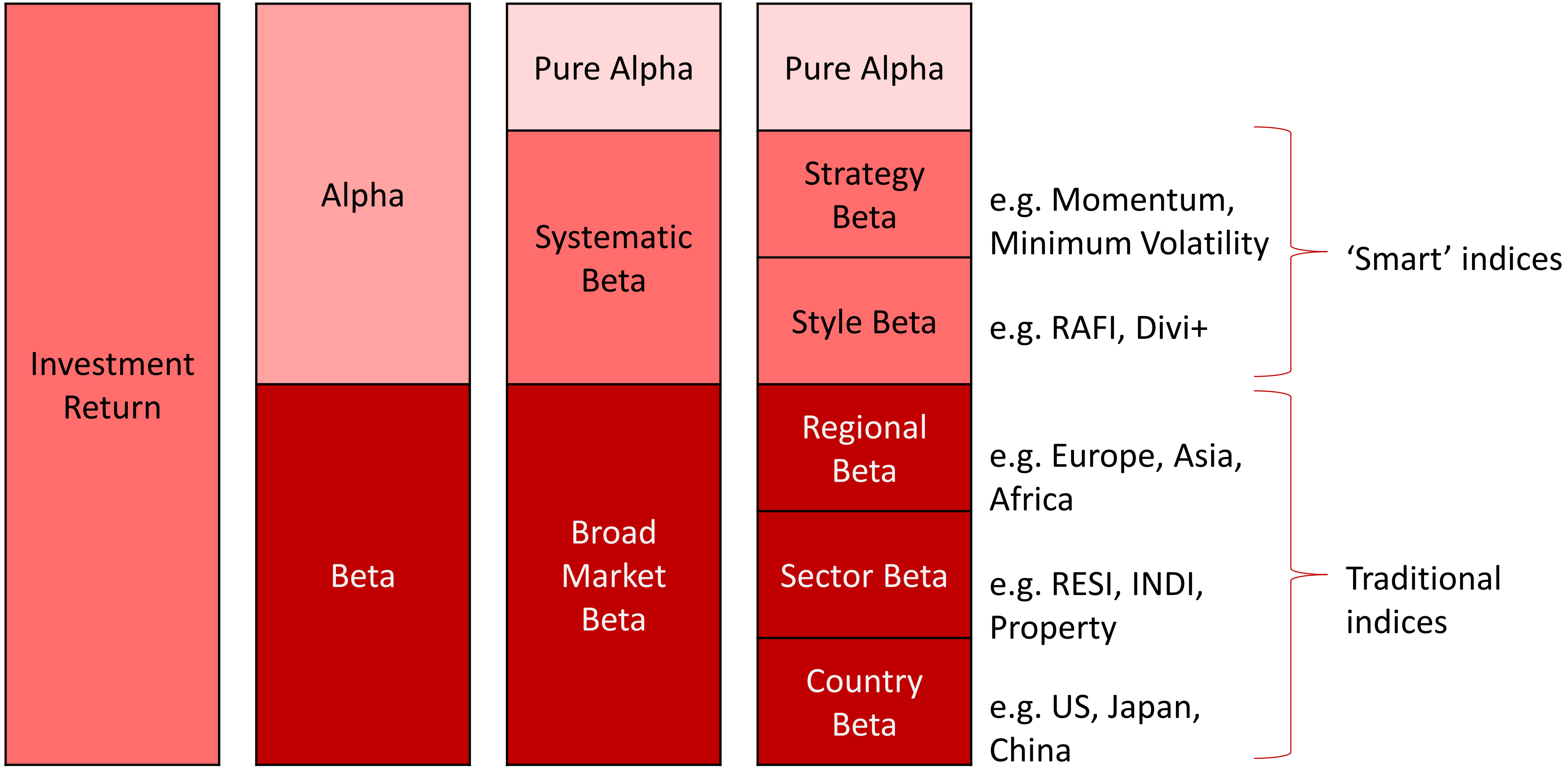
# Indices Reflect Different Sources of Investment Return

- The different sources of investment return can be accessed using either active or passive instruments
- ‘Smart’ ETFs offer the **passive** replication (index-tracking) of **active**, or ‘smart’ indices




*Illustrative*

# Indices Reflect Different Sources of Investment Return



# Mechanics of Indices

Ground rules and methodology, consisting of:

- Selection criteria
  - Size
  - Sector, Region, Country
  - Style, e.g. High Dividends (Value), Momentum
  - Strategy, e.g. Minimum Volatility, Low Risk, BEE, Green
- Weighting methodology
  - Size (market cap) – e.g. full, free float, capped, shareholder weighted (SWIX)
  - Strategy / Fundamental – single factor (e.g. dividend yield), multi-factor (e.g. revenue, cash flow, dividends)
  - Equal weighted
- Calculation formulas

# Part IV

## Let’s talk costs

# What we know to be true

Passive

costs less than

Active

# What we know to be true

Buy & Hold Passive

costs less than

So-called Passive

costs less than

Active

doesn't exist

# What we know to be true

Buy & Hold Passive costs less than So-called Passive costs less than Rules-based Active costs less than Traditional Active

doesn't exist

'smart' beta

# Let’s talk costs

- What makes an ETF less expensive?
  - The ‘package deal’ allows for economies of scale
  - There is only one ‘wrapper’ (plastic bag), only one transaction
  - Nobody is paid to make investment decisions for the fund

- But that’s not all…

# How big is impact of trading costs?

- Trading costs, incl. brokerage & statutory charges
- Buying & selling 40 individual shares rather than 1 ETF is a LOT more expensive…

| | **Basket of Top 40 shares** |
|---|---|
| Gross investment amount | R 100 000 |
| Brokerage (0.5% + VAT)* | R 570 |
| JSE fees & levies** | R 555 |
| STT (only buy) | R 250 |
| Net investment amount | R 98 625 |
| **Total cost of investment** | **1.4%** |

** etfSA.co.za brokerage is only 0.08%+VAT*
*** Statutory charges are shared amongst all investors on the day due to bulking*

# How big is impact of trading costs?

- Trading costs, incl. brokerage & statutory charges
- Buying & selling 40 individual shares rather than 1 ETF is a LOT more expensive…

| | **Basket of Top 40 shares** | **Top 40 ETF** |
|---|---|---|
| Gross investment amount | R 100 000 | R 100 000 |
| Brokerage (0.5% + VAT)* | R 570 | R 570 |
| JSE fees & levies** | R 555 | R 13 |
| STT (only buy) | R 250 | |
| Net investment amount | R 98 625 | R 99 417 |
| **Total cost of investment** | **1.4%** | **0.6%** |

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*** Statutory charges are shared amongst all investors on the day due to bulking*

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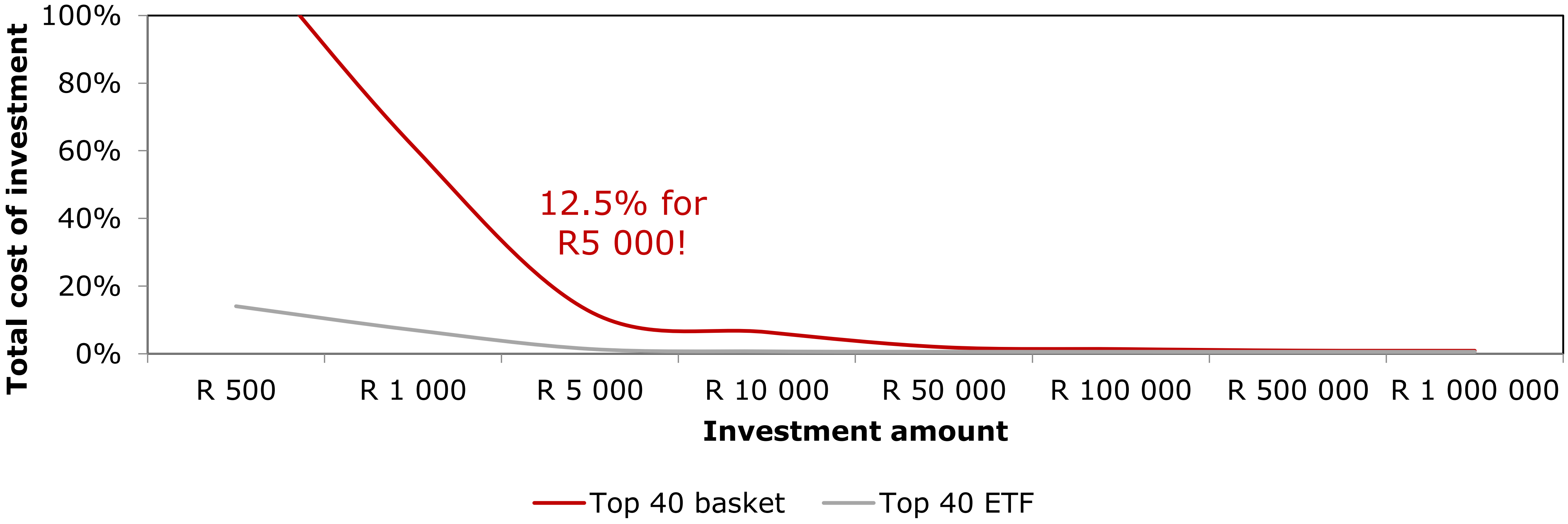
# How big is impact of trading costs?

- …especially if your investment amount is relatively small (retail investors)



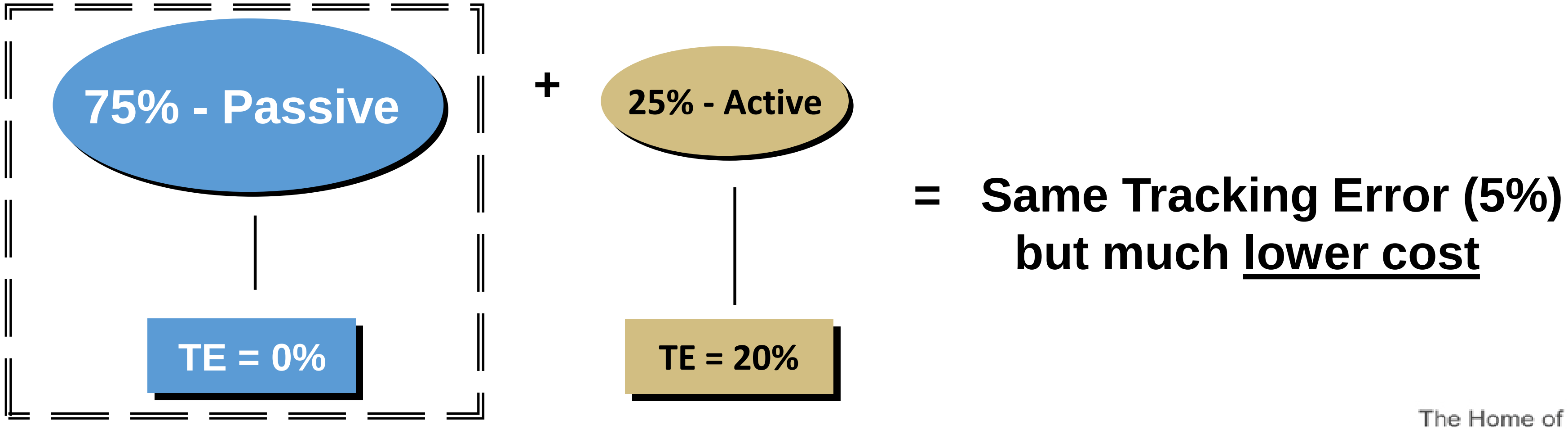
# Part V

## Portfolio Construction

# The Early Years

## Using Beta / Passive to Reduce Costs; **Single** Asset Class (Equity)

- Allowable tracking error (or risk budget) for portfolio: 5%
- 75% Passive (beta), 0% tracking error, very low cost
- 25% Active, 20% tracking error, pay active management fees
- Achieve allowable 5% tracking error at much lower cost

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# Current trend:
# ETF Managed Portfolios

- Investment strategies with >50% of portfolio assets invested in ETFs
- One of the fastest growing segments in the managed account universe:
  - Sep-11: 370 strategies holding $27bn in assets, 43% growth over trailing 1 year
  - Jun-16: 787 strategies holding $84bn in assets, 11% growth q-on-q
- Reasons for strong growth amongst financial advisers:
  - Growth in fee-based models (rather than commission-based)
  - Fiduciary responsibility is shifting towards adviser
  - ETF strategists facilitates access to institutional-type diversification and portfolio management; adviser can focus on gathering & retaining client assets and managing overall financial profile
- Provides access to a broad range of strategies – from stand-alone strategies to one-stop, complete-solution offerings

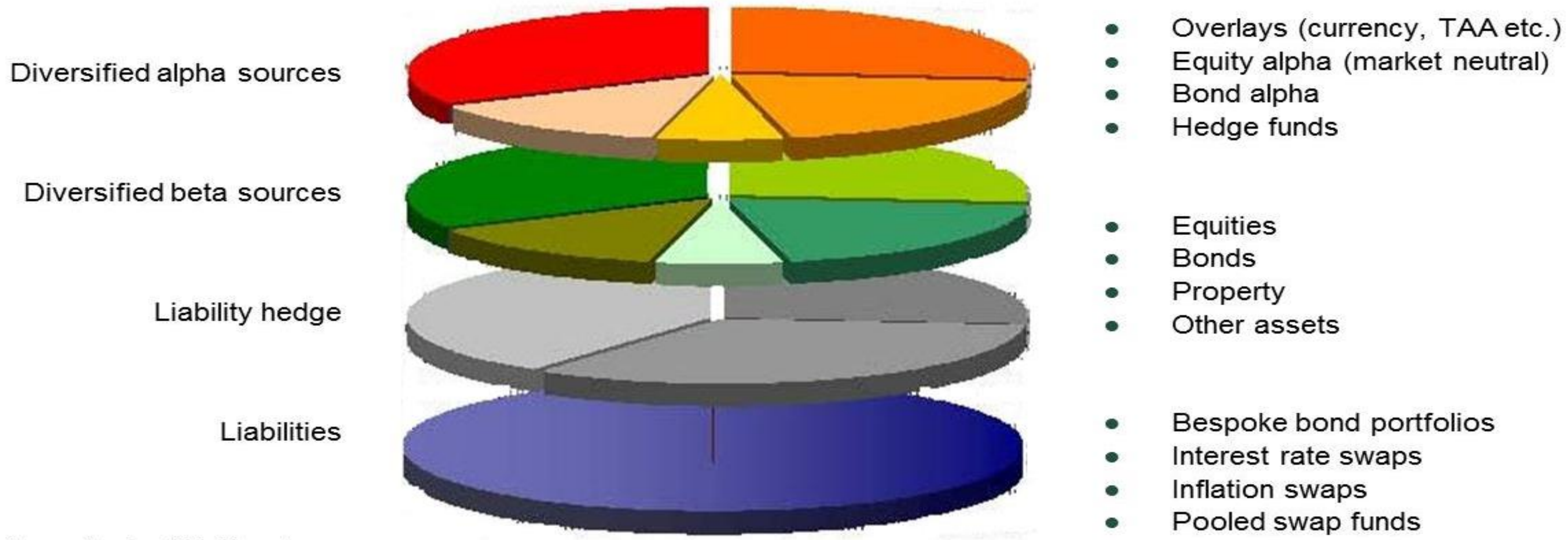
*Source: Morningstar Inc.*

# ETF Managed Portfolios – Classification

| **Universe** | **Asset breadth** | **Portfolio Implementation** | **Primary ETF Exposure Type** |
|---|---|---|---|
| Global | All assets (at least 10% in 'other' assets) | Strategic | Broad market |
| International (non-US) | Balanced (mostly equity & fixed income) | Tactical | Sector |
| US | Equity | Hybrid | Country / region |
| | Fixed Income | | All-inclusive |
| | Alternative | | |

# Target-driven Portfolio Construction

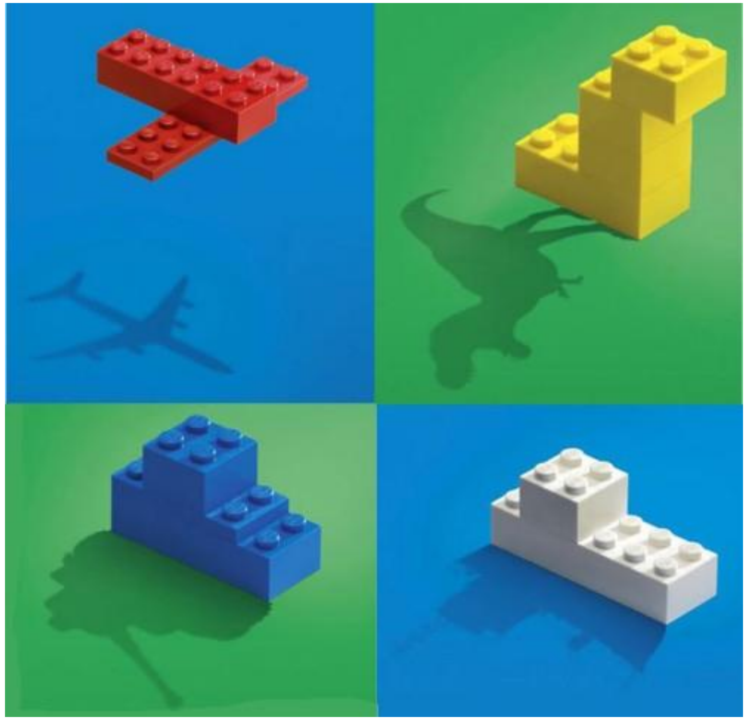
- Construct portfolios by matching risk factors / return drivers, rather than asset classes
- Focus on performance-cost optimisation rather than mean-variance optimisation




*Source: Barclays Global Investors*

# ‘Lego’ Portfolio Construction

- A box of Lego pieces allows you to build lots of things
- The greater the variety of pieces, the more amazing your construction options



# Rules-based, Modular Portfolio Construction – Multi-Asset

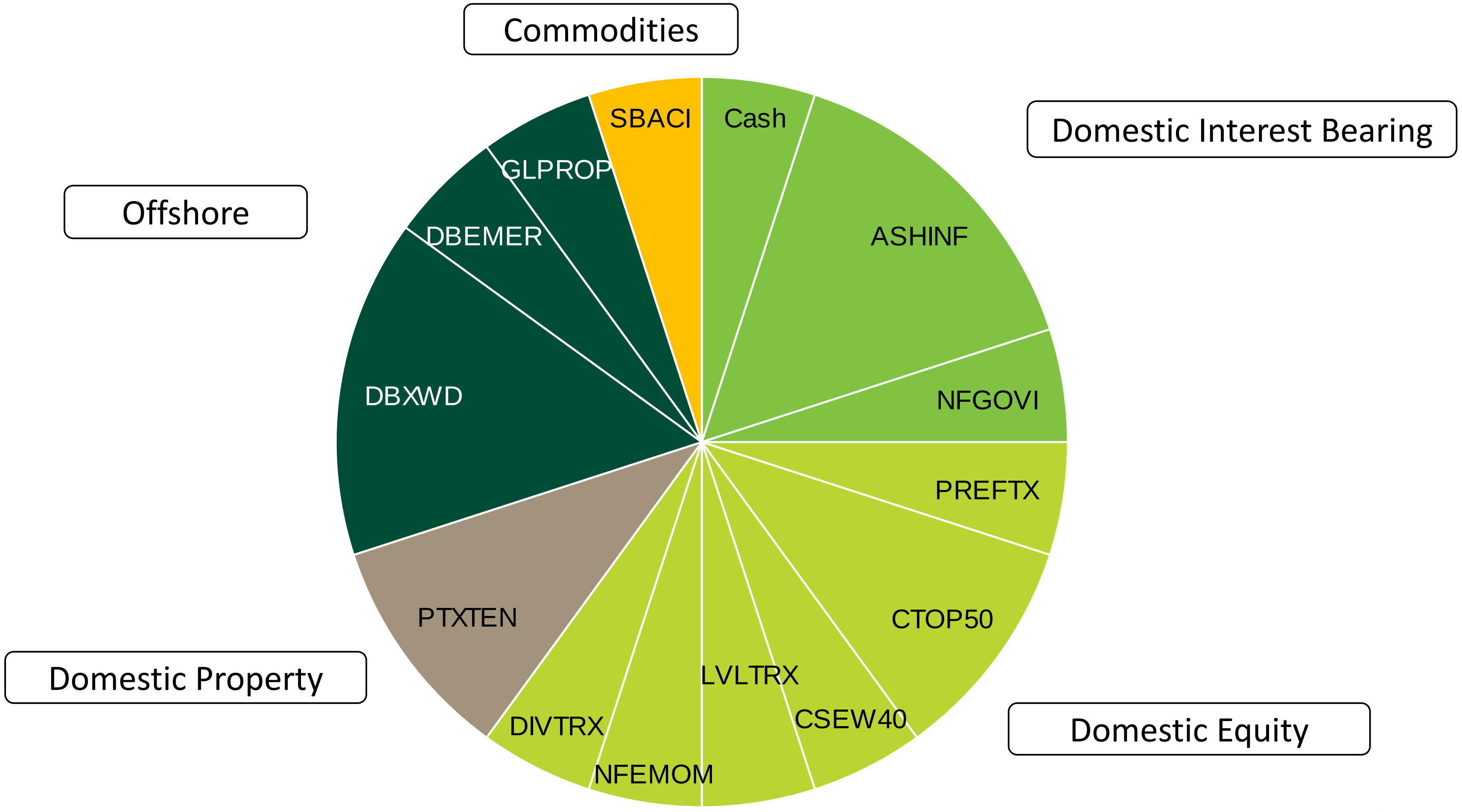
**Balanced Fund: Strategic Allocations into Multi-Asset Classes**

| Equities | Fixed Income | International | Alternatives |
|---|---|---|---|
| Large Cap | Inflation-linkers | Developed Markets | Commodities |
| ESG | Vanilla Bonds | Emerging Markets | Currencies |
| High dividends | Cash | | |
| Property | (Preference Shares) | | |

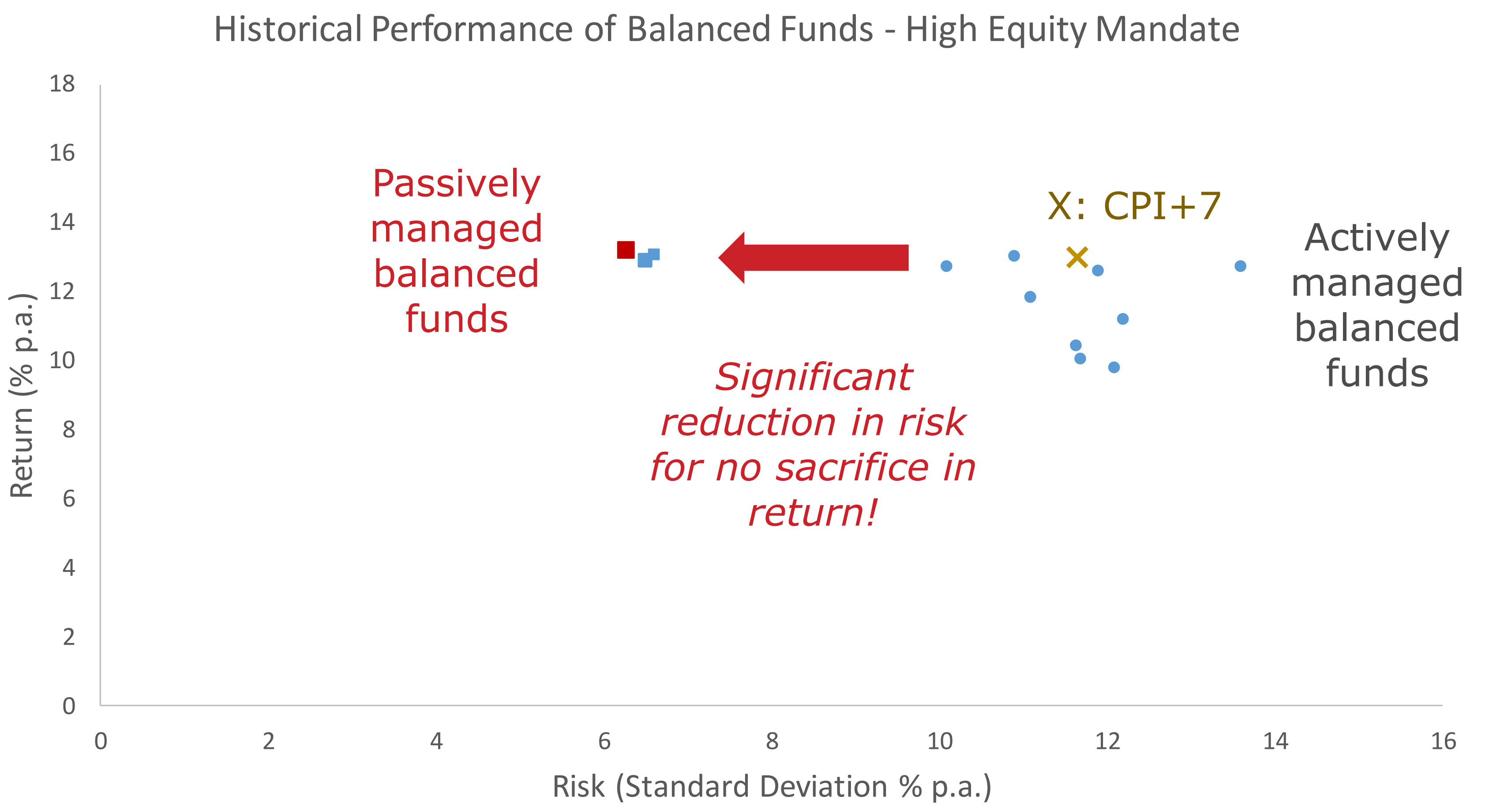
# Examples of ‘passive’ building blocks – JSE-listed ETPs

- 76 Exchange Traded Products (ETPs) – covers most major asset classes
  - Domestic equity
    - Traditional (size-based): e.g. Top40 (Satrix, Ashburton, Stanlib); SWIX40 (Satrix, NewFunds (ABSA), Stanlib); CoreShares SA Top50; Ashburton MidCap
    - Strategic / Factor (smart): e.g. Satrix Dividend Plus; CoreShares Dividend Aristocrats; NewFunds Equity Momentum; Satrix RAFI; NewFunds GIVI series
    - Thematic: NewFunds Shariah40 (Islamic finance); NewFunds NewSA (BEE scores)
  - Domestic bonds: Ashburton Inflation-X; NewFunds GOVI & ILBI; Satrix ILBI
  - Domestic property: Proptrax SAPY & Ten; Stanlib Property, Satrix Property
  - Foreign equity: DBX Trackers World, UK, Europe, Japan, China, Emerging Markets; CoreShares S&P500; Satrix World (developed markets), Emerging Markets, S&P500; Cloud Atlas AMI Big 50 Africa ex SA
  - Foreign bonds: Firstrand Dollar Custodial Certificates
  - Foreign property: CoreShares Global Property
  - Commodities: Precious Metals (e.g. NewGold, Platinum, Palladium, Rhodium); Agricultural Commodities (StdBank Corn, Wheat); Energy (StdBank Oil)
  - Currencies: US Dollar, Euro, British Pound
- Can construct fully diversified, Reg.28-compliant, balanced fund portfolios just using ETPs

# Strategic Asset Allocation
# Target return: CPI+7% (example)



# Comparative Risk and Return Profiles of Passive and Active Strategies




*Notes: Average performance for the 5 years to Oct-16*
*Source: ProfileMedia data; etfSA calculations*

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# ‘Passive’ strategies for different time horizons

| Strategic (multi-year) | Both strategic & tactical | Tactical (<1 year) |
|---|---|---|
| Core index or Enhanced index exposure | Achieve target exposures starting from active positions | Allocate cash inflows based on target exposure weights |
| Implementation of strategic investment policy | Over- or under-weight (tilt) relative to index exposures | Active / tactical overlay to strategic allocation strategy |
| Asset allocation / Top down investment strategies | Risk factor management – single or multi-asset | Completion strategy – fill gaps or change effective exposure |
| Strategy / factor / ‘smart’ index as active manager alternative | Thematic or Style tilt investing | Portfolio transition during manager or policy shift |

# Closing Thoughts

# What we know to be true

## *Performance of an index*

*– regardless of performance benchmark or allocation guideline –*

*is a theoretical calculation that can never be matched exactly by actual fund performance*

*neither passively nor actively managed*

# Active 'versus' Passive

- Let's get the basics right:
  - 'Active' and 'Passive' refer to investment **styles**, not investment **instruments** – it's NOT about ETFs vs. unit trusts
  - ETPs cannot be grouped together and compared on a relative basis as if they offer homogenous investment opportunities
  - Index-tracking unit trusts are also 'passive' and 'smart' indices incorporate varying degrees of 'active' decisions
- Active-Passive is a continuum

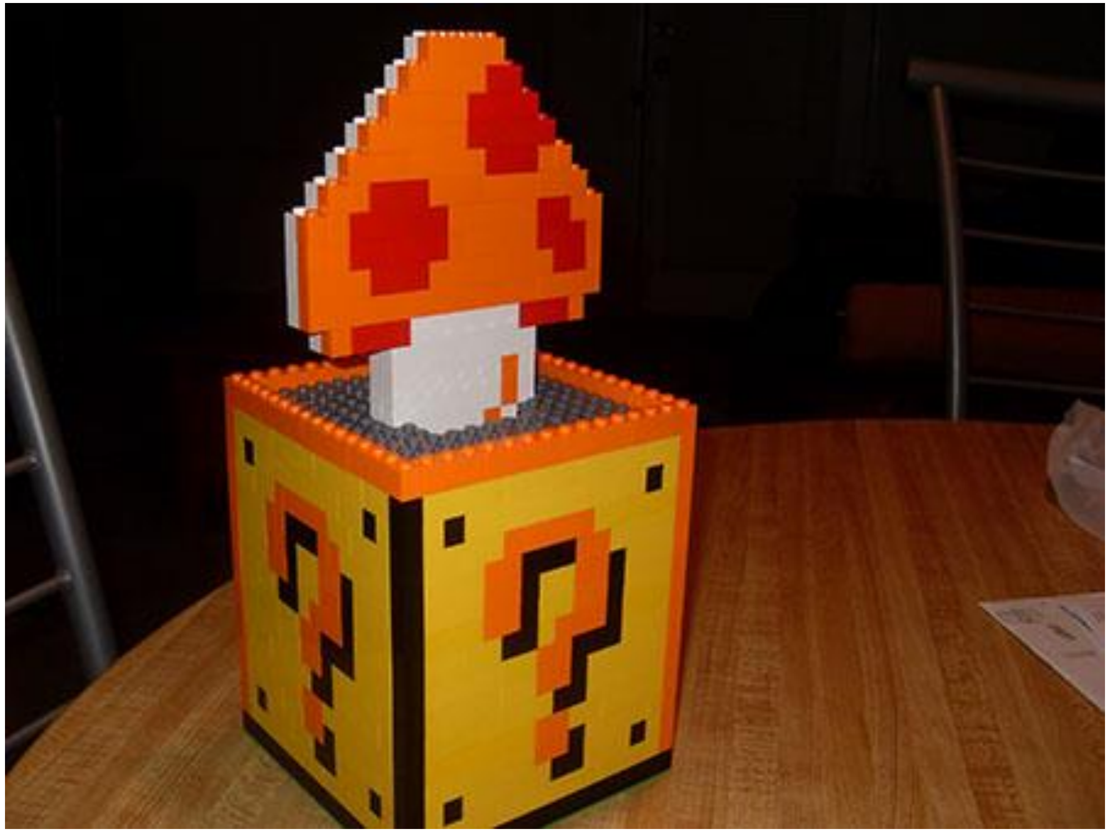
# Final Thoughts on Active & Passive

- There is no such thing as a purely passive investment
  - You still have a target to reach – how will you get there?
  - Someone has to determine the asset mix, the indices to use, the allocations over time
- The key lies in a solution that has the highest probability of meeting your investment objective / funding goal
  - Income, protection from loss, growth, liability matching all demand different investment strategies
- It’s not about the highest return
  - It’s about matching the strategy to the time frame and the certainty you require that you will get there
- Costs matter – understand them, and understand what you are paying for

# In Conclusion

- The new active manager is the one who can best combine all of this
- ‘Active’ design of solutions around a risk budget that adjust exposure to different building blocks, in a pre-determined, rules-based framework, to meet goals like
  - Growth
  - Income
  - Capital protection
- Selection (or termination) based not on performance (returns) but ability to maintain control and meet goals

# Questions – Discussion



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