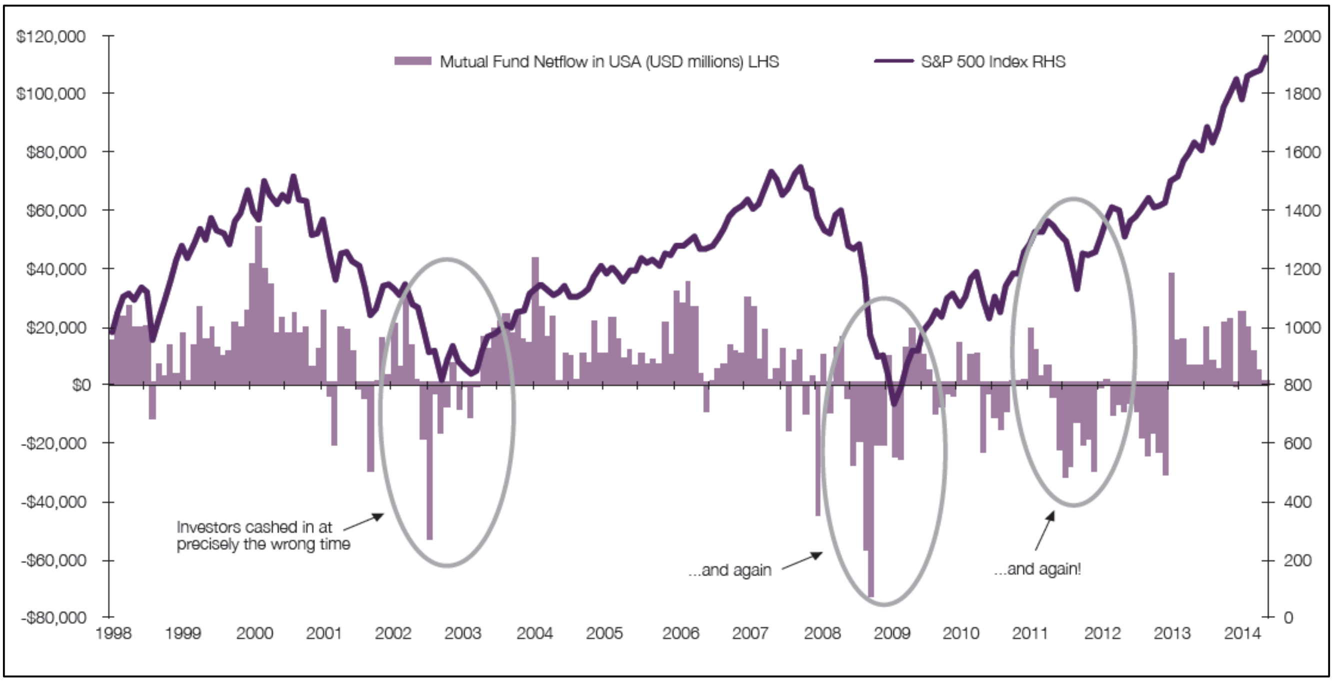
Time-In versus Timing
The Case for Active Management

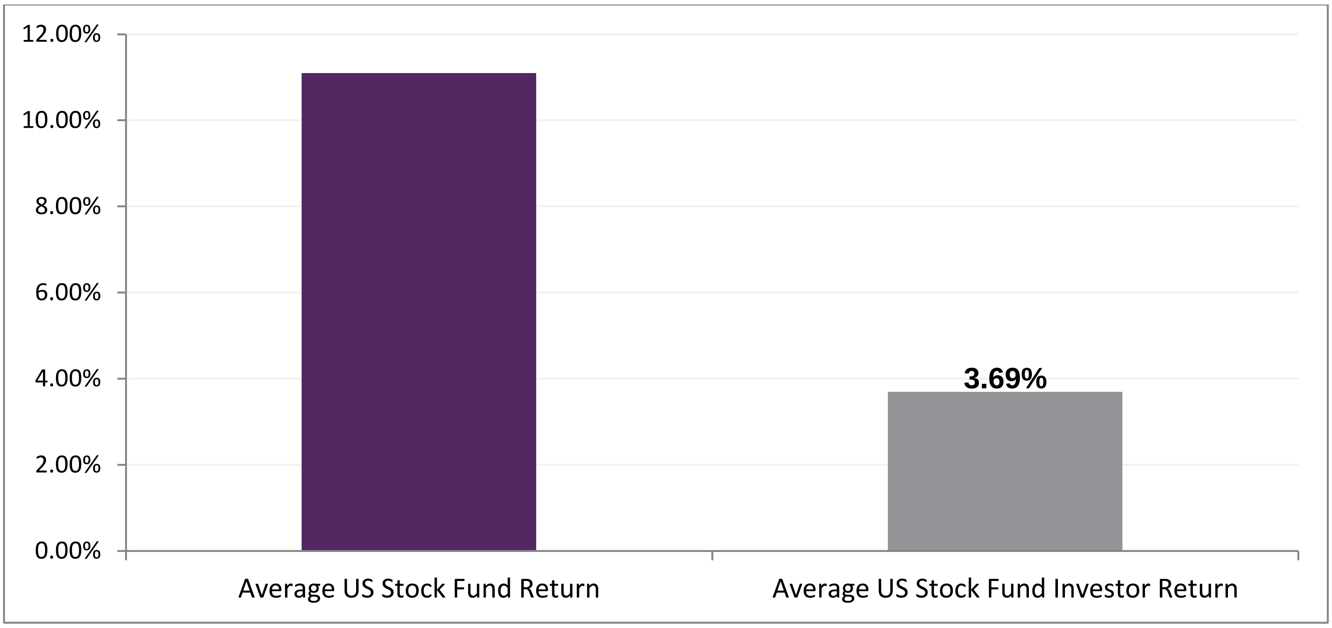
It's around this time of the market cycle that the passive-investment zealots emerge armed with historic reasons as to how active management fails to deliver. However, it is exactly this time of the market cycle when volatility increases, that active managers earn their fees – exploiting investment inefficiencies whilst individual investor emotions and the weight of money create mis-pricings.



Source: Bloomberg and ICI as at 31 May 2014

The debate about the merits of active versus passive investment management has been inflamed following the Global Financial Crisis (GFC) and the failings of outdated portfolio construction theories to preserve client wealth. The increased volatility in financial markets that followed the GFC crisis exposed the frailties of many investment approaches which failed to preserve investor wealth, and in many cases, amplified portfolio risks. The euphoria of the pre-GFC environment, coupled with inadequate research, excessive borrowing, and a poor understanding of the financial instruments being promoted were also contributing factors impacting upon investor's expectations in active investing.

Whilst the reaction of many investors to the turmoil in financial markets and innovation, to flee to the perceived safe-haven of passive investing to fulfill their various investment objectives was appropriate, they have mistaken that 'passive' investment approaches would have been effective in avoiding the mayhem. Unfortunately the findings of studies commissioned to consider the case for an active versus a passive approach have been muddied by the use of skewed statistics, questionable association of outcomes and causes, and disingenuous extrapolation of past events. The inability of passive-enthusiasts to effectively argue against market inefficiencies, has forced them to focus on the price benefits of passive investments. The adoption of passive discussions by the advisory community, demonstrates a systemic issue of an industry that has difficulty in defining its value proposition. The end result is that intermediation soon becomes irrelevant to the consumer, if the main differentiator is price.



Average US Fund Return vs Investor Return (1984-2013)
Source: Dalbar (2014)

Whilst a passive approach may be appropriate for the circumstances of some, there is a strong case for most investors to employ a proven active approach in pursuance of their investment objectives. The concept of 'market efficiency' is erroneous, with passive investments failing to 'neutralize' risk, and introducing significant 'concentration risk' and benchmark risk (and, in relation to exchange-traded funds, counterparty risk) to investors. Active management allows 'risk' to be managed appropriately in the context of investors' specific objectives

About the Author

Clayton Coplestone has been working in the Financial Services industry since 1984, with a background in share broking, money markets, financial planning and asset management. In 1995 Clayton left New Zealand to take up the position as Australasian Sales and Marketing Manager with a boutique asset management firm based in Sydney.

During his 10 years in Sydney, Clayton was responsible for co-authoring several books on the future of the financial advisory industry, and continues to write numerous articles for various media on global financial services & distribution trends. Clayton has spoken as a keynote speaker at most of the Australian industry conferences throughout the past decade, and remains a sought after speaker on all aspects of the financial services and investment industry.

Clayton now heads up Heathcote Investment Partners – a third party distributor of boutique investment services to New Zealand family offices, institutions and Authorised Financial Advisors. Clayton has a Bachelor of Business Studies (major in Finance) and Diploma in Business Studies (Personal Financial Planning), and is a Registered Financial Services Provider.

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About Heathcote Investment Partners

Heathcote Investment Partners was established in 2008, to become New Zealand's leading third party distributor of boutique investment services to family offices, financial intermediaries, institutions and authorised financial advisors.

Drawing on past asset gathering successes in Australasia and Asia, Heathcote Investment Partners provides financial intermediaries with access to a range of quality active investment capabilities from New Zealand and around the world. Our due diligence of these Managers is aided through the findings of leading research houses, the suitability for the New Zealand market, and consistent delivery of returns over a full market cycle.

Heathcote Investment Partners is a regular contributor to mainstream & industry media, providing thought leadership in areas ranging from the future of the financial services industry to observations on various participants. Heathcote Investment Partners and their exclusive managers are well regarded in the industry as providing timely and relevant contributions and are frequent presenters at industry conferences & forums.

Heathcote Investment Partners each year hosts a number of their own industry events throughout NZ designed specifically for the New Zealand financial industry. The intention of these events is to bring together leading investment professionals to provide ongoing education and value adding to the financial services community.