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INVESTMENTS

# Active and Passive arrows in the advisor's quiver

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# Active AND Passive

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## 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

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# Financial advise has come a long way.

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

# Typical IFA's journey

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# Leading to a financial planning “toolkit”

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## But... advisors are always facing changes

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

# Passive: a new arrow in the advisor's toolkit

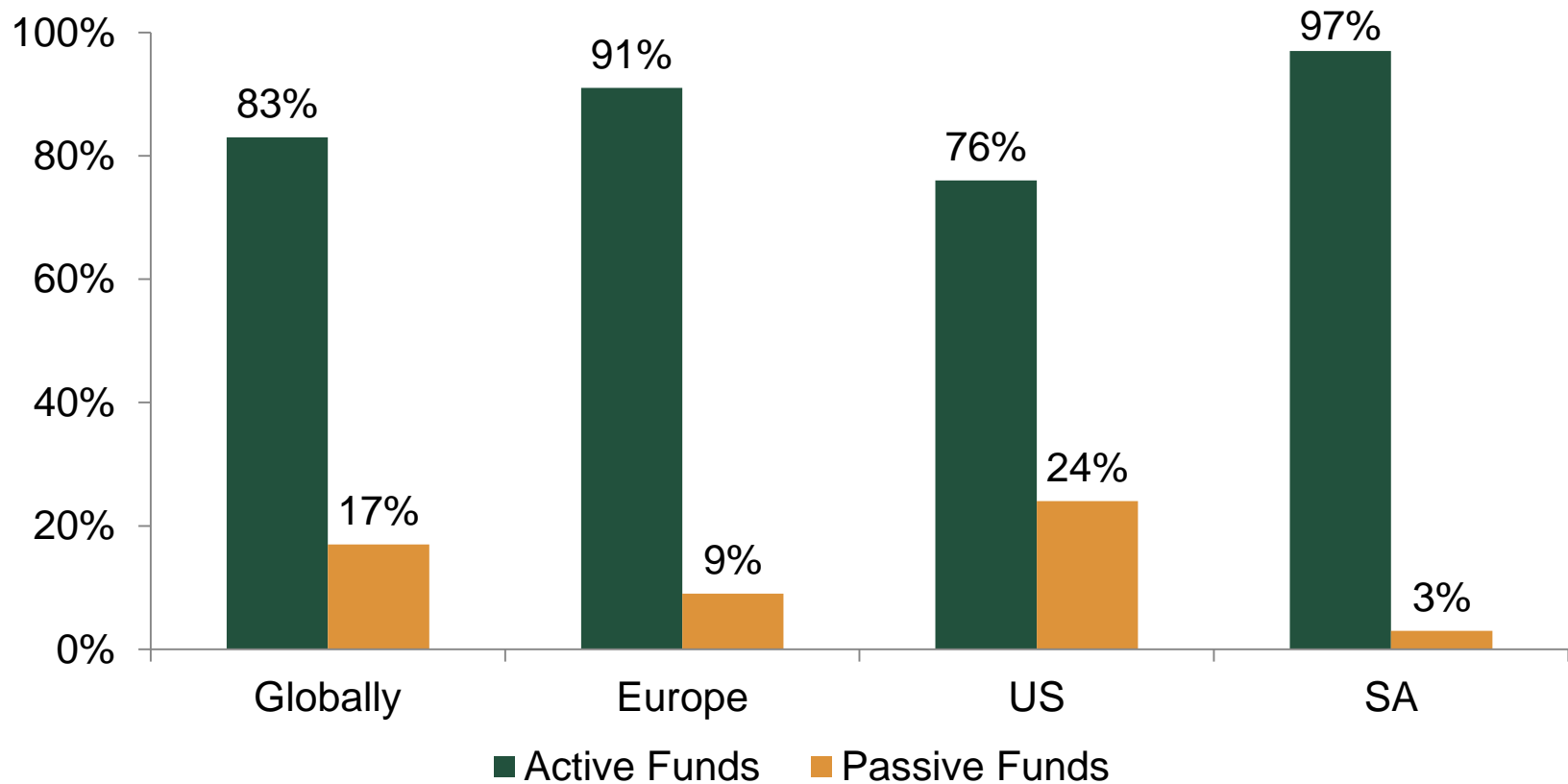
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# Active funds still dominate



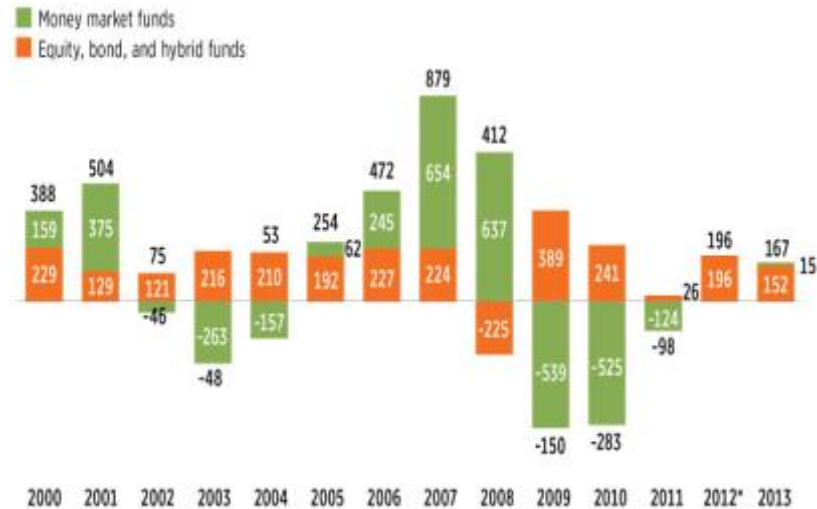
Source: Morningstar, Financial Times, CFA Institute, Nedgroup Investments

# 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.

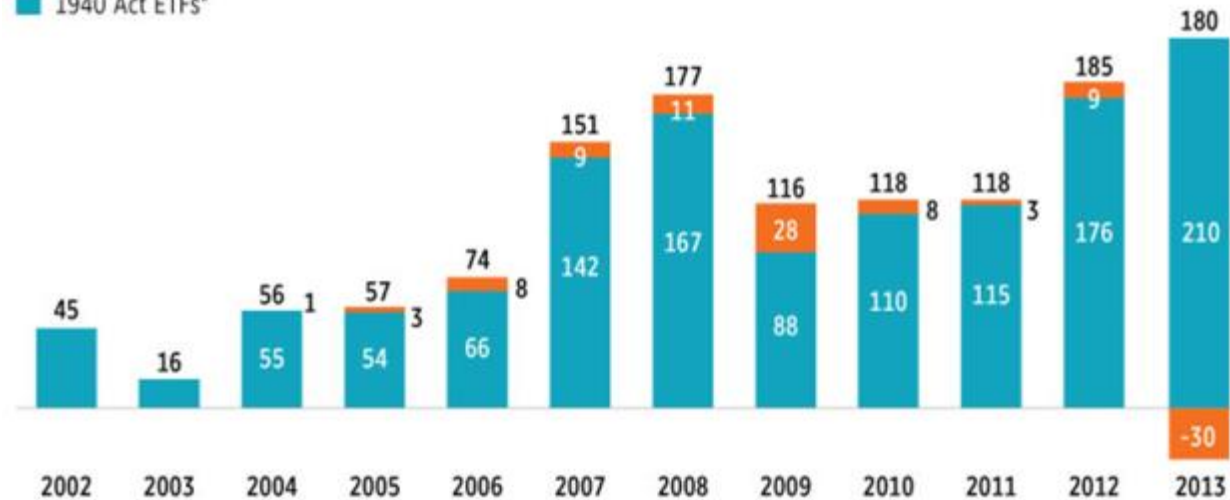
Note: Components may not add to the total because of rounding.

# Even more flows have gone into ETFs

## Net Issuance of ETF Shares

Billions of dollars, 2002–2013

- Non-1940 Act ETFs<sup>1</sup>
- 1940 Act ETFs<sup>2</sup>



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

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

<sup>2</sup> 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

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# The revolution in SA Index funds

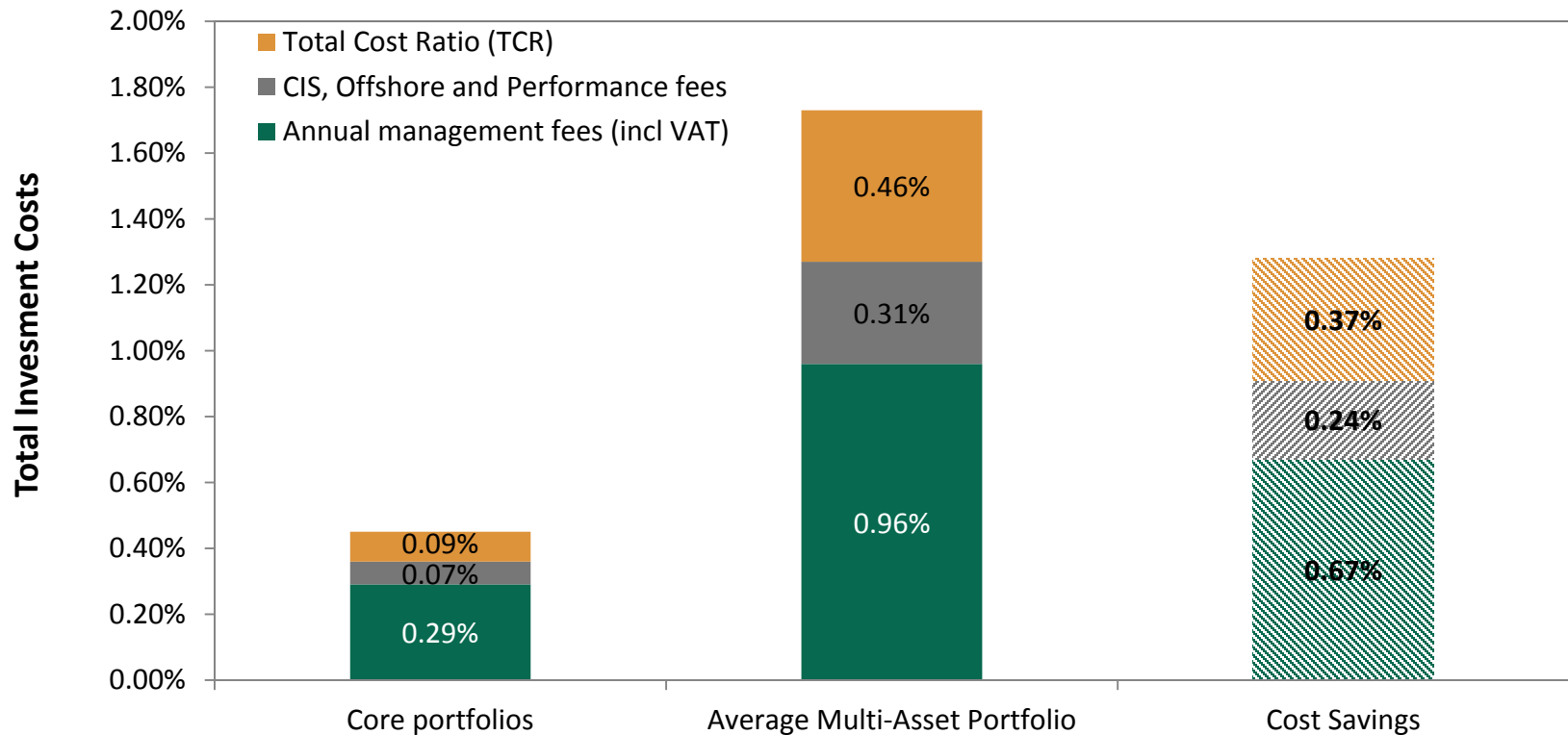
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## Multi-asset core portfolios (passive balanced)

- 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

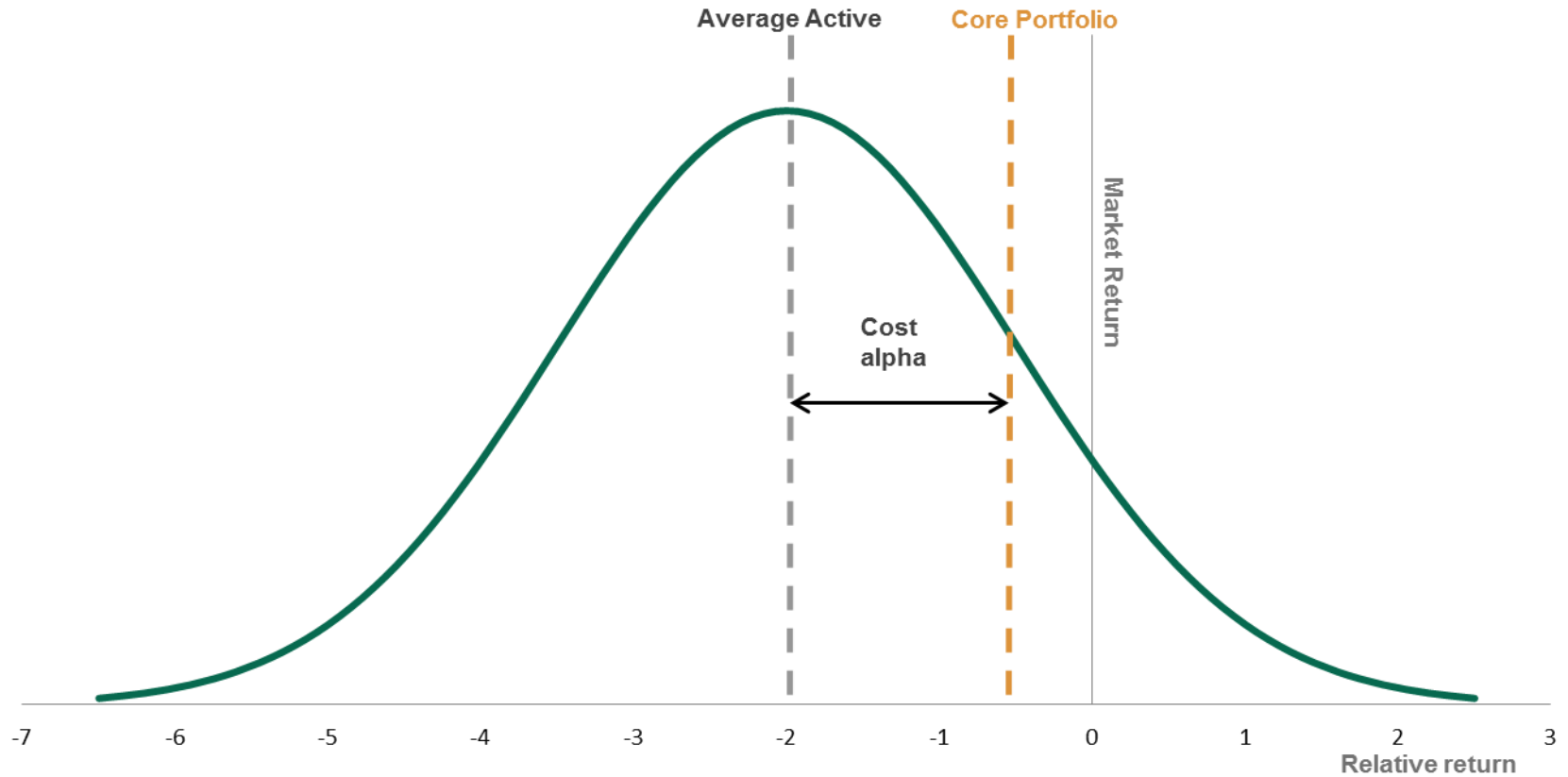
# Overall impact on costs – Core Range

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?

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## 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

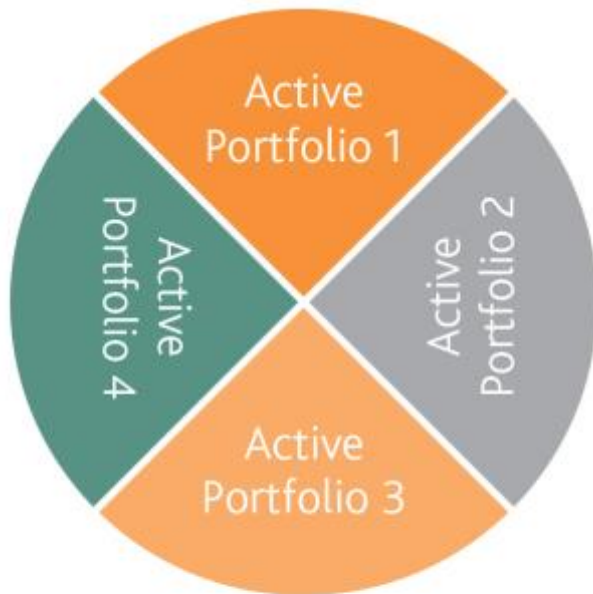


# Combining active and passive strategies

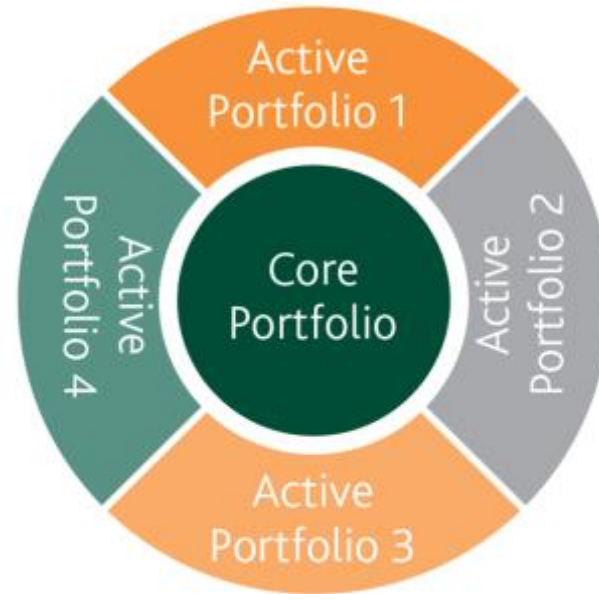
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A Core-Active™ approach

# 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

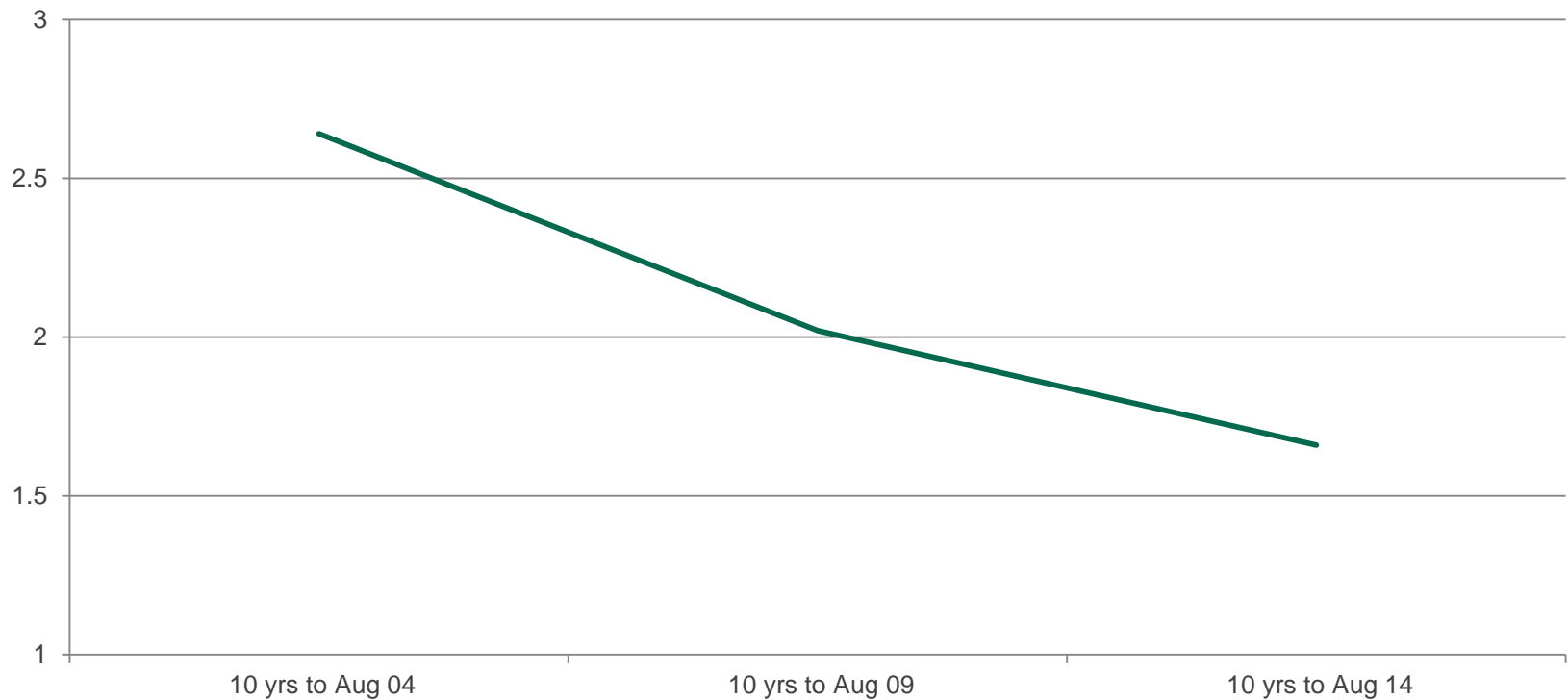
# Some important questions

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- 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

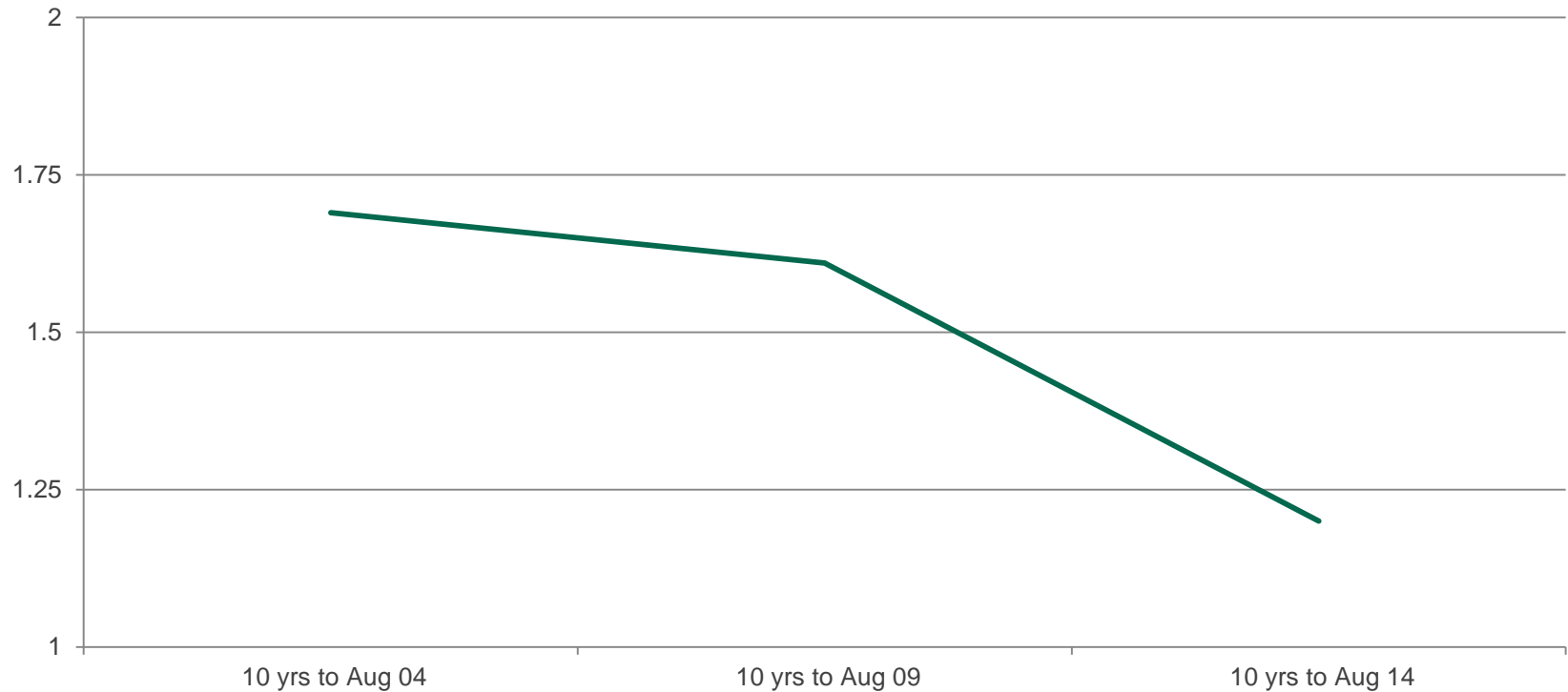
South African equity funds: Top quartile 'alpha' (% p.a.)



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

# 'Alpha' has been shrinking

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

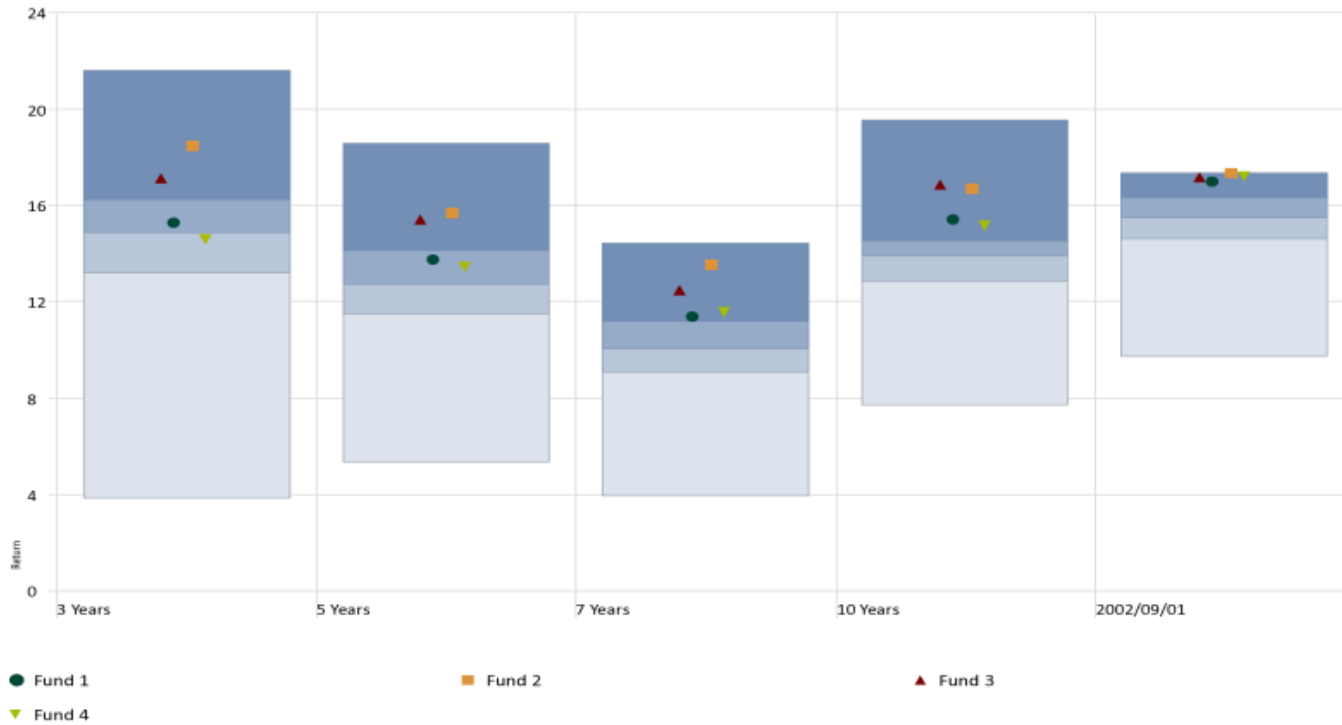


Source: Morningstar, Nedgroup Investments  
Calculation benchmark: Average fund in category



# South African investors have done well

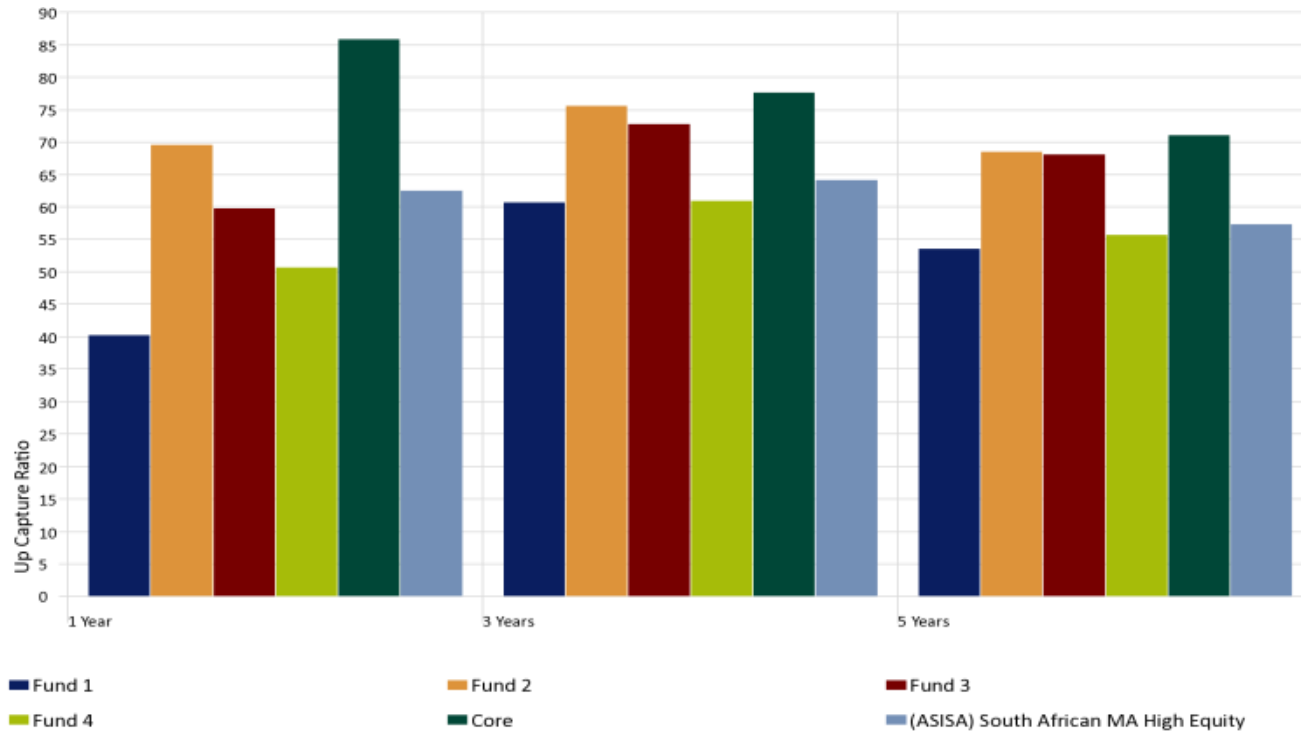
## Four largest funds in the SA Multi Asset High Equity category



Source: Morningstar Direct

# Different investment strategies - upside

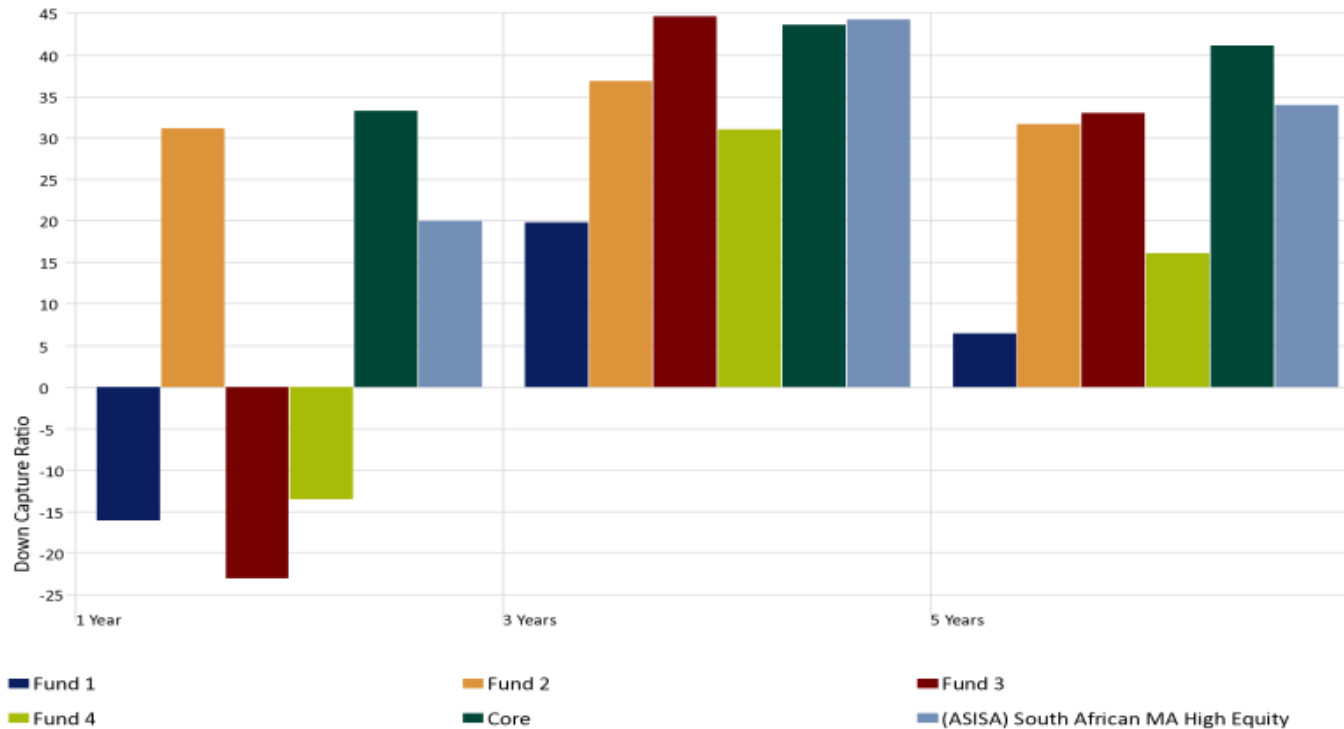
## Four largest funds in the SA Multi Asset High Equity category vs SWIX



Source: Morningstar Direct

# Different investment strategies - downside

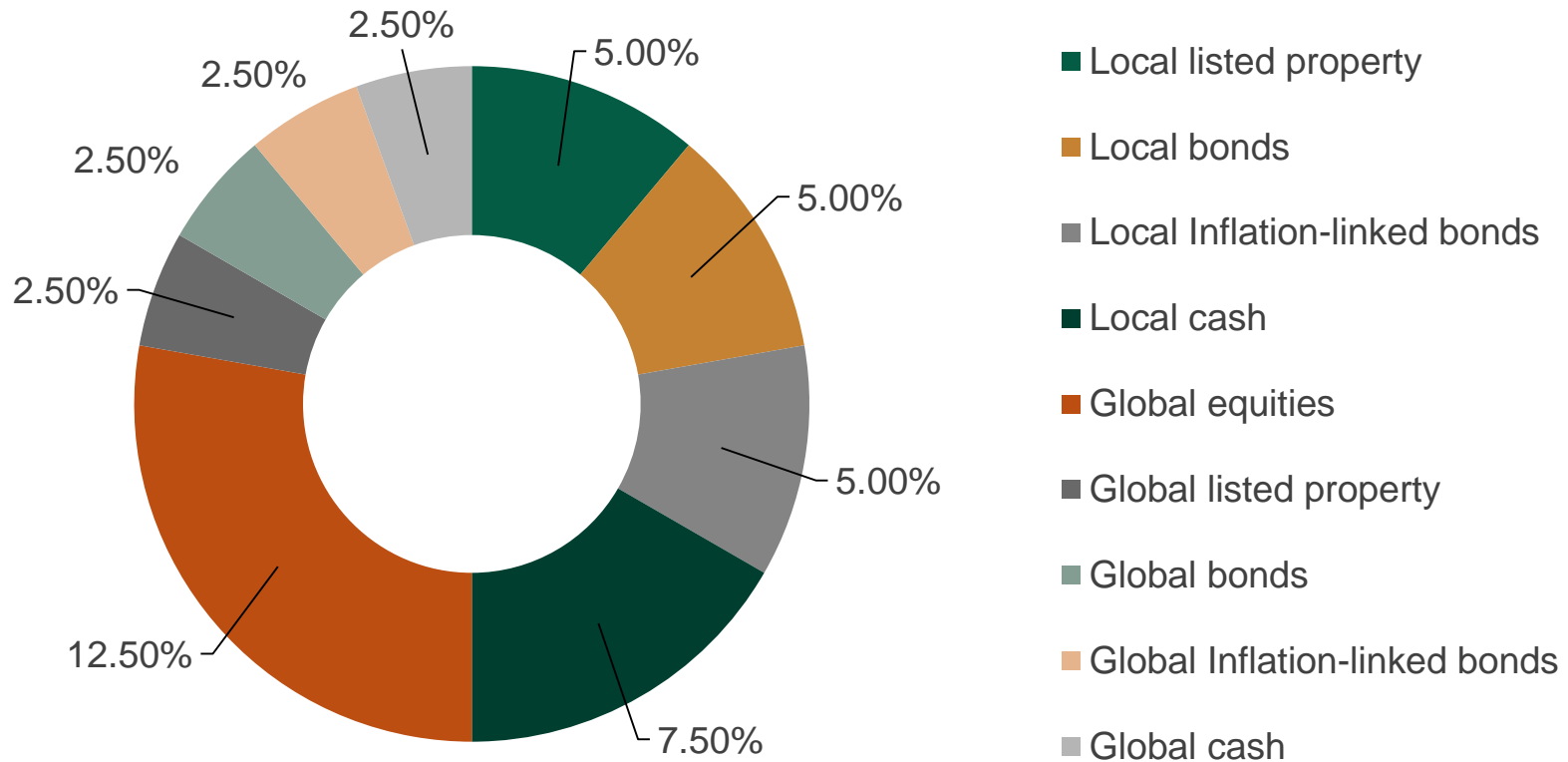
## Four largest funds in the SA Multi Asset High Equity category vs SWIX



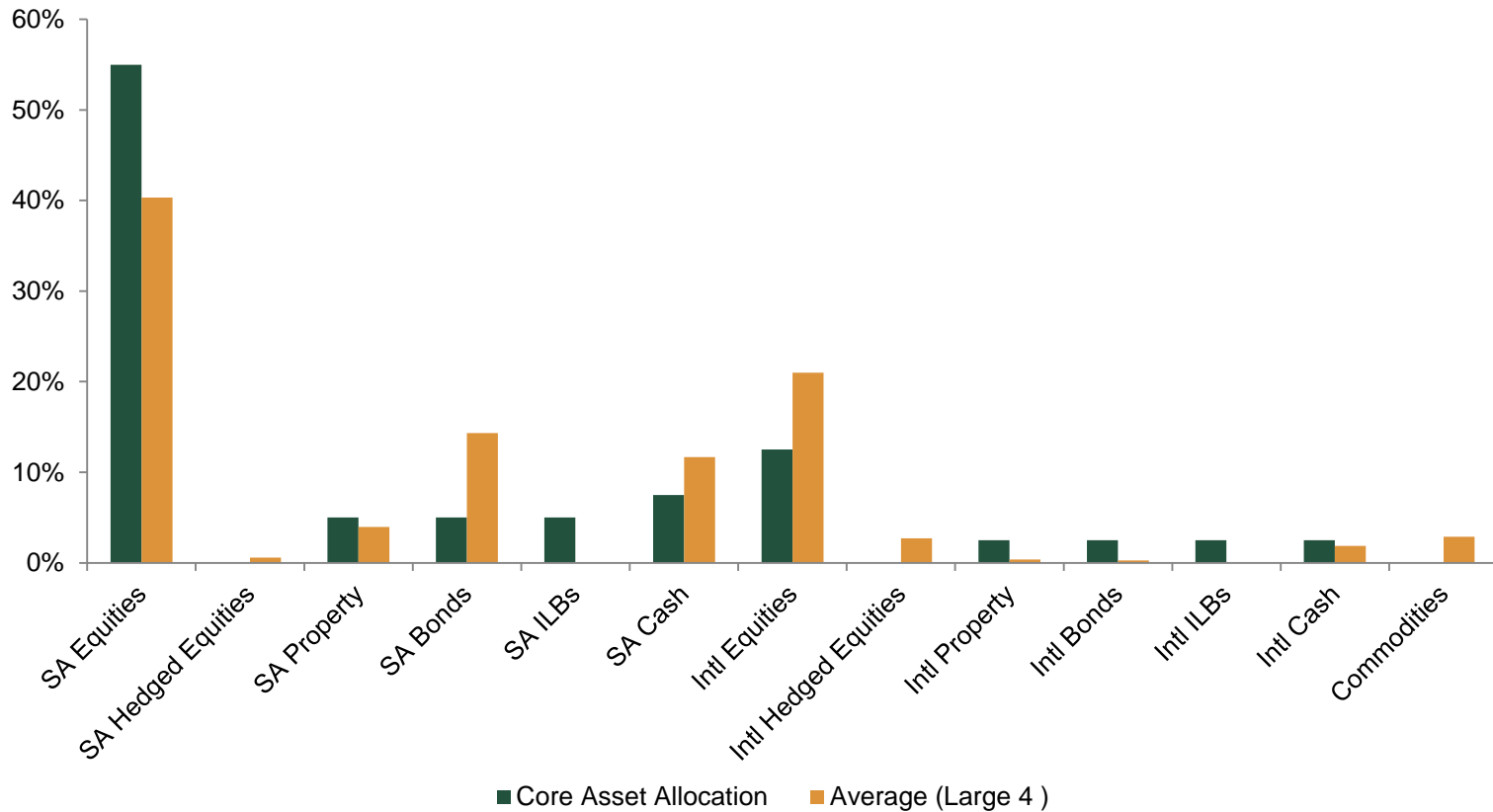
Source: Morningstar Direct



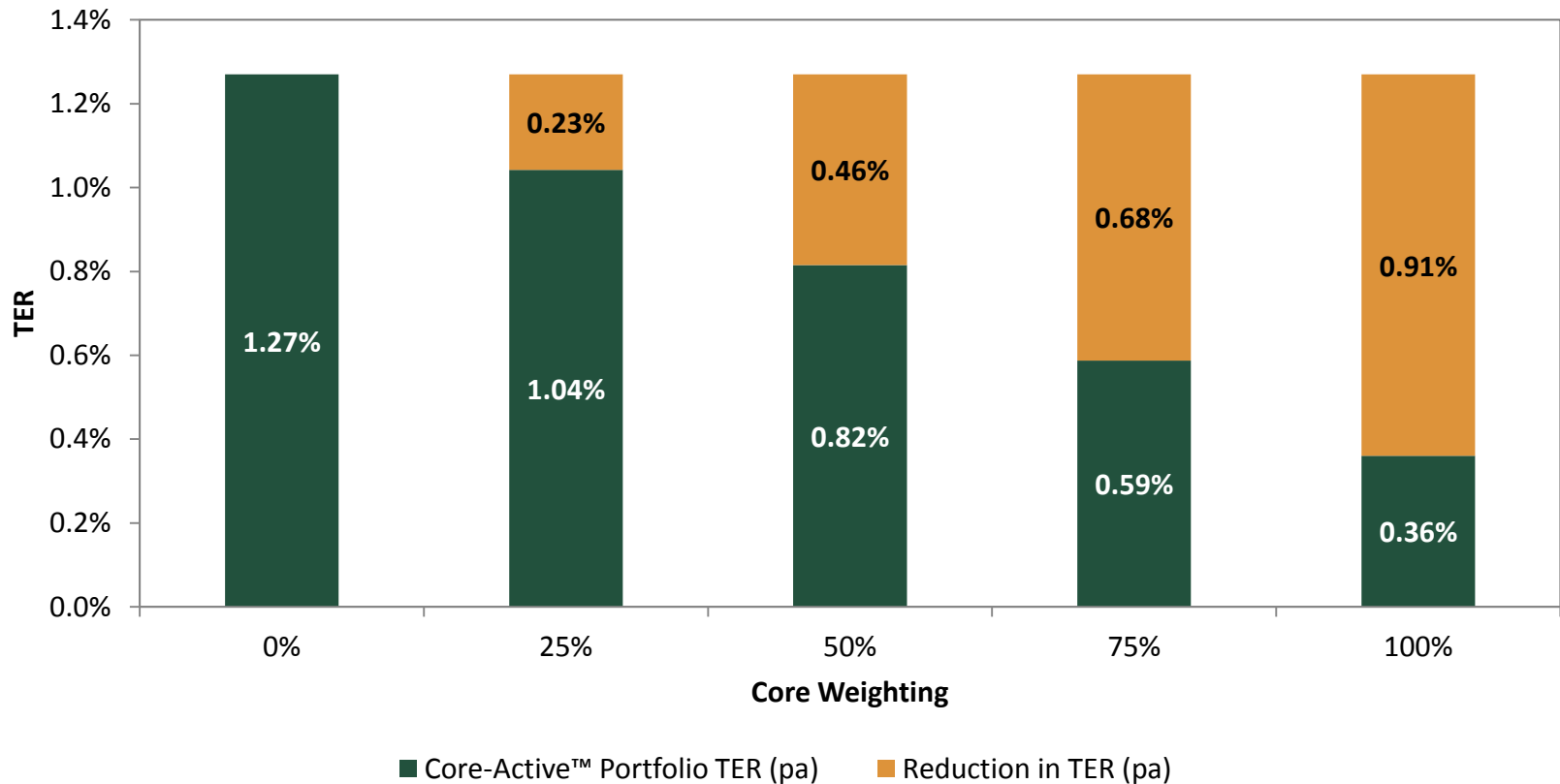
# Core Asset Allocation – getting all your Betas



# 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

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Core-Active™ model portfolios

# Example 1 – Core-Active™ 40/60

**Keep existing active portfolio**

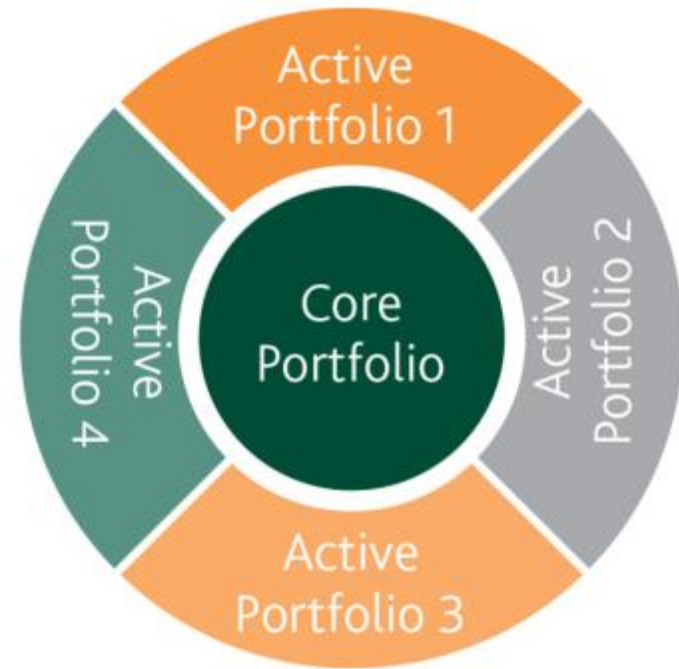
**Add Core Portfolio by**

- 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

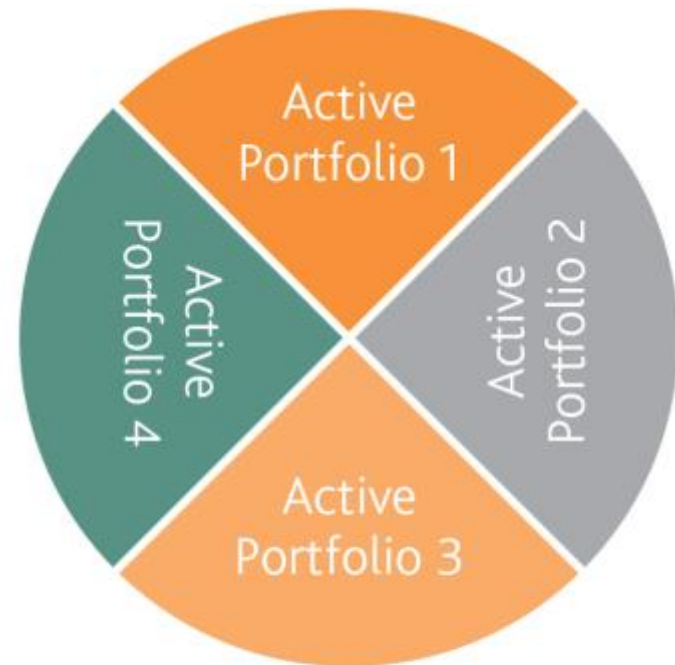
- Do you have the skill to pick the right managers

### 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	<b>13.5%</b>	19.5%	<b>22.4%</b>	<b>6.6%</b>	14.3%
Fund 1	9.0%	23.7%	<b>13.3%</b>	<b>11.9%</b>	<b>10.4%</b>
Fund 2	10.9%	<b>25.6%</b>	20.1%	6.8%	15.4%
Fund 3	10.1%	22.0%	21.9%	9.4%	<b>15.5%</b>
Fund 4	<b>8.0%</b>	<b>13.0%</b>	17.3%	10.5%	10.9%

# Conclusion

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## 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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**Thank you**

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