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NEDGROUP
INVESTMENTS

Active and Passive arrows in the advisor's quiver

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Active AND Passive

Active versus passive debate “old news”

- Benchmarking a problem

Active and passive are inextricable linked

- Passive needs active for market price discovery and liquidity
- Paradox of skill constrains alpha – more difficult to choose an active manager

Evolution of the IFA's toolkit

Financial advise has come a long way.



"Well, you have an excellent life policy — now, would you be interested in some *lifestyle* insurance?"

Typical IFA's journey



Leading to a financial planning “toolkit”



But... advisors are always facing changes



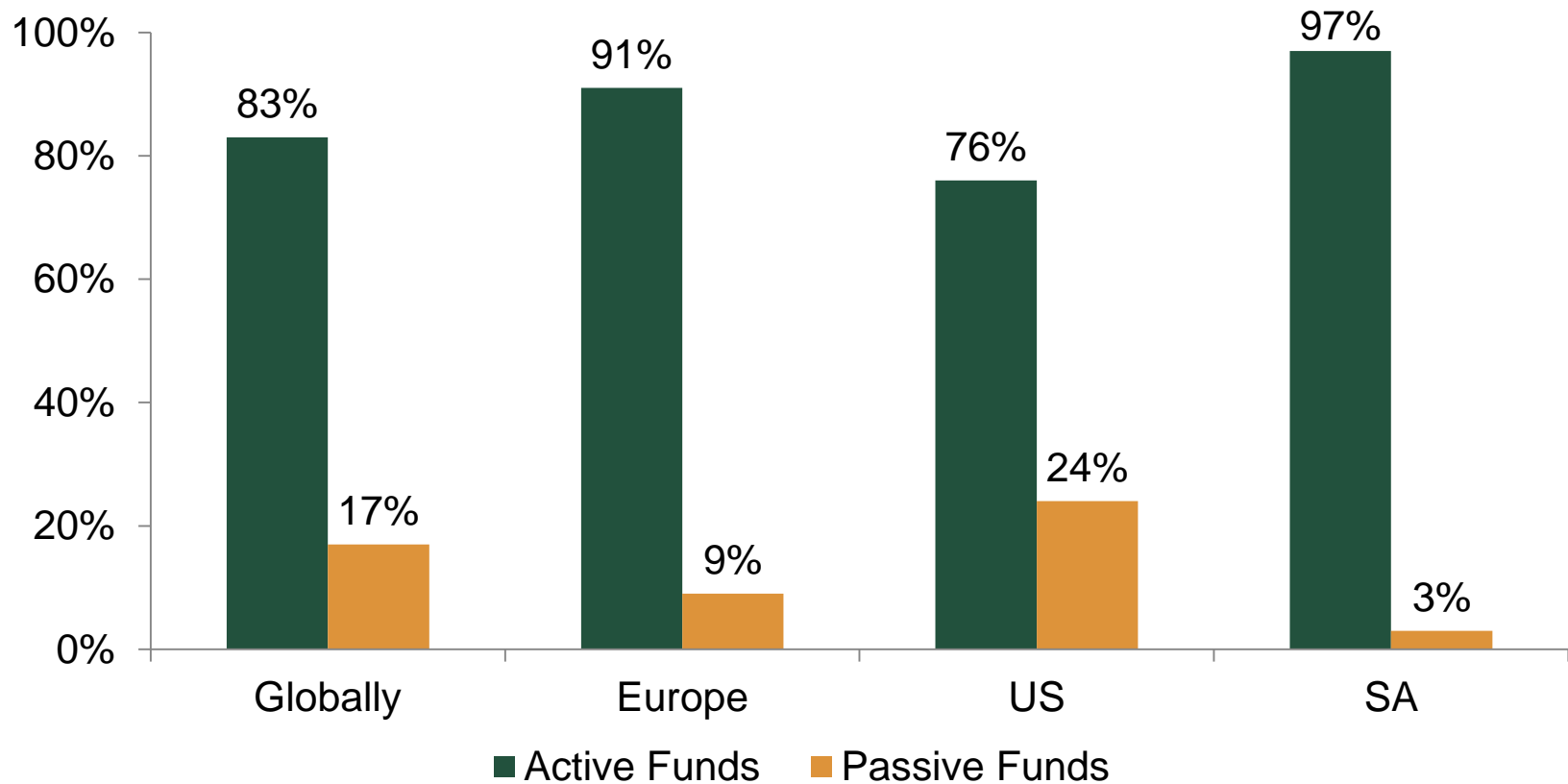
“Hello. We’re from the Government, and we mean you no harm.”

Passive: a new arrow in the advisor's toolkit

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Active funds still dominate



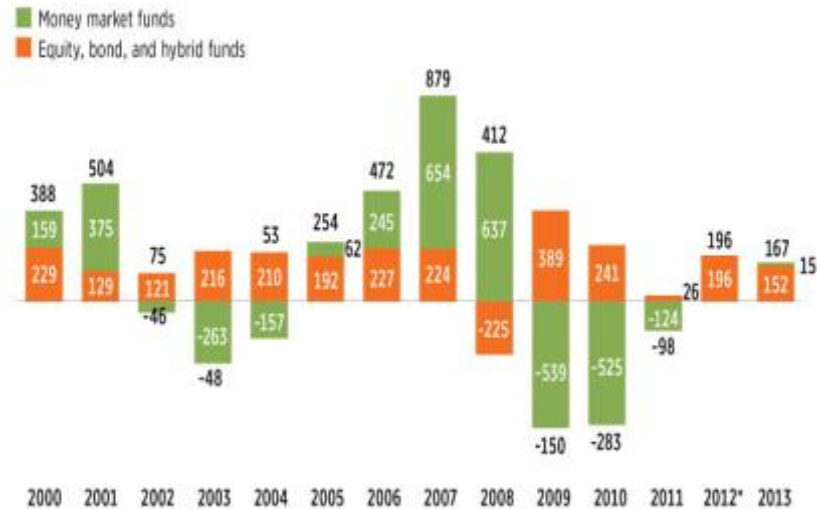
Source: Morningstar, Financial Times, CFA Institute, Nedgroup Investments

Global flows to mutual Funds

Index funds take 75% of net flows in 2013

Net New Cash Flow to Mutual Funds

Billions of dollars, 2000-2013



Download an Excel file of this data.

* In 2012, investors withdrew less than \$500 million from money market funds.
Note: Components may not add to the total because of rounding.

Net New Cash Flow to Index Mutual Funds

Billions of dollars, 2000-2013



Download an Excel file of this data.

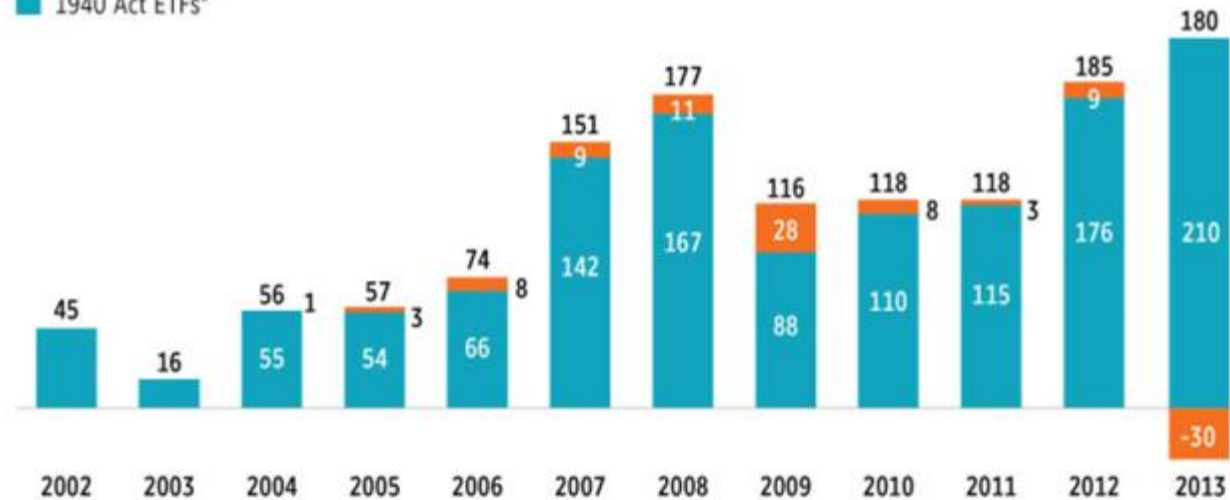
Note: Components may not add to the total because of rounding.

Even more flows have gone into ETFs

Net Issuance of ETF Shares

Billions of dollars, 2002–2013

- Non-1940 Act ETFs¹
- 1940 Act ETFs²



Download an [Excel file](#) of this data.

¹ The funds in this category are not registered under the Investment Company Act of 1940 and invest primarily in commodities, currencies, and futures.

² The funds in this category are registered under the Investment Company Act of 1940.

Note: Data for ETFs that invest primarily in other ETFs are excluded from the totals. Components may not add to the total because of rounding.

Key benefits of passive investing



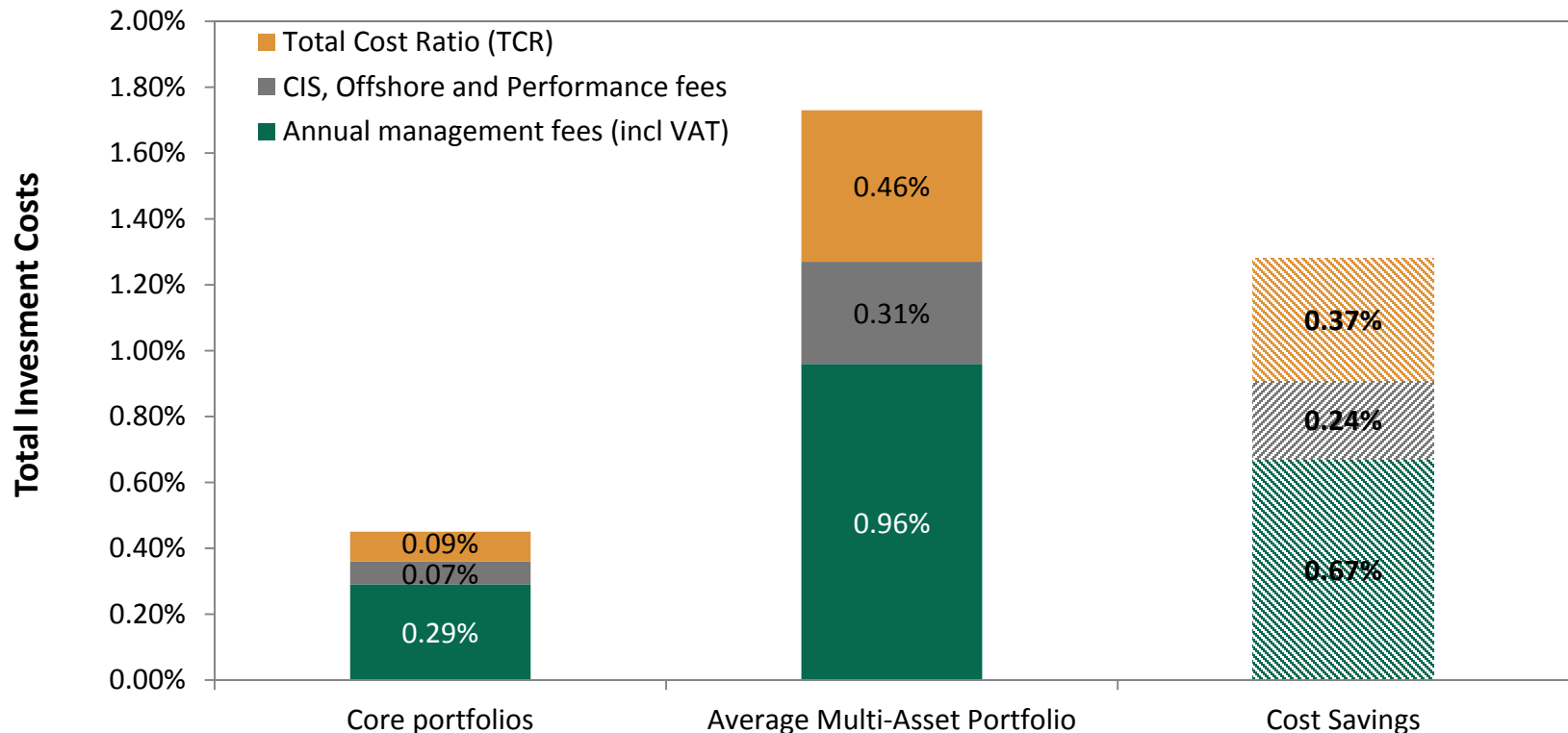
The revolution in SA Index funds

Multi-asset core portfolios (passive balanced)

- Incorporated in to traditional financial planning process
- Combined with active portfolios in Core-Active™ strategy
- Help lower overall investor TER, especially for larger investor
- Member level Regulation 28 compliance
- Unit trust preferred to ETF

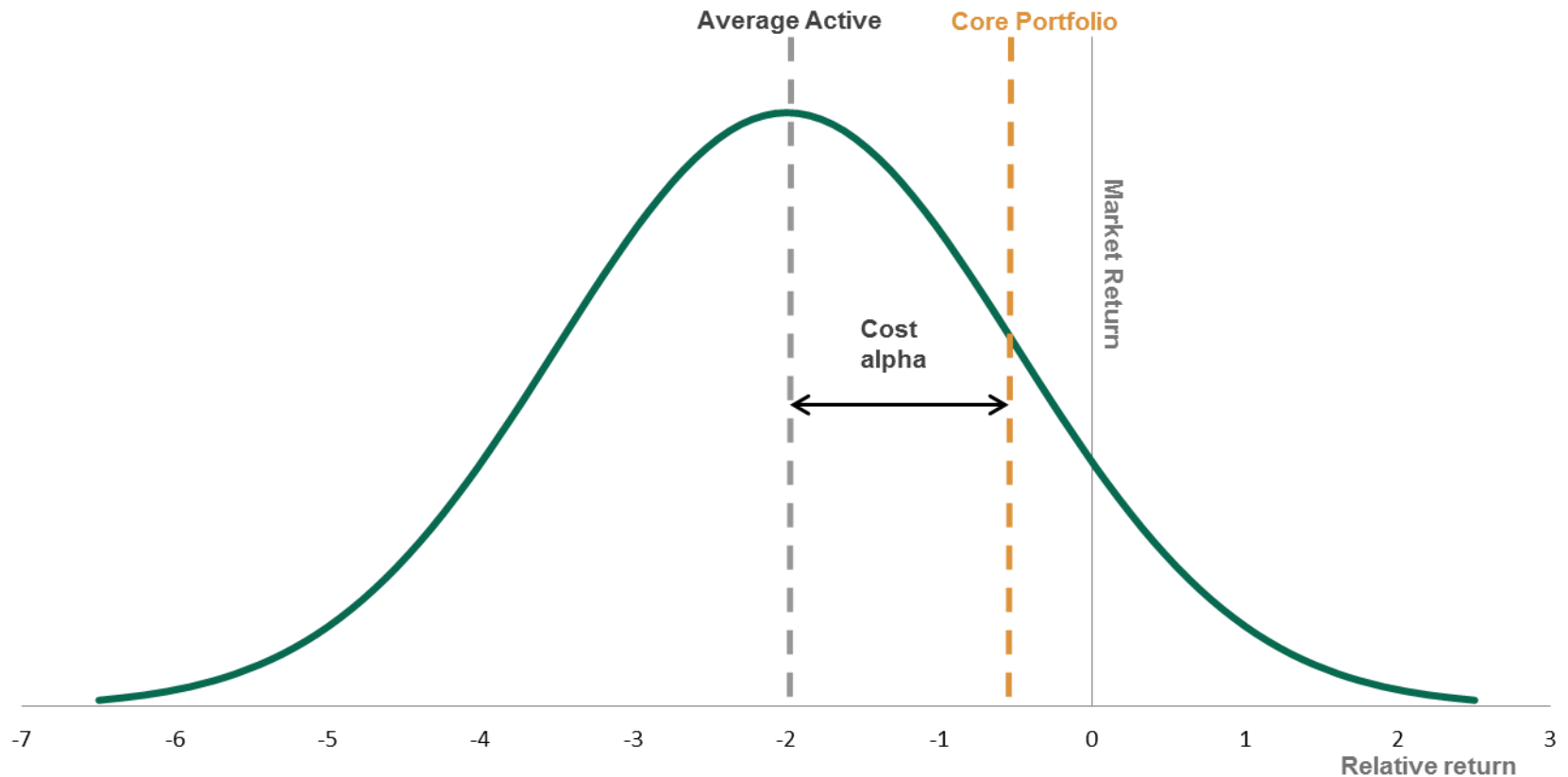
Overall impact on costs – Core Range

Allan Gray Platform (rebates included)



1. Based on the September 2014 TERs of all low, medium and high equity multi-asset funds (excluding Fund of Funds).
2. Total Cost Ratio includes all trading costs including brokerage, STT and STRATE. For average (active) portfolios we have assumed a 60% turnover of the portfolio over 12 months with brokerage charges of 0.25% on the buy and sell side.

Cost 'alpha' – a diversified source of alpha



What makes a good passive investment?

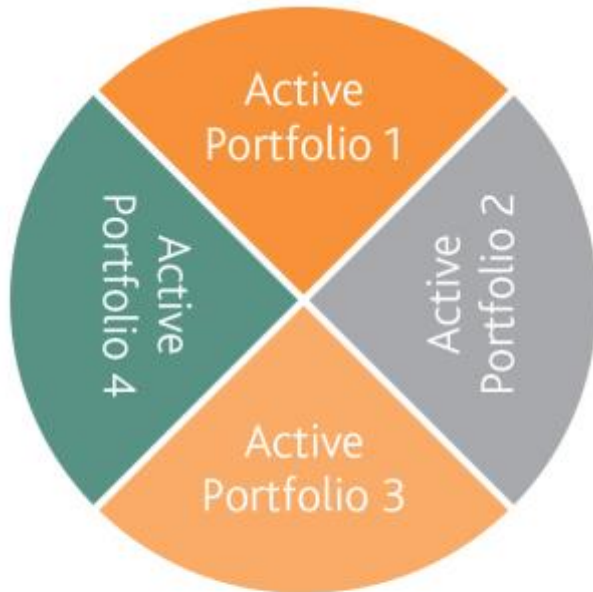
A good passive investment portfolio

- Designed with a clear goal in mind
- Low overall expenses
- Fits into your financial planning process (multi-asset)
- Scale to drive down costs and improve efficiency (TE)
- Optimally implemented by a portfolio manager with scale and experience

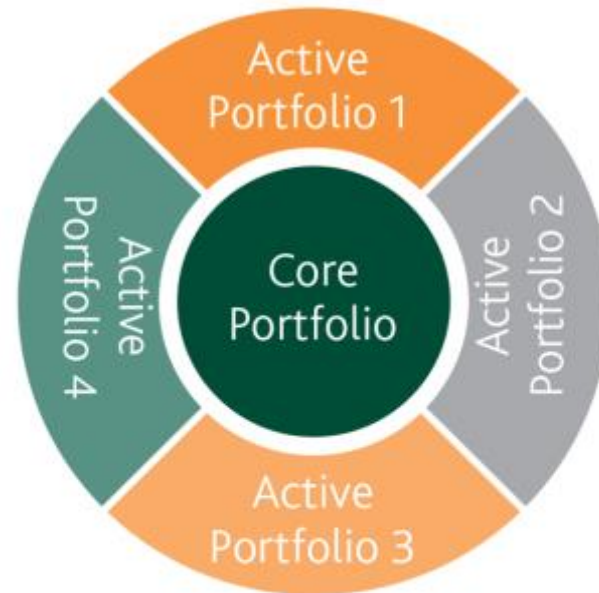
Combining active and passive strategies

A Core-Active™ approach

A Core-Active™ approach



Typical investment strategy consisting of four different active balanced portfolios



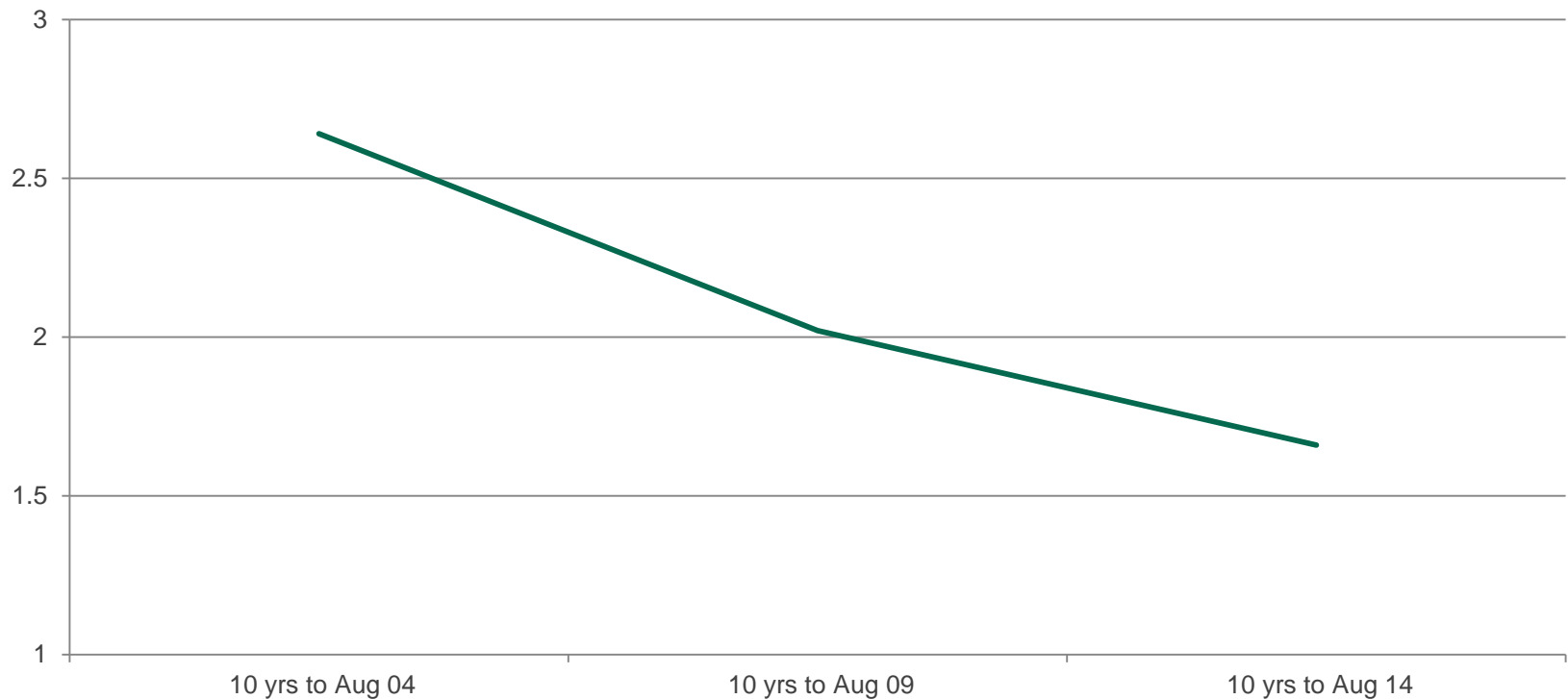
Core-Active™ strategy including four active balanced portfolios and a low cost Core portfolio

Some important questions

- Do you have the skills to pick active managers that will outperform?
- Are you sufficiently diversified across
 - Investment strategies?
 - Asset classes?
- How important are costs to you?

'Alpha' has been shrinking

South African equity funds: Top quartile 'alpha' (% p.a.)

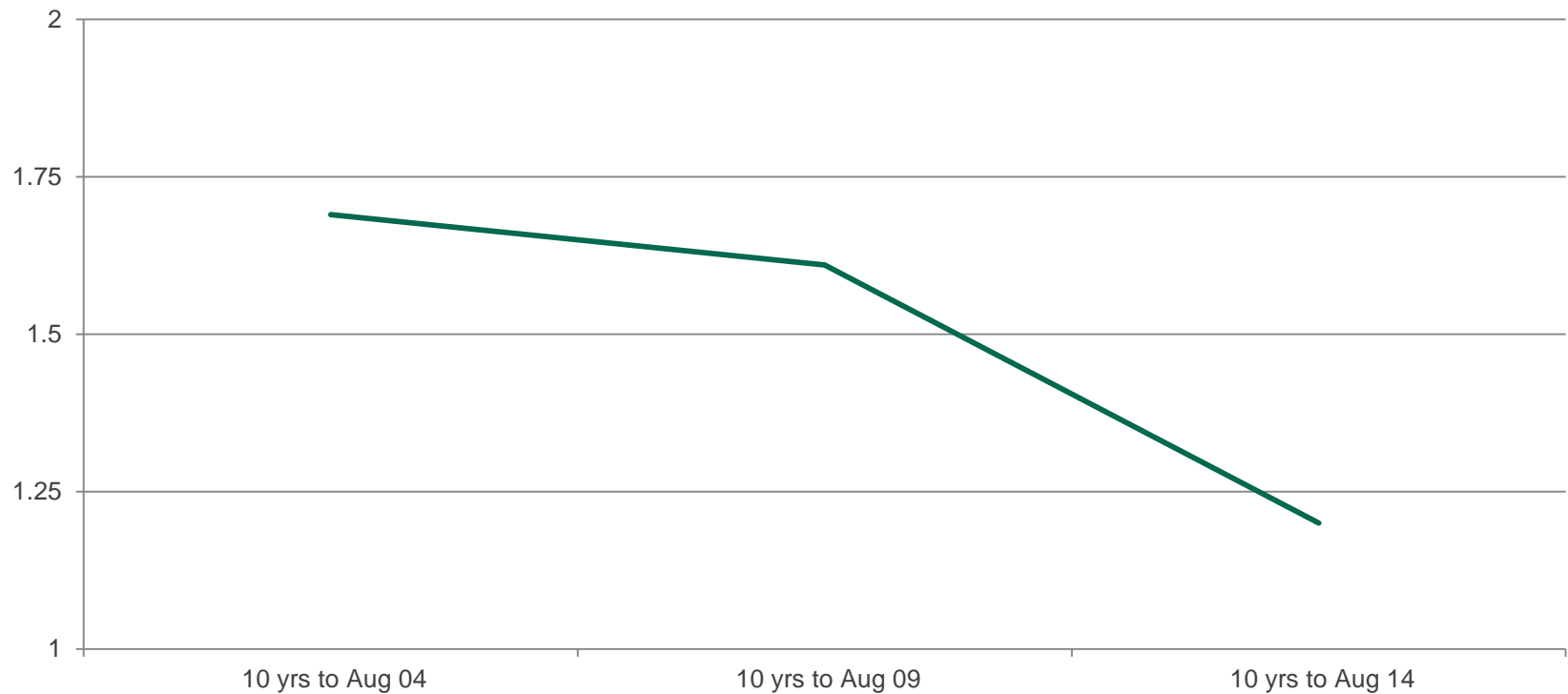


Source: Morningstar, Nedgroup Investments
Calculation benchmark: Average fund in category



'Alpha' has been shrinking

Global equity funds: Top quartile alpha (% p.a.)

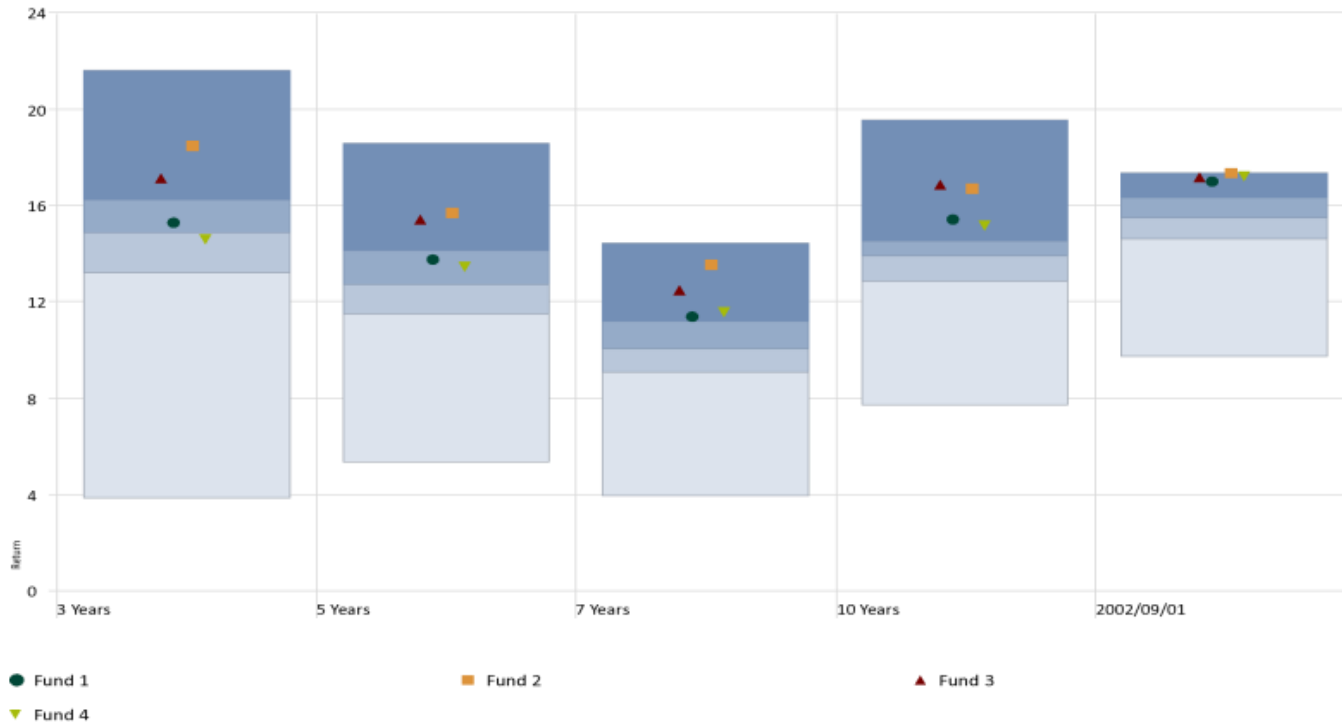


Source: Morningstar, Nedgroup Investments
Calculation benchmark: Average fund in category



South African investors have done well

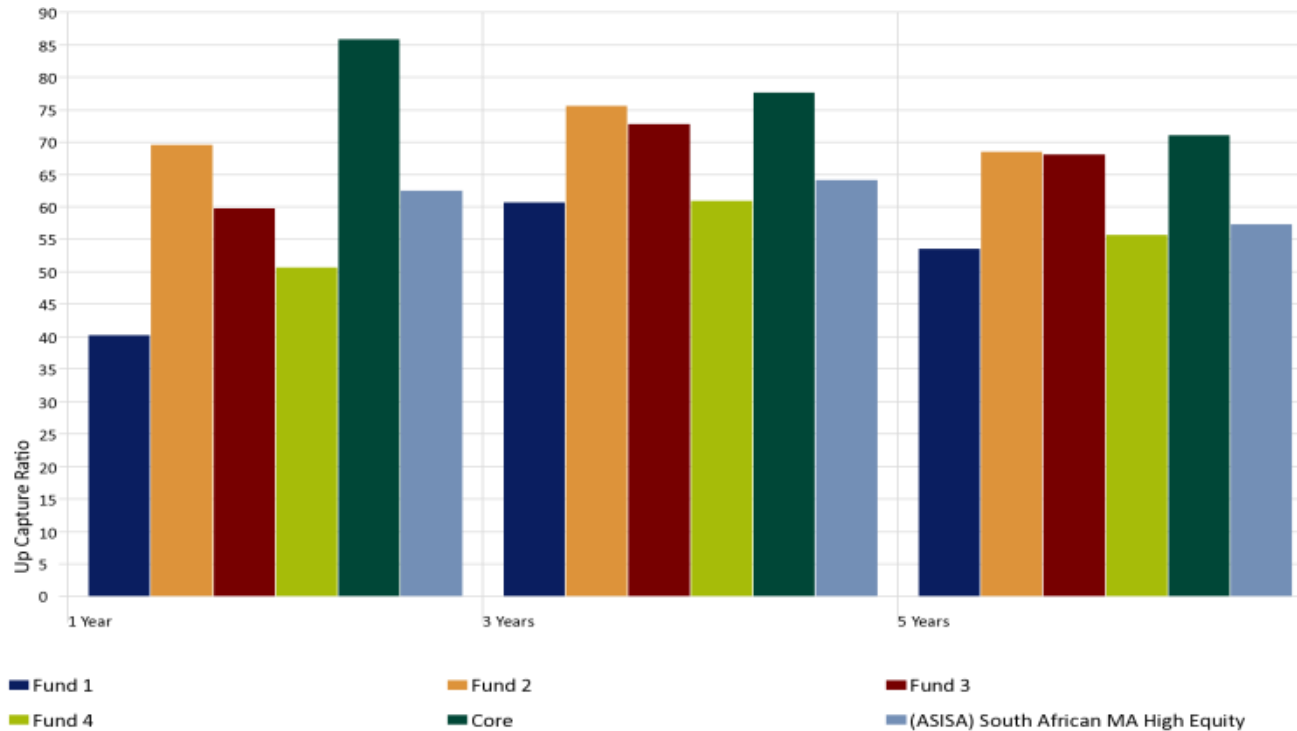
Four largest funds in the SA Multi Asset High Equity category



Source: Morningstar Direct

Different investment strategies - upside

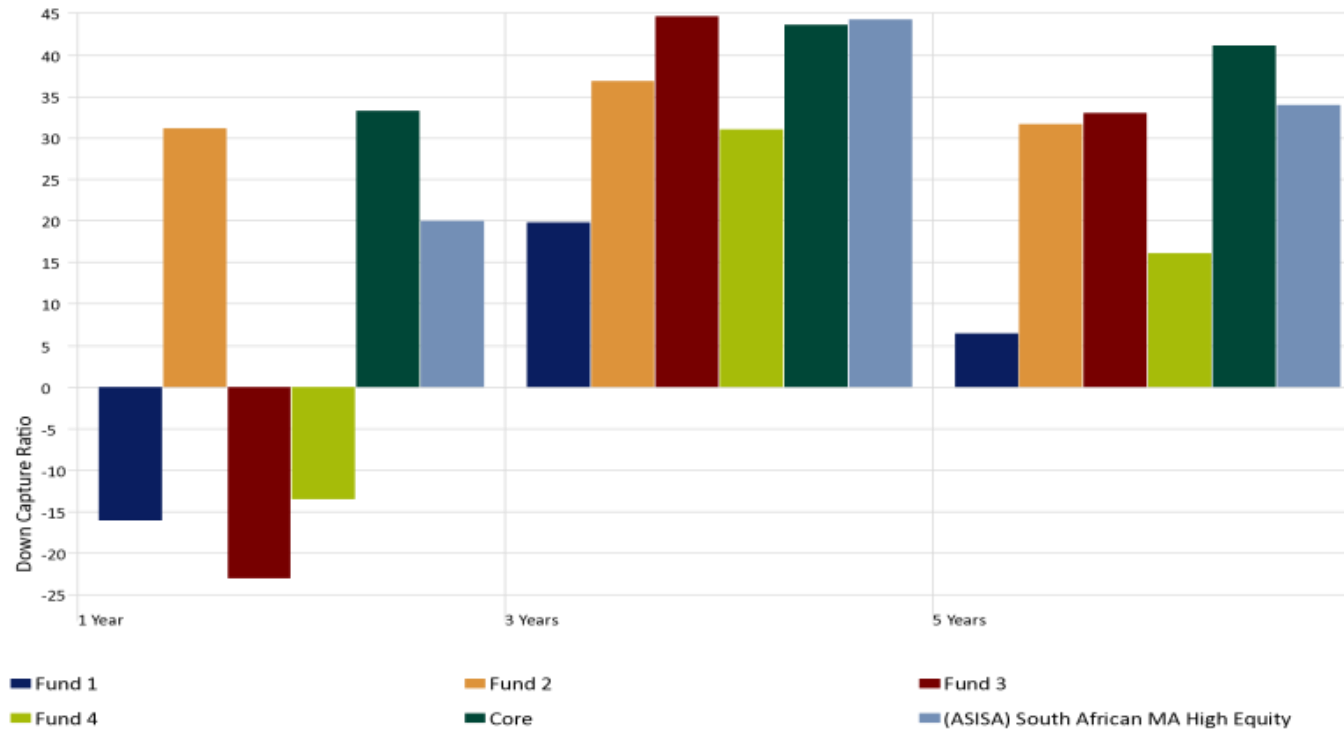
Four largest funds in the SA Multi Asset High Equity category vs SWIX



Source: Morningstar Direct

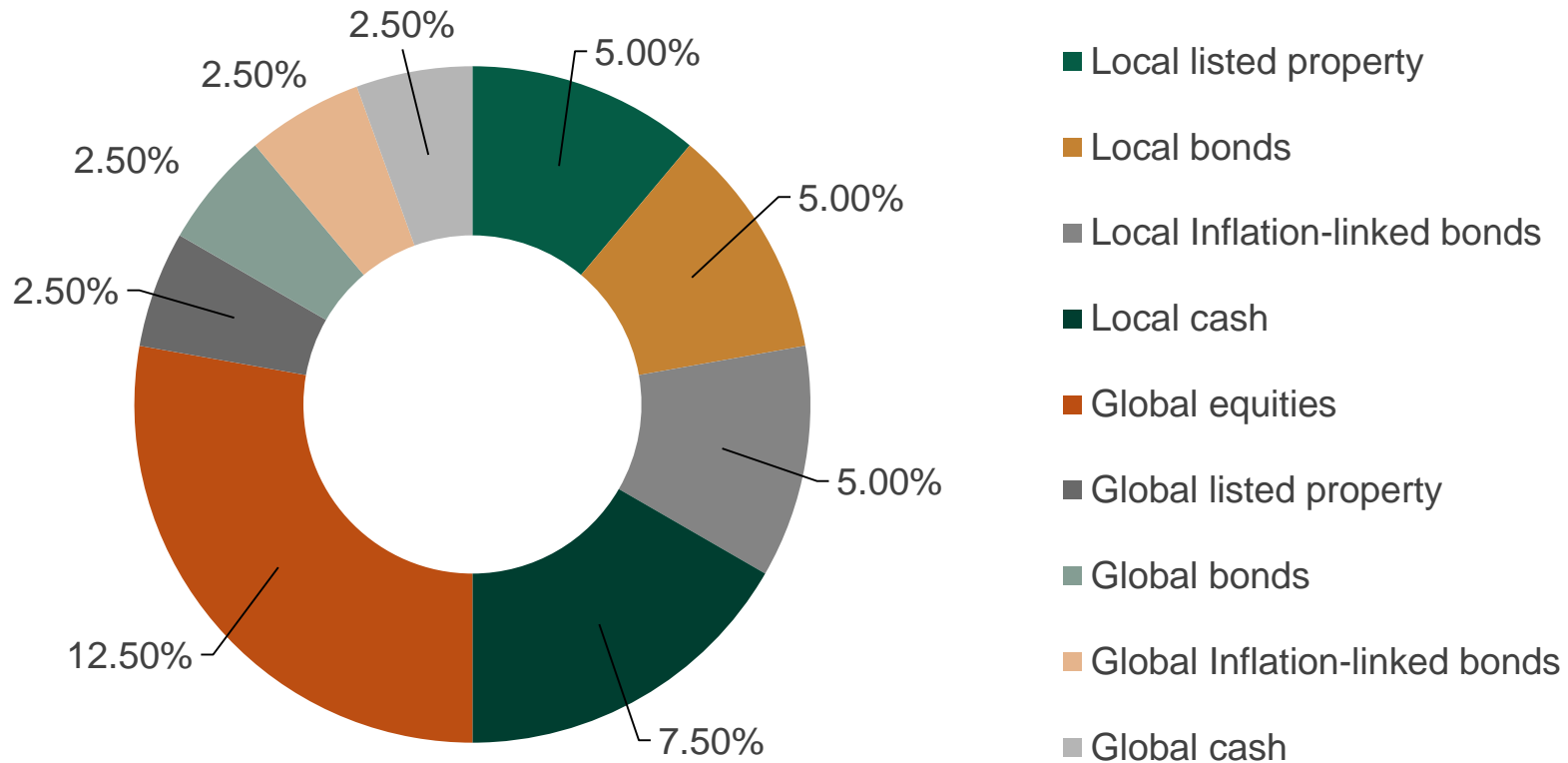
Different investment strategies - downside

Four largest funds in the SA Multi Asset High Equity category vs SWIX

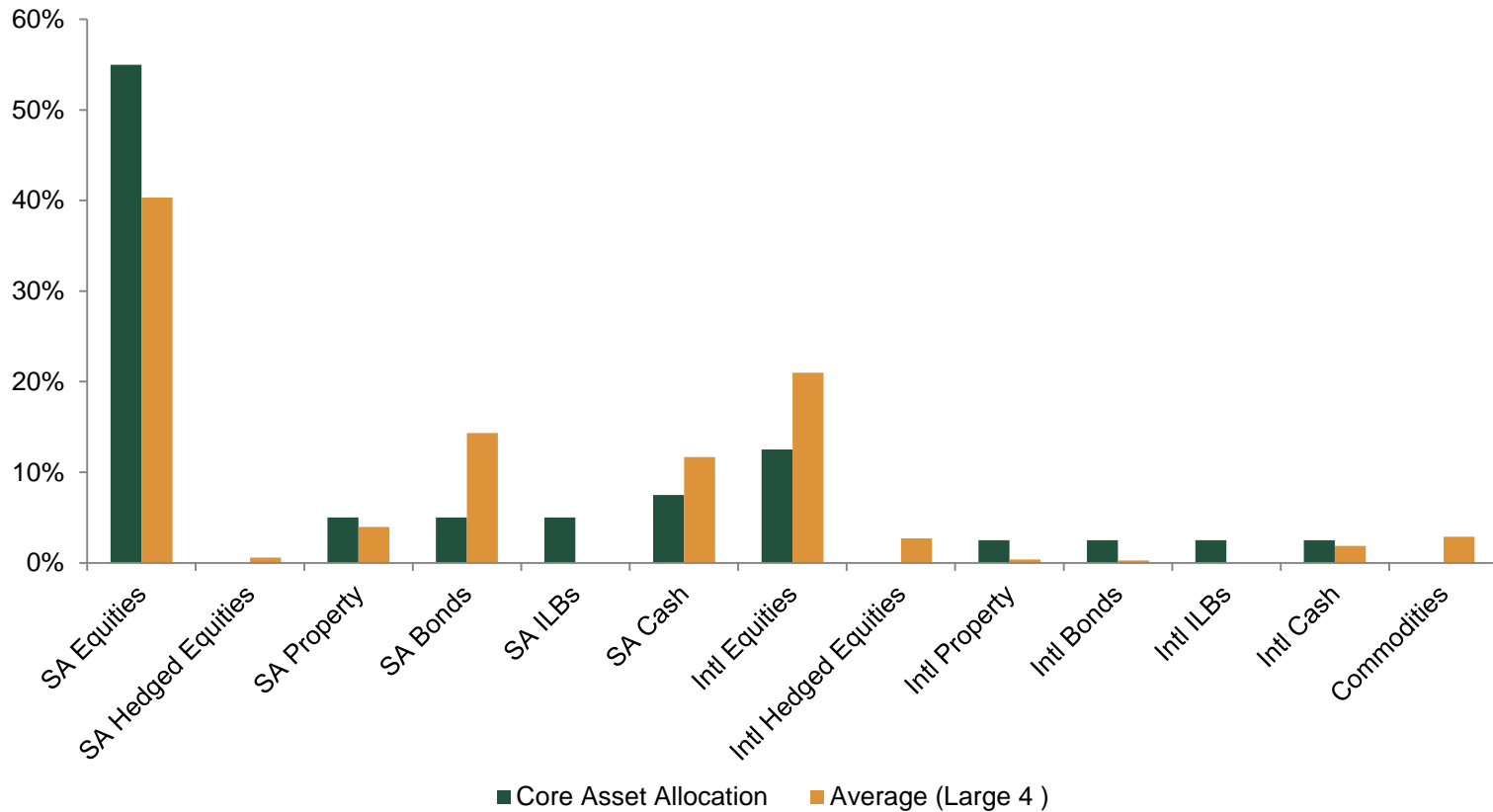


Source: Morningstar Direct

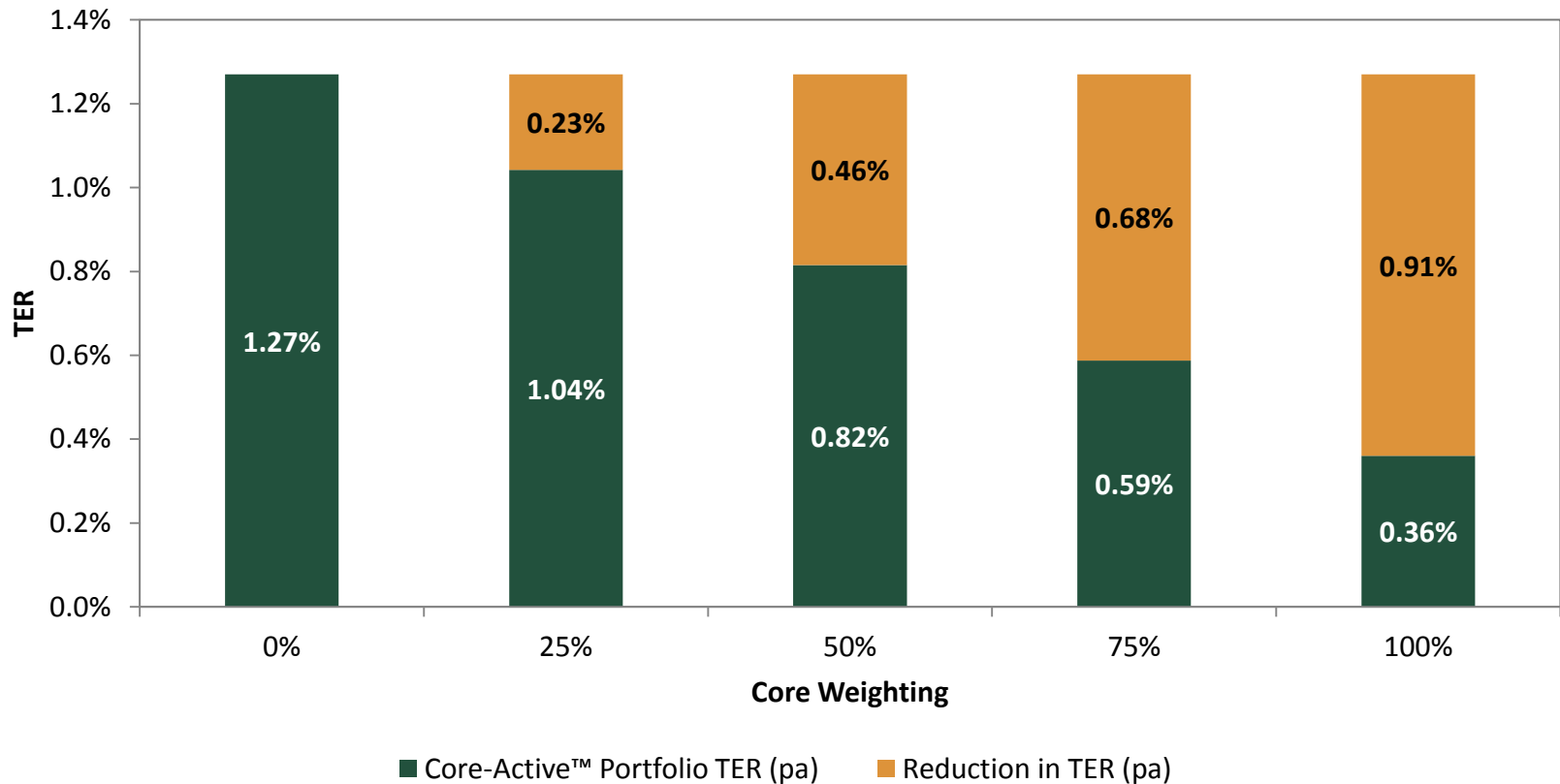
Core Asset Allocation – getting all your Betas



Asset allocation – largest 4 funds



Reduction in TERs by using a Core-Active™ portfolio



Based on the Sep 2014 TERs of all low, medium and high equity multi-asset funds (excluding Fund of Funds).

Examples

Core-Active™ model portfolios

Example 1 – Core-Active™ 40/60

Keep existing active portfolio

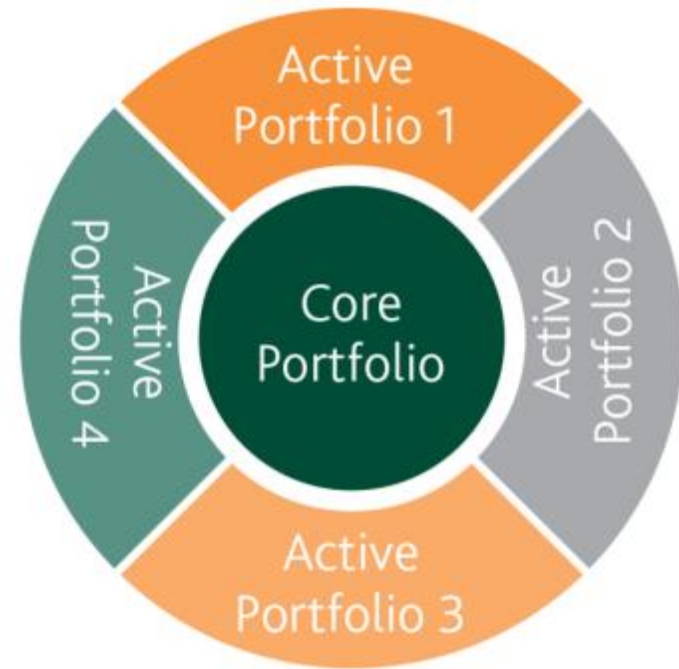
Add Core Portfolio by

- Reducing weights in each active portfolio
 - 5% or 10% of each
 - Will depend on the answers to the three questions

Final portfolio 40/60

- 40% Core portfolio
- 15% in each of the 4 active portfolios

Four largest active portfolio used in model



Core-Active™ strategy including four active balanced portfolios and a low cost Core portfolio

Example 2 – Core Active™ equally weighted

Replace one active portfolio with Core

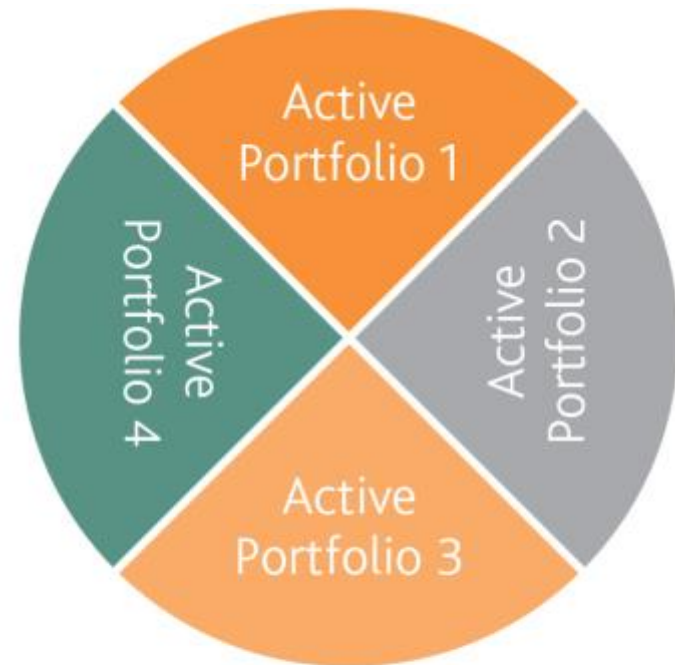
- Do you have the skill to pick the right managers

Final portfolio 25/75

- 25% Core portfolio
- 25% in each of the 3 active portfolios

Three active portfolio used in model

- Removed Fund 2 as it has high Beta



Typical investment strategy consisting of four different active balanced portfolios

Risk - return of model portfolios

September 2009 to March 2015 (annualised)

Model portfolio	Return	Volatility	Sharpe Ratio	Sortino Ratio	Maximum Drawdown	TER
Active (Equally weighted 4 funds)	15.0%	5.9%	1.63	3.55	- 3.5%	1.29%
Core-Active™ 40-60	15.2%	6.0%	1.64	3.54	- 3.8%	0.92%
Core-Active™ Equally weighted	14.9%	5.7%	1.65	3.52	- 3.5%	1.09%
Peer average	12.6%	5.5%	1.30	2.52	- 3.6%	1.67%

Calendar year returns - models

Model portfolio	2014	2013	2012	2011	2010
Active (Equally weighted 4 funds)	9.7%	21.6%	18.7%	9.9%	13.3%
Core-Active™ 40-60	11.3%	20.8%	20.1%	8.5%	13.7%
Core-Active™ Equally weighted	10.4%	20.1%	19.2%	9.8%	13.0%
Peer average	9.5%	18.0%	16.3%	5.3%	11.4%

Calendar year returns - funds

Model portfolio	2014	2013	2012	2011	2010
Core-Portfolio	13.5%	19.5%	22.4%	6.6%	14.3%
Fund 1	9.0%	23.7%	13.3%	11.9%	10.4%
Fund 2	10.9%	25.6%	20.1%	6.8%	15.4%
Fund 3	10.1%	22.0%	21.9%	9.4%	15.5%
Fund 4	8.0%	13.0%	17.3%	10.5%	10.9%

Conclusion

Active and passive cannot be separated

- No active versus passive
- Passive needs active for market price discovery and liquidity

Core-Active™ approach

- Combine the best elements of active and passive strategies
 - Core provides low cost market exposures (Beta)
 - Active provide downside protection and possibility of excess returns

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